

23 October 2009

VIA EMAIL: Hpy submissions@rba.gov.au

Head of Payments Policy Department
Ms Michele Bullock
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Dear Michele

Submission – Consultation on Proposed Changes to the EFTPOS Interchange Fee Standard

MoneySwitch Limited trading as Tyro Payments is a Specialist Credit Card Institution authorised by the Australian Prudential Regulation Authority. It has launched acquiring services for credit, scheme debit and EFTPOS cards and electronic Medicare processing services for patient paid and bulk-bill claims.

Tyro Payments is responding to the Reserve Bank of Australia's invitation for submissions on *Proposed Changes to the EFTPOS Interchange Fee Standard*.

A domestic debit card system requires a regulated low interchange fee

We agree with the need of alignment between the debit card systems, but we strongly submit that the scheme debit card system should be subjected to the current low range of interchange fees of the EFTPOS system to give the Australian proprietary EFTPOS debit card system a chance.

The domestic debit card system can only survive as low cost system allowing Australians a convenient access to their funds held in Australian bank accounts and providing them with Australian specific functions and features. Indeed an efficient low-cost domestic debit card system offers government agencies like Medicare, low-ticket providers like transit systems or news agents and general retailers a choice between accepting an efficient domestic card payment system or the dominant high-priced global card schemes.

Entrusting the debit card interchange fee setting to the market, more specifically to an industry governed company dominated by the major banks risks robbing the EFTPOS scheme of its fundamental competitive advantage, the low cost position and low interchange fee, thus dooming it for failure. The EFTPOS Payments Australia Limited needs regulatory support in securing a low interchange fee range for scheme debit and EFTPOS debit card transactions.

(Note: Further background is supplied to the Reserve Bank of Australia via a separate commercial in confidence submission.)

Interchange fee flexibility is pre-mature given the broken access regime

Domestic competitive pressures continue to be weak given the high access barriers in the Australian payment system and the anti-competitive behaviors of the major payment industry players.

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We are indeed very concerned by the need for the small but innovative entrant Tyro to maintain a commercially viable access to the Australian payment system, if the interchange fee setting mechanism is to be under the control of the major competitors as would occur under the Proposal. We are also vulnerable in the negotiation of switching and settlement services of transactions with issuers with whom we are barred from having a direct connection.

Our most significant initiative, providing Medicare Easyclaim with a very innovative and highly efficient electronic claiming solution, is threatened in its viability and thus our whole company, since the critical cost driver i.e. the setting of the credit EFTPOS interchange fee is now in the hand of our major competitors.

Tyro has been and needs to continue to fund its Tier One Equity requirements and the costs of establishing and building the business through successive fund raisings and that against the background of very difficult financial markets.

We are very concerned with the heightened competitive risks that are introduced with the flexibility in interchange fee setting while in reality the access to the Australian payment system remains at the mercy of the major competitors and remains prohibitively priced.

(Note: Further background is supplied to the Reserve Bank of Australia via a separate commercial in confidence submission.)

Interchange rates are driven by issuers and creep up to the cap

The Reserve Bank's initial involvement in the payment space was driven by the observation that in the issuing-acquiring market - left to itself - interchange and scheme fees tended to raise continuously driven by the issuers and schemes to increase the fee revenue. The unregulated scheme fees increase year-on-year in domestic markets and even faster in international markets with less of a regulator's shadow. Every time interchange fees were capped by the regulator, they crept rapidly up to the cap so as to maximize the issuers' revenue line.

EFTPOS Payments Australia Limited represents these forces, thus interchange fees will most probably raise to a maximum level, so as to maximize issuers revenue. The self-acquirers will most probably trust in their current bilateral arrangements and their market power to roll those advantageous terms over in the future, so that they will not be affected by the raise in interchange fees. They are the only ones who can credibly impress on major banks the possibility of a selective discrimination of cards, if they are not given the requested terms.

The competitive position of an EFTPOS scheme versus global schemes

We understand the Payment Systems Board's concern about the differential of interchange fees between the scheme debit and the EFTPOS debit card system creating a disincentive for banks to issue EFTPOS cards.



While issuers have initially issued ATM cards to each new bank holder that served also as an EFTPOS card, they issue and promote today scheme debit cards, which are a far superior value proposition. They combine them mostly with an EFTPOS facility to allow customers a convenient and low cost ATM feature (dual card). We are convinced that even at equal interchange fee, they will still issue the more functional and heavier promoted scheme debit cards.

Acquirers and merchants have the possibility and the incentive to influence the card holder's choice, when he has a dual card, but only then. They have not really used that capability aggressively in the general market. Today, only the largest retailers have the skills and as self-acquirer the technology to steer a transaction into the more efficient EFTPOS network. But the other retailers lack the education and the technology.

Tyro in its position as the only "acquirer-only" is not conflicted by issuer interests. We create transparency around the costs of the different debit card products, so that merchants can start to manage their acceptance costs. We report openly the interchange and fee differences on our merchant portal and we propose merchants to insist on processing dual cards as EFTPOS transactions. We propose technology that would prompt or enforce switching dual cards down the EFTPOS network.

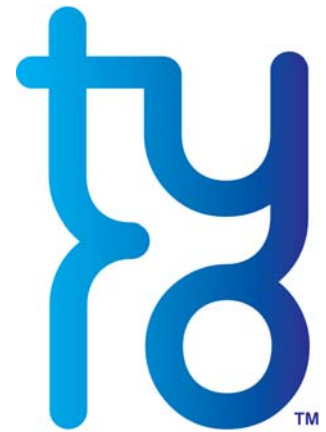
We share the view that the survival of a domestic debit card network is very much in the interest of Australia. Aligning the EFTPOS interchange fees de facto along the high priced scheme debit card fee, will eliminate today's lower cost alternative for the merchant. We think that for a domestic debit card system to be competitive and sustainable, it must

- provide a low or no cost electronic bank account debit/credit access for every Australian
- provide a low or no cost electronic payment acceptance facility for every Australian merchant
- provide an efficient and secure point-of-sale payment method with functions and features serving the interests of the Australian community and government

We fully support the creation of the EFTPOS Payment Australia Limited as an organisation with the mission to compete with the international schemes. We are however sure that the proposed flexibility in EFTPOS interchange fee standard will doom the initiative for failure.

The EFTPOS scheme will for the foreseeable future have the following competitive position compared to the international schemes:

- It is poor in functions and features and lacks the scale to compete on generic features that are attractive to world markets. These are for instance international acceptance, chip card, pre-authorisation, card-not-present acceptance, eCommerce security features. It will take years to catch up, when the international schemes have then already moved on.



- It is exposed to scheme fee competition, because the international schemes share their cost base across credit and debit and across the globe. They also do or certainly can cross-subsidize fees between international and domestic transaction business.
- It is exposed to international schemes offering interchange fees at the cap and adding multiple other marketing and bundling advantages to entice issuers.

In our thinking, a “Me Too” strategy is doomed for failure. Why would issuers not continue to substitute EFTPOS cards with scheme debit cards, a more capable product for the same price?

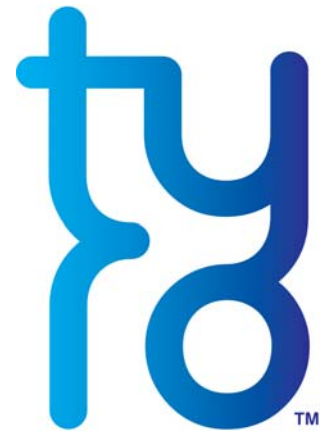
EFTPOS Payments Australia Limited would have to promise to fill in the holes in its product left by years of underinvestment and lack of global scale and would have to keep its fees significantly under the one levied by the international schemes for domestic transactions.

The battle for issuers, worldwide, has been won by the international schemes. These have always concentrated on issuers and developed the market from that side. Only regulator intervention and law suits have brought forward the interest of the acquiring and merchant side of the payment industry.

The high EFTPOS interchange rates will accelerate the demise

There are multifaceted consequences of increasing the cost of an EFTPOS transaction:

- Medicare’s fastest growing electronic rebate system “integrated Easyclaim” allows it to credit an Australian patient’s bank account at no cost (in fact minus 4.5 cents interchange as long as credit EFTPOS is not implemented by the major banks). As a consequence of the current proposal, Medicare would have to pay 12 cents interchange. In the future, with the accelerated demise of the domestic debit system, Medicare would have to negotiate with the two global schemes and pay currently US50 cents.
- Newsagents and other low ticket providers would be priced out of the card payments market with a 16.5 cents increase in the price of a domestic debit card transaction. Today, they use the EFTPOS card, preferably with cash-out as a no or low-cost payment for bus tickets.
- Australia’s general retailers would have to pass on the additional costs of 16.5 cents to the Australian consumer. The resulting price increase would impact mostly the intensive debit card users which tend to be the socio-economically less advantaged citizens.
- Australia’s general retailers would suffer a cost-disadvantage facing the price increase of the multilateral EFTPOS scheme interchange fees, while the large self-acquiring merchants are sheltered by existing bilateral contracts and their ability to negotiate continuously preferential rates once the contract terms of the existing arrangements run out.



- We as Australia's only new entrant into the payment space would have to absorb the high multilateral EFTPOS interchange face, whereas large self-acquirers or acquirers could obtain preferential interchange rates.

Left to themselves, proprietary national debit card systems fail, because they cannot match the scale and scope of the two worldwide leading schemes. Australian issuers have been aggressively pushing scheme debit cards and will continue to do so, because these cards provide a compelling customer proposition.

Only the regulator can ensure the domestic debit card survival

If the survival of an Australian debit card system is in the public interest, the regulator has to ensure issuance through mandatory EFTPOS functionality on Australian scheme debit cards or through undertakings to that effect and to enable usage through a low interchange cap for debit card transactions.

Only, the approach of leveling the interchange between minus 4 and 5 cents or at a low level will allow the newly created EFTPOS Payments Australia Limited to develop a sustainable, competitive, domestic alternative to the international schemes. It could then be highly differentiated by being low-cost and custom-tailored to Australia specific requirements. It will provide each and every Australian bank account holder and the Australian government access to securely and efficiently debit or credit transactions to Australian bank accounts.

A quarter of a billion dollar cross-subsidy for the large issuers

In addition, a new quarter of a billion dollar cross-subsidy levied on Australian merchants and consumers would thus be avoided. The transfer would do nothing to entice EFTPOS card issuance, because issuer would still not issue an inferior card in term of functions and features for the same price.

What the transfer would cause is the starvation of the acquirers' and merchants' incentive to innovate. Acquirers could launch technology around contactless, card holder protection, surcharging and steering and micro-payments all driving ubiquitous usage. Given the stage in the life cycle of the Australian payment card market, the issue is not around more card issuance, but rather innovations pushing usage further substituting cash and check as a tender. Progress is not about further reward and loyalty programs designed by issuers, but it is driven by investments and innovations into the merchant and acquiring front end EFTPOS technology.

If most new cards issued continue to be scheme debit cards – and we see no compelling reason why not – we would have seen a massive transfer of fee income from the consumer and merchants to the issuers.

- In the last twelve months, 292m scheme debit card transactions have been processed in Australia corresponding to an interchange fee volume of \$35m at the 12 cents cap. If the 1.6B EFTPOS transaction had been charged with the same capped interchange, a total of \$264m corresponding to the 16.5 cents change in interchange would have been transferred from the acquirer, merchant and consumer space to the issuers.



- In a year, Medicare processes 300m services, which could potentially mostly be switched via the innovative integrated Easyclaim system using the up-to-now cost efficient EFTPOS system. For that potential EFTPOS volume the change in interchange would transfer up to \$50m from the acquirer, Medicare and patient space to the issuers. If Tyro was not able to recover this change, the only integrated EFTPOS claiming service in Australia so far would most probably have to cease.

Giving an Australian EFTPOS debit scheme a chance

While we have no voice in the EFTPOS Payments Australia Limited, we have considered what it would take to allow this scheme the longer term survival. One thing is clear: It cannot be at the mercy of the bank-issuers, nor of the large self-acquirers' interest. The EFTPOS card rather has to be positioned as a low or no-cost debit and credit access that every Australian has to his funds in an Australian bank account. This requires the regulator. There are several recommendations with varying intensity of regulatory intervention:

- **Cap the interchange fee for scheme debit at the current level of the EFTPOS card (minus 4 to 5 cents)**

The merchants and an acquirer-only have then obviously an interest in maintaining the infrastructure and steering towards the domestic debit card scheme. The consumer benefits from a no-surcharge and secure payment instrument.

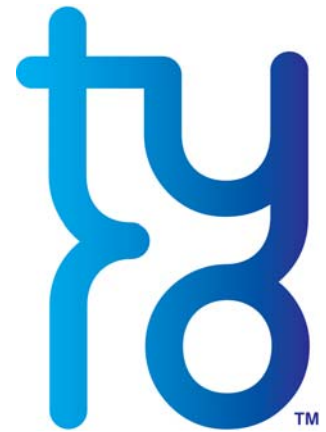
The issuers, the decision making unit in the card payments market, would most certainly provide both products in his suite of offerings or the current dual functionality, i.e. the card holder has one card and the choice between processing the transaction with a PIN entry through the cheap EFTPOS network or with a signature or PIN through the expensive scheme network.

The issuer would provide the basic access to the bank account function at low cost (minus 4-5 cents) to every Australian and offer preferably in addition the features of an international scheme debit card to the sophisticated global consumer. The latter would attract the scheme fees as compensation for the global scheme brand, global acceptance and full function and feature set.

Now the domestic debit scheme is differentiated as a basic no-frills card, because it saves the issuer the high international and domestic card scheme fees that are not buffered by significant interchange fees.

- **Mandate the EFTPOS capability on any debit card product**

This approach ensures that every Australian and the Australian government have a cost efficient access to debit and credit Australian bank accounts.



Today's dual cards give the cardholder the choice to use alternatively the international scheme or domestic EFTPOS network by pushing credit or check/savings at the EFTPOS terminal. That is a good system of choice for merchants and consumers.

A domestic debit card network is of critical importance to government plans to overhaul its payments systems into a more citizen centric and efficient process. Its demise would price initiatives like Medicare Easyclaim, Basic Card income management or low ticket transit payment systems out of the market.

- **Allow third parties (for instance merchants) to issue EFTPOS cards**

Competitive tension would be created by allowing merchants direct debiting on existing Australian bank accounts (decoupled cards).

- **Carve out the credit EFTPOS capability**

Maintaining the current interchange range for credit EFTPOS (or the EFTPOS refund used for that purpose for the time being) would at least enable in a high EFTPOS interchange fee environment to safeguard the Medicare Easyclaim initiative and allow extension of such an offering to other government payment services like Centrelink, PBS, Child Support, state agencies ...

- **Clarify the Cash-out EFTPOS capability**

The twenty cents negative interchange fee has been an enabler for low value transactions and for cash distribution. Given the new ATM regime, the feature being a differentiator to scheme debit and a significant revenue contributor for some retailers, the risk of dislocating this market through a high EFTPOS interchange fee is high again. The largest retailers are sheltered with bilateral arrangements, but what is the impact on the general market?

Tyro-specific (new entrant) concerns

In addition, we do want to emphasize our risk perception regarding our own interchange fee negotiation abilities with the major banks.

Taking our most significant project as an example, we receive for each Medicare Easyclaim transaction 20.9 cents from Medicare and 4.5 cents from the issuer. We have to pay switching fees to the issuers, because of the unworkable EFTPOS access regime not commercially and timely allowing direct connections. We also pay a revenue share to our software and marketing partner.

Going into negotiation with our EFTPOS interchange and switching partners or possibly all issuers, we will have to negotiate the fee to credit the patient's bank account via an EFTPOS transaction. The original project of creating a discreet credit EFTPOS transaction was discontinued by the major banks. Instead, we are all using the EFTPOS refund process although there was often no original purchase transaction.



Since technically an EFTPOS refund transaction can be today recognised as an Easyclaim rebate, all kind of pricing options are thinkable: maintain the minus 4.5 cents, apply the possibly new cap of 12 cents or apply the same new cap as a negative amount as the international schemes do. On a refund they indeed reconstitute the interchange fee that they have levied during the underlying purchase transaction. Since in the Easyclaim case, there was no initial purchase transaction the fee could be set at zero. These would be existential negotiations of Tyro with the major retail banks.

Conclusion

A level playing field is indeed advantageous as long as it is a regulated range at the level of the current EFTPOS card, because it will allow the EFTPOS Payment Australia Limited (EPAL) to position its product as a no-frills, basic bank account access card, responding to domestic requirements and thus covering another space than the one controlled by dominant international schemes. This alignment has been voluntarily undertaken by VISA launching its scheme debit card at the same zero interchange fee of the domestic debit card system in New Zealand.

At a minimum, the current system must be maintained giving time to the EPAL to propose and undertake a non-discriminatory EFTPOS interchange and scheme fee regime as well as a non-discriminatory EFTPOS access regime. This way the industry demonstrates self-regulatory performance creating the pre-requisites for an increased flexibility in setting the interchange fees up to a regulated cap.

The global schemes deliver benchmarks in terms of providing one access point with reasonable efficiency, time and cost and without the unmanageable (at least for a new entrant) need for bilateral interchange agreements.

We do not see a benefit in transferring potentially more than a quarter of a billion dollars to the issuing side of the card payments business. It prices a low-cost payment system out of the market, forces higher prices into the retail market and deprives the acquiring side of the investment incentive to promote innovation.

Leaving the interchange rate setting mechanism to an industry body dominated by the major banks is pre-mature when the access regime remains broken. An initiative like Tyro Payments, establishing an innovative acquirer-only, requires the continuous oversight and regulation by the Reserve Bank. The same is certainly equally true for the EFTPOS Payments Australia Limited and the EFTPOS interchange rate setting mechanism.

Capping the interchange fee of scheme debit card at the current lower EFTPOS level, would give this new organisation (and Australian issuers) the chance to establish a real competitive domestic alternative – in terms of functions, features and pricing – able to compete with the dominating international scheme fees.

Yours Sincerely

A handwritten signature in blue ink, appearing to read 'Jost Stollmann', written in a cursive style.

Jost Stollmann
CEO