



20 April 2012

VIA EMAIL : pysubmissions@rba.gov.au

Payments Policy Department
Tony Richards
Reserve Bank of Australia
GPO Box 3947
SYDNEY NSW 2001

Dear Tony

Submission to the Review of Innovation in the Regulatory Framework for the EFTPOS System: Consultation on Designation

Tyro Payments Limited is a Specialist Credit Card Institution authorised by the Australian Prudential Regulation Authority. Tyro is Australia's independent provider of 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 consultation from the perspective of the only new entrant into the payment space competing with the incumbent banks as an acquirer only i.e. an ADI that does not issue cards and does not take deposits and as a technology innovator.

The Options posed by the RBA

The RBA announced in March 2012 that it considered a new designation was required in respect of EFTPOS due to recent changes in this payment system. The two options put forward by the RBA for such new designation are:

Option 1: A definition based on ePAL membership and rules

Option 2: A broader definition of the EFTPOS system in order to capture those parts of the system that lie outside the scope of ePAL's membership and scheme rules."

In the consultation material the RBA also made reference to the possibility that:

"One possible outcome of the review of the broader regulatory framework is that regulation of the EFTPOS system may no longer be required. Were this approach preferred, consideration would be given to revoking the current designation of the EFTPOS system at the appropriate time, without replacement."

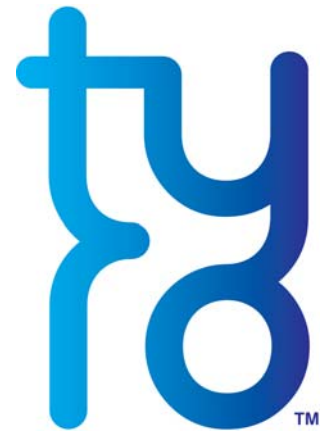
It is Tyro's submission that

1. The RBA must continue to designate EFTPOS and use its statutory powers to issue appropriate standards in the public interest that will control risk and promote efficiency and competition in the EFTPOS debit card system.
2. The EFTPOS system should not be defined by reference to ePAL and its rules but rather by a broader definition that recognizes the interests and roles of participants and users of EFTPOS that are not members of ePAL.

These are discussed in more detail below.

Tyro Payments Ltd
abn 49 103 575 042

125 york street
sydney nsw 2000
p+61 2 8907 1700
f+61 2 8907 1777
h+1 300 966 639
www.tyro.com



Self-regulation is ineffective in an oligopolistic industry

The Payment Systems Board is charged with ensuring the safety, efficiency and competitiveness of payment systems such as EFTPOS for the public benefit. It is only the RBA that has such powers and the legal obligation and perspective to act solely in the public interest.

An entity such as ePAL which is owned and controlled by companies, who are otherwise legally obliged to act in the interests of their own shareholders, cannot satisfy these fundamental thresholds.

The fact is that the Australian payment system is dominated by the four major retail banks. There is no countervailing power, except for government and regulator. The two payment industry bodies APCA and ePAL are controlled by the dominant quartet.

As a consequence, while proprietary innovations recently flourish providing value to the respective institution's customers and locking out competition, the innovation and investment into the core and openness of the Australian payment system has been excruciatingly slow. Australia, once perceived as leading in payment solutions has thus been falling behind.

Faith was put into the banks to foster innovation and invest securing the required resilience and performance of the nation's payment systems, but they have not delivered. The online payment project Mambo has been abandoned. Interbank settlement processes remain overnight batch processes. The legacy retail payment systems have collapsed under outages, failures and glitches.

The lack of investment by the major retail banks has put the resilience, security and performance of the Australian payment system at risk.

The inertia and coordination failure in this oligopoly can only be overcome by the designation and ensuing stringent regulation setting goals, standards and timelines. Then the overdue investments are not anymore doomed with each institution's "business case not stacking up at the time". Mandatory project delivering reliable and fast electronic transfers at retail level are finally given the priority they require.

If new entrants, innovators and or non-banks, were to contribute their part to the efficiency, risk mitigation and competitive tension in the payment system, the fact that only one new entrant has dared to enter the market reflects poorly on the factual and perceived openness and fairness of the Australian payment space.

A new designation is required to foster efficiency, risk mitigation and competition

The move to the cash-less society and new mobile technologies will result in dramatically increased transaction volumes putting further stress on the failing legacy core payment systems.

Despite the complex networked nature of the payment system, the global schemes have successfully shown that the only way to maintain a level of innovation commensurate with the changing requirements of consumers is the ability to



mandate binding decisions and to enforce deadlines of mandates with significant financial incentives or penalties. The mandating dispenses of the business case and forced the dominant banks to upgrade security and functionality.

As far as the domestic debit card system is concerned, nobody but the Reserve Bank of Australia should mandate the outcomes, standards and access of the payment system. Eftpos Payment Australia Limited (ePAL) is unsuited to be entrusted with this role, since it is

- not a company charged with the statutory duty to act in the public interest;
- not transparent nor inclusive of non-member participants of EFTPOS; and is
- de jure and de facto dominated by the major banks.

It is of significance that the RBA designated EFTPOS after the Australian Competition Tribunal had found that the zero interchange fees for EFTPOS proposed by the banks and financial institutions was contrary to the public interest. (See Re EFTPOS Interchange Fees Agreement [2004] ACompT 7 25 May 2004).

This decision of the Australian Competition Tribunal underlined the importance of weighing up the interests of all participants and users in the EFTPOS payment system, including merchants, card holders and general consumers. The position that the banks arrived at on zero interchange fees was opposed by merchants and the Tribunal agreed that any proposed public benefit was outweighed by the public detriment of the banks' proposal.

Unlike ePAL, the global organisations Visa and MasterCard are governed by boards reflecting a broad diversity¹. However, even with such different controls the RBA has and continues to designate these schemes (and extracts undertakings from other charge card or credit card operators) so as to be able to implement appropriate standards to ensure safety, efficiency and competition in the card payment systems in Australia.

Again, Tyro notes that the designation of the MasterCard and Visa schemes eventuated after litigation was commenced by the ACCC alleging anti-competitive conduct in respect of the setting of rules and fees within those schemes.

Given the networked nature, the two-sidedness of issuing and acquiring and the high concentration of the Australian payment space, new entrants will only trust to enter, if they see a strong regulatory framework and an engaged regulator as arbiter instead of being dependent on their competitors' goodwill.

How would ePAL be able to fairly balance its major shareholders' interest with those of the community and those of new entrants bringing disruptive innovation to the payment space? No business will invest with its competitors in charge of its destiny.

¹ <http://investor.visa.com/phoenix.zhtml?c=215693&p=irol-govBoard>
<http://investorrelations.mastercardintl.com/phoenix.zhtml?c=148835&p=irol-govboard>
<http://www.eftposaustralia.com.au/corporate/board/board-of-directors/bruce-rathie>



Thus the designation as the result of the current consultation is of critical importance to the likelihood of enabling innovation and competition through new entrants participating in the Australian payment system.

The type of innovation that Tyro brought to the market, for example non-stop acquiring (100 per cent availability) or non-exposure of sensitive data (PCI PA-DSS) will only happen, if investors into new payment solutions can believe in fair access and a level playing field.

The prerequisites for an open and innovative payment system

Innovation through new entrants will only happen, if innovators and investors can believe in a strong regulatory environment that delivers the following pre-requisites:

1. A new entrant needs a commercially competitive access to the credit, debit and charge card schemes and the clearing and settlement systems. The access has to be comprehensive, since a new entrant on the acquiring side can only compete, if he can offer all credit, debit and charge cards. The current EFTPOS access regime is impractical and broken.
2. A competitor operating on only one side of the payment system (acquirer-only) depends on a cost based transfer price (interchange fee) between the two sides of the payment system to compete with the dominant issuer-acquirers.

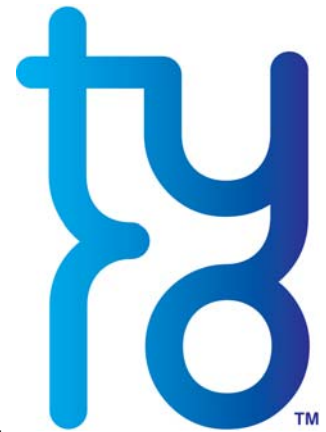
The experience in the payment industry, in Australia and worldwide, is that with the industry left to itself, interchange fees and particularly multilateral interchange fees are driven up to the benefit of the issuing side of the payment system. The most recent example was eftpos Payment Australia Limited (ePAL) decision to reverse and increase the domestic debit card interchange fee to satisfy their major shareholders' issuer interests.

It is the existence and activities of acquirer-only participants that lead to more transparency and tension around interchange fee settings. An acquirer-only participant brings to the table the interests of the merchants in the payment system.

The setting of an interchange fee is complex and possibly imprecise. That being, the regulator delivered a cost benchmark in the past and one-sided competitors depend on a cost based interchange fee as a pre-requisite for a level playing field in the future.

A definition based on ePAL membership and rules is problematic

Tyro has as an industry initiative supported the establishment of eftpos Payments Australia Limited (ePAL) so as to create a body that is focused on of promoting, coordinating and marketing the domestic debit card system. Tyro is not against a coordinated approach to strengthening EFTPOS as a payment system. However that coordinating body, ePAL, cannot also be left to self-regulate and determine critical matters such as interchange fees and access to EFTPOS.



Tyro is not a member of ePAL. There are various other participants in the current EFTPOS system who are not members of ePAL. There are also the users or participants in the payment system generally such as merchants and the public who are not members of ePAL.

These non-members and other participants do not have any say in the shaping, interpretation, and possible amendment of such ePAL rules.

Designating EFTPOS by reference to rules that are not

- transparent,
- established after consultation with all participants;
- set in the interests of all participants; or
- open for comment or change by all EFTPOS participants

is contrary to public interest.

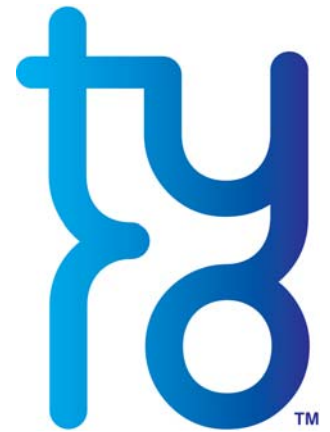
Any definition of EFTPOS must be broad enough to encompass the roles and interests of non-members of ePAL and other participants. Further the RBA's designation should not be defined by reference to rules that are not set by the RBA.

It is problematic to have a designation defined by reference to rules that can be amended at the election of ePAL and the RBA would have no power to stop or otherwise be involved in such amendments. This means that the RBA would not be able to control the definition of its own designation.

Another major concern in using ePAL as a definition of designation is that contrary to the global schemes' shareholding and governance, ePAL's is made up predominantly of banking/financial institutions. ePAL is de facto dominated by the four Australian major retail banks. The only non banking representation on ePAL are Australia's two dominant retailers, who must necessarily act in their own corporate interests.

That has severe repercussions for new entrants and other competitors of the major banks, because they are now vulnerable to one all decisive body. Looking at historic industry behavior:

- Since 2005, Tyro has been requesting commercially viable access from the four major retail banks and American Express. Of the five counterparties, two finally granted access against significant initial funding and ongoing fees.
- Effective October 2011, ePAL announced a multilateral interchange fee that switched the flow of interchange fees in favour of issuers. The rationale for this decision of ePAL was not explained, did not involve the considerations or input of any non-members of ePAL and is not open to fair and appropriate scrutiny such as the decision of a public agency would be.
- While the RBA had set an access standard for the EFTPOS system, the Australian Payment and Clearing Association (APCA), an industry body dominated by the four major retail banks, implemented the EFTPOS access code in a way that is impractical and was to our knowledge never used. The result is a broken EFTPOS access regime



This is a good example of how the industry body was able to negate the clearly regulated outcome of the eftpos access standard, by implementing the technical details of the EFTPOS access in such a way that it practically bars access.

While the RBA would legitimately not be involved in the details on how its mandated outcomes are delivered, it needs to maintain sufficient involvement and oversight to counter effectively behaviors driven by strong proprietary interests of the dominant banks to undermine the regulatory goals at the technical implementation level.

Against the background of failing industry behavior, using ePAL membership as definition for the designation, Tyro then would be in the hand of another industry body that is again controlled by Tyro's major competitors.

Inherent in the ePAL power structure is the capability and incentive to restrain competition. As such ePAL is in no way comparable to the global schemes which are accountable to a broad investor base, serving thousands of banks and being supervised by dozens of regulators across the globe.

It is a big risk to expect smaller competitors, innovators, investors and new entrants to entrust their destiny into the hands of those dominant competitors that they are supposed to dare and endeavor to compete with.

In the past and in the bilateral world, Tyro pushed its requests directly with the individual banking institutions. Again and again, Tyro only advanced in becoming a participant of the payment system by seeking and obtaining guidance and support from the regulator.

The RBA and APRA have indeed created the Specialist Credit Card Institution (SCCI) regime with the intention to induce innovation and competition by attracting new entrants into the payment space.

It was the trust in the regulator assuring access and equal playing field rules that encouraged Tyro investors to fund the development and deployment of an innovative acquiring technology that in its fifth year of operation now serves 6,000 merchants and transacts \$3 billion per annum.

If Tyro had to deal in all the issues of competitive survival only with the one or two organizations (APCA and ePAL) dominated by its four competitors, significant safeguards and a strong regulatory oversight would need to be credibly in place.

In order for ePAL to satisfy the uniqueness of the new entrant and the acquirer-only model, there would need to be a

- functional access regime,
- commercial membership terms for a small participant,
- debit card interchange fee terms analogous to the regulated bilateral (cost based and flowing to the acquirer) and
- settlement arrangements excluding acquirer-only pre-funding.

Given how the major Australian banks and the industry bodies have dealt in the past with the one and only new entrant, frustrating access and limiting growth,



there is a significant credibility gap when considering ePAL or APCA as a fair industry body accommodating the legitimate interests of small and new payment participants.

Forcing EFTPOS participants to join ePAL is not in the interest of the payment system or otherwise fair. If this was going to happen and ePAL membership became compulsory in order to participate in the domestic debit card system, the industry would still require a strong regulator to protect and ensure that there is access, level playing field, competition and efficiencies in the system. This regulator should be the RBA who understand payment systems and the many complexities involved in this industry.

The role of this skilled regulator will always be critical for small or new participants.

A broader definition provides more flexibility and trust

Adopting a broader definition of the EFTPOS system outside the scope of the ePAL membership would maintain a more transparent and trusted regulated space that would allow affording protection to new entrants, who are typically one-sided participants such as the acquirer-only model adopted by Tyro.

These participants could thus be covered by rules that are not covered by the ePAL scheme and reflect the specificities of those smaller participants pursuing a specific role that is clearly in the public interest.

It would mean that all participants have clarity as to what the EFTPOS standards require, how they are formed and implemented and how they can be varied or queried.

Critically the designation of EFTPOS must be framed in a way that allows all participants whether a member of ePAL or not to have a genuine ability to contribute and consult in respect of the terms and setting of standards.

Ideally, an acquirer-only would stay within a regime similar to the current regulated bilateral fee regime benefitting from a set cost-based interchange fee or from a non-discriminatory protection affording to the acquirer-only the same terms as self-acquirers can obtain through their sheer commercial purchasing power.

Certainly, the EFTPOS access regime has to be revised so that it becomes practical and effective.

Conclusion

The Reserve Bank of Australia needs to reinforce its setting and monitoring of outcomes, standards, access and target dates. It also needs to maintain a level of involvement that allows the RBA to remain a skillful arbiter, certainly for new entrants, smaller specialized participants and innovators who otherwise would be delivered without recourse to the industry bodies controlled by dominant competitors.

The details of coordinating and executing the mandated changes can very well remain with further empowered industry bodies such as APCA and/or ePAL, but under continued oversight.



The Tyro experience has put the torchlight on access and expansion barriers and imbalanced and discriminatory structures and behaviors in the payment space. The score card for the industry's ability of allowing a new entrant to bring innovation and competition to the Australian Payments System has fallen short.

Tyro's endeavor has advanced when it enjoyed the support of the regulator. For the Tyro endeavor to scale up, succeed and make a difference, the persisting barriers to access and expansion need to be lowered.

And this is not about Tyro seeking an advantage. To the contrary, it is about making sure that the Australian payment infrastructure and framework becomes an open system, where all participants and new entrants can compete within fair rules and on a level playing field.

If that is not the case, parallel payment worlds will develop without regulatory oversight and thus with all the risks and failures that this engenders for the community. It is in the public interest to have an open but regulated payment system where innovation can happen inside the system with trust and security maintained.

The fact that so far there has been only one new independent EFTPOS system participant combined with the fact that there is so much innovation enabling technology on the horizon underlines that a lot of work and conviction still has to be performed, before innovation and competition through smaller participants and new entrants can happen within the payment system.

We trust that the regulator who created the reform initiative that we responded to will continue to designate EFTPOS so as to achieve the competitive and efficiency improvements needed for this payment system.

Yours Sincerely

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

Jost Stollmann
CEO