The Senate – Economics References Committee

Inquiry into Competition within the Australian Banking Sector

30 November 2010

Executive Summary

Tyro Payments is the first and only new entrant into the EFTPOS payment space in over 14 years and competes successfully with the Australian major retail banks. BRW recently recognised Tyro as the 4th fastest growing business in Australia.

Tyro operates as a specialist banking institution and supplies EFTPOS terminals and provides card acquiring services, i.e. it authorises, clears and settles Visa, MasterCard, American Express, Diners, JCB and EFTPOS card payments on behalf of medical practices, pharmacies, newsagents, book and duty free stores, car dealers, restaurants and general retailers. Tyro also provides a real-time claiming and rebating solution to Medicare Australia, an online tenant rent payment facility to Westfield Limited and a card payment facility for Coca Cola Amatil vending machines.

Tyro facilitates the transfer of funds from the end customer to the merchant. Funds payable to merchants are settled into any Australian transaction bank account of their choice. All transactions are viewable online in real-time. With its specialised banking license Tyro does not take money on deposit.

Tyro has developed and operates an end-to-end transaction acquiring solution using state-of-the-art server hardware, (open source) software, IP networks, development tools and agile methods, as opposed to the legacy solutions offered by the major retail banks. Tyro develops customised solutions for many of its clients to suit their business and operational requirements.

The Reserve Bank of Australia enabled Tyro (a non-bank with a specialist license) to compete in the core banking process of merchant acquiring. Tyro has brought fair and transparent pricing to the market, EFTPOS claiming and rebating for Medicare Australia and fast, secure, non-stop, integrated EFTPOS for Australian merchants.

Innovation and competition are of prime interest to Australian consumers and merchants as it gives them both fee and product choice. Indeed, it is also in the interest of the major retail banks to encourage and foster a thriving

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entrepreneurial layer in the banking industry as it generates innovative ideas that spill over into their organisations.

Actual and perceived competitive barriers need to be reduced in order for more companies like Tyro to bring innovation and competition to the banking space.

This submission seeks to identify obstacles that Tyro faced and still faces in its effort to bring better, less expensive and innovative EFTPOS solutions to the Australian consumer and small business market.

The following items highlight opportunities to increase competition in the card payment space.

1. Relieving new acquirers (which are already APRA supervised ADIs) from significant collateral requirements unilaterally requested by the credit card schemes.
2. Elimination of bilateral arrangements and associated excessive access costs to EFTPOS networks, replacing these with common access technology and a single affordable access cost, i.e. usage of the COIN by EPAL, RBA et al.
3. A requirement that the major banks offer new acquirers the same settlement timing into transaction accounts as they do to each other or to their own acquiring business.
4. Adoption of the RBA's LVSS (Low Value Settlement System) by all banks, when it becomes available.
5. Avoiding the bundling of acquiring services as working capital packages or support for debt facilities.
6. Mandating EFTPOS network access for all debit cards at a low cost interchange fee.
7. Limiting the cross-subsidy of the card issuing business through interchange and scheme fee arrangements.
8. Creating a level playing field between the acquirer and issuer by imposing reciprocal compliance and business rules.
9. Explicitly working to open access to government payment markets for new entrants.
10. Ensuring proper access to oligopolistic and monopolistic markets such as private health funds, cab, fuel, and other dominant card issuers.
11. Monitoring the impact of heightened regulatory capital requirements and open access for card scheme receivables debt funding.
12. Providing behavioural undertakings by the major retail banks relating to price transparency, settlement, bundling and switching.

If the Australian community wants to foster innovation and competition, the banking industry and the card issuer organizations must introduce self-regulated access, standards and rules. If they don't, government and regulators must drive industry initiatives and maintain competitive access.

Due to its network nature, the payment industry requires a strong set of standards and rules to protect the integrity and stability of the system. However, the standards and rules must also enable innovation and competition. Rules may need to be differentiated to reflect the differences between broad-line and mono-line ADIs, rated and non-rated ADIs, new entrant and incumbent providers.

The fact that Australia has seen such strong consolidation without new entrants challenging the oligopolistic structures highlights the need to continue and intensify the payment space reforms.

In Tyro's opinion, it is in the best interest of the major retail banks, government bodies, card issuers and merchants to encourage, fund and support the best and brightest Australians to try it on their own and compete with innovative technologies and implement bold business models.

The banks will benefit from seeing innovative ideas validated under their eyes. These concepts spill over and energise their own organizations. Over time the new companies might sell out at a more mature stage, become significant companies in their own right or even create a base for international competitive advantage.

The Australian community expects fair and transparent pricing as well as fair and transparent dealings with new entrants. It is important that innovation and competition embracing behaviour visibly permeates the major banks' organisation.

Significant innovations come from mono-line players. If a new entrant and innovator cannot access medium to bigger merchants, because the major retail banks block the access by bundling, potential new entrants will be discouraged and the ones daring to enter will fail to build sufficient scale.

A recent UK Office of Fair Trading Review identified the major bank behaviour and the merchants' switching inertia as the most significant barriers to entry and expansion.

For the government, public tendering should be constructed in a way to maintain access for new entrants. The Medicare Australia Easyclaim project was a great validation of the approach that allows new entrants and incumbent veterans to compete.

Tyro is the new entrant challenging the incumbent veterans. We are proud that there is already one Tyro innovating and competing successfully in a core banking process, but where are the others? It is these growth companies that drive economic growth and welfare.

We encourage this issue to become an ongoing topic of debate.

The Tyro Background

Tyro is Australia's EFTPOS innovation institution and is the first new entrant into the EFTPOS industry in over 14 years.

Tyro holds an authority under the Banking Act to carry on a banking business as a Specialist Credit Card Institution (SCCI) and is supervised by the Australian Prudential Regulation Authority (APRA). Under this authority Tyro provides credit, debit, EFTPOS, gift and loyalty card acquiring and Medicare claiming and rebating services, but is not authorised to take money on deposit.

Tyro's transparent payment solutions are uniquely merchant focused, enabling reduced fees, increased productivity, better cost management and a better payment experience for consumers.

Tyro is accredited by Medicare Australia to facilitate the electronic claiming of Medicare benefits through the Medicare Easyclaim service. In partnership with Health Communication Network (HCN), Tyro offers integrated EFTPOS and Easyclaim for PracSoft and integrated EFTPOS for Blue Chip, HCN's practice management systems.

Tyro is a wholly Australian owned company fully funded by its Executives, Directors, and independent and strategic investors.

The Technology Advantage

Tyro was founded as MoneySwitch Limited in February 2003 by three Australian computer networking engineers. Previously focused internationally, they had built and successfully sold two companies that designed and commercialised technology solutions for the internet packet switching and routing market sectors. This time, focused on Australia, they developed an end-to-end acquiring solution using the state-of-the art hardware, software, tools and methods of the internet age.

Using commodity hardware, open source software and internet protocol they deployed a very cost effective and highly reliable financial transaction infrastructure. On 11 November 2006, Tyro's first EFTPOS terminal processed credit and debit card transactions.

New IP and technology developed by the local Australian team has been fit together, tested and certified and is now delivering new benchmarks in speed and reliability. Today, Tyro has two secure data centres operating live, with the EFTPOS terminal in the field moving between redundant switches and sites, without the merchant noticing any disruption due to maintenance or component failure. Tyro's technological innovation makes the EFTPOS terminal outage which is still so common in Australia today, a thing of the past.

The use of the merchant's corporate broadband network or public internet has eliminated the expense and time delays of dedicated communication lines or networks. A unique architecture integrating the EFTPOS terminal with point of sale software provides a streamlined process eliminating re-keying amounts, data entry errors and reconciliation headaches while protecting the merchants against any data breach.

For the merchant this new technology means 3 second processing time, seamless integration, no more EFTPOS failure or degradation in peak trading times, no extra cost for communications and integration and no exposure to data breaches.

The Tyro Innovation so far

Technology advances are enabling rapid change in banking in Australia in the way consumers pay and the cost of doing business and delivering benefits for the community. That said, it appears difficult for the large financial institutions to change existing systems. The network infrastructure and the back-end systems are outdated. To the extent that new entrants have restrictions on their access, the Australian community will not benefit from the technological changes available. There remains a lack of transparency in the current payments system that means the pace of innovation has been slow.

2010/11 is Tyro's fourth year of live operation. Tyro's contributions to the payment industry are:

- Tyro launched transparent and differentiated cost based pricing and transparent fee reporting. It offered no strings-attached, no hidden fee, no term contracts.
- Tyro educated merchants about ways to minimize interchange fees; for instance by processing Visa and MasterCard debit card transactions through the efficient EFTPOS network.
- Tyro advocated in industry submissions for the merchant's interest, for example supporting the efficient and low cost Australian EFTPOS network providing merchants and cardholders with an inexpensive electronic payment alternative.
- Tyro launched the first real-time and practice management integrated electronic Medicare rebating solution for general practices allowing Australian patients to avoid queuing in Medicare offices to obtain their reimbursement – and meaningfully progressing Medicare's goals to decrease the number of paper based transactions.
- Tyro launched the first acquiring platform designed for non-stop acquiring, eliminating the costly failure of the acquirer causing severe disruption to merchants' businesses.
- Tyro eliminated the additional communication and integration costs that incumbent, slow and unencrypted dial-up EFTPOS technology levied on Australian merchants.
- Tyro has removed the data breach risks for Australian merchants through the innovative way its EFTPOS terminals are integrated into the point of sale, practice or property management system. The Tyro architecture ring-fences the critical cardholder data from the merchants' sphere.

The Regulatory Environment

Since 2003, the Reserve Bank of Australia has been reforming the payment space dominated by the four major retail banks with the goal of promoting the efficiency of the payments system and promoting competition in the market for payment services.

The Reserve Bank of Australia analysed and published the different fees flowing between the acquirers and the issuers. The trend of subsidizing the banks' issuance business and cardholders through interchange fees was limited by a cap at 50 basis points. Merchants were also allowed to surcharge the acceptance of card payments. As a consequence, merchant service fees dropped from 1.4 percent to 0.79 percent saving merchants and ultimately consumers over a billion dollars.

To attract non-banks into the payment space and thus encourage innovation and add competitive tension around technology and solutions, the Reserve Bank designed a specialized bank license (SCCI) that authorizes the new entrant as an Australian Deposit Taking Institution (ADI) to process credit and debit card, direct debit and BPay transactions without taking deposits.

Tyro is the only non-bank acquirer who applied for this new bank license. The license has allowed Tyro to become a principal member of Visa and MasterCard and a tier one member of the Australian clearing and settlement system. Tyro was thus authorized to compete directly with the major retail banks in a core banking segment i.e. merchant acquiring or EFTPOS.

Today, Tyro is still the only non-bank that competes with the major retail banks in the heartland of payment services. The challenge for the banking community and the regulator is to encourage more innovation and competition, especially if one believes that new entrants and entrepreneurial companies are more suited to contribute break-through technologies and bold new business models.

Major retail banks actually benefit from seeing innovative ideas being validated under their eyes and from those spilling over into their own organizations. New entrants find it easier to rethink business processes and apply new technologies that eventually will be taken on by larger organisation to improve their efficiency.

There is a whole catalogue of measures that should be considered which are summarized below.

<u>The Access to the Scheme Card side of the Payment Infrastructure</u>

With the banking authority of an SCCI to process credit card transaction, a new entrant can apply for membership with the scheme organizations (Visa and MasterCard). As longstanding membership organizations, there is a well established process to connect into their global networks and to certify payment applications with them.

One of the obstacles that needs to be considered by new entrant acquirers is that schemes demand additional risk capital. In the early phase of building the business a new entrant cannot hope to attain a rating from the leading rating agencies. The schemes demand from these non-rated ADIs, additional capital in collateral, instead of satisfying themselves with the RBA licensing regime, APRA supervision and prudential capital requirements.

The card schemes also require significant excess capital from acquirers who provide their services in what they consider higher risk merchant acquiring markets. For instance, in the online payment market, prohibitive excess capital requirements bar a new entrant like Tyro from providing its low risk brick and mortar merchants from offering a card-present and card-not-present solution from one platform and on the basis of one contract.

For specific cases like a secure real-time cab and limousines payment system and an online rental payments solution, Tyro obtained waivers from the standard additional capital requirements.

The Access to the EFTPOS Debit Card side of the Payment Infrastructure

The Australian EFTPOS debit card system was established in its present form in the early 1990's using technology available at the time. It consists of many point-to-point communication links between financial institutions, together with bilaterally negotiated contractual, technical and pricing terms.

Encouraged by the Reserve Bank of Australia to address the access issue, the Australian Payments Clearing Association (APCA) established an EFTPOS Access Regime, operated under EFTPOS Access Australia Limited's Access Code, to facilitate access to the EFTPOS network in set time frames and within set maximum costs.

During the significant time while the access regime was being drawn up, Tyro negotiated two interconnect, switching and settlement agreements with two major retail banks. While Tyro had to pay significant set-up fees and pays ongoing switching and settlement fees, it was the only practical way to gain timely access all members of the EFTPOS network.

In Tyro's opinion, the access regime as created by APCA is not a commercially viable way for a new entrant to proceed. For example, a new entrant today must be a prudentially supervised ADI, a self-acquirer or a switch, able to comply with obligations in the Access Code and the CECS Manual within 12 months; and use the Access Code to establish 2 direct connections in 12 months and either a third in 36 months or a third and fourth within 12 months of each other. In order to connect to all EFTPOS members multiple years must pass before a new entrant is able to even begin to function.

The requirement to connect to all members bilaterally, the costs and details of the access regime and process are impractical. As a consequence, Tyro continues to seek access to the remaining major retail banks in direct negotiations. No entrant has ever used the access regime.

The current migration of the outdated bilateral point-to-point network architecture into an IP-based virtual private network, the Community of Interest Network (COIN), will simplify the physical connection to all participants in the Australian payment system, but potentially put new entrants at a variable cost disadvantage over participants with existing bi-lateral links

The COIN is only the transport layer. It does not establish logical (message) connectivity, and does not cover the commercial relationship between the parties.

The Issue of outdated Batch Settlement Systems

The Bulk Electronic Clearing System (BECS) allows Tyro to instruct the transaction banks to pay the merchants the next day for the credit and debit card transactions that have been acquired during the trading day. It is still only an overnight batch process. The future lies in multiple intraday settlements or real-time settlements. The bank executes the payment either as soon as possible or awaits a later batch job.

The result for a new entrant like Tyro is that:

a. some merchants' funds are settled into their bank account by their transaction bank, as they would have been if they had the acquiring relationship with the same bank (merchant acquiring and transaction account bundled). In this case funds are settled into the merchant's transaction account on the next business day;

b. other merchants are settled a day later, if they have an acquiring account with Tyro and a transaction account at another bank, where that bank performs its own once-per-day, batch mode reconciliation/settlement processes; and

c. some merchants at a major bank are being offered early "same day settlement" if they keep their merchant acquiring bundled with their transaction account.

Clearly, a) represents equality between Tyro and the other banks, while b) and c) represent bundled product offerings that restrict competition.

<u>The Issue of bundled Working Capital Solutions and Loan Solution</u>

A new entrant like Tyro specializes in bringing innovation and competition to a single segment or aspect of the entire spectrum of banking services. Tyro uses state-of-the-art technology to offer features and functions that improve the efficiency of an EFTPOS solution. Depending on the funding and bandwidth of the organization, the depth of the advantage builds over time, as the solutions become more complete.

The risk for the challenger, particularly during this phase and in general, is broad line competitors who bundle their services, cross subsidize between offerings or positively appraise credit applications depending on the retention of the acquiring business.

Significant innovations come from mono-line players. If a new entrant and innovator cannot access medium to bigger merchants, because the major retail banks block the access by bundling, potential new entrants will be discouraged and the ones daring to enter will fail to build sufficient scale.

A recent UK Office of Fair Trading Review identified the major bank behaviour and the merchants' switching inertia as the most significant barriers to entry and expansion.

http://www.oft.gov.uk/OFTwork/markets-work/othermarketswork/review-barriers/#named2

<u>The Challenge of Issuer Competition</u>

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

Tyro acquirer-only model is unique and a reflection of the Reserve Bank of Australia's innovative approach as a self-described reluctant regulator. It has created the only banking institution in Australia that is not conflicted by issuer interests. Tyro helps merchants to drive down the card acceptance costs by educating the merchants about interchange and scheme fee cost dynamics and arbitrage opportunities. It does not try to help credit card companies make more money. In all of its submissions to the Reserve Bank, Tyro has been the outspoken advocate of merchants' interests in the card payment space.

The main interest of major issuer-acquirers is in protecting the issuer-side profitability through interchange fee revenue. The interchange fee is a cross-subsidy by the merchant community funding the issuers' card-holder business. The higher the interchange fee and the more a large competitor has a relatively strong issuer base, the more Tyro's cost position is disadvantaged. The effect is most beneficial for the incumbent market leader who will have a significant share of transactions involving his cards at his merchants, the so called "on-us" transactions, where no interchange fee and only a fraction of the scheme fee occurs.

<u>The Challenge for the Australian Small and Medium Enterprises (SMEs)</u>

The two large retailers of Australia have the size, scope and representation in the payment governance bodies to pursue their interests. They have implemented their own transaction switching platforms and negotiated bilateral EFTPOS interchange agreements and advantageous scheme interchange categories.

Big merchants designated by card schemes to be strategic, because they meet certain volume and/or growth thresholds, benefit from interchange fees that can be up to one half of what merchants in general are charged. The corresponding issuer losses in interchange revenue can be compensated by them through interchange fee increases charged to the general merchant community, since it is the average of the interchange fee that is capped through the RBA regulation. Put more simply, as the credit card companies and the large retailers reach bilateral agreements on fee levels, the interchange rate charged to all other merchants – especially SMEs – may very well go up.

This trend may be exacerbated as the soon to be determined new multilateral EFTPOS debit card interchange fee might charge the merchant community a heightened interchange fee to motivate the card issuers, but shelter the big retailers from the cost increase through the continuation of their bilateral agreements.

Tyro is the only acquiring banking institution that has no interest in driving up the interchange costs for Australian merchants. Tyro is an advocate for SMEs who lack the negotiating power that the big retailers can use to protect themselves against increasing interchange and scheme fee costs.

<u>The Challenge of Scheme and Issuer Competition</u>

With the growth of international travel, providers of multi-currency solutions and acquirers partnered to offer Visa and MasterCard credit card holders the choice of paying with their home currency at a foreign point of sale. The economic effect of this innovative solution was to share the foreign exchange margin between the currency provider, the acquirer and the merchant. As a consequence, this margin was not available to the scheme and issuer for transactions where the cardholder had chosen to convert at the point of sale.

Visa then changed its membership rules to the effect that acquirers were no longer allowed to offer new merchant outlets this Dynamic Currency Conversion (DCC) service. Presumably reacting to concerns presented by currency providers, acquirers, merchants and competition authorities, Visa withdrew its limitation of the DCC business for acquirers.

New entrants like Tyro, who are building their solution base and merchant franchise, are particularly vulnerable to such changes in the competitive field, especially in the early years of their operations. We would expect that acquirers and issuers give cardholder choice and full disclosure. We would trust that schemes ascertain that acquirers and issuers face the same compliance requirements without a side being disadvantaged.

<u>The Survival of a Competitive Domestic Debit Card System</u>

The Australian domestic debit card system (EFTPOS) is under pressure from the Visa and MasterCard debit card solutions. The international schemes provide richer functionality and a higher interchange fee, rewarding banks that issue these cards instead of EFTPOS cards. Scheme debit cards offer issuers 12 cents interchange income whereas EFTPOS debit cards cost issuers 4 to 5 cents. Thus the share of scheme debit cards on issue has been increasing.

The demise of the domestic debit card system along with the previous demise of the domestic credit card system (Bankcard) would further limit card payment choices and reduce competitive contestability. Essentially, VISA International and MasterCard could end up receiving a fee for the majority of Australian domestic transactions. To help preserve a domestic scheme capability, the Reserve Bank of Australia has encouraged a new governance framework with the creation of EFTPOS Payments Australia Limited (EPAL) and has aligned the standards of the scheme and EFTPOS debit card systems interchange regime.

Since EPAL is issuer dominated, there is an incentive for the organization to close the current interchange fee gap between the EFTPOS and the scheme debit card system. EPAL is now free to set a new high multilateral fee benefiting the issuer banks to the detriment of the merchants. The big retailers can shield themselves against this effect by maintaining or negotiating advantageous bilateral interchange arrangements for their own benefit.

Tyro and the Australian merchants are exposed to the risk of being disadvantaged by higher interchange fees, now that the interchange fee setting mechanism is under the control of the major banks and the major retailers.

In Tyro's opinion, the domestic debit card system can only survive if it acts as a low cost system allowing Australians 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 such as Medicare, low-ticket providers like transit systems or newsagents and general retailers a choice between accepting an efficient domestic card payment system or the dominant high-priced global card schemes.

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, EMV (chip & pin), NFC ("tap-and-go"), pre-authorization, card-not-present acceptance and e-Commerce security features,. It will take years to catch up and the international schemes will already have 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. The expected higher EFTPOS interchange rates will accelerate the demise. There are multifaceted consequences of increasing the cost of an EFTPOS transaction, such as:

- Medicare's fast growing electronic rebate system, aka "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 a high multilateral interchange fee, 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 on current levels pay 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 competitive disadvantage versus the large self-acquiring merchants who likely would be sheltered from the additional EFTPOS costs with their existing bilateral contracts and their ability to negotiate continuously preferential rates once the contract terms of the existing arrangements run out.
- Tyro, as Australia's only new entrant into the EFTPOS payment space, might have to absorb the high multilateral EFTPOS interchange face, whereas large self-acquirers or acquirers could obtain preferential interchange rates.

Left unsupported, 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 this increases their profitability.

It should be noted that international card schemes currently threaten the existence of Interac, Canada's not-for-profit debit card scheme which operates for the benefit of all Canadian merchants and customers. It is threatened because today there is no interchange fee passed from acquirers to issuers; and the schemes are positioning themselves to offer Canadian banks interchange on debit card transactions.

Recognizing this threat, on 30 June 2009 the Canadian Standing Senate Committee on Banking, Trade and Commerce released a report pertaining to "Greater Transparency and Accountability in Canadian Debit and Credit Markets", which contained several recommendations pertaining to debit card network operations. These recommendations were to:

- require the calculation of switch and interchange fees on the basis of a flat fee for debit card transactions;
- set the interchange fee at zero for a period of three years for all debit card transactions;
- recognise that there is no justification for percentage fees on debit transactions;
- prohibit priority routing in order that cardholders are able to select, at the point of sale, their preferred payment method when using a co-badged card; and
- for the purposes of ensuring a level playing field, the Minister of Finance should deem Interac, Visa and MasterCard as designated payments systems under the Canadian Payments Act if he or she believes that this action is necessary to promote the efficiency and competitiveness of payment systems in Canada.

Quite clearly the Canadian government prizes the continued operation of Interac as a not for profit organization, offering a low cost debit card processing facility for all Canadians.

The complete senate submission can be found by visiting the following link:

http://www.parl.gc.ca/40/2/parlbus/commbus/senate/Com-e/bank-e/09cv-e.htm?Language=E&Parl=40&Ses=2&comm_id=3

A Scenario of the Australian EFTPOS Debit Card Survival

Tyro submits that the survival of an Australian debit card system is in the public interest. If the Australian debit card system is to survive, the issuer side of the industry has to undertake, or the regulator has to enforce, that all Visa and MasterCard debit cards are issued with EFTPOS access functionality.

With assured access to the Australian debit card-holder base, EPAL can set EFTPOS interchange fees at levels that introduce competitive tension and foster innovation. It could then be highly differentiated by being low-cost and custom-tailored to Australia specific requirements.

It would provide each and every Australian bank account holder and the Australian government access to securely and efficiently processed debit or credit transactions to associated bank accounts. Government agencies such as Medicare, Centrelink, PBS, Child Support and state agencies could use an efficient low cost EFTPOS system to deliver payments to various beneficiaries.

Such a scheme would provide acquirers and all merchants the ability to offer card-holders a choice between using a feature and reward rich scheme network, or a no-frills low cost EFTPOS network.

The Access to Government Payments Markets

Tyro is innovating and competing in a core banking process that has significant network effects and complexities. The banking community has, to an extent, connected with us and is transacting with us. That has allowed Tyro to deliver a faster, safer, more reliable and more efficient EFTPOS facility.

However, the real break-through lies in the combined use of modern network, security, computer server and software technology to make electronic payment acceptance a seamless part of a government agency's or a merchant's business process. This requires access to industry participants, contractual relationships and technical integration.

For Tyro, a decisive break-through in terms of market access occurred when Medicare invited providers for a new electronic EFTPOS claiming initiative; not using the traditional way via request for proposal (RFP) but via an innovative scheme-type approach. Medicare had specified the business processes and accreditation criteria and invited banks to participate. Medicare's approach sought to invite innovation from the industry in order to provide a better solution at a lower cost to the governments. In December 2006 CBA and Tyro signed the Medicare contract.

Benefiting from its technology base and agility, Tyro launched an integrated Medicare Easyclaim solution into general practices. Now the process of paying, claiming and receiving funds into a bank account takes the patient seconds. Medicare has significantly reduced paper claims and less people queuing up in its offices. One and a half years after the launch, Tyro processes 10 million claims or eight percent of all general practice claims.

In general, the banking business government agencies– across both the Federal and State levels – can offer fertile ground for encouraging competition and innovation in the payments and general banking industries. We suspect that the Pharmaceutical Benefit Scheme would constitute another example of serving Medicare, the pharmacist and the patient with a seamless real-time co-payment solution. There are undoubtedly many more possible initiatives, where a concerted effort to foster competition through the letting of government business could quickly yield results.

The Access to Oligopolistic and Monopolistic Markets

For the benefit of the general population, monopolistic, oligopolistic or other closed network industries must grant access to new entrants, allowing them to compete and bring innovative solutions to market. For example, Tyro has long aspired to gain access to the private health fund claiming market. A major retail bank currently dominates this space; where Tyro is prevented from bringing to market new payment options that would benefit health care funds and their members alike. Medical practitioners and practice management software providers are eager to see innovation, choice and competition. However, if progress is to be made, the major health funds would need to engage with Tyro. Another participant in the private health fund claiming market would undoubtedly decrease costs and improve service.

Examples of other opportunities abound for large players in vertical markets to reappraise their interest in encouraging and enabling innovation, through a thriving level of innovators and entrepreneurs. These people we call Tyros. It is definitively in the interest of the nation, but also in the interest of the dominant institution. In more general terms, the Australian ethos of giving someone a “fair go” should be applied equally to the government and business community. Tyro stands tall as an agile and responsive organization keen to embrace the challenge of delivering useful, cost effective payment solutions to government, business and the wider community by working in partnership with relevant stakeholders (including software vendors of point-of-sale and patient management systems).

The Challenges of Funding Growth

Tyro faces proportionally higher capital requirements than incumbents, thus imposing a higher cost of capital that potentially limits our ability to expand. The prudential regulator may need to consider and monitor over time the impact on competition of these higher standards.

Tyro needs to pre-fund card scheme settlements, especially for international card transactions, since it instructs payment to its merchants for the next day, but receives itself payment by the scheme one to two days later. Tyro has not been able yet to secure a debt facility to fund these card scheme receivables.

The Challenge of Scaling up by Building a Merchant Base

For Tyro, the challenge now is scaling up with a growing merchant base in partnership with the growing number of certified software vendors. As a new entrant, Tyro faces significant challenges in convincing software vendors and attracting customers, thus expanding its market share in merchant acquiring.

Merchants are reluctant to consider a brand that they do not know. They have to go through the effort of comparing fees and switching their acquiring account. They also may face possible exit fees or fee increases elsewhere or even side effects on their loan application.

Indeed, bank relationship managers have an incentive to concentrate their efforts on merchant accounts that they can sell the full line of service to. They have an interest to avoid the intrusion of a mono-line provider, focussing on a single product, unbundling the relationship and lowering the switching costs for transaction accounts. Certainly Tyro has experienced the fact that businesses perceive that it is very difficult to get financing from the major banks and thus they are wary of moving any business away from them.

Conclusion

For the banking industry, a lot of work lies ahead. The Reserve Bank of Australia is keen to see advances in the technical payment infrastructure that will support a higher pace of innovation and accommodate new entrants.

The community expects fair and transparent pricing as well as fair and transparent dealings with new entrants. It is important that innovation and competition embracing behaviour visibly permeates the major banks' organization.

Behavioral undertakings by the four major banks could effectively increase price and service level transparency (e.g. EFTPOS settlements or EFTPOS availability), align settlement timings, reduce switching costs (e.g. by eliminating exit fees) and limit the bundling of current transaction accounts or debt facilities with merchant acquiring services.

For the government, public tendering should be architected in a way to maintain fair and equitable access for new entrants. The Easyclaim project was a great validation of the approach that allows new entrant and incumbent veterans to compete.

For the regulator and the competition authority, new entrants should be made to feel supported by a fair access and competition regime that limits exclusions, predatory pricing or third line forcing behaviour.

As a nation we all have to address the issue why there is only one Tyro and not dozens driving change in payments and other segments of the financial services industry.

The Tyro experience provides some direction. A prerequisite for innovation and competition driven by new entrants is access to industry and market participants. If monopolies or oligopolies do not grant fair access, public policy measures are warranted. There have to be effective time and cost rules allowing and encouraging new entrants to compete with innovative technologies and new business models.

There is also a predominant perception that competition against the powerful incumbents is doomed. The community and the market leading institutions have to turn this around. It is in the interest of the major retail banks, government, schemes, issuers and retailers to encourage, fund and support the best and brightest Australians to try it on their own and compete with innovative technologies and bold business models.

The large financial institutions benefit from seeing break-through ideas validated with their own eyes. These concepts spill over and energize their own organizations. The new companies might sell out at a more mature stage or become significant companies on their own right.

Tyro is the new entrant challenging the veterans. We are proud that there is one Tyro innovating and competing successfully in a core banking process. But where are the others? It is these growth companies that drive economic growth and welfare. We encourage this issue to become an ongoing debate.

Jost Stollmann
Chief Executive Officer

Further information on Tyro and financial reports under www.tyro.com