

Challenging the big banks in the card payments market

► by Jost Stollman

The Australian government and Australian merchants accept \$400 billion per year in card payments, processed at the point of sale (EFTPOS), as recurrent billing or online. They are charged an estimated \$3 billion per year in merchant services fees for these payments.

Predominantly these fees fund the international schemes (Visa, MasterCard, American Express, Diners) and the issuing business of the four major retail banks (CBA, Westpac, NAB and ANZ). The mechanism that transfers so much value from the merchants into the big bank world is called scheme and interchange fee.

The Payments System Reform

The 1997 Financial System Inquiry (Wallis Report) led to the establishment of the Payments System Board at the Reserve Bank. Mandated with the responsibility and powers to promote greater competition, efficiency and stability in the payments system, the board instigated the card payment reform, embarking on such measures as reducing and capping interchange fees, requiring the removal of anti-competitive restrictions imposed on merchants (in particular no-surcharge rules, honour-all-cards rules and no-steering rules), and liberalising access to both the debit and credit card systems. These reforms caused merchant service fees to fall from 1.4 % in 2003 to 0.81 % in 2010, saving merchants some \$1.3 billion per annum.

More recently, the Payment System Board has focused on ways to support the widely used, low-cost debit card system (EFTPOS) that is threatened by the competition of the fast growing international debit card schemes. Governance arrangements were changed with the establishment of the industry body EFTPOS Payments Australia Limited, and the domestic EFTPOS system's interchange fee caps were brought into line with the international schemes.

Currently however, the major retail banks (issuers) and big retailers are negotiating a new EFTPOS interchange rate. They plan to reverse the currently favourable rate of 4 to 5 cents to as much as 12 cents, all of which will then pass to the issuing banks. The cost per EFTPOS transaction could increase up to 17 cents. This will permit major retail banks (issuers) to charge the Australian government and merchants approximately \$250 million in additional fees. The big retailers, who directly negotiate this interchange fee with the major issuers, can protect their interest in the



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EFTPOS space using the tiered pricing approach they have already been granted by Visa and MasterCard and the issuer banks for their credit and debit card transactions.

Tyro Payments is not conflicted by the major retail banks' interest of augmenting the interchange revenue, and therefore can truly act as an advocate of government and merchant interests. Tyro's submissions to the Reserve Bank and the Prudential Regulator, representations in banking forums and its own EFTPOS solutions demonstrate this, with its vocal lobbying against raising scheme and interchange fee charges. Tyro is, however, a small voice trying to be heard in protecting the Australian government and merchant community from this huge and difficult-to-justify impost.

Challenging the establishment

Tyro, as the only new market entrant and independent banking institution in Australia, challenges the four major retail banks in one of the core banking processes: merchant services. In facilitating credit and debit card acquiring for government and merchants, Tyro does not take money on deposit but instead, deposits funds into the merchant's transaction bank account of choice.

Tyro offers government and merchants of all sizes an alternative choice of supplier for their merchant service requirements. Moreover, it allows them to actively shift the competitive landscape of banking

by either supporting the status quo, or instigating competition and encouraging smaller providers. A decision to do the latter, by entrusting Tyro with their merchant services (EFTPOS), is an effective contribution to more innovation and competition in the banking sector.

The reality is that government, customers and merchants have moved into the internet age, while the core payment systems of the dominating major retail banks remain reliant on legacy systems that are at least 30 years old. Today, government, consumers and merchants expect fast, secure, reliable and easy-to-use solutions, but the existing banking IT systems are slow and unreliable, leaving their customers - and especially small and medium enterprises - poorly served and overcharged.

During peak trading times, service response times typically degrade and EFTPOS can, in the worst case scenario, fail. The ramifications of this were made only too clear in 2010, when the community experienced six major service failures. This has happened simply because investment into the core systems has been lagged to sweat the assets and generate profit, despite the dramatic increase in merchant traffic. Inevitably, this will eventually result in the need for major software rewrites, many of which have and will fail substantially. The complexity and risk of migrating to the new world in a one big step is significant.

Tyro, however, has already developed an end-to-end technology, offering an Internet Protocol (IP)-based EFTPOS solution that brings technology, innovation, efficiency, transparency and fairness to the Australian merchant community. Contrast this with the large retailers who have liberated themselves from the dominance of the major four banks by bringing payment technology in-house and delivering payment solutions directly to their customers.

The large retail banks benefit from their scale, which offers them significant cost advantages and, more importantly for strategic reasons, the ability to bundle payment processes with data capture, targeted marketing, traffic generation and discounting. Their activities will make it increasingly harder for SMEs to hold on to customers that will be constantly targeted by the big retailers and driven into the latter's outlets.

With Tyro, however, government and merchants can access innovation beyond what big retailers currently have in-house. Already, 4000 medical practices, pharmacies, newsagents, bookshops, duty free stores, car dealers, restaurants and general retailers have chosen Tyro's EFTPOS solution. An increasing number of Australian universities are deploying the Tyro solution across business units within the campus including student services, bookshops and medical clinics. Tyro also provides an online tenant rent payment facility to Westfield Limited and a credit payment facility for Coca Cola Amatil vending machines

The government promoting innovation and competition

A prime example of the benefits of Tyro's systems is the Medicare Easyclaim initiative that is quickly replacing its cumbersome predecessor. Medicare Easyclaim has enabled the federal government to deliver citizen-centred health payment, rebating and information services by cost-efficiently leveraging the existing EFTPOS infrastructure and working in partnership with private enterprise.

At general medical practices that use Tyro terminals, Australian patients can pay, claim and get their Medicare rebate directed to their bank account in seconds, putting an end to queuing at a Medicare office. Only 18 months after launching this solution for Medicare Australia, Tyro processes 10 million claims per year and gives a great example of what government can achieve through a flexible tendering that is open for new entrants.

Architecting and tendering the Medicare Easyclaim service as a scheme allowed multiple private providers to deploy their solution as long as they satisfied the Medicare accreditation requirements. Thus competitive tension for the best functions, features and service was maintained and Tyro had a go.

The benefits of Tyro's broadband EFTPOS

Tyro's infrastructure has been specifically developed to leverage new and emerging technologies, be they in networking, computer server and system software or open source projects areas, and offers tangible ways of improving government's and



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merchants' operations:

1. Integrated EFTPOS and POS over the internet
In the Tyro world, EFTPOS devices and POS systems do not communicate directly with each other. Instead they securely communicate via Tyro's transaction-switching fabric, which pairs the two devices together. All transactions are sent directly from the terminal to Tyro, with the annotated, authorisation response details sent back to the POS. This ensures no unencrypted cardholder data ever leaks into a merchant's computers or network and thereby eliminates concerns about PCI DSS/PED compliance.

2. Elimination of infrastructure and communication costs
The use of the customer's existing Internet Protocol (IP) network eliminates the risk, complexity and costs of old and duplicate network equipment, of dedicated communication lines (PSTN dial-up or Argnet) and of an entire software middleware layer (PC-EFTPOS or Quest).

3. Transaction speed
Tyro terminals use today's local area networking technology (Ethernet and WiFi) or mobile data networking (GPRS) to connect to the Internet. These communication methods, combined with novel terminal hardware design, result in transaction authorisation speeds of between 1.5 and 3 seconds. Tyro thrives in high-speed lane merchant locations such as duty-free stores.

4. System availability
Tyro employs two data centres architected to operate in a live-live manner. In other words, both data centres operate concurrently and are designed to tolerate excess load should the other data centre fail. Moreover, each data centre uses a routed, redundant network design, so if single network elements fail, re-routing occurs immediately. Tyro terminals that detect a failed transaction switch will automatically and quickly reconnect to another, which may be in another data centre. This effectively eliminates the merchants' worst nightmare of acquirer failure on Christmas eve.

5. Transaction reporting
Merchants can view their transactions in real-time, through merchant reporting web pages that are hosted on Tyro's web infrastructure. Transaction data can be directly uploaded into individual accounting systems for fast reconciliation or to rapidly perform ad-hoc queries regarding individual transactions.

6. Terminal management
The ability to remotely manage a terminal fleet is critical when providing scalable, timely and cost-effective ways to deliver new features and important upgrades to merchants. 'Health-monitoring' of the terminal fleet, which includes performing remote diagnostics, allows Tyro customer support and operations to quickly identify and resolve customer problems.

Tyro technology has been developed in-house and the acquiring platform has been in live production for over four years. It currently acquires 2 million Visa, MasterCard and EFTPOS transactions, 100,000 American Express and Diners Club transactions and 800,000 Medicare Easyclaim transactions. This transaction volume is growing by 10% a month and BRW recently recognised Tyro as the 4th fastest growing business in Australia.

Tyro Payments has a vision to provide Australian government and merchants with an innovative and efficient acquiring platform for all cards and all channels that is unequalled in availability, speed, ease-of-use and transparency.

**Jost Stollman is the chief executive officer of Tyro Payments. This article is a reproduction of his introductory witness statement at the Senate Hearing into Competition in the Australian Banking Sector.*

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