PAYMENTS SYSTEM REVIEW : SUBMISSION / PETER MAIR

CUT TO THE CHASE

The primary proposal here is that,

...................after four decades of mismanaged regulation of the retail banking and payments systems, Australia needs an independent coordinating authority in this arena. An oversight regulator, briefed to reorient and coordinate the agendas of the principal agencies currently involved, the RBA, Treasury, ACCC, ASIC & APRA.

Four particular initiatives are proposed to address present flawed policy settings.

(i) bartering destroys competition

It is time to ring the changes on banks, mainly the 4Pillars, bartering free services (as income in kind) for holding deposits, interest-free, in transaction accounts. This tax avoiding scheme is a fundamental flaw.

Historically, no regulator-condoned malpractice was as destructive of a competitive financial system as this practice has been.

The timing could not be more right to remove this distortion.

Interest rates can hardly go lower, so requiring banks to credit customers' accounts with deemed taxable interest income, at a daily rate, will never be less onerous than now.

Acting now, before interest rates move higher, will preclude any return to these competitively destructive concessions which the Pillars exploited in the 1980s+ to drive out any and all other deposit takers and competitors more generally.

(ii) proper pricing of retail banking services

One converse, of denying Pillars easy earnings on investments of interest-free deposits, would likely be moves to charge explicit prices for transaction services currently available ‘free of charge’ to most customers.

This would loom as an affront to a community conditioned to ‘free banking’ and inclined to knee-jerk protests ...... ‘fees for taking my money from my account’.

Well ahead of so confronting the community, a newly independent regulator would be responsible for explaining and exposing hidden-truths in past practices for pricing retail payments services.

The community will be astonished to hear anything like the truth.

Fancy having a major national industry denied, for decades, the possibility of operating fairly and efficiently. An industry, on the contrary, ‘regulated’ to operate completely contrary to the public interest.

If ever there was an opportunity for a newly independent regulator to turn a lemon into a lemonade .... this is one, albeit one requiring professional and political skills normally lacking among regulators. Denying their responsibilities, they were never ever independent of political anathema precluding anything approximating truth and candour about costs and prices in the retail payments system

This game is up.

That failing, of so many for so long, is the strongest case for a new independent overseer .... one that will tell the truth sensitively.............. in ways that keep the community on board.

(iii) objectionable trade practices

The ‘cooperation’ needed to operate national banking and payments systems spills too easily into arrangements more clearly seen as ‘collusion’. As well ‘joint-venture’ provisions in the trade practices law legitimize de facto monopolization. This notwithstanding that some ‘arrangements’ are clearly contrary to the public interest. Arrangements that have not been addressed and redressed as the ‘Dawson Report’ proposed some two decades ago.

The Visa and MasterCard twins (VMC) should be in the sights of reformers.

Their credit-card operations are best regarded as a deceptive and redundant racket while ever ad-valorem, %-interchange-fees, are levied on merchants. If the card-payments game was competitive, issuers of debit cards would add a line of credit for customers wanting and eligible to borrow.

[The EU allows interchange fees of 0.20% and 0.30% for debit and credit card transactions respectively .... not ideal but an intelligent advance on the fee-caps of some '8 cents' and 0.50% in Australia.]

These globally dominant players, long under regulatory pressure to cut credit-card %-fees, diversified into cash-displacement. The 'pay-wave' and 'tap-n-go' options allow quicker, lower-value transactions, not individually authorized. These transactions use VMC credit-card (not debit card) processing protocols with fee structures that inflate costs for merchants denied a least-cost routing option.

COVID was a boon for these players as merchants resisted cash payments.

A properly competitive environment for card transactions would see the VMC twins brought into line with the public interest.

(iv) discordant notes about cash

The RBA's note issue policy, issuing additional banknotes on demand, is more like an unfolding embarrassment than a sensible national policy.

There is no longer any genuine need for the high-denomination $50 and $100 notes to make purchases. These notes now function more as bearer bonds (hoarded and exchanged) disguising black-market activity and tax avoidance (including means-test manipulation).

[Given present taper rates for 'excess assets', age pensioners hoarding banknotes to boost entitlements are effectively 'earning' some 7.5% p.a. .... not bad when the cash rate is 0.1% p.a.]

There would still be cash – notes and coin – for convenient retail payments: a role met presently with no need for denominations greater than $20.

The RBA, funding its operations with first claim on note-issue profits, may baulk at withdrawing both high denomination notes. However, an RBA depending on note-issue profits, 90% from high-denomination notes, compromises its wider responsibility for payments system efficiency, promoting electronic substitutes for currency.

Funding the RBA with conventional budget allocations would bring it in line with other agencies.

.... at the very least high-denomination banknotes should have clear colour-code marking of two-year 'use by dates' after which they could be redeemed only at a discount of 10% p.a. Forcing the turnover of these notes would complicate and discourage hoarding, facilitating monitoring of flushed out hoards. The current annual $-billions 'cost' to the public purse, of misuse of these notes, would swamp any concern about printing and distributing replacement notes.

From a different perspective, if Treasury were the note-issuing authority, as it was until 1911, it is likely that the character of Australian banknote policy would be reformed. Treasury has incentives to minimize a substantial and fast growing drain on the public purse.

THE STATE OF PLAY

Welcome to a long overdue review of the operation and regulation of Australia's retail payments system. Preferably this review is not another facade for confirming undisclosed predilections ....as these games go, that 'ask' may be a bit hopeful.

Understanding mistakes made, and not corrected, guides the quest for a regulatory framework conducive to competition and efficiency in the retail payments system and retail banking more generally.

As fashionable deregulation progressed in the 1980s, the RBA, the primary regulator, did not adapt to the Pillars banking-business model. Consequently, retail banking business has, for decades, not been conducted in the best interests of the community. Moreover, even as the predictable consequences unfolded so visibly, no purposeful initiatives were taken to arrest entrenched inefficiency or repair damage done to the competitive environment.

While some recent Damascene stirring of gubernatorial intent[1] is welcome, it is probably too late to consider any rite of 'forgiveness' for the role played by the RBA over the past four decades.

Some reflections on 'the state of play' flow into responses to questions posed in the issues paper[2] .... some background to particular issues follows.

[1] Innovation and Regulation in the Australian Payments System, Governor Lowe, https://www.rba.gov.au/speeches/2020/sp-gov-2020-12-07.html

[2] The most sensibly managed national retail payments systems are in Norway, Finland, Sweden and Denmark ....the worst in our usual reference group, the UK,USA, Canada, Australia and New Zealand. The European Union also has a good handle on appropriate regulation.

The retail payments system is reasonably a national political concern ...... with clear implications for restoring independent regulatory authority.

This system, superficially changing dramatically, has atrophied in its fundamentals.

An independent regulatory coordinator would sensibly be given an oversight role with a brief, and secretariat resources, to restore a competitively efficient retail payments system ....and, the corollary, to outlaw de-facto cartels masquerading as competitors before compliant regulators.

In mind is an oversight authority comprising an independent chairman and well-resourced secretariat -- overseeing and coordinating cooperation between the RBA, Treasury, ACCC, APRA and ASIC.

This authority would have close working relationships with established payments industry bodies, retailer representatives and consumer representatives.

As is, Australia’s retail payments system is akin to a cartel operated by the 4Pillars with the implicit cooperation of appointed regulators

In return, the Pillars show only a sense of entitlement and, otherwise, disrespect for the RBA and other regulators as well as the community generally. They have a long and legendary record of abusing their social-licence -- ‘going slow’, ‘selfishness’ and ‘obstruction’. For example -- slow to adopt the NPP, selfish rorting of currency exchanges and obstructive refusals to cooperate more generally.

This aggression was complemented by regulators forbearance to deal with it.

What needs to be displaced is a ‘system’ ....operating, for far too long, with inappropriate protection of both RBA banking policy and its associated Payments System Board.

Industry alliances, operating contrary to the public interest, need to be disbanded. They include those between the RBA and the Pillars; between the Pillars/RBA and the Visa/MasterCard twins (VMC) ......and similarly collusive arrangements for Pillar-franchised schemes, like BPay.

Preferably, Australia’s retail payments system might operate akin to a public utility ... which it could sensibly be, in all essential respects ... albeit as a cooperative of otherwise separate provider-participants.

Some such prospect seemed to be envisaged with the RBA-guided establishment of the NPP and, newly, current proposals to merge the NPP with EFTPOS Australia and BPAY.

Alas ......all a bit late ...... with, yet, no consensus. The Pillars are not on-board.

A 'utility' vision replicates but contrasts with the present, contrived, cartel-like dominance of the Pillars in association with VMC, especially credit-card schemes now best regarded as a redundant racket. This VMC racket – now extends to the credit-card like (pay-wave / tap-n-go) displacement of cash and (railroaded) debit card payments............... taking high fees while frustrating least-cost routing.

Concurrently, BNPL 'afterpays', are exploiting the market failure enduring in the credit-card racket run by the VMC twins and the Pillars. Among others, the RBA was caught off-guard by 'afterpays' eroding the fees taken by the Pillars linked to VMC schemes. There will be tears before bedtime.

Payments providers exploiting merchants exploit their customers ... customers are misled to believe they are using a 'free service' .... not facilitating a high-cost rort recovered in higher prices. Australia does not need BNPLs ... except as a means of exposing exploitation by VMC.

Not acting now risks compromising the viability of green-shoot start-ups sprouting in a market and technology climate conducive to innovation and entrepreneurship in financial services.

An alternative prospect, plainly unfair, would see the Pillars' excessive profitability restored as interest rates rise – again triggering marauding-absorbing of the best of the start-ups and driving others out.

RELATED ISSUES

One early contribution of a new regulatory authority would level frankly with the political, business and consumer communities about what went wrong, what needs to be put right and how that might be done.

Whatever happens next starts from here .... it requires, not least, properly identifying and explaining the regulatory mistakes now reflecting in a cartelized retail payments system. This essential history has never been openly acknowledged and the RBA, as the regulator responsible for it, is unlikely to write it candidly now.

Comments that follow are truncations of key-points in submissions to seemingly 'interminable' reviews.......... circle-work over decades.

The submissions were previously published by the RBA, the ‘Murray Committee’, the Productivity Commission ..... along with a raft of Parliamentary ‘House&Senate’ Committees reviewing the financial system.

Talk about directionless circle-work ....

1980s banking and payments system policy

1982 is a starting point for reflecting on historical developments. This ‘post Campbell’ history has not been written candidly.

Apparently, no one remembers and no one knows.

The push to ‘deregulate’ gathered pace in the 1980’s as regulatory attention turned to setting bank capital requirements and enshrining consumer-protection. Talk about a tragedy of errors unfolding over decades.

The touted ‘deregulation’ of the 1980s is now more correctly seen as the exact opposite. Regulatory ‘reforms’ were grossly misunderstood and mismanaged in the market circumstances of the time.

The sequence of regulatory mistakes handed the retail financial system to the 4Pillars on a platter.

In quick time, the Pillars, on a competitive rampage funded by the misguided regulation, absorbed all the state banks, drove out the new foreign banks, took over newly converted building-society banks and most life-insurance companies – as well as dominating retail superannuation and discount share trading ....among other things.

Concurrently the international brotherhood of central bankers was busy in Basle drafting what became the blueprint for the global financial crisis. At the time it was mistakenly billed as a framework for ensuring bank capital-adequacy.

What we got, what we have, are the Pillars dominating retail financial services while holding, and abusing, an unassailable competitive advantage gifted from the regulators.

Concurrently worrying, the Pillars are teamed up with party-political allies blatantly running interference on the not-for-profit, industry super funds. The Pillars do not enjoy others encroaching on their territory.

- **central banks did not know what they were doing**

By 1980, in most countries, not paying interest on transaction account deposits was a concession enjoyed by a few major banks collectively holding all the 'free' deposits. Concurrently, the inflationary surge of the 1970s reflected in high nominal interest rates.

Markets joined one thing to the other. As the widening gap opened between the low-cost of banks' 'free deposits' and their 'high earnings' on investments .... a market primed to fail did.

What mattered then was the differential between deposit-costs and investment-returns. It blew out as nominal cash-rates hovered around 15% p.a. Destructive 'competition' was unchecked – profiteering-Pillars on a regulation funded rampage, went on to collectively monopolize the retail financial system.

To complete the brief recap of prelude events – US banks, also newly over-empowered and playing with flawed capital guidelines, distributed systemic risk globally. .....the global financial crisis followed as night follows day ..... it lingers.

...........the business of retail banking

A focal point is, of course, the consequences of banks holding transaction account deposits on which 'no' interest is paid while providing related account keeping facilities and transaction services either free of charge or underpriced, relative to costs.

The free-services banks provide on transaction accounts are best seen as tax-free, income-in-kind, available to customers as an alternative to explicit interest payments which would be taxable income. The converse is that banks cover the costs of giving 'free services' from part of their easy-earnings on the investment of 'free deposits' in loans and investments at market rates.

Beyond that the Treasury is denied the tax payable on income paid in kind. The community generally, seduced into a tax-avoiding barter-scheme, is denied a fair, competitive and efficient financial system (because, practically, no other player can build a substantial 'free deposit' base needed to match a Pillar deal.)

As of now of course, with cash rates close to zero, this bartering distortion is of less consequence .... except that the erosion of 'rents' flowing to banks also eroded the de-facto bank-capital embodied in the capitalized value of 'normal times' rents. No one talks or talked about this ... it was a driving force in the Murray inquiry, pre-set agenda for banks raising more capital.

The situation in the 1980s was very different — with interest rates running at 15%+ p.a. the major bank coffers were flooded with the easy-money funding 'plundering competition'. Two of the Pillars tripped over their pile of easy-money, nearly fatally.

This arrangement can be seen, truly, and fairly, as the banks being given an enormous subsidy from the public purse to run their business as they liked – in many ways which only disadvantaged the community.

Other 'losses' inherent in these grossly inappropriate arrangements include official endorsement of the cultural attachment the community has to 'free banking'. Allowing the customers to pay, directly, little or nothing for payments services is contrary to the regulators obligations to ensure a properly functioning payments system – with a proper pricing system, one where bank costs are recovered from customers with explicit fees for services provided.

In the middle of this muddle is an astonishing failure of political and regulatory commitment to sound policy. The bartering of 'free deposits' for 'free services' entailed an objectionable political and regulatory agreement to turn a blind-eye to the income tax evasion inherent in this banking practice – and the anti-competitive consequences.

The RBA knows what a 'free money' business is all about – people holding bank notes, in effect, have a deposit with the RBA on which interest is not paid. The natural-profit on the note issue (seigniorage) funds the RBA before the remaining surplus is paid to Treasury.

What is not comprehensible is the RBA being unconcerned with commercial banks taking, and misusing, the natural profits from essentially the same style of business – 'free deposits' invested in loans and bonds at market rates.

These days, of course, banknotes on issue – some $100 billion – pale in comparison to 'transaction account deposits' running to some one-trillion dollars .... held mainly by the Pillars who are not accountable for their use, and misuse, of the associated market power.

The Pillars unfair advantage can be measured as the interest not paid as taxable income to individual depositors. Applying a 'deeming' interest rate to customer’s daily deposit balances would bring to account, as taxable income, the interest income not paid.

The adjustment to such a different regime would be generally beneficial but, initially, noisy as banks would likely be charging explicit prices for transaction account services.

[Welfare recipients could be shielded by government calling tenders for providing them with basic ‘free of charge’ banking facilities – a cost to the budget easily covered by the income tax then payable on the deemed (or paid) interest income.]

One has to go back to the engine-driver Treasurer in the 1940s to find someone that both understood the issues and had the political courage to deal with them.....as he did in the 1941 and 1945 banking legislation.

.... regulators let it happen unstopped

This policy decision – a mistake -- was not some momentary lapse of regulatory attention: what happened was apparently intended and the consequences for the community have been dramatic.

Commentary, like the above, will not be found in mainstream anything anywhere locally. In Australia, Canada and the UK it is as if it such things are simply not to be spoken of. Conversely, in Scandinavia, the banking authorities consider it entirely sensible to expose these facts and their implications for market failure.

...............is broke ... needs fixing ....are thoughts that come to mind.

Peter Mair   17 December 2020