

## 2007/08 REVIEW OF PAYMENTS SYSTEM REFORMS

Ten years on from the RBA being given renewed responsibility for reforming the efficiency of Australia's retail payment system, one can only wonder when the government will reallocate the task to a different, possibly new, regulatory agency likely to pursue the objective with a sense of purpose.

Over the past decade the RBA has, on a generous assessment, inexplicably failed to discharge its legislated responsibility to properly reform the retail payments system – and that followed a prior decade plus, when it also only toyed with a similar responsibility allocated by the then Treasurer (Keating).

This sense of a legislated responsibility not genuinely accepted was underscored when the inaugural, chairman (for nine-years) of the RBA's Payments System Board, having just retired, took positions on the boards of a bank, ANZ, and a retailer, Woolworths -- both major players in Australia's retail payments system but with directly conflicting interests: that no one noticed this exquisitely underscores the foregoing criticism.

One might also wonder why the RBA is asking the questions in an issues review paper when the community generally was probably thinking it was well beyond the time that the RBA provided the answers to those questions.

The process in train presumably seeks responses to questions, asked with a rhetorical flourish, intended to head-off powerful interest groups still determined to take a deceptively self-serving stance. *Does any one expect even a glimmer of respect for the public interest in the submissions from the major industry players?*

One might well say 'go on' to the RBA and just settle down to await the usual contrived nonsense in industry submissions – all the while still hoping that the RBA will soon reveal its own answers to the questions in a way that will expose the self-servers and deal them out of the cartel games at which they are adept.

The following submission is in two parts. The second part offers comments on questions the RBA posed. The first part puts to the RBA a range of questions bearing on the need for whole-of-system reforms, issues well beyond its lingering preoccupation with card schemes to the exclusion of all else. There are other skeletons in the cupboard where the RBA has not been looking.

There is discussion of relevant issues also in articles of mine published in *CFO* magazine between March 2006 and August 2007: *Retailers hold the aces*; *World war on cards*; *Trump card*; *Cash in your chips*; *Call card bluff*; *The twisted fee game* and *Time's a wasting*: these commentaries have also been made available to the RBA, among others, separately.

**-- executive summary: the RBA is the problem not the solution**

The RBA is the biggest single impediment to a properly functioning retail payments system in Australia.

The RBA issues conventional currency notes in \$50 and \$100 denominations which, for the most part, are hoarded, undisclosed, to avoid assets-tests limiting eligibility to receive age pensions: high-value notes also facilitate tax evasion and the black economy.

Looking forward, \$50 and \$100 notes no longer have a useful place in Australia's retail payments system and, with five years prior notice, they should be withdrawn from circulation. The RBA has the responsibility and independent authority to tell the Australian people that, with the prospect of electronic money, bank notes are redundant technology. Such decisive frankness is akin to the 'tough love' which is, these days, a synonym for actually being responsible – and the RBA alone has the resources and the authority to oversee and even subsidize the development of electronic substitutes for conventional cash and newly offer forms of e-money for use over the internet. This objective would be more effectively pursued in association with other central banks having regulatory responsibilities for payments system efficiency.

Much the same goes for excessive levels of interchange fees currently permitted for credit card transactions: the 'tough love' mantra demands that the permitted level of these fees is reduced to a flat fee close to zero. It is similarly imperative that the RBA works in co-operation with the ATO to neutralize the very substantial advantage established banks get from not paying interest on deposit account balances and then under-pricing their transaction services. Those so far elusive decisions are prerequisite to a sense of freedom for the market for, and technology of, retail payments to develop.

Sadly, and over so many years, the RBA has shown no appetite at all for meeting these obligations and responsibilities – however understandable is that reluctance, both the RBA and those looking for it to do the job need to look elsewhere for the appropriate regulatory commitment.

Asked to reform the payments system, the RBA is bedeviled first by its own commercial business operations, the note issue, and next by some lingering sense of continuing the feather bedding of banking industry revenues to protect the solvency of the financial system. Both conflicts of interest and related disinclinations are totally inconsistent with the RBA having the responsibility to reform the retail payments system.

## PART 1: QUESTIONS PUT TO THE RBA

### What is the appropriate scope of this review?

What may have been done (and not done) so far to regulate card payment systems, can be read in conjunction with what it was also decided not to be done to correct endemic flaws in other retail payment arrangements.

It is characteristic of retail payment operations generally that regulatory authorities condone, and do not correct, a range of market misbehaviours rewarding to banks but clearly contrary to the public interest.

The credit card racket is just one of a range of rorts enjoyed by the banking industry contrary to both the public interest and deceptively insincere official protestations of the importance of ‘new entrants boosting competition’ and related protections of fair dealing.

A recurrent theme in what follows concerns the blind-eye turned to the tax avoiding barter inherent in the swapping of ‘free transactions’ for ‘interest free deposits’. As well it is simply never recognized that these ‘interest free balances’ should be offset against the interest-free credit tied to the use of most credit cards. For most credit card customers, there is no net indebtedness when interest-free deposit balances are offset against interest-free credit -- and insult is added to this injury when penalty fees are imposed on customers making simple mistakes in managing these unnecessarily separate accounts. *Has the RBA done, or asked to be done, sample reviews of customer relationships designed to identify and expose the extent of the disadvantage to customers arising in contrived separations of their different accounts – in particular, banks claiming ‘costs’ for free-credit and overdrawn accounts, when the total account relationship is clearly in the black at all times?*

This is not frivolous point scoring. Looking forward, a world without conventional credit cards will instead have (scheme) debit cards linked to customers’ basic transaction accounts with a line of credit attached. Looking back, one can only wonder why banks were not already led well down this very ‘debit-with-credit’ track by appropriate regulation. The necessary envisaging involved here is not complex.

More generally, without labouring the general point, one can fairly ask why plainly deceptive arrangements like ‘scheme debit’ were allowed to run for years until checked recently and other blatantly contrived rorts, like BPay with interchange fees, were allowed to be introduced in preference to a more comprehensive revamp of underused direct debit arrangements. Looking more widely afield it is similarly plain that members of the global cartels associated with Visa and MasterCard are exploiting with high fees the unregulated market for cross-border access to card and ATM networks.

In general, banks have been permitted to enjoy very effective barriers to entry and, behind the barrier, to engage in a raft of cartel and follow-the-leader behaviours quite contrary to the public interest – *one fairly asks, why has the RBA condoned this?*

Things ‘credit cards’ may finally be changing but accountability for policy decisions (and non decisions), would rank highly with any independent reviewer of card-payments policy developments over the past decade. Let’s not forget that this credit card rort is of some considerable magnitude, a veritable ‘steal’ -- inappropriately excessive fees -- running to some \$1 billion or more per annum for most of a decade and still substantially ongoing.

### **How come there is no proper pricing system in place?**

Any independent reviewer of the development of payments policy over the past decade could well take the long handle to the RBA. It has been blatantly inconsistent in oft stating the importance of a properly functioning, cost-related price system for self-regulating payments system efficiency, and then ignoring the very obvious reality of the payment system operating without one. The retail payments system operates predictably inefficiently when the prices motivating customers have no semblance of a reasonable relationship with the costs of providing the payment services used by those customers.

The operation of the retail payments system was not only denied the essential prerequisite of a proper price system but, prices that are in place are often quite perverse – typically the most costly services are explicitly priced very cheaply while the least costly services typically have excessive ‘hidden’ prices levied in ways which confuse and exploit retailers and their customers (and, apparently, the RBA).

The RBA should immediately make clear its determination to install a properly functioning price system in the payments system and so put an end to a situation fairly assessed as an absolute nonsense and plainly an affront to community trust in the integrity of the RBA’s regulatory processes.

Consider the appearances, when the RBA presents reports of its regulatory stewardship for payment systems it piously extols the necessity of a properly functioning price system to ensure appropriate ‘cost-price’ signals to guide customers choosing one payment medium over others and protect the efficiency of the system. However, as a practical matter, this pious pap is invariably completely contrary to the day-to-day realities and the RBA, above all, must be well aware of the inconsistency. *What does the RBA have to say about this clear contradiction between what is and what it repeatedly says should be?*

Again, without labouring the point, has the RBA made any serious attempt to measure the value of interest not being paid on current (transaction) accounts not bearing interest (at anything akin to the cash rate)? My own rough guess (*The twisted fee game* CFO July 2007) suggests we are talking some \$ 10 billions annually, an implicit cross-subsidy some four times greater than account keeping and transaction fees actually collected (and, still, commonly

protested as excessive). Moreover the \$10 billion includes income-tax avoided of the order of some \$3 billion annually – *does the community really agree that banks are entitled to a government funded subsidy of \$3 billion annually to run an inefficient retail payments system?*

The fees that are collected for deposit account services have only a very tenuous connection with costs at best – typical fee structures allow all-you-can-eat of whatever you want, after paying some relatively small fixed monthly fee. Beyond that, credit card interchange fees are widely considered excessive as are penalty fees imposed on simple mistakes and ‘foreign’ ATM fees, especially overseas.

Put plainly, the deceptive price system in place, and operating unchecked, is illustrative of cartel-style market power being routinely and blatantly abused – in no way consistent with the efficient and fair operation of the national payments system.

.....and one can only ask, *just how does the RBA square this apparent reality with its legislative responsibility to ensure that it does not happen that way?*

**‘Not an RBA responsibility’ – another failure of RBA independence?**

It is no good claiming ‘independence’ for the RBA if it is unable to speak up clearly, and in a timely manner, when its particular policy responsibilities are being compromised by the decisions of other, more political, arms of government. Not to speak up as appropriate can be seen as a failure of character: for example, look at the excessive inflation of house prices as a direct consequence of an inappropriate mix of community proclivities and tax concessions fueling them.

**-- an aside on Amex et al**

By way of additional illustration and to dispense with a somewhat minor matter, a simple and equitable reorientation of personal tax policy would deal effectively with the noisy nonsense surrounding the Amex and Diners Club charge-card schemes. These card schemes mainly servicing the so-called ‘travel and entertainment’ market typically convert high transaction-commissions on inflated business expenses into untaxed personal income personally payable to card users as ‘rewards’. That’s unfair and it distorts the payment system.

An ATO decision to tax these ‘rewards’ in the same way as it does other personal income and fringe benefits, would remove the advantage of an unfair privilege underwriting the existence of these schemes. *The RBA should ring the changes on this blatant nonsense distorting the payments system and adding grist to the hot mill of pointless distracting debate.*

**-- another ATO aside**

The single most important explanation for entrenched inefficiency in the retail payments system is the ‘blind eye’ turned to the practice of banks bartering under-priced ‘free transactions’ in exchange for largely ‘interest free’ personal deposits held in transaction accounts.

Banks use the earnings on the investment of funds held in these ‘current accounts not bearing interest (CANBIs)’ to subsidize the provision of free and under-priced transaction services, not least with all-you-can-eat pricing arrangements that leave the customers confused about their practical choices being concurrently rational and perverse.

It is well beyond time that the RBA asked for the ATO to be brought to account on this matter. If pension and social security benefits are docked for interest deemed to be received at a commercial rate on bank deposits and other ‘non earning’ assets, it is surely appropriate for depositors more generally to be deemed to receive taxable income on ‘interest free’ deposits exchanged for free transactions.

In short, the RBA should be looking to install a proper pricing regime in the retail payments market and *if it has the independent authority to ask for unreasonable impediments to be removed, it should do so.*

[And, incidentally, how does the RBA account for decades of declining to do so while purporting to be actively and intelligently reforming the retail payment system so it could work efficiently? Pray tell.]

As is, the parliament has given the RBA a responsibility for payments system efficiency while concurrently allowing distortions that predictably frustrate efficiency in retail payments – *the RBA should use its independence to demand that the government properly coordinates its policy objectives for payments system efficiency and an equitable personal tax system.*

.... and there is no need to wait another two years before doing so.

**Does the RBA have a conflict of interest about currency notes in the payments system?**

The RBA is a major player in the retail payments system by virtue of its responsibility for the national currency note issue.

There is, on the face of it, something wrong in the conflict of interest between this operational business responsibility – which funds RBA operations – and its responsibility to ensure that currency, generally considered inefficient as a payments medium, is displaced by modern electronic payment instruments.

This conflict is so fundamental as to suggest that the note issue function should either be shifted from the RBA to a different public enterprise or the RBA should take the responsibility to issue electronic 'cash' and wind down the conventional note issue function.

As to the choice, I favour the RBA in association with other central banks taking responsibility for the development and issue of electronic money (e-money). As is the prospect is for the general global community to be further exploited as the VMC global cartels develop e-money at a pace and on terms suitable only to themselves. Central banks seem to have forgotten their origins – wresting control and responsibility for the currency issue from a commercial banking industry proven unable to handle it.

More to the point, how can we ever gain the benefits of a dot.com economy without dot.com money?

**-- an aside on hoarding (means-test management)**

It is generally not openly recognized that the great bulk, some \$25 to 30 billion, of the \$40 billion of RBA currency notes on issue in Australia is simply 'under the bed', hoarded with no prospect of being used for conventional cash transactions. Some hoarding reflects a sensible demand for a store of ready cash and some is associated with income tax avoidance and black-market dealing. Most hoarding in Australia is, however, predictably defensive asset management driven by the means-tested eligibility for age pensions. The contrast with New Zealand, without such a means test, is stark.

Notes on issue in Australia run to some \$2,000 per-head, about three times as much as in NZ: the relative importance of the most hoarded \$50 and \$100 notes also varies markedly – 90% in Australia and 55% in NZ. Put differently, frequently used low-denomination notes (\$5s, 10s and 20s) on issue in Australia run to only some \$4 billion (\$200 per head).

One consequence of the considerable investment profit (seigniorage) which the RBA makes on its note issue operations, – currently some \$2.5 billion p.a. – is that the RBA predictably has mixed feelings about payments system developments that would erode this profit and its business of issuing conventional cash.

More generally one can only wonder about the prospects of the RBA actively managing its note issue business in ways which frustrate hoarding and the related avoidance of means-test obligations. What once were currency notes are now best regarded as zero-coupon bearer bonds mainly used to facilitate robbing the public purse: one wonders why the RBA is so closely and unintelligently entwined in facilitating this when there is a really useful contribution to be made by changing the technology of its currency issue to e-money.

Will the RBA consider withdrawing from circulation, with five years notice, all \$50 and \$100 notes – and, after that, discount redemptions of these notes by 10% p.a.

**What has the RBA done to ensure the community generally understands the economic realities of operating a national retail payments system?**

One of the major problems with the appropriate management and regulation of the retail payments system is the complete absence of commonsense evident in the usual community and political attitudes to ‘bank fees’ and the prospect that they may be charged or, heaven forbid, increased.

One often feels that a revolution has only been avoided by the deft deceptions embodied in the prevailing arrangements for recovering banks’ costs of providing transaction services: in broad terms unlimited transaction services are to be provided apparently free of charge while the substantial costs are recovered from retailers in secretly loaded retail prices and from customers bartering interest-free deposits in exchange for free-of-charge transactions. In short, the social contract is that transaction services will not be priced.

Conversely no one has had the courage to tell the people,

- first, that the ‘excessive’ explicit fees for deposit account services represent only one-fifth of their total cost which they still pay but in ways hidden from their proper comprehension;
- second, that, apparently free credit-card transactions (and related free-credit and rewards) hides the reality of a bankers’ price-fixing cartel taking excessive fees from merchants that inflate the prices consumers pay; and
- third, proper prices for transactions would soon usher in a better and cheaper payments system.

One might reasonably have expected the RBA, after some 25 years, to have levelled with the people in the style of parental chat with Virginia about the reality of Santa Claus.

The contrary reality, that the RBA has very deliberately never told the people the truth, suggests it is a partner in the ‘crime’ – and it might like to explain why it should not be held accountable with a revised allocation of responsibility for regulating the payments system to some agency prepared to speak frankly.

The questions are:

- *will the RBA now explain frankly to the community the various deceptions currently underpinning the apparent availability of banking and transaction services more or less free of charge?; and*
- *will the RBA then go on to explain the importance of removing those deceptions and distortions so that proper, cost-related, explicit prices might be put in place, and offensive price fixing agreements outlawed,*



*to ensure the retail payments system is reformed to serve the community more effectively.*

*[PS:.....and will the RBA concurrently advocate a conventional budget funded arrangement for social security recipients to have access to basic banking services free of charge?]*

### **More detailed studies**

While the study of Australian payment system costs now underway may lend some local credibility to related calls for action it would be surprising if the findings are substantially different to the results of similar studies in mainly European countries.

It is a confident expectation that any local study will show continued over-reliance on cheques, credit cards and cash and the counterpart under-use of automated direct transfers, debit cards and internet payments.

More generally a revolution is hopefully in the offing with study after study revealing the considerable benefit likely to attend the development of electronic payments media akin to cash for use over the internet as and as a more efficient alternative to point of sale transactions for values up to say \$20.

*It will be interesting to see just what it is that the RBA feels it does not already know or understand about what's wrong and what must be done to fix it?*

### **Electronic cash --played off a break again?**

Whatever credit the RBA may now be conceded for the hopefully emerging prospect of ending the rackets long associated with the VisaDebit scheme, and eventually displacing credit cards, the 'success' was not without costs.

In particular, allowing VisaDebit to become entrenched over the past decade before recently being shortened up seems to herald the demise of Australia's independent EFTPOS payment system: like *Bankcard* before it, local EFTPOS cards will almost certainly be replaced by scheme-debit card systems operated by the international ringmasters, Visa and MasterCard.

Whatever, this history is fair warning about the next major play in the development of retail payments schemes globally – Visa and MasterCard operations allowing small payments in some fast, tap'n'go mode using conventional credit cards and scheme debit cards, transactions that will require 'no-signature' and 'no-PIN' to be authorized.

It would be a travesty if these innovative developments using scheme debit cards were to be established with loss-leader pricing and then left in place with ramped-up prices exploiting new payment habits among customers, and merchants again left at their 'no mercy'.

Visa and MasterCard (VMC) and especially their participating card-issuer banks should be put on notice by payments system regulators, globally, that no new cartel-style torts will be accommodated.

Ultimately the development of these fast-payment arrangements will be the basis of some more sophisticated e-money, chip-card function embodied in scheme debit cards to allow both stored-value 'cash' transactions at point of sale and presumably also over the internet, including so-called micro payments.

Given the prospect of any successful e-money initiative being global in scope, close international cooperation particularly with European regulators would seem to be prerequisite.

### **Appropriate trade practices: credit cards out, e-money in**

I would expect any further study of the costs (and rewards) of operating credit card schemes to be enlightened by the wisdom of policy shortcomings over the past decade in Australia, and the emerging determination in Europe to ensure that exploitative credit card schemes do not take hold. Scheme debit cards with lines of credit, please, and interchange fees if we must, but conventional credit cards no longer, thanks.

The past decade has revealed some intriguing tensions between the RBA and the ACCC in the administration of trade practices policy to the banking industry. If it is now finally conceded that the RBA is the arbiter of banking trade practices then one would like to see some proper sense of balance imposed on the use of interchange fees for credit card transactions.

Not to lead the witness but a few steps to this end seem sensible. Chips on cards will both eliminate fraud and presumably the eligibility of a cost allowance for it in permitted interchange fees. More importantly the eligibility of the real or imaginary, but always extraneous, costs of 'free credit' for credit card purchases should be outlawed, again perhaps as a united front with sympathetic European regulators.

These two steps taken, the permitted interchange fee for credit card transactions would be more akin to the small fixed fee for scheme debit transactions – and the likely further implications for credit cards are obvious enough.

Again, lessons so painfully learned with credit cards have future application – not least to ensure that any cash-substitution schemes are, from the outset, priced fairly to the community and participating retailers rather than monopolized and cartelized by the banks and their coordinating front organizations. [That wish list does not rule out regulated permission to use an interchange fee temporarily to protect the establishment of 'infant instrument' forms of e-money for use at point of sale and over the internet.]

In short whatever uniform price fixing may be considered appropriate to the establishment and operation of e-money schemes should be done in open consultation with both the Australian and other international communities.

### **How can cash transactions be priced to discourage them?**

A major impediment to a properly functioning pricing regime for retail payments is the apparent difficulty (unacceptability) of charging users for making cash transactions.

Difficult or not the RBA is responsible for finding a way of ensuring that the community is made aware of the cost of cash transactions and the relative attractions of various forms of e-money payments.

So far the emphasis on neutralizing ‘costless’ cash transactions, has been met by also offering non-cash transactions – credit and debit cards -- free of explicit charge. Nonetheless resistance to imposing a cost for using cash needs to be confronted if the retail payments system more generally is to be given a fair chance to deliver the benefits of modern, electronic payments technology.

*The ‘how to do this’ is a fair question to put to the RBA who has a responsibility to deliver an answer irrespective of its own commercial interest in shrugging its don’t-ask-me shoulders, as it usually seems to do.*

#### **-- concluding note**

The story of the development of retail payments systems over the past 30 years in Australia, and the world more generally, is sad story. It is a case study of the heavy price the community pays when powerful commercial interests – the banks – are permitted to monopolize critical public infrastructure, extracting excessive rents, and then protect their commercial power by withholding the benefits of technological change.

Sure there have been changes in the operation of the retail payments system, and cumulatively dramatic changes at that, but the pace of change has been slowed to protect the commercial position of dominant banks. Much more dramatic reforms have been withheld – that is the problem.

Not only has the community paid the heavy deadweight costs of progress slowed and denied in the retail payments arena but, in important respects, the viability of banks has been sapped as they became over reliant on the soft and featherbedded revenue flows associated first with the tax-free barter of free transactions for interest-free balances and more latterly with the rent-extraction schemes associated with the credit-card cartels. Not a critical issue for Australian banks perhaps, but potentially a survival breakpoint for US banks overly dependent on unfair credit card fees and exposed to any regulatory correction.

## **PART 2: RESPONSES TO RBA QUESTIONS**

### **First question**

Based on card transaction activity published by the Bank, the reforms to date (Q1) have done little to encourage the wholesale substitution of debit cards for credit cards when making purchases.

Practically (105) noble ambitions about ‘more closely’, ‘addressing restrictions’, ‘liberalising access’ and ‘improving the transparency’ are largely unrealized. If anything cartelization of the retail payments system is ever more evident and any suggestion of better price signals and transparency borders on being deceptive: lamentably, the community still has no useful understanding of the economics of retail payment systems.

The effect of the interchange fee reforms on cardholders and merchants (107) generally seems to be marginal. Credit card customers continue to be misled by deceptive offers of ‘free’ everything. Most merchants dare not risk losing customers by surcharging credit cards or taking fees for cash-outs or not passing on fee reductions in lower prices: perversely, competition in retailing is underwriting the credit card cartel. All-you-can-eat (and annual-fee) pricing of bank transaction activity coupled with merchant fees hidden in retail prices, confuses cardholders and everybody else. The pricing regime for retail payments, across the board, is plainly corrupt.

Interchange fee reforms have affected financial institutions (108) -- not least precipitating an insightful display of public incontinence by MasterCard recently. Even so the reduction in credit card interchange fees has not been sufficient to discourage their promotion (and use) in preference to debit cards. About innovation, I am concerned that Visa and MasterCard (VMC) are tweaking their conventional, expensive, card products and positioning them to displace currency. Frankly, it is an indictment of the management of national banking and payment systems that, in no country, is there a viable form of e-money for making both low cost in-person payments and micro and small payments over the internet. Again, sadly, the lack of a proper pricing regime for retail payments is corrupting the system, and it is getting worse not better.

In respect of outlawing the card scheme rules against ‘surcharging’ and those requiring ‘honour all cards’ (109 and 110) and liberalizing ‘access’ (112), these changes may have been a technically complementary regulatory response to the excesses of credit card schemes but, of themselves, have been of little practical consequence so far. It would have been preferable, by far, that the RBA held its proposed line on regulating interchange fees close to zero in 2002.

In respect of the competitive position of different payment systems (111): regulating interchange fees for scheme debit transactions close to zero has set the scene for scheme debit to be preferred over credit cards by merchants but to little avail so far.

Conversely relatively attractive, additional features of scheme debit cards will likely see them displace the national EFTPOS network – not a costless ‘win’ and given the boost to Visa and MasterCard, and a questionable precedent for developments internationally.

On the related matter of desirable reforms to credit card schemes inadvertently favouring Amex and Diners charge card schemes (111) – what can one say? This is primarily a matter about the Treasurer ensuring tax policy and payments policy are coordinated: it is beyond belief that, for businesses, the taxation rules recognize a deductible cost for both the annual fee for the card issued to an employee and then the full extent of loaded expenses booked to the card, which in turn return a tax-free flow of personal income-in-kind (as ‘flyer’ points) to employee card holders. This aspect of the card debate is a frivolous distraction, remarkable only for not having been dealt with resolutely. What has the RBA said to the Treasurer about this nonsense driven by tax breaks unfair to the rest of us? What is the RBA doing about the introduction of so-called platinum credit cards that embody the same objectionable features?

The prospects for beneficial innovations (111) are bleak while ever VMC are permitted to offer credit card products on prevailing terms – not least the prospects of getting cheap, viable e-money card and internet payments are diminished if VMC is allowed to dictate the pace and character of e-money developments.

These thoughts also bear on the matter of ‘access’ (112) if VMC, through their participating member banks, are assisted to deny competition by virtue of tied deals on merchant sponsorship. Nor do I consider it reasonable that the embryonic acquirer entrant, Money Switch, is touted as evidence of new competition. That’s a long bow to draw.

## **Second question**

As regards an appropriate future regulatory regime, after decades of a powerful global cartel dominating the market, it is evident enough that hard-edged prescriptive regulation will be necessary to protect the public interest and, ideally, that regulatory action will be coordinated internationally, especially with the European SEPA initiative. It is otherwise fanciful to imagine that some new entrant will emerge to confront the global might of an entrenched cartel (113-115).

It is similarly plain enough (116-118) that cooperation, domestic and international, among providers of retail payments services is essential to the operation of payment networks. It is also evident that such cooperation can be obtained without the excessive interchange fees that characterize credit card schemes. In many countries credit cards are not widely used and alternative debit card schemes operate without interchange fees.

In the event, however, it seems that for cross-border transactions the networks established by VMC have a dominant first-mover advantage.

That said the relevant global network going forward is scheme-debit rather than credit cards, and established scheme debit systems can function with small flat interchange fees to cover network overheads. In other countries, as in Australia, scheme-debit systems operated by VMC now seem likely to displace independent national networks.

The RBA might like to reflect on the apparent distribution of sympathetic academic support for unregulated interchange fees conveniently residing in those countries where the (mal)practice is entrenched. The increasingly contrived confusion generated by academic commentators about an enduring role for high interchange fees for credit cards is frankly sad to see – and possible explanations for it are disturbing.

I see no scope (119-120) for regulation of card payment schemes to be removed or relaxed – on the contrary. The idea of self regulation (121) is similarly fanciful – see below – as is the idea that merchants generally are practically free to either ‘surcharge’ or decline ‘platinum’ variations of VMC branded cards.

The gist of the other issues raised here (122-127) has been covered in other responses.

### **--- an aside on BPay**

A classic Australian illustration of the cartel mentality among banks involved the introduction of BPay a decade ago. Australia’s banks contrived the BPay network (an alternative to enhanced direct debit transfer arrangements) to take into the banking system the cost savings of businesses that would then be processing fewer cheques. Modeled on the credit card racket, an interchange fee was included to extract the ‘surplus’ otherwise likely to flow to the community.

It was especially lamentable that the BPay scheme was developed, in secret, by the major banks at the very same time as the very same people were declaring their determination to revamp Australia’s ‘direct debit’ arrangement (in the context of an industry working party on which the RBA, being the governments’ banker, was represented as a key player). Not only did Australia not get cheap and efficient direct transfers to the same extent as most other countries, our banks put harsh penalties on direct debit users making simple mistakes, encouraging a shift of business to BPay.

The Australian form guide on ‘less’ and ‘no’ and ‘self’ regulation is a damning indictment of banks prepared to screw their customers. Forget it.

### **Third question**

The priority plea in this submission, relating to card transaction schemes (128-133), is for the permitted interchange fee on credit card transactions to be set close to zero (at a level identical to the flat 12 cents now applicable to scheme debit card transactions).

It is, accordingly, not considered essential for all interchange fees to be ‘set to zero’. That said a program should be in place to use PIN authorisation for all in-person card payments to rule out fraud and thus the case for any allowance for fraud in interchange fees: (merchants accepting card details ‘over the phone’ carry the risk of fraud themselves). Implicitly the reneged 2002 decision, to allow ‘free credit’ as an eligible cost in interchange fees, was an egregious mistake.

Setting a small flat fee, at most, should deal with the problem of ‘platinum’ cards (134) --- and the tax avoiding distortions underpinning Amex and Diners should be dealt with by the ATO.

‘Cash-out’ from retailers is akin to the provision of an ATM facility and, provided any separate fee is disclosed in advance, should remain unregulated.

In respect of available legislative approaches to regulating card schemes, one would like to see restored, voluntary respect for the judgments of the RBA: one might however also recall that a bank shareholder reluctant to limit his representation on a bank board, as requested, was effectively ‘adlered’ with a speedy special amendment of the Banking Act.

#### **‘Fourth’ question (improving transparency)**

The feigned innocence of the question (137) about ‘improving transparency’ frankly warrants special recognition (and condemnation). Please read Part 1 again if this point is not understood.

In brief, one could hardly imagine a major national enterprise that is being conducted with the determined sense of obscurity and deception that has long characterized the retail payments system – one could never forgive the RBA for condoning that lack of transparency for so long. Clues to the nature and extent of information needing to be discovered and disclosed transparently pepper this submission.

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28 August 2007