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SUBMISSION TO TPA REVIEW

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EXTRACT 22

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"BANKS SPIT THE DUMMY"

COMMERCIAL POWER V. LAWFUL AUTHORITY

(*Published as 'Banks spit the dummy' in the July 2002 issue of 'CFO' magazine)*

Sit back and watch powerful commercial interests confronted by lawful authority. Pattern-volatility in petrol prices is one attention-getter. The imbroglio about credit card interchange fees is another, customers have been deceived by overpriced 'free credit' and 'rewards' for frequent buyers.

Paraphrasing the credit-card story, the Reserve Bank of Australia finally 'called' bank agreements on credit card interchange fees last December: no mention of prior shortsightedness or of past misconduct, just a proposal to constrain credit card interchange fees within limits in future. At worst, a little politically correct, at best, be grateful for what you should be about to receive.

Given the weight of opinion against interchange fees, banks surprisingly chose to stand and fight. Remarkably, those beholden to credit card schemes used colourful language to roundly dismiss the Reserve Bank assessment as defective. One foreign hopeful on the banks' team had the temerity to encourage its customers to send a 'hands off' letter to the Treasurer, and provided a draft. Hopefully that little effort was rewarded. The role of the media here is largely unobjectionable: controversy sells 'news' while the occasional editorial can rebalance the debate.

There are four key players in the credit card game. The Reserve Bank blew the whistle and the bank team is defending. Looking on are the retailers that collect the fees and the community that pays the fees. Politicians won't get involved.

Three of these players are sitting on the bench. The Reserve Bank showed its hand and left the field of play. Editorial comment supports the Reserve Bank: one broadsheet editorial in late-March tore apart the banks' contrived defences, with Reserve Bank approval. Bank customers are bystanders enjoying 'free credit' and 'rewards': knowing the banks are 'having a lend' of them, but not how, so the customers say nothing. Consumer organisations speak up for the customers but have complex agendas and not enough resources to attack confidently. Retailers' oppose credit card fees but have been reluctant to speak up. Customers suspect retailers will not reduce prices when credit card fees are reduced. Retailers will undertake to do this as the game unfolds.

The banks, left alone on the field of play to defend credit card schemes, have had the proverbial field day. "The Indefensibles', the banks' team, with no opposition on the field, has taken free-kicks at will -- while jeering 'not guilty' and threatening legal action. The media reported some spectacular, unmarked point scoring by the banks but any repetition of these very trying displays would only applaud the tantrum. One would nonetheless pay quids for a copy of a thoughtful reply from the Treasurer to the 'hands off' letter, that MasterCard suggested. The suggested draft was daft.

The way the debate about credit cards has unfolded in Australia is pathbreaking and breathtaking. The immature and intemperate behaviour of local bank CEOs perhaps reflects their pay being linked to share prices which is likely to fall when the Reserve Bank cuts interchange fees. The anger expressed was so practically pointless as to evidence only misplaced loyalty to the international credit-card cartels, of which they are members. Rarely has the Australian media and community been so regaled with such puerile behaviour by 'leaders' of major corporations.

One can only wait for the evidence of the commitment our bank 'leaders' have to these foreign cartels when they take the matter to the courts. The commitment no doubt includes ensuring that the matter stays in the courts unresolved for ever, as it so seems to remain in the great department of justice that is the US court system. Hopefully our banks and their foreign allies have misread the Australian Parliament.

Among other things, the terms of reference have now been released for the inquiry into the trade practices law and its administration. In submissions to be put to the inquiry, the disregard that banks have shown for the spirit of the trade practices law will be deplored. It would be astounding if the inquiry were not inclined towards stronger laws to promote competition, to preclude price-fixing and to impose personal penalties on the individuals in companies responsible for the law being broken.

There is already much to lament in how policy about credit cards has been mishandled for so long. This farce should not be permitted to continue in the courts, after the Reserve Bank makes its 'final' decisions. At a minimum the court processes could be adjourned while both the ACCC and Reserve Bank draft persuasive proposals to strengthen the trade practices law, using the banks' credit card and BPay schemes as 'never again' case studies.

EXTRACT 24

JUNE 2002, COMMENT PUBLISHED ON "CRIKEY.COM.AU"

"CREDIT CARD POLICY: A COMMUNITY UNEASY"

CREDIT CARD POLICY
A COMMUNITY UNEASY

The front page, headline story "Banks cave in on credit card fees" in the Australian Financial Review for Monday 17 June 2002, warrants comment.

The following may be jumping at shadows. However, this press report and evidence recently given by the Reserve Bank to the Parliamentary 'Banking' Committee (EFPA), is a foundation for some unease in the general community about policy-making processes bearing on credit card schemes conducted by Australia's banks.

A reasonable impression from the AFR headline is that the banks have now agreed to accept the thrust of the regulation of credit card schemes foreshadowed by the Reserve Bank in the 'Consultation Document' issued last December. A more realistic interpretation of this story is that far from the banks having 'caved in', it is the Reserve Bank that has been offered the opportunity to do this -- a consequence that would more fairly be described as a 'sell-out'.

What did the story say?

Looking closely at the story, the substance is that three of the four major banks have apparently agreed to 'something' but one -- the Commonwealth Bank -- has not. The 'something' agreed to apparently is the Reserve Bank proposals to allow 'new entrants' into the business of issuing credit cards and another, to allow merchants to 'surcharge' customers for credit card transactions.

Significantly no one (including the banks) attaches any material practical importance to either of these points of agreement. There is little prospect of retailers surcharging normal credit card transactions and even less prospect of new entrants to the business of issuing credit cards (on the contrary, the consensus is that some existing issuers will stop).

What banks have not agreed to is the Reserve Bank proposal to substantially abolish interchange fees payable for credit card transactions. That is the real point of the AFR story. As the debate about interchange fees has unfolded the common interpretation is that the Reserve Bank has proposed to cut the interchange fee from about 1% of purchase values to about "0.3%". Also in circulation is the possibility that the cut in interchange fees would be to a level of 0.7%, consistent with the proposal eventually put to European banks by the European Commission about a year ago. The Reserve Bank document is also sensibly open to a tighter 'reading' -- that the permitted interchange fee would be very close to zero.

No interchange fee at all would best serve the community interest. This would mean the effective withdrawal of the credit card product and the issue, in substitution, of debit cards to which is attached the line of credit normally associated with a credit card. Not surprisingly, the banks prefer the status quo but if there is to be a reduction, to make only the minimal reduction proposed in Europe (to 0.7%) the new standard.

The offer in the paper

As I read the story yesterday, the banks were offering 'not to appeal' against the Reserve Bank decision if it were to reduce the interchange fee only marginally to 0.7%. However, if the Reserve Bank pressed ahead with proposals to substantially reduce the fee then the offer of 'no appeal' would be withdrawn.

The offer to not appeal was accompanied by submissive remarks by Visa -- "the RBA is judge, jury and executioner" -- and by the Commonwealth Bank -- "It is the court of no appeal once again for business in Australia" and 'banks would have no recourse to appeals against RBA decisions'.

Conversely, if the Reserve Bank holds to its hard line then other comments in the AFR story have a different relevance. Visa said, we 'might sue the Reserve Bank if reforms damaged the economic appeal of Visa to member banks or provided a competitive lift to Amex and Diners' Visa also said "if its fundamental interests are being compromised, then litigation is a strong option". That was followed by " we see this as having a long way to go".

For its part, the 'disagreeable' Commonwealth Bank was reported as willing to broaden the scope of the debate to include interchange fees on debit card transactions -- a tactic that might see the Reserve Bank back at the drawing board for another 18 months, or more.

In short, the banks are bargaining a plea of 'no appeal' in exchange for minimal change (0.7%) -- but to litigate and otherwise delay effective reform if the Reserve Bank wants more than marginal change to the interchange fee (0 to 0.3%)

Reserve Bank attitude

As noted last week in a paper "A Governor Uneasy" it would be almost incredible for the Reserve Bank to now back down, or water down, its intention to substantially abolish interchange fees for credit card transactions. Still the Parliamentary Committee left hanging on the air remarks by the RBA consistent with some rethinking of the proposals foreshadowed in December. There are shadows in play worth jumping at.

More important is the reliance that the Reserve Bank seems to be placing on "there is no right of appeal" (against 'the outcome' that it will announce). One can only wonder from where the Reserve Bank got this idea, and why the Chairman of the Parliamentary Committee put the rhetorical question "there is no right of appeal" to the Reserve Bank. Time will tell but one might fairly wonder which legal adviser gave the Reserve Bank and the Parliament this opinion -- and the converse, why the legal advisers to the banks and Visa are giving them a different, conflicting opinion.

The question about appeals or not, is a matter of fact that will presumably be answered shortly. The danger is in the offer, the plea bargain, being made to the Reserve Bank.

Consider,

- if the Reserve Bank accepts the banks' plea bargain on 0.7%, then the Reserve Bank will be made to look good -- especially after the banks and Visa and MasterCard , promise to over react to a 0.7% decision in a way that would make Jerimiah look like an unbridled optimist; but

- if the Reserve Bank presses ahead for 0.3% or less, and the banks go to court, then not only will the Reserve Bank look 'powerless' but attention will shift to the review of the trade practices legislation and the potential to put in place effective laws against 'price setting' and restore the ACCC as the pre-eminent competition regulator, including for the banking system.

If the RBA does not bite the apple it is likely to lose its 'almighty' power. Normally, one would not stand between a bureaucrat and his designated powers. In this case, to be fair to the RBA, it never wanted those powers -- taking them away would be a 'blessing' for the RBA and the community.

The RBA probably won't take the apple but it is a worrying situation that leaves the community in an uneasy position -- if the Reserve Bank is soft on the banks again, an 'appeal' on behalf of the community would be very difficult to mount. The Reserve Bank's record in dealing with the banks is not one that is reassuring to those who are keen to protect the interests of the broader community against the banks. (What about BPay? -- for example).

In the Reserve Bank, the 'payments policy' and 'financial stability' functions are conducted in the same division. When payments policy decisions make banks more competitive and make it harder for banks to earn profits, it simultaneously makes it harder in future for banks to recover from any threat that that might emerge to their viability. The Reserve Bank has a conflict of interest.

Ideally the payments policy responsibilities of the Reserve Bank would be limited to issues -- 'settlement' and so on -- associated with stability of the financial system. Ideally the Reserve Bank would not have responsibility for making choices that may make banks more competitive and unable to set prices collectively, but less profitable. The Reserve bank cannot be relied on to make these conflicting decisions impartially. This conflict of interest was recognised in the UK where the Office of Fair Trading was given responsibility for banking competition and the Bank of England relegated.

Trade practices law and the ACCC

The situation in which the Reserve Bank now finds itself is unsatisfactory. Australia needs strong provisions in the trade practices law against prices being fixed or collectively set, against the public interest. Australia does not need defacto trade practices law that is compromised by the simultaneous pursuit of otherwise conflicting responsibilities.

Proper, effective trade practices law is the imperative. The scope of such effective trade practices law is broader than the banking industry. The expertise needed to identify and assess 'price-fixing' in the public interest would preferably be concentrated in the competition regulator -- the ACCC -- rather than dispersed to other regulatory agencies, including the Reserve Bank. In the UK the resources available to the Office of Fair Trading were augmented by separately constituting a division to deal with banks and the retail financial services industry more generally.

All things considered, the UK approach would probably be best for Australia as well.

A submission to this effect has been made to the TPA Review Committee.

Credit card schemes may threaten bank stability

The ineffective development of competition policy about credit card schemes has perhaps created the very circumstance that underpins a developing concern for the viability of financial institutions.

Credit card schemes have burgeoned in the past few years while much 'circle work' was being done ineffectively aimed at bringing the operation of these schemes to heel in the public interest. Banks grown fat on excessive profits from excessive interchange fees on credit card transactions will eventually be vulnerable to competition from foreign banks offering cheaper and more efficient retail payment systems, without interchange fees.

This risk is perhaps not so evident in Australia where foreign banks not dependent on credit cards, are only slowly building the transaction deposit base that would sustain a better, different retail payment system. The risk is more evident in the UK where, as part of a united Europe, there is more effective scope for European banks that do not promote credit cards, to offer UK retailers and UK customers linkages to the better cheaper payment systems operated from outside the UK. In the USA some banks have chosen to concentrate their activities on credit card business and their viability is accordingly more effectively tied to continued access to bloated interchange fee 'fixes' in credit card schemes.

The circumstances where the bank stability authorities could be looking to cut retail banks off from an unsustainable flow of interchange fee revenue may be coming into range.

End Piece

Unexpectedly, Australia is now in a position to make a useful contribution to the development of retail payment systems policy globally. The action foreshadowed in December by the Reserve Bank is clearly in the right direction. These decisions should now be formally implemented without further delay and the matter of whether there will be an appeal or whether there won't be, decided by the banks and the promoters of credit card schemes.

Irrespective of that, the TPA review now getting underway should start with a clean slate about proposing effective trade practices law. This need is especially so for provisions that would preclude agreements taking effect about price-fixing or collective price setting, unless and until the ACCC had assessed the agreements. The test would be not only are they in the public interest but also, are they the 'best' agreements that could be reached in the public interest to achieve their objectives.