SUBMISSION

REVIEW OF THE COMPETITION PROVISIONS OF THE TRADE PRACTICES ACT

RETAIL BANKING INDUSTRY

This submission is about the need for different authorisation (and notification) provisions in the trade practices legislation to protect consumers and promote competition.

It is appropriate that the law promotes competitive trading and proscribes collusive behaviour that is against the public interest. Where collusive (cooperative) behaviour may be in the public interest -- and often it can be -- it is similarly appropriate for the permitted cooperation to be limited. Permitted cooperation is best restricted to that necessary to maximise the public interest. Elements of cooperation that unnecessarily compromise the public interest, meeting tests of 'net benefit' overall, should be proscribed.

There are judgments to be made but usually judgments within reach of experienced and fair minded panels of expertise which can be reviewed and modified in the light of experience.

The objective is a more efficient, fair, timely and accessible framework for competition law that will meet the reasonable needs of the general public more effectively than now.

-- not good enough

The present trade practices law and related administrative arrangements are unsatisfactory. The current balance of power leaves the broader public interest disadvantaged in important areas of economic activity.

As things stand, erstwhile competitors in the banking industry make 'secret' agreements, including about pricing, for the supply of network services without any obligation to notify relevant authorities or otherwise make transparent the provisions of such agreements. Apparently, parties to network agreements that are partly in the public interest are permitted to include additional, self-serving, provisions that erode the public benefit provided only that, on balance, a 'marginal' net public benefit remains. More generally, where agreements are found to have been against the public interest there is apparently no effective provision to either prohibit their operation or to penalise past misbehaviour.

-- what to do?

The proposals in this submission are that:

- any and all commercial agreements affecting the terms and conditions on which

goods and services are supplied be made 'notifiable' and, in the normal course, published in an accessible register of such agreements;

- where an agreement may be deemed to be 'in the public interest' any associated provisions in the agreement should be limited to those necessary -- this to ensure that the 'net' public interest is maximised rather than compromised and marginalised;

- where agreements include provisions for uniform pricing in the public interest, the operation of those agreements should be proscribed pending ratification by the ACCC; and

- persons reasonably representative of the general public interest and reasonably apprehensive that a certain agreement is against the public interest, should be able to seek, inexpensively, a restraining order requiring disclosure and otherwise stopping an agreement taking effect, or continuing in effect, until such time as the agreement is ratified by the ACCC.

The sense of these proposals is developed in the attachment that has particular reference to the banking industry. In short, those that would fix (or collectively set) prices should notify their intention to do so and delay doing so until approval has been obtained from the ACCC that the proposed 'setting' of prices is in the public interest. The present commercial model of 'do it and defend it to the death when they find out' is not acceptable.

-- retail banking practices

It can be appropriate to look to specific examples of inappropriate behaviour to identify and to illustrate shortcomings in current arrangements. Knowing what has gone wrong also helps to find a better way to go forward.

The attachment does this: it comprises 'identifying' and 'illustrating' extracts from published commentaries and correspondence about banking industry practices. The 'extracts' also advocate action to be taken by the authorities responsible for competition in the retail banking industry. The relevant authorities included the ACCC and the Reserve Bank.

Consideration of the extracts in sequence may facilitate understanding of both shortcomings in the current legislation and the difficulty of obtaining appropriate, effective and timely regulatory responses to the issues raised. When it was eventually 'discovered' that the banks were parties to inappropriate trade practices in various schemes for delivering retail transaction services, the authorities proceeded reluctantly, slowly and ineffectively to investigate and deal with that misbehaviour. The 'authorites' look inept -- all huff and puff.

-- so what?

The sequence of events has elements of a farce. The 'remedy' still only in prospect, is a direction that the inappropriate practices -- embodied in schemes for credit card transactions -- be discontinued. Other similarly inappropriate 'practices' -- affecting

transactions using debit cards and BPay -- have been recognised but apparently await a direction that they also be discontinued. There is no suggestion of a penalty being imposed for inappropriate behaviour extending over many years.

On the face of it, one might say that corrective action has now been foreshadowed about credit card schemes and action on other malpractice is in the pipeline -- rest easy. Against that nothing has actually yet been done to stop the banks misbehaviour. The accumulating offense to the general community includes:

- the very material consequences of this action being delayed for a decade or more longer than it should have been;

- the eventual realisation that the trade practices law was inadequate for the task of prosecuting allegations of price-fixing;

- the probability that any regulatory decisions now taken will be challenged in the courts in a way designed to frustrate effective regulatory action, to the ongoing benefit of banks that are parties to the agreements; and

- the consequences of focusing on a particular issue -- credit card schemes -- that are part only of a broader ranging (and similarly objectionable) set of agreements in the retail banking industry affecting the pricing of transaction services including from ATMs, from EFTPOS terminals using debit cards and access to the BPay scheme for bill payments.

-- assessment

The existing trade practices law does not meet the test of reasonable effectiveness -- on the contrary, it has been found wanting in an important area of the national economy, the retail payments system.

The revealed ineffectiveness of the trade practices law is to be deplored, as is the related maladministration that has permitted inappropriate agreements between banks to operate unchecked, clearly contrary to the public interest. The general community has every right to feel let down by the appointed authorities that exercised their discretion (inappropriately) to allow these agreements and practices to continue, notwithstanding that they were known to be against the public interest. These same authorities otherwise failed to advise Parliament on shortcomings in the trade practices and related legislation so as to foster legislative reform and enable the objectionable agreements to be proscribed effectively.

A consistent theme running through a fair assessment of this policy shambles is the confusion of authority between Reserve Bank and the ACCC. Among other things it is manifestly inappropriate that the Reserve Bank simultaneously has responsibility for the viability of banking institutions and for taking action against collusive agreements underpinning profiteering behaviour by those same banks. The conflict of interest is clear. As in the UK, this confusion should be removed by making the ACCC primarily responsible for the administration of competition policy bearing on the Australian banking industry. As in the UK also, it would be appropriate to augment the resources of the ACCC to enable the effective administration of trade

practices law in relation to banks and providers of retail financial services more generally.

I similarly believe the general community has every right to feel aggrieved by the behaviour of the executive management of banks that designed and subscribed to agreements which they knew to be unfairly in the interests of the banks (and themselves) and against the public interest. It should not need to be said that individuals participating in such inappropriate behaviour should be recognised as criminals and be subject to the penalties of the criminal law, including imprisonment.

-- the attachment

The attachment contains supporting illustrative documentation. The focus of the attachment is a contemporary policy issue -- credit card schemes -- of very material significance to the global economy as well as to Australia.

There are extracts (otherwise unedited) from some 23 documents charting the course of a public policy debate that unfolded since April 1999. These documents have been widely circulated, especially to individuals and organisations directly involved in, and otherwise actively interested in, the issues at stake.

Not all the documents have equal ongoing relevance. A reasonable appreciation of their overall cut and thrust could be gleaned from those dating from October 2001 (Extract 17). A couple of these papers were linked directly to the proposal for this Committee to conduct a review. The prospect of this Committee eventually being established influenced the content of papers written in recent months.

End piece

I appreciate that this Committee is forward looking and will not review particular previous decisions. Nonetheless the Committee may consider it appropriate to recommend that a review body be constituted that would have the authority to consider the way in which inappropriate trade practices were permitted to remain in place in the retail banking industry unchecked for so long.

The injury to the general public interest over many years runs is valued at many $ billions. Not only was current income improperly appropriated from the general community to the benefit of bank management and bank shareholders, but the process of protecting banks continuing access to ill-gotten revenues entailed the 'deadweight' cost of denying improvements in the efficiency of the retail payments system.

A forthright review of the processes underpinning this unfortunate situation would yield benefits for many years to come.

Peter Mair 15 June 2002

ATTACHMENT TO SUBMISSION

REVIEW OF THE COMPETITION PROVISIONS OF THE TRADE PRACTICES ACT

RETAIL BANKING INDUSTRY

Commencing in April 1999 I have written discussion papers, conference papers, correspondence and magazine articles about retail banking reform.

These contributions continued, more effectively, similar work undertaken over many years at Reserve Bank of Australia -- work that was largely disregarded.

The objective was about reforming retail banking in the interests of promoting a competitive environment conducive to efficiency. However, in that broader more general context, it was recognised that some of the worst excesses of inefficiency and entrenched uncompetitive behaviour in the banking industry reflected inappropriate agreements on trade practices.

Agreements underpinning credit card schemes and the BPay scheme were easily identifiable as operating contrary to any reasonable settings of public policy bearing on cooperative and collusive behaviour among competitors, including behaviour tantamount to price-fixing. Though easily identifiable as inappropriate it has been no easy matter to have banks brought to book for the malpractice.

The saga is ongoing -- it is not over by a long way. That is the point of the submission -- the ineffectiveness of current arrangements and the need for more effective policy foundations.

The malpractice in respect of credit card schemes was of long-standing, never notified and initially came to light in the wake of investigating other misgivings about credit card schemes. The malpractice associated with the 'BPay' bill payment scheme, though similarly deceptive and 'secret', apparently duplicateed objectionable features of credit card schemes, in particular incorporating an interchange fee for transactions that is probably excessive, if not unnecessary. The establishment of the BPay scheme in 1997 was particularly reprehensible in that by doing so the banks involved directly confronted the authorities responsible for both trade practices and banking policy, as well as disregarding the spirit of the trade practices law and official understandings on banking industry policy.

Commercial power confronted lawful authority with alacrity -- and got away with it. The following extracts trace some steps involved in making sure the banks did not 'get away with it' forever.

-- the format

The following extracts are arranged in chronological order and identified by title. Almost invariably in addition to usually being published, each piece was separately circulated by e-mail to representatives of the people and organisations mentioned as well as other interested parties including journalists and parliamentarians.

For the most part the extracts are limited to matters directly relevant to the credit card and BPay schemes -- they do however belong in a context of broader ranging proposals for retail banking reforms. The full papers are, of course, available.

EXTRACT 1

APRIL 1999, DISCUSSION PAPER

"THE AUSTRALIAN RETAIL PAYMENTS SYSTEM--- SOME UNRESOLVED ISSUES"

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THE MARKET HAS FAILED

-- CARD GAMES

Notwithstanding the ubiquitous character of plastic cards, especially Visa and MasterCard, very little is on the public record about the internal contractual arrangements under which these credit card services are provided to member banks, the merchants they sponsor and the customers operating credit card accounts. The following assessment may not be correct in all details but is offered as a fair assessment of the apparent situation.

It was reported in the Australian Financial Review in October 1998 that "the United States Justice Department has declared war on global payments giants Visa and MasterCard, alleging that they have colluded in illegal behaviour that has thwarted competition and stifled consumer choice." It was further reported that Visa international issued a statement saying it did not think the government needed to file the lawsuit, "once the people and the courts know the facts, they will agree that the market is working just fine without government intervention." MasterCard international was reported to have described the lawsuit as "entirely misplaced" and a mystifying effort to disrupt a highly competitive market structure.

Visa and MasterCard may be right.

From my perspective, however, the design, marketing and management of credit card schemes have confusing, and practically deceptive, "smoke and mirrors" characteristics. The overall product management structure is unreasonably self-serving to the collective (and individual) commercial interests of banks participating as card-issuing members in the schemes of credit card associations.

For some schemes, the underlying agreements on terms, conditions and pricing-policy frameworks under which the members of these associations operate are apparently not

registered with the relevant trade-practices authority, in Australia, the ACCC.

Moreover, the banking industry has decided that credit card schemes are to be excluded from the policy-making processes of APCA, the industry policy body established to oversee payments clearing arrangements in the Australian payment system. That means that the relevant industry body has proscribed discussion of the major credit card schemes -- Visa, MasterCard and Bankcard -- in its payments policy-making forums.
This is surprising, and sometimes explained by crediting Visa and MasterCard as operating under "international agreements", and thus, somehow, a law unto themselves across international boundaries. Visa and MasterCard are not beyond the reach of the Australian Parliament or other national governments, individually and collectively.

Credit cards have some outstandingly good attributes and excellent service is usually provided to cardholders and merchants. Nonetheless, there are aspects of the industry agreements covering credit card payment systems that would seem to be objectionable on a reasonable test of the public interest.

The questionable features include:

- Credit cards are marketed as a payment instrument which, when used to make purchases on credit, are "free" of any issuer-imposed, transaction fees and charges to card holders. While true in a limited sense, it seems not to be widely understood that the merchant service fee arrangements provide for a high percentage - typically over 2% - of the value of credit card purchases to be paid by merchants to the banking industry as merchant service fees. Of that total merchant service fee, 0.8 to 1.2%, of the customer purchase price is kicked back to the card issuer. This, so-called, issuer-interchange fee is in turn a cost recovered by retailers, from their customers in the retail prices charged for goods and services. Credit card purchase transactions are not "free" to customers in any meaningful sense, in the same "smoke and mirrors" way that cheques are not "free" either. Customers pay a high price for credit card services while being led to believe that they are free.

- One unfortunate consequence of the credit card issuer, kickback, revenue arrangements is that promotional effort is withheld for the use of debit cards (a comparable product without card-issuer, kickbacks). In some instances, the supply of payment facilities using debit cards (e.g.: for over-the-phone payments) is apparently withheld to ensure the customers use the credit card facility, which is more profitable to the card issuers. All this notwithstanding that for many customers their "separate" credit cards and debit cards are embodied in the one piece of plastic. The whole arrangement, reduced to its basics, is that the one card allows access to the account of the customer with the card issuer. Card issuers could open one account for a customer and at their discretion, grant a line of credit (overdraft facility) which would dispense with the inherent contrivance of the separate "deposit" and "credit" account arrangements. A properly competitive environment would embrace such alternative arrangements.

- An especially objectionable practice has emerged where credit cards are issued to

customers but described as debit cards. Customers holding these credit cards undertake to conduct the underlying account with a positive deposit balance always. One consequence is that such no-credit, credit card purchases attract merchant service fees (including card-issuer kickbacks) as if they were genuine, credit card transactions. Insult is added to this injury when the promotional material for credit cards masquerading as debit cards, advises customers about avoiding bank transaction fees. It says transaction charges can be avoided if, when making purchases, at EFTPOS terminals, customers select the credit-card button rather than the debit-card button. The net effect of this "smoke and mirrors" marketing is that the card issuer, instead of paying a small, fixed fee to the sponsor of the merchant where the purchase was made, actually receives a kickback equivalent to some 1% of the value of the purchases made. This arrangement has not been exposed or explained, to the holders of those deceptive, credit card/debit cards, nor to the community generally where the kickback to the "no credit" card issuer raises costs and retail prices for everyone without reasonable cause.

- More than 10% of all credit card transactions are made using credit cards that do not have an interest-free period. There is no "free" credit for holders of "no-free-period cards", they pay interest from the date purchases are recorded. Notwithstanding this merchants are given no concession on the kickbacks charged for these transactions, even though they are said to cover the "free credit" which is (not) provided.

- The much-touted "free credit" element of credit card product is, when properly analysed, little more than an illusion for all but a very few customers.

Among other things:

- The free credit is only "available" to those customers who pay their credit card account in full by the due date -- generally using funds held in a deposit account on which little, if any, interest is paid. The customers who borrow "free" under the credit card arrangement also lend "free" to the same group of credit card issuing institutions. On balance these customers get nothing for free. To the extent that their available deposit balance consistently exceeds their credit card debt, the customers are, overall, probably net losers from the arrangement.

- Free-period credit cards attract annual fees of some $25 per annum, whereas cards issued without the benefit of a free credit period do not. $25 annually, paid only by the "free-period" cardholders, is equivalent to the cost of constant credit card debt of $500 over the full-year (monthly purchases of $1000), when calculated at an interest cost of 5% per annum. The "free credit" is not free.

- Holders of free-period credit cards are, moreover, charged a higher interest rate than holders of other credit cards, if they fail to pay the balance of the account in full by the due date. For these customers, borrowing "free" and not paying by the due date attracts a penalty. A customer's failure to make the required part-repayment of credit card debt for two consecutive months now attracts an additional penalty: this, even if the total debt is within the agreed credit limit. The law-of-large-numbers means that, inevitably, some customers who intended to pay

by the due date do not -- for customers taking the risk of obtaining "free" credit the end result can be costly.

- As well, those free-period card users, who do not pay their credit card account in full by the due date, and do actually borrow, are charged for the privilege at an interest rate of some 15% per annum. The interest charge is moreover, backdated to accrue from the date purchases are recorded. "Free" credit can be costly.

- When responding to criticism that credit card interest rates are "high", banks are inclined to say:

  -- many customers pay their credit card bills within the interest-free period so the bank cannot charge interest to cover its transaction costs: every transaction made costs the banks money: and

  -- there is a component of the interest rate to cover the cost of transactions.

  Such explanations conveniently ignore that merchants have already paid unnecessarily high fees to cover the transaction costs. Banks add insult to injury by blithely assuming it is somehow fair that those unable to pay their credit card bills on time, in full should cover the transaction costs of those who can.

- A justification for the card-issuer kickback of some 1% of credit card purchase values is that it compensates banks for the "free credit" provided by banks to their customers that draw on their line of bank credit when shopping.

- Practically this set of arrangements entails that any actual provision of credit is being paid for twice, if not three times. First, by the retailer, embodied in the merchant service fee kickback; second, by the borrower paying interest on any credit actually taken, at a rate acknowledged to be high; and third, embodied in the card-holder's annual, card issue fee. On the face of it, this would seem to be an arrangement, which, overall, warrants review by the authorities.

- It is historical and systemic inertia that retailers, not usually expert in customer credit assessment nor well-placed to raise cheap loanable funds, agree to be charged for providing credit to the borrower customers of banks. Banks are expert at both raising loan funds (deposits -- often at very low-cost) and making credit assessments based on broad banker-customer relationships. Why do retailers pay fees to cover the cost of credit that banks provide to their own customers? There is no good reason. Retailers, these days, can hardly decline to offer credit card purchase facilities that are universally available at all retailers. No effectively organised objection from the retailers seems to have been raised against the "rules" of the credit card associations. An apparently remarkable situation, save for an observation that all retailers (their customers, really) are, more or less, "taxed" equally by the requirement to subscribe to a uniform agreement in respect of overall service fees, including a uniform kickback paid to credit card issuers -- for what?

- The rules of the credit card associations also preclude retailers offering to discount prices for purchases paid for with cash or by debit card. Retailers that advertise to breach this rule are threatened with removal of the credit card purchase facility from their store. Because no action has been taken against them, these rules could be incorrectly inferred to be in the public interest. Even if the rules of association are not "registered" trade practices, this should not preclude a "public interest" review of their consequences.

- The credit card business is dominated by two major card schemes. Both schemes are organised as cooperative associations (which themselves make no material profit). The same, card-issuing, member banks own both schemes. Both schemes have a more or less identical set of terms and conditions, including conditions about card-issuer kickbacks, which are binding on card issuing members -- oh joy to be so bound!

- In any event, to the extent that some, few, customers may meaningfully be said to obtain free credit, this is a benefit subsidised by the tax system, unnecessarily. In this case a tax deductible business expense, the cost of funds lent free by the banks, becomes non-taxable, income-in-kind in the hands of the customers taking the free credit. Why should the government, the community, subsidise this benefit to the relatively well off able to pay their credit card accounts on time?

- The offering of "loyalty" cards and associated "reward"/rebates related to customer purchase transaction volumes has recently enhanced the attraction of credit cards to customers. The option of offering a "loyalty" card scheme to customers is, realistically, only open to the largest card issuing institutions. Such arrangements are likely to further concentrate market power in the retail banking industry and unlikely to enhance diversity and competition in the provision of credit card services. The net effect of loyalty schemes is likely to disadvantage the smaller card-issuing institutions. As usual, the promise of an apparently attractive reward by credit card issuers is another likely instance of "smoke and mirrors" marketing to the eventual detriment of all customers.

-- regulatory inertia

In mid-1997 the ACCC refused to authorise the proposed rules and procedures for the conduct of the Consumer Electronic Clearing System (CECS) which were submitted to the ACCC by APCA.

This rejection was a watershed event. Unfortunately little useful has flowed through the shed subsequently.

The ACCC required APCA -- effectively the major national banks -- to make changes to the proposed agreement on rules and procedures. The required changes concerned matters affecting competitive access to the system, by smaller financial institutions, and a requirement that industry pricing agreements and arrangements covering transactions at ATM and EFTPOS terminals be reviewed to ensure they complied with "efficient pricing principles".

Apparently scant progress, to comply with the ACCC requirements, has been made by

APCA in the year or more since. The system continues to operate as if no challenge had been raised to the "unauthorised" CECS rules.

In any event the proposed CECS rules and procedures apply only to ATM and EFTPOS facilities. They do not apply to credit cards.

The major banks have elected not to bring credit card payment arrangements within the purview of the national payments industry body, APCA. Instead, credit cards remain under the administrative control of the major credit card associations, particularly Visa and MasterCard, and at the direction of their owner members, especially major banks.

The Visa and MasterCard agreements with member card issuers, and between the merchant-sponsor banks and merchants, remain off the public record.

This separation of industry control of the debit card and credit card schemes -- two very similar (same piece of plastic) and very comparable payments facilities (same card issuers, same terminals), is remarkable. The agreed industry rules for the conduct of credit card businesses should no doubt be the subject of the same (promised) public-interest scrutiny as those for the ATM/EFTPOS system (which failed to pass the public interest test, when reviewed by the ACCC).

For the reasons outlined above, credit card agreements, to which the major banks are party, are unlikely to meet a "public interest" test.

Bpay
-- on a good thing, stick to it

The major banks, and some others, established a new bill payments facility in 1997 -- it is known as BPay.

Customers using BPay quote a BPay reference number and transfer funds directly to the participating payee from their transaction account or credit card account. The utilities offering BPay facilities to their customers pay banks a collection fee that is no doubt significantly higher than the fee those same banks would charge for processing direct debits.

The development of BPay occurred, concurrently with the difficulties being experienced, at APCA, in dealing with proposals to revamp the direct debit system. The direct debit system in Australia had failed to develop, in large part because of the way the service was marketed -- bank customers felt they lost control of their right to challenge unexpectedly high, utility bills. The shortcomings in the marketing of the direct debit system were of major concern to public utilities, now willing to resist the high costs, fees and charges associated with credit card, cheque and cash payment transactions. A better, customer-friendly, direct debit system would enable the utilities to collect bill payments at a small fraction of the cost incurred when customers pay by cheque, credit card or cash or, now, BPay. It could reasonably be asked why banks do not offer the cheaper, better direct-entry facility on proper, user friendly, terms.

The BPay system is a generally sound concept -- similar to an electronic ""giro" payment system. It leaves control of bill payments with bank customers and there are no risks of "dishonors" because BPay payments are debited immediately against available deposit balances or unused credit card limits.

The problems with the BPay arrangement include:

- BPay transactions are substantially more expensive to customers than direct debit transactions would be; and

- The higher cost is not paid directly by the customers using the BPay facility, rather the higher cost is paid indirectly by the billing utility (and, no doubt, recovered by passing on the cost to the customers of the utility).

The BPay system appears to have been set up along the same lines as the major credit card associations. Under these arrangements there is centralisation of BPay account administration, presumably, including pricing and, presumably, elements of uniform pricing -- if only because the customers of any participating bank may use the system to transfer funds to a public utility banking with a different bank.

Uniform pricing, if it prevails, is not necessarily inappropriate, but there are warning signs, including:

- The BPay agreement is not registered with the ACCC, the relevant trade practices authority; the provisions of the agreement (access, pricing etc.) have not been tested against the "public interest"; and

- The agreement was made outside the auspices of APCA, the relevant payments industry body, that previously coordinated such developments and had a standing policy of referring new payments clearing agreements to the ACCC for authorisation.

Details of the underlying participation and pricing agreements have not been made public. However there are enough warning signs to suggest that the BPay agreement should be registered with the ACCC and reviewed to ensure that it is likely to operate in the "public interest".

Notwithstanding the suspicion that the BPay arrangement is likely to be very profitable to participating banks, the National Australia Bank has seen fit to impose what a spokesman described "as a small fee of 30 cents" on its customers using the BPay facility. This decision would seem to be quite inappropriate. The full costs of this service can be (and probably are) recovered from the business payees which can claim the cost as a deduction against taxable income -- a benefit which individual customers are denied. If an additional charge is required, it would seem preferable to charge the business payee, who would need to pass on only about half of the cost to customers as a loading on customers' accounts. The BPay decision of the National Bank offends commonsense and points up a capacity for banks to effectively charge customers twice for the provision of the same service.

WHO IS (NOT) RESPONSIBLE?

-- THE AUSTRALIAN COMPETITION AND CONSUMER COMMISSION (ACCC)

The ACCC has not, in its normal course, devoted much of its resources to scrutinising the soft, cooperative/collusive, arrangements endemic in the retail banking industry.

These arrangements are administered by industry managed, quasi-regulatory institutions such as Visa/MasterCard and APCA (the successor to the Australian Clearing House). Such arrangements in the retail banking industry affect the supply and pricing of particular transaction services: on the face of it some of the agreements would not pass any reasonable test of being "in the public interest".

TRADE PRACTICES POLICY

A range of trade practices in the payments industry and related, express and implied, agreements have been let run, untested against the public interest. The obvious exception as regards official interest is in respect of bank merger proposals, where the ACCC may have decisive authority in calm-market circumstances.

By way of a slight digression a comment about the ongoing bank mergers debate is appropriate. Not allowing the debate on big-bank mergers to proceed, effectively ensures that informed discussion about the structure and conduct of the retail banking industry does not take place. The associated failure to address issues, which would inevitably come to the fore in a proper debate about the merits of big-bank mergers, is lamentable. While some bank executives may be annoyed that the ban on mergers remains, they would be pleased that the focus on the merger issue diverts attention from other issues on which they would be vulnerable, especially in the negotiation of the required preconditions for mergers to be approved.

It would be far preferable if a properly informed debate about the retail banking industry were conducted separate to the current cat-and-mouse game on big-bank mergers. Under the rules of cat-and-mouse, the mice simply have to wait for suitable market circumstances to achieve their objective, without having to subscribe in advance to an appropriate code of public interest behaviour. Ideally, on the contrary, some "takeover" redistribution of banking business could be achieved if the major banks were placed in the situation where they had to compete with each other to build and defend their position in the market.

The threat of using official consideration of merger proposals to negotiate needed reforms to industry trade practices should perhaps be put to one side and the negotiation of needed reforms commence forthwith.

A range of matters, identified in the context of "what's wrong?" would seem to warrant the close attention of the trade practices authorities.

Casual observation of what is happening, and is not happening, in the way retail payment services are provided - and not provided - to the Australian community, points up a need for more careful scrutiny of banking industry practices.

It would seem appropriate for parties to trade practice agreements -- express or implied -- to clearly and transparently explain why the agreements are in the public interest. As things stand, the banking industry seems to disregard the trade practices authorities and to be generally disrespectful of broad community concerns to be assured that common industry practices operate in the public interest. Many agreements within the banking industry (including common, "bilateral" agreements) are not even registered with the ACCC and thus not on the public record to be transparently assessed against "public interest" benchmarks.

Many banking industry agreements are necessary and clearly in the public interest. These agreements fall within the range of necessary cooperation: the national payment system would not work unless all classes of payment instruments were automatically interchangeable with all participating providers of those payment services. The format of all classes of payments (whether they be cheques, cards or direct entry) must meet common industry standards. Such necessary cooperation is clearly in the public interest.

A danger arises when agreements founded in "necessary cooperation" include additional, discretionary provisions and informal "side agreements". It can be a short step in the process of drawing up industry agreements for "discretionary cooperation" to become collusive practices, masquerading as reasonable cooperation, and clearly against the public interest.

In the normal course it might be expected that policy-making for the retail payment system would be guided by developments in other countries -- especially those in the normal reference group, the United States, UK and Canada. Unfortunately these issues do not seem to have been dealt with properly in those countries either.

-- Does it matter?

Banking industry agreements affecting the nature, range and pricing of services across the industry can be judged against the public interest in different ways. Some agreements are clearly OK, some agreements clearly not and most have a mix of good and bad features. The assessment process balances matters of high principle against the pragmatic need to accommodate agreed practices, which enable the industry to operate effectively.

In the normal course it may not matter all that much if a particular banking industry agreement were to deliver relatively generous benefits to the parties to the agreement, albeit at the expense of the wider community. Objectionable in principle but accepted as a pragmatic reality. Excess profits, if any, find their way back into the community -- especially to those with direct, or indirect, holdings of shares in banks.

Well-justified concerns arise, however, when the provision of inferior, high-cost banking services persists, while better, lower-cost alternative services are withheld or

not marketed effectively. In those circumstances the community is doubly disadvantaged. Not only does the community pay (directly or indirectly) for inferior, high-cost services but also they are denied the better, low-cost alternatives. There can be a substantial, dead-weight cost imposed on the community by industry practices that would, if scrutinised, be judged improper.

Casual observation suggests that some agreements have been let run because the first-glance, redistribution of income in favour of the industry, does not seem to be beyond the pale. The acceptance of such agreements takes on a colour of very different hue when the consequences underpin a continuing substitution of more profitable, but worse, services for less profitable, but better, services.

-- A ray of hope

In a landmark decision in September 1997, the ACCC rejected the proposed industry agreement on rules, put forward by APCA, for clearing retail payments transactions made using automated teller machines (ATM) and facilities for electronic funds transfers at point aside (EFTPOS).

This decision was remarkable because the industry proposals put by APCA to the ACCC carried the specific endorsement of the Reserve Bank. Moreover, two officers of the Reserve Bank held positions, separately, as Chairman of the Board of APCA and as a member of the Board that approved the application.

A paraphrase of points made in the ACCC press announcement on 5 September 1997, includes:

- it is likely that the current ATM and EFTPOS access and payment arrangements would raise trade practices concerns;

- the proposed rules were substantially incomplete and require further development and amendment; and

- There would be considerable efficiency and competition advantages in:

    - the development and monitoring, by APCA, of mandatory interchange standards for participation by card issuers and transaction acquirers, in the ATM and EFTPOS networks.

    - ensuring that transaction interchange fees paid between banks were based on efficient pricing principles so as to ensure that access to the ATM and EFTPOS networks is available to card issuers and card transaction acquirers on fair and reasonable terms; and

    - removing the "banks only" rules on direct participation in the associated payments clearing system because it was unnecessarily restrictive and not justified in the public interest.

This announcement by the ACCC included two other relevant comments:

- First, "The credit card arrangements of Visa, MasterCard and Bankcard, which include participation criteria and clearing and settlement rules, do not form part of the APCA applications for authorisation, and have not been considered by the Commission in the draft determination."; and

- Second, " Current credit and debit card payment arrangements are not protected under the Trade Practices Act, so persons taking part in any such arrangements that may breach the Act would be open to court action by an aggrieved party or the ACCC."

These comments echoed recommendations in the 1995 report of an inquiry by the Prices Surveillance Authority into fees and charges imposed on retail accounts by banks and other financial institutions and by retailers of EFTPOS transactions. The PSA specifically addressed suggestions at the time, that the Visa and MasterCard associations may assume control of Australian EFTPOS debit card operations, and establish a pricing regime similar to that existing for credit card transactions, including kickbacks to card issuers. The PSA recommended "that any proposal to introduce international debit cards into Australia be monitored, with a view to ensuring that the pricing principles adopted reflect the costs and risks of providing the service."

It is regrettable that such a useful insight by the PSA in respect of debit cards was not logically extended to a recommendation that similarly objectionable and long-standing practices in respect of credit cards be critically reviewed.

While these decisions, comments and remarks are encouraging in the context of proper scrutiny of trade practices agreements in the retail banking industry, there are the further questions of when appropriate action will be taken, and at whose initiative.

-- THE RESERVE BANK OF AUSTRALIA (RBA)

The RBA has long had a difficult balance to strike in dealing with issues that might compromise its primary responsibility for the safety bank of depositors. Until recently the RBA took only a vague responsibility, if any, for efficiency in retail banking. The shift of responsibility for the supervision of individual banks, from the RBA to APRA, is a necessary precondition to a better balance in policy development, within the Reserve Bank, to foster payment system efficiency.

Freed of its responsibility for individual banks, the RBA will be less inclined to accept the trade-off of system efficiency for arrangements that both featherbed bank profitability and are inimical to efficiency in the retail payment system.

APRA, on the other hand, may not appreciate the withdrawal from the banking industry of soft, unaccountable income flows, originating in unwarranted subsidies effectively drawn from the public purse of the Commonwealth, or excessively profitable services provided to the community.

RESERVE BANK: PAYMENTS SYSTEM BOARD

The newly established payments system board (PSB), yet to strike a blow in public, is concurrently a focal point of both hopes and fears for needed reform of the retail payment system.

As usual, the hopes reflect the legislative charter given to the PSB -- especially the emphasis on competition and efficiency, as well as more traditional, stability and safety objectives.

The fears reflect the risk that, once again, a public policy body reliant on the Reserve Bank for its practical sense of purpose and direction will be found wanting. The form line on the Reserve Bank in this context, taken through the Australian Payment System Council (APSC) and the Australian Payments Clearing Association (APCA) is, as noted, not good.

On disclosed form there is no reason to expect the PSB to be a major force for reform of the efficiency of the retail payment system in Australia. Rather the rational expectation is that the PSB will busy itself with ensuring that administrative arrangements in the retail payment system underpin a safe and sound payment system, but be unable to do much to redress ongoing inefficiencies in the system which will go unchallenged.

Support for this view was provided in the transcript of the discussion between the Governor of the Reserve Bank and the Parliamentary banking committee on 15 December 1998.

Asked to address issues of competition in credit card business, especially the high interest rates charged, the Governor said that he "did not know", "never really understood" why credit card interest rates were so high and referred the committee to APRA and the ACCC. Asked if that meant the Reserve Bank did not propose to do any work on that, the Governor said "No. We do not have any responsibility for the banking sector per se."

This was a surprising and disturbing response, given that the Governor is also the Chairman of the new Payments System Board, a body many hoped would at last take some accountable responsibility for the proper conduct, reform and development of the Australian payments system.

Safe-and-sound is an important, non-negotiable base point for the structural arrangements underpinning the national payment system. Safe and sound does not, however, preclude that the retail payment system could be efficient as well as safe. As things stand the retail payment system is not efficient and, on past form, it is unlikely that the PSB will take purposeful initiatives to turn things around.

Among the handicaps which the Reserve bank carries are:

- A long history of considered inaction in addressing impediments to efficiency in the retail payments system:

- A practical day-to-day dependence on the major national banks to actually implement preferred changes. The major national banks are renowned for

their reluctance to disturb the status quo unless it is clearly in their commercial interest to do so, and it rarely is; and

- Ongoing confusion of responsibility between the ACCC and PSB for trade practices matters in the banking industry: matters that are in need of prompt attention. The legislative reluctance to clearly define the location of accountable responsibility for retail payment system efficiency (and prevailing trade practices) is regrettable. The recently published memorandum-of-understanding between the Reserve bank and ACCC hardly presages a surge in regulatory accountability.

-- another governor speaks

Central bank governors, worldwide, are preoccupied with "safe and sound" objectives for national payment systems and rarely, if ever, address issues affecting the efficiency of retail payment systems.

An exception to this general disinterest was a one-off contribution to the debate made by Governor Fraser in 1994. In a short prescient commentary on the issues, Governor Fraser remarked on:

- The lack of competitive pressure on the major national banks stemming from the unwillingness of the customers to shop around for banking services.

- The endemic and extensive cross-subsidisation inherent in the marketing of packages (bundles) of retail banking services, evidenced by loans and deposit products being overcharged (or underpaid) so as to enable banks to give other, expensive, transaction services away largely free of charge; and

- Progress in achieving efficiency gains would be frustrated by customer reaction to bank branch closures; bank staff reductions; higher bank fees and the "forced" shift to using different payment technologies.

Prescient or not, the implied challenge was left on the table with no purposeful effort being made to address the task of turning attitudes around in the community; in the banks and among the regulatory authorities.

.....

Giving the Reserve bank a charter to pursue payment system efficiency is, in many ways, the antithesis of its more fundamental charter to deliver systemic stability -- a safe and sound financial system. The conflict between these objectives has some parallels in the juxtaposition of *price stability* and *full employment* as the " dual objectives" of the monetary policy pursued by Reserve Bank.

In the context of the payment system, this inherent conflict of objectives coupled with the Reserve bank's natural preoccupation with safe and sound does not bode well for the RBA making an effective contribution to the efficiency of the retail payment system.

THE MAJOR BANKS
--the self regulation of the banks, by the banks, for the banks

The major national banks effectively control the key defacto public policy body -- the Australian Payments Clearing Association (APCA)-- and, when they permit it to operate, the ABA (Australian Bankers Association) -- sometimes jocularly referred to in the trade as the Australian Burglars Association.

It is essential and proper that the banking industry has a semi-official, self-regulatory role in managing the payment system, through the Australian Payments Clearing Association (APCA). The industry performance that is evident in the output of APCA has, however, been found wanting -- the unwarranted delay in shortening that cheque clearing cycle being but one example. It seems that not much purposeful progress towards a better retail payment system will be made at APCA with its current attitudes and in the current failed market.

Needed reforms in the public interest run counter to the individual and collective current interests of the major banks, and other payments service providers. The dividing line between beneficial cooperation and efficiency-sapping collusion can be a fine one. APCA is not working effectively in the public interest.

While an industry body like APCA is essential, it has some operational features the community could do without. The operation of APCA could be constrained in the public interest by changes to relevant tax and trade practices policies, but there is also attraction in ensuring that the governing board has "public interest" representatives, including the chairman.

THE MAJOR BANKS MORE GENERALLY

It is appropriate to discuss the role of the major banks in the general context of "public policy".

The nature of the industry is such that it is essential for the industry as a whole to be the major formulator and administrator of the practical policy framework under which the industry must uniformly operate. The poor performance of the retail banking industry nonetheless points to the need for industry "policy" work to be done in a setting more tightly constrained by proper public policy objectives.

There is, however, no point in simply blaming the banks for the problems besetting the retail banking industry. The banks do what is best for them in a market environment, and a compliant public policy environment, that fails to serve the community properly in the general public interest.

The banks cannot be expected to volunteer insights into the ways that the retail banking market fails to work in the public interest, nor into the shortcomings of public policy that allow them to play the game to benefit themselves. The banks play to win: it is not for them to identify rules of the game that, while inappropriate, serve their interests. After all, the banks set most of the rules to suit themselves.

Even so, some of the ways banks play the game are deserving of censure. Not least the day-to-day observation of patterns of common behaviour that the senior executives of banks would know is unlikely to meet the test of scrutiny against reasonable, public-interest criteria. They do what they are allowed to do and they tend to do the same things the same way together.

Collectively the major banks often show a good measure of disrespect for the Australian community. The banks seem to operate outside the legal framework that is supposed to define basic constraints on acceptable commercial behaviour -- including, no tax-avoiding bartering, which offsets personal customer income against bank costs, and no agreements on pricing and marketing practices that are untested against the public interest.

Among other things, banks would be unlikely to welcome scrutiny of their behaviour, against public-interest criteria, in a number of product areas.

The relevant products include:

- credit cards and their attendant marketing strategies;

- debit cards and the withholding of facilities giving access to linked accounts;

- the BPay, bill payment facility and the associated diversion of payments activity from direct debit facilities; and

- the supply of inefficient cheque payment facilities at prices (if any) which bear no relationship to the private and social costs of providing the facilities.

The provision of these facilities is, or should be, overseen by APCA, the self-regulating industry body owned and managed by the banking industry.
.
Any prospect of establishing proper market disciplines on the provision of the products would, no doubt, be strongly resisted by the banking industry.

The resistance movement in the banking industry is led by two major national banks. These two banks have developed considerable expertise in playing a, stop-it-I-like-it game ("bank-bashing") with the general community.

The general community is given to knee-jerk reactions to changes in the established order in retail banking. The community reacts predictably to higher fees and charges for bank transaction services, where there were none previously; the closure of convenient but often unnecessary bank branches; the withdrawal of customer services from remaining bank branches and the tough enforcement of contracts with bank borrowers -- among many other things.

Given a choice between giving proper, rational explanations of the need for service reforms or making provocatively insensitive remarks that fuel the fire of community angst -- two of the major banks often opt for the latter. Without repeating a litany of such provocative remarks, some come readily to mind. These include -- references to

the provision of expensive branch banking facilities said to be conducive to a community social gathering, and lamentations that the community writes letters of complaint to banks about branch closures rather than letters of congratulation for exceptionally good performance. On one, memorable, earlier occasion credit card customers who paid their credit card bills on time were described as "free-loaders" when, in truth, it was they who were being loaded with expensive charges indirectly. The banks apparently see such provocative remarks as good sport at the expense of the community.

There are reasons for this repeated, deliberate, public misbehaviour of banks.

One explanation is the pressure thereby put on political government to be wary of intervening in banking policy issues and otherwise to treat the major banks gently. The banks have a capacity to precipitate that special kind of political unrest where the heat in the debate is inversely proportional to the fundamental importance of the issue raised. The banks rarely raise the hard issues in public -- they do not like to be drawn into proper debate.

There is a reward to the major banks for this misbehaviour: it buys time for them to resist, delay and obfuscate reforms that might threaten their current commercial interests and their dominant market position.

Those who doubt this could reflect on the likely outcome of public policy decisions that would restore proper market disciplines in the retail banking industry. For example:

- the likely outcry if banks were denied access to soft income flows originating in the uniform industry practice of not paying proper market interest rates on customers transaction deposit balances; or

- if banks were required to modify the high and uniform pricing arrangements underpinning credit card schemes (and the withholding of better, cheaper services).

The major banks stand ever ready to make necessary changes in the way they operate, but only in their own good, chosen time -- unless the need to change is forced upon them.

A better public policy framework would expose the major banks to more effective competition from smaller retail banking institutions. That said, the prospect of greater competition coming from small banks is often greatly overstated.

The way the market is structured, it usually suits smaller banking institutions to play much the same game with the customers as the major banks. However, it is also likely that the smaller institutions are wary of proper competitive markets for some

retail payment services such as credit cards. Small banks are better focused on providing payment services other than cheques and credit cards and, among other things, more willing to expand their direct entry processing of direct debit and credit transfers -- this could be a competitive advantage if the market environment were reformed.

The major banks are usually resistant to change at a pace quicker than they would choose themselves. One current preoccupation is to extract what they can from the market imperfections underpinning the cheque and credit card payment systems. Both the ABA and APCA are ever ready to disparage criticism of the soft income banks make from the unduly long cheque clearing cycle. They deny an advantage to banks in terms of interest income, saying that interest on deposit accounts is paid from "day one" when the cheque is deposited. What they fail to say is that most cheques are deposited in transaction accounts on which, if interest is paid, it is paid at a fraction of 1% per annum.

Australia has two (rare) case studies of the banks under competitive pressure. One was the cash management trust initiative in the early 1980s. The other, more recently, the competition offered by the housing mortgage originators. In both cases the majors did not adapt quickly to the changed market circumstances. The majors were nonetheless ready to attack be newcomers once they realised the competition was effective; their business was being eroded and particular aspects of the game that they were playing had reached their use-by-date.

A lot less talk about the dubious benefits of further mergers among the major banks and good deal more focus by them on collectively providing efficient payment services would be a very useful outcome of purposeful, official scrutiny of prevailing arrangements.

A danger however is that there could be a further round of sycophantically compliant public policy posturing supposedly aimed at pressuring the major banks to perform properly while knowing full well that, unless constrained by market circumstances, the banks will do nothing that is not clearly in their commercial interest. Why would they volunteer to do the right thing?

EXTRACT 2

28 MAY 1999, LETTER TO ACCC
(not previously published -- no reply was recieved)

"BANKING INDUSTRY TRADE PRACTICES"

Mr Alan Fels
Chairman
Australian Competition and Consumer Commission

PO Box 1199
Dickson ACT 2602

Dear Mr Fels,

.....

Given the nature of the payments system it is, of course, appropriate that there be agreement in the industry on those features of a scheme that are necessary to permit the seamless flow of transactions between banks. At issue is the tendency for such agreements to extend beyond necessary cooperation to include discretionary agreements, especially on uniform transaction pricing. If it were considered reasonably appropriate for there to be uniform pricing agreements, it would also seem to be appropriate for any proposed agreements to be registered with the ACCC, made public and reviewed against public interest criteria.

Among other things I am concerned both that this due process was not followed in respect of the Bpay scheme put in place some year or so ago, and that there has been no retrospective review of this scheme to determine its (unlikely) fit with the broader public interest.

The Bpay scheme was developed outside the established industry policy body, APCA, and apparently cast in the same mould as the longstanding, unregistered and untested, agreements underlying the major credit card schemes. Schemes of agreement, incidentally, which I understand the ACCC has said publicly, may not pass a public interest test.

From the perspective of an interested observer, the apparent ability of the banking industry to enter into such trade practice agreements, unchallenged ex ante or ex post, seems to fly in the face of the spirit of the trade practices law.

The banking industry's tendency to disregard the reasonable, apparent intent of the trade practices law sits uncomfortably with me. I am similarly uncomfortable with the apparent inaction of the relevant public policy bodies charged to ensure that the community gets a fair go.

Among other things a game is being played out by the banking industry which, on the face of it, would seem to confront the authority of the ACCC and PSB. Discouraged by the PSA from newly imposing a uniform pricing agreement on the interchange of debit-card transactions, banks have effectively sidestepped this warning by, in my view, deceptive marketing of " free" credit-card transactions coupled with newly imposed, direct customer fees for debit card transactions. Perusal of the RBA statistics on transaction card activity suggests that before long the number of monthly credit card purchase transactions will exceed the number of debit card purchase transactions. It would be very difficult to see such a development as being any thing but contrary to the public interest.

Apart from encouraging the ACCC to take a close interest in these, related, matters, I would appreciate,

· an update of the progress that the banking industry has made in addressing the preconditions set by the ACCC in late 1997 for the reconsideration of the application to register the CECS agreement proposed by APCA; and

· related to the decision to refuse to register the CECS agreement, some indication of the process someone aggrieved by the prevailing industry agreements on credit card schemes, may need to follow to initiate the appropriate disclosure and review of such agreements.

Thank you,

Yours sincerely, Peter Mair

EXTRACT 3

MAY 1999, LETTER PUBLISHED IN AFR

"BANKS ARE USING THE WIDE COMBS"

The gentle-spokesman for the Australian Bankers Association, Mr Tony Aveling ("Banks not fleecing the public", 'letters', May20), brings a more conciliatory, though similarly diversionary, tone to his role than some other banking CEOs. He still speaks for his masters, not the public interest.

Banks may be competing for new business in funds management and share trading, and for the moment, not "fleecing" housing and small-business borrowers as they are wont to do. However, the banks continue to use the wide-comb on customers of their retail transaction business where there is no semblance of an efficient, competitive market.

The ABA may like to address those fees-and-charges issues about retail transactions that have captured the community's attention and hold untapped potential for further unrest.

How is it that cheques, the most used and most expensive of the non-cash payment instruments, are usually provided "free of charge", while less costly services are explicitly charged for? Why does the direct-entry, funds transfer system remain so underdeveloped in Australia even though it is potentially, by far, the cheapest and most efficient alternative to the cheque? Do the banks consider their "uniform" credit card schemes, and Bpay, - which appear to embody indirect, but lucrative, transaction pricing agreements - to be reasonably in the public interest? Unchecked, how long does the ABA think it will take for the number of high-priced, credit card transactions to exceed the number of, less profitable, debit card transactions?

One may reasonably ask where are the appointed referees for these retail-

banking games, and whether they are able to find their whistle?

EXTRACT 4

SEPTEMBER 1999, DISCUSSION PAPER

"THE AUSTRALIAN RETAIL BANKING AND PAYMENTS SYSTEM -- STATE OF PLAY"

BENCHMARKS

.....

credit-card games

Credit and debit cards -- signature or PIN -- are essentially the same transaction authenticators. Their apparent separateness has more to do with the opportunities that separation opens to banks for profit taking on 'credit-card' business.

Any inquiry into the conduct of credit-card businesses, operating with the benefit of private agreements on practices and pricing, would be unlikely to conclude that the terms of the agreements were in the public interest. Why are inquiries not held? Why are these agreements not even registered with the competition authorities?

Credit card fraud, largely an unnecessary consequence of 'signature' rather than 'PIN' authentication, is one price banks are prepared to pay keep the credit-card 'game' separate—current credit-card pricing rules would not be sustainable if the same PIN authenticated both credit-card and debit-card purchase transactions when using the one card.

It should be a matter of public concern that, in Australia, the number of credit-card transactions will shortly exceed the number of debit-card transactions. This prospect is not in the public interest. No clearer illustration could be given of 'smoke and mirrors' marketing strategies (mis)leading customers to pay a higher, credit-card transaction fee, indirectly, for essentially the same service available by using a debit card or direct entry transaction facility.

It is well past time for a proper market environment to be re-established so that developments of this kind—an affront to the collective community commonsense—are not viable commercial options for the industry.

BPay

There is every reason to suspect that the same judgment fairly applies to the industry agreements behind the BPay 'phone-banking scheme for bill payments.

industry cooperatives

Rules for payments games are set by industry cooperatives -- often, apparently, unfettered by the appointed regulators.

Semi-official, and well-documented, agreements have been reached under the auspices of the Australian Standards Association and rule-making bodies operating in conjunction with the banking regulators to facilitate matters like coordinated cash distribution.

Defacto, a range of other semi-official agreements can be observed to be operating but they are not well documented now, if they ever were.

Consider, would retailers borrowing money from the general public, be permitted to give tax-free entitlements to free goods to the lenders (depositors) instead of paying 'interest' on which tax would be payable? Who authorised the banks to do this?

Many agreements between key players in the industry seem to operate without official scrutiny. These agreements include those reached by members of the credit card cooperatives (Visa and MasterCard); the sponsors of BPay; members of the Australian Bankers' Association and some elements of agreements within the scope of the Australian Payments Clearing Association (APCA).

Many aspects of these private, industry agreements are likely to be both necessary and unobjectionable -- some aspects of the agreements warrant review against public interest criteria.

industry agreements

The nature of the retail banking industry is such that agreements on trade practices, including elements of uniform pricing, are probably essential to the proper functioning of payment systems.

The observed 'voluntary' behaviour of the industry is nonetheless such that the establishment (or endorsement) of any necessary agreements would preferably involve accountable public officials and community representatives. As things stand the way this industry operates is objectionable on any reasonable criteria of outcomes consistent with a properly functioning market and proper regard for the public interest.

THE RESERVE BANK

.....

-- a couple of 'wides' bowled, not even a quick single taken, its not cricket!

> *"Those who expected—or feared—that the Board would begin to swing lustily as soon it reached the crease can be reassured that it is more interested in building a long and carefully constructed innings. Payment system evolution is that sort of match!"*

John Laker, Assistant Governor RBA (Financial System) & Deputy Chair, Payments

System Board (16 June 1999)

.....

John Laker --*"The Role of the Payments System Board"*

This first venture of the Payments System Board into the public arena was very welcome.

On the one hand it endorsed common testimony to the inefficiency of the present, retail payment system. On the other, while identifying emerging focal points around which the push for reform might gather pace, it hardly presaged a clear determination to move promptly to address obvious, long-standing problems.

Instead we have a Board balking --

> *at the definition or measurement of efficiency; needing to do a good deal of pioneering work to gather the facts, digest them and develop rigorous benchmarks on costs and performance .. to be assessed against international best practice ... complex and painstaking work that must be done well ..*

To continue the cricketing analogy chosen by John Laker, there seems to be little inclination 'to take a quick single' (don't count shorter cheque clearing times) in a game where at least some of the balls in the air might easily be put 'over the clocktower'.

This Board is playing for Australia—for openers, can we please have even a 'Bill Lawry' back to the crease while a 'Bradman' warms up in the nets?

To use an alternative analogy, can the lessons which the Reserve bank has learned so painfully and well, about the importance of well functioning markets in pursuing monetary policy objectives, be translated, and effectively applied, to the obviously failed market in which retail payment system efficiency founders?

common ground?

Putting aside the rhetoric of,

> *evolution; watershed; strong regulatory powers; determine rules of participation; rules on access; set standards; arbitrate on disputes; gather information; co-regulatory approach; safeguards for the private sector; transparency; full consultation; recognition of the interests of all; careful stocktake or 'benchmarking'; safety; the mandate ... for a more competitive, efficient and flexible financial system in Australia; no doubt about the Board's authority or its ability to initiate change where this is deemed necessary*
> .

the Board's preliminary stocktake was reassuring.

The stocktake included assessments of,

considerable scope to increase efficiency; Australia's heavy dependence on cheques; the number of cheque payments per head in Australia has been on the rise; total payments system costs relatively high; potential for substantial gains in efficiency, especially from substituting electronic forms of payment for cheques; wrong mixture of payment types; costs higher than necessary; middle of the field .. efficiency .. not at international best practice;

-- there was a light on,

***direct debits**.. the most economical way of paying routine bills.. little used in Australia .. in sharp contrast to comparable countries .. Australia lagging well behind .. Australia is going backwards .. APCA has been working **(ineffectively did I hear?)** on changes to the direct debit system for some years .. the Board believes .. the Board has .. the board is now considering how best to take this exercise forward .. to bring Australia up to best practice in this area.*

However, while clearly testifying to the failure of the direct-debit market, the Board has chosen the route of 'directing/leading the market' rather than addressing more fundamental reforms to ensure the market works properly on its own.

This will be an entertaining spell at the crease for the RBA -- especially as the banks' fast bowlers actually worked effectively, outside the APCA framework, to put the substitute, BPay system, in place, and they will not lightly surrender such a good wicket.

A credible public policy objective would be a doubling of the share of direct-entry transactions from 25% to 50%: a substitution of some 750 million transactions per annum. A conservative estimate might put the banks' potential 'lost profit' from this transition at $1 for each transaction, and some $750 million in total.

Only a proper market could deliver such an outcome—politely asking the banks to 'volunteer' to give up $750 million p.a. is unlikely to be an effective approach. Watch the banks more experienced batsmen carefully craft their turn at the crease! Bet on the banks to win this match.

and, there was a light off,

At the beginning of the 1990s, EFTPOS and credit cards together accounted for around 15% of non-cash payments but that share has now risen to almost 40%. The story with credit cards is somewhat more intriguing .. a reasonably mature product by the close of the 1980s .. credit card usage per capita has gathered pace in recent years, and is now (much) above 1990 levels.

Why would a relatively mature product suddenly get a new lease of life .. new classes of payments .. loyalty and reward programs .. (apparent) marginal cost (to customers) actually negative .. (real) cost, of course, positive borne by merchants directly .. mixed up in all this is the interchange fee paid to (credit card) issuers .. an interesting mixture of pricing and incentives to say the least .. but probably a

clue

A clue. Spare my days.

Apart from credit cards, what about BPay, EFTPOS etc., where the same style of 'co-operative' industry agreements would seem to be in place covering pricing, among other features of these products.

Can we have the basic-economic-analysis-light on please? Perhaps the switch might be found in the chapter and verse of the book dealing with modern approaches to cooperative monopolisation and industry pricing agreements.

OTHER REGULATORY AUTHORITIES

Apart from the work of the Parliamentary Banking Committee, which took an interest in the matter of margins, fees and charges, there is nothing on the public record to indicate that other relevant regulators -- the ACCC, APRA and the Treasury/tax authorities -- have been taking much of an interest in retail banking and payments system matters.

The ACCC

There are a number of issues in the context of payment systems that remain outstanding with the ACCC -- for example, it is now two years since the ACCC refused to authorise rules proposed by APCA for the conduct of the Consumer Electronic Clearing System. This system has of course continued to operate, presumably inappropriately in the view of the ACCC.

The '4 Pillars'-- Australia's major banks -- probably think this authorisation process is a bit of fun -- even though not authorised, they continue to run the system on their rules—they know it can't be stopped. Less funny, they appear to have taken the ACCC decision, not to authorise CECS, as a reason to never again ask for approval of an 'industry-scheme' -- they will now make 'rules', in frameworks outside APCA, that are not referred to the ACCC for approval.

I really think these people need shortening up, properly.

Be that as it may, one would expect that the ACCC would be reviewing its hands-off attitude to a number of banking industry agreements, including about uniform pricing, that many find objectionable. Moreover, one would expect that the newly agreed working relationship between the ACCC and the Reserve Bank, would be starting to pay dividends in terms of joint regulatory appreciation of what is actually happening and whether that fits reasonably with the legislation about acceptable trade practices.

As well, press reports suggest that the ACCC has reached an understanding with its counterpart in the United States for sharing information about the acceptability of trade practices which extend beyond particular national boundaries -- the Visa and MasterCard agreements might be expected to come within range of this international cooperation.

Even a superficial perusal of the information publicly available on the website of the US Department of Justice makes it clear that the US authorities are not mincing their words in framing an anti-trust action against Visa and MasterCard. Against that, this 'action' in the US already has a long, and somewhat ineffective, history -- further development of this matter is likely to be protracted and costly.

A probably more effective approach to resolving these issues, in the US and elsewhere, would see action taken under the tax law to ensure that the value, of any "interest-free", credit card borrowing concessions, is deemed to be taxable, income-in-kind, in the hands of credit card users. Similarly the tax authorities should probably deem to be taxable, the income in-kind paid to depositors as underpriced transaction services. Others have been 'caught' by the tax law when other approaches failed.

THE BANKS

The practical realities

Among other things a game is being played out by the banking industry which, on the face of it, would seem to confront the authority of the ACCC and PSB. Discouraged (in 1996, by the PSA) from imposing a new more profitable uniform pricing agreement on the interchange of debit-card transactions, banks have effectively sidestepped this warning by marketing " free" credit-card transactions and credit-card debit cards coupled with newly imposed, direct customer fees for conventional debit card transactions.

Perusal of the RBA statistics on transaction card activity suggests that before long the number of monthly credit card purchase transactions will exceed the number of debit card purchase transactions. It would be very difficult to see such a development as being in the public interest.

One further wonders, however, what 'regulatory forbearance' might be an essential precondition to the major-bank plans unfolding.

One implication is that the four major banks are developing the plans under the auspices of the ABA rather than APCA (where many would think this sort of industry cooperation belongs). Working through the ABA might suggest that what the banks have in mind is an arrangement in the mold of the BPay and credit card schemes -- 'cooperative' industry arrangements not registered with the ACCC, nor, apparently, tested for their appropriateness against public-interest criteria.

Are the banks saying 'our way, or no way'?

BPay

The banks have also been doing an active articles-in-the-press, marketing job on BPay -- consider the following extracts from recent press reports:

BPay was the next giant leap. It allowed consumers to break out of this closed-circuit

environment to pay their bills to corporations that banked elsewhere.

Until BPay's introduction in 1997, 70% of household bills were paid over the counter. It has also got rid of the need to write cheques, address envelopes and look for postage stamps. BPay transaction fees vary from institution to institution. Some banks include it in their free-free transaction limit, charging about 55 cents to 60 cents thereafter. National Australia Bank charges 40 cents for each transaction. But whether its 40 cents or 60 cents it still cheaper than the cost of 45 cent local stamp and envelope and a lot less stressful than the alternatives. For further information check out the BPay website.

Guess the (not 'which') bank this journalist was talking to.

EXTRACT 5

MARCH 2000, DISCUSSION PAPER

"CREDIT CARDS: THE BANKS AND THE PARLIAMENT"

What's wrong with credit cards?

The indictment of banks' credit card business ranges widely over a litany of questionable pricing and marketing practices that are against the public interest. It is not a judgment that required a 12-month study to make confidently and correctly.

Among other things,

- Banks encourage their customers to use 'free' credit card transactions rather than their EFTPOS, debit cards. The customers are, however, not told that credit card transactions attract high fees which, though paid by retailers, are recovered from customers in higher retail prices. Individual customers are pitted against customers generally in a game where customers generally finish up worse off and the banks better off.

- In 1996 the number of EFTPOS (debit card) purchases was running 50% higher than the number of credit card purchases. The difference, in favour of debit cards, was expected to widen -- in fact it has now been eliminated. This observation is one persuasive indication of the failure of the market for retail banking services to function properly in the general public interest.

- Often, both a customer's 'credit card' and 'debit card' is on the same piece of plastic. It is fair to ask why customers often choose to use the credit function -- and typically reward the banks with a collective $2.50 -- rather than the debit function -- for which the collective reward to the banks is typically some 50 cents? This wonder of modern marketing is apparently the stuff of fashionably languid discussion. One could think that the customers may be being misled or that they are not properly informed.

- Customers may want a line of credit -- an overdraft -- attached to one or more debit card accounts but, generally, such a cheaper linked credit and transaction facility is withheld from them. In the context of modern banking technology the credit card has hallmarks of a contrivance

- For typical credit card customers, the much-touted '55 days free credit' is an illusion. The customers pay for 'credit' on these card accounts in both direct and indirect ways -- and usually at high rates of interest. For example, annual fees are usually charged only on credit cards that offer 'interest free' concessions and these cardholders pay a penalty rate if they do actually borrow. Some credit card products offer no 'free' credit period at all and one hybrid (Visa Debit) does not permit cardholders to take credit at all, only to access deposit funds: the banks still take high transaction fees as if they did genuinely allow a 'free' credit concession.

- 'Hidden' high fees -- 2% or more of purchase values -- are uniformly charged for 'free' credit card transactions and make these transactions very profitable for banks and conversely, very expensive for retailers and customers.

- Credit card accounts are the only customer account with banks able to be used for making purchases over-the-phone or online (on the net) -- this notwithstanding that when on-the-phone or online only an account number is quoted and the physical card is irrelevant. This credit-card-only rule is of considerable benefit to the banks but a costly disadvantage to retailers and customers.

- Credit card customers are made to 'feel' responsible for fraud on their account. The fault lies with banks choosing to run the risk of credit card fraud by not putting secure customer identification systems in place. It is somewhat ironic that the susceptibility to fraud is, technically, the main feature distinguishing credit cards from debit cards.

These objectionable practices and outcomes are underpinned by a remarkable arrangement. Banks as card issuers are members of associations (Visa and MasterCard) that set the operational 'rules' binding on the members in their dealings with card-users and retailers. Not surprisingly the rules set by the associations favour the commercial interests of their members, especially the pricing provisions relating to interchange fees collected by card issuers. Credit card business is very profitable to the card issuers. Card issuers receive fees of about 1% of the value of all credit card purchases, this over and above substantial service fees charged to retailers, and account fees and (high) interest rates charged to customers.

A particular focus of concern, however, is that because credit card transactions are so profitable, banks withhold from the community cheaper and better (but less profitable) services. The deadweight cost of the credit card business is high.

On any reasonable interpretation of the spirit (fair play) and purpose (overall efficiency) of the law on trade practices, prevailing industry credit card agreements are against the general public interest.

It will be interesting to see, first, if the appointed regulatory authorities -- the Reserve bank and the ACCC -- make a similar assessment and, second, how they propose to fix the situation.

Why are official reports being done now?

The credit card product is not new; it has been around for many years.

The problems -- systemic inefficiency, deadweight costs and unfair trade practices -- have been widely recognised for many years. However, not only was nothing effective done to rein in the excesses of credit cards, but the problem has grown progressively bigger.

In recent years banks (and their card associations) 'refined' their terms for credit card business so as to make it ever more profitable for the card-issuing banks and ever more costly for retailers and their customers.

What has prompted the regulators to now undertake studies and investigations? Ironically, it seems it was market developments following the introduction of customer "reward" schemes in the mid-1990s. The customers were seduced by the reward of a few cents and stepped up their use of credit cards.

In the event this 'marketing' initiative may have been the proximate undoing of credit card issuers and promoters.

The regulators form guide

The form guide for the relevant regulators in dealing with credit cards is not good. It is sufficiently 'not good' to put observers on notice to be only cautiously optimistic about the likely findings of their credit card studies.

The regulatory bureaucracies are in something of a spot. They will not be keen to be taking action on credit cards now that observers may say they should have taken some years ago.

One has every right to be cautious about the wisdom of using the same judges that acquitted the credit card product previously, to now find charges proved on the same evidence.

Nor has the senior judge on this bench been silent on related matters in recent times.

Some indication of the lack of a sense of regulatory purpose can be gleaned from the Hansards reporting the contributions of the Reserve Bank Governor before the Parliamentary Banking Committee in June and November 1999. The Governor of the Reserve Bank is also Chairman of the Payments System Board.

One question is whether the community can regard these contributions as indicative of someone taking their legislative responsibilities to heart.

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What to do next?

Respected opinion here, and now abroad, raises the question of Parliament reconsidering the legislation allocating responsibility for the Payments System Board to the Reserve Bank.

The key question is what framework for regulatory oversight will most effectively deliver the efficient retail payment system that the community is fairly entitled to. The traditional model of newly chartering 'old regulators' (the RBA) to do jobs (regulate the payment system) that they were previously asked to do but did not do properly, seems to have flaws.

The PSB, formally established for some two years now, should perhaps be given some new-start allowance. Against that it is recalled that the Reserve Bank was for many years responsible for the Australian Payments System Council, a body with a similar charter to the PSB. The Reserve Bank also provided the chairman and a member of the board of the payments industry body -- the Australian Payments Clearing Association -- from its inception in 1992 until 1998: it retains membership of the APCA board that purports to have a broadly similar mission to the APSC and PSB. Equally many would assess the trade-practices problems inherent in the credit card business to have been fairly within the range of the ACCC for many years.

In looking for explanations for past regulatory performance, it is worth paying close attention to the recently published report of the "Review of Banking Services in the UK".

In a very telling critique of the apparently, similar historical performance of the UK banking regulators, the Cruickshank Report highlighted the "old contract" between the banks and government regulatory agencies. The Report suggests that under the terms of the 'old contract' the regulatory agencies responsible for regulating the banks, in effect protected the UK banks from competition in a featherbedded exchange for a quiet life and stability of the banking system.

In seeking to have the 'old contract' revoked, the UK Report called for the establishment of a new Payments Commission which would be independent of the regulators that were party to the old contract with banks.

This bell tolls for Australia also. The composition of the PSB does not meet the test of independence of the old contract: -- on the contrary.

EXTRACT 6

MAY 2000, ARTICLE PUBLISHED IN AFR

"CREDIT CARDS: A CLEAR MESSAGE FROM THE UK"

Banks' credit card business has been slated for fundamental reform in a *"Review of*

Banking Services in the UK".

The report is a wake-up call for Australia where benign regulatory attitudes to banks' credit card business are being reconsidered in the course of 'studies' and 'investigations' by the Reserve Bank and the Australian Competition and Consumer Commission.

The UK assessment was politely understated, as one might expect of a report drafted in Her Majesty's Treasury, but banks' credit card business received a right, royal bucketing.

Readily understood are judgments like -- *the major banks have control of all the UK payment systems -- the interests of bank run schemes do not coincide with the public interest -- retailers, especially small retailers, pay too much for the facility to offer credit card payments.*

Not so widely understood in the wider community is the focal point of the pricing of credit card services -- the so-called 'interchange fee' paid to the bank that issued the card for purchases made with a credit card. The interchange fee averages some one per cent of the **value** of credit card purchases ($60 billion annually in Australia) and, though paid by retailers, reflects in higher retail prices charged to customers generally.

The problem with the level of interchange fees was said to be most severe in the Visa and MasterCard credit card schemes and the Visa Debit scheme. Both schemes (effectively owned and run by the major UK banks) kept secret the details of the 'cost studies' on which the fees are based. An academic study concluded *the interchange fee is a tax on retailers reflecting the market power of the main credit card schemes.*

Examining the categories of 'costs' that card issuers say they incur, for justification of this impost on retailers, the review concluded, *"a highly sceptical view should be taken of all costs included in interchange payments".*

A key element of that judgment concerned the cost of the 'interest-free period' offered on some credit cards. The report said -- *Of the cost categories identified as being supplied by card issuers to retailers, the funding of an interest-free period for credit card customers is, by some way, the least justifiable. The supply of credit to holders of credit cards (including the first fifty or so days) is fundamentally not a payment service supplied to retailers. Rather, it is a credit service supplied by credit card issuers to credit card holders.*

The new regulatory regime proposed for credit card business would allow non-banks (e.g.: retailers) access to these network schemes as both 'card issuers' and 'transaction acquirers'. In addition, interchange fees would be set in a transparent way based on estimates of eligible costs, which would not include the cost of supplying an interest-free period to customers.

Comparable reforms in Australia would put some $600 million per annum directly on the table for redistribution from the banks to retailers and their customers.

How did these things get out of hand?

The inappropriate pricing of banks' credit card business is not new. A notable contribution of the UK review is the explanation given for the failure of the UK regulators to deal effectively with credit cards and other similarly evident problems, previously.

The review team identified 'an old regulatory contract' that set the terms of the close relationship banks have traditionally had with government. Under the 'old contract', government exchanged privileges for banks for cooperation in policy-making. The privileges banks are said to have received included effective barriers to the entry of new retail banks, high profits and being allowed to write their own rules against the wider public interest. This assessment no doubt strikes a sympathetic chord with many in Australia.

In calling for a new regulator to be established for the UK payment system, the report recommended a body that would be independent of all parties to the old contract.

What's in it for Australia?

Having inherited a typically British banking system and associated 'old contract' attitudes to its regulation, it would be some redress if the Australian authorities were to endorse the reforms proposed for credit card business in the UK.

Looking back on a decade or more of regulatory forbearance in dealing with well recognised shortcomings of credit card schemes, the 1997 Wallis Report on the Australian financial system offers some solace -- it was on the right track about credit cards. Hopefully the current rethinking at the Reserve Bank and ACCC will press the case for change more resolutely.

On the bright side, reform would set the scene for a redistribution of market power in the conduct of retail banking. Retailers (and their customers) would be the main first-round beneficiaries.

There would be second-round effects. The credit card business has had a pernicious effect on the efficiency of the retail payment system, including stifling e-commerce. A contestable market, including newly admitted 'card issuers' and 'transaction acquirers', would stimulate competition bringing better and cheaper transactions across open retail networks.

Banks will re-work their retail payment strategies. The credit card could be restructured as a universal debit card with the option of an overdraft, line-of-credit. Banks, no longer cosseted by their credit-card-only rule for online shopping, may well look afresh at the potential for electronic 'web' money and stored-value smart cards.

There would be some movement at the station, and not before time.

EXTRACT 7

JUNE 2000, CONFERENCE PAPER

"FRAUD-FREE AND EFFICIENT TRANSACTIONS"

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***old-economy* instruments: inefficiency with fraud**

Credit-cards (the hybrid)

(a) fraud

The Sydney Olympics will see an at-home demonstration of what most distinguishes credit card transactions now -- their susceptibility to fraud. The account information stored magnetically on credit cards can be copied (scamed) and 'authentic' signatures added.

Banks only bear the cost of fraud using counterfeited credit cards at the point-of-sale. Not only do they deserve little sympathy they probably warrant censure for not replacing signature authorisations with secure electronic alternatives such as PINs . Banks only allow credit card fraud in retail purchase transactions -- cash advances from ATMs require PIN authorisation. Continuing with a system so readily subject to fraud reflects a manageable incidence of actual fraud on banks coupled with a sufficiently profitable scheme to enable the costs of fraud to banks to be buried with little enduring consequence.

The irony is that banks cannot 'afford' to make credit cards fraud-free, at point-of-sale. If they did it would point up the contrived character of the product and presage a restructuring of the way banks link credit to a transaction instrument. Forcing customers to take tied-sale, 'free' credit when simply making a transaction underwrites unreasonably high, and hidden, prices for the service. More generally the costs of running credit card schemes unnecessarily duplicate the costs of running the safer debit card schemes which can easily substitute for credit cards.

(b) inefficiency

As with cheques, the banks' costs of operating credit card schemes are subsidised from the public purse. To the extent that the 'free credit' is anything more than an illusion, the process involves converting a tax-deductible business expense of banks into a tax-free income component for the borrower. If the value of the free-credit were counted as taxable income in the hands of the borrower, credit cards would soon give way to debit cards with a line-of-credit. Already most credit cards have no effective access to 'free credit' anyway, but all credit card transactions are priced as if they all do.

The EFTPOS system is already in place nationally and increasingly, internationally. It is simply remarkable that the much more highly priced (and susceptible to fraud) credit card is still widely used in these circumstances.

The continued popularity of credit cards is emerging as a real embarrassment to the regulatory authorities.

The signature-authorised, credit card is well past its use-by date. Slowly but surely the 2020 sights on the armory of public policy are being more sharply focused on the industry agreements supporting the credit card. . Expect to see some action on this front from the RBA/ACCC in the near future -- and as a by-product, less transaction-card fraud.

Those interested in supporting views could peruse the report of the recent *UK Banking Review* where a generally polite report drafted in Her Majesty's Treasury nonetheless gave the credit card product a right royal bucketing.

credit-cards-only!

Of more contemporary concern is the industry-dictated exclusivity which credit cards enjoy for remote -- *over-the-phone and online* -- purchases. Without a signature to authorise the transactions, retailers are vulnerable to losses from charged-back, disputed transactions and customers to the inconvenience of awaiting the resolution of disputed transactions. These risks of loss and inconvenience could be greatly reduced if banks' risk management systems required passwords over the phone and used securely encrypted communication for online trading.

It is important to note in the context of remote transactions on card accounts, that the card is, of course, not relevant because it is not presented -- simply the account number is quoted, and that 'number' could just as easily be the number of a customers' debit-card account. The same unwinding rules could apply to 'unauthorised' transactions on debit cards as apply to credit cards. The credit-card-only rule for remote transactions does not reduce fraud -- it bolsters the profitability of the banks at the expense of retailers and their customers

***new-economy* instruments: "no fraud" - very efficient**

--the Bpay 'stunt' (a digression)

In was in anticipation of public-policy inspired reforms to the direct transfer system (that the banks did not want) that the banking industry in 1997 developed a competing direct transfer system known as Bpay. Under the Bpay scheme, participating billing organisations append a Bpay reference number to their accounts and paying customers quote that number when paying bills over-the-phone or online, usually by direct access to an ordinary deposit account. This arrangement protects customers against fraud and, in concept, it is a step in the right direction. It has some shortcomings, however, compared with direct transfers, including:

- the need to make a phone call has both a cash-cost and time-cost, and some banks charge paying customers an additional transaction fee that usually does not apply to an automated direct transfer: and

- the Bpay arrangement has the same -- industry-agreed overpricing -- hallmark of the banks' credit card schemes. Indeed there is good reason to suspect that a BPay transaction may be over-charged for, twice. The billing organisation pays a collection fee and the customer may also be charged an account transaction fee -- and it is very likely that both Bpay fees, individually and collectively, far exceed

the nominal fees associated with direct transfers.

(Note: references to 'credit cards' should generally be read to include 'Bpay' because the arrangements underlying both have elements of industry-agreed pricing structures that are likely to be against the public interest).

rebalancing 'rights' and 'obligations'

Because the customer is always right, retailers are left with the cost of customer dissatisfaction. That holds for both old and new economy transactions and, in general, it is a fair and unavoidable outcome.

Complexities arise when the transaction is fraudulent and the fraud relies on deceptions permitted by weaknesses in banks customer-identification systems.

Retailers accepting 'dud' cheques get what they deserve -- sympathy but no relief.

For in-person, card-present transactions retailers are at no risk with PIN-authorised, EFTPOS transactions. That same level of protection would be available for the 85% of credit card transactions captured electronically in point-of-sale terminals -- provided the authorisation was by PIN not 'signature'.

Remote, card-not-present transactions made online and over-the-phone will continue to present difficulties for retailers unable to clearly identify customers as the owner of the accounts against which sales are charged. The solution mainly lies in the implementation of technologies, especially end-to-end message encryption, permitting the secure transmission of PINs or supplementary coded-keys. Suitable technologies are becoming available.

A particular issue however concerns the banks' credit-card-only rule for remote, one-off, card-not-present, transactions. This rule suits the banks and no one else. It is against the general public interest and should be rescinded -- not least because it would stimulate banks to implement security protocols superior to simply charging back disputed transactions to retailers.

At worst the credit-card-only rule is an arrangement motivated by the high transaction interchange fees paid only on credit card transactions. Retailers (and their customers) would welcome the opportunity to not pay the 1% or more of transaction values typically paid to the issuer of the credit card.

It would seem reasonable for public policy to intervene in the market to achieve this.

EXTRACT 8

JULY 2000, COMMENT ON ACCC DECISION

"BANKS GET A CONCEDED PASS FROM THE ACCC"

The ACCC has drafted a determination to authorise the "Regulations and Procedures

for the Consumer Electronic Clearing System" proposed by the banks in respect of ATM and debit card, EFTPOS, transactions.

Because the banks' proposal is not the optimum in the public interest, there is an undertone of reluctance in the draft determination. However, it seems the banks must be given a conceded pass because the ACCC is unable to require appropriate amendments.

A 1998 decision by the Australian Competition Tribunal (the '7 Eleven' case) said of the role of the ACCC in authorisation matters:

"… the Commission's role is not to design for others business arrangements that can be authorised, nor insist on optimum arrangements before granting authorisation, but rather to assess formally whether some proposed conduct that might breach the provisions of the Act yields a net public benefit and therefore can be authorised."

Networks are emerging as key features of the new economy but risk reviving some old problems that gave rise to anti-trust laws. Network alliances have features of cartels fostering the private interests of their industry promoters. The private benefits are less if new entrants can join the network and more if the network agreements provide for uniform pricing of network services.

The community can benefit considerably from industry networks, including bank transaction networks. The issue is whether network agreements may include unnecessary 'erosion' provisions contrary to the public interest, provided only that the attendant loss does not outweigh the gross benefit. On the face of it, a net-benefits test is contrary to good public policy suggesting the need for changes to allow the ACCC to require industry agreements to be structured to optimise the net public benefit. The ACCC stops short of making forthright judgments on questionable aspects of the banks' proposal and otherwise does not call for sufficient authority to better protect the public interest.

The proposed CECS rules unnecessarily impede new entry and protect uniform pricing arrangements from public scrutiny. The public interest in the CECS would be greater if the rules were:

- comprehensive and embraced the credit card and BPay schemes that are key elements of the consumer electronic clearing system rather than restricted to the partial coverage of ATM and debit card transactions;
- re-cast to supplement mirror-image bilateral agreements between banks with provisions for eligible new card issuers and transaction acquirers to sign on as members at a central point;
- extended to permit real-time gross settlement of card-issuer liabilities (or a close approximation - intra-day batch settlements secured by collateral) to facilitate the participation of card issuers that are not authorised deposit taking institutions supervised by APRA; and
- extended to allow the managing committee of CECS (among others) to oversight arrangements for pricing interchanges of network services that are likely to have elements of uniformity, including common provisions in otherwise bilateral agreements.

Not being authorised has not stopped the consumer electronic clearing system operating in recent years and, with much attention now being focused on banking industry agreements thought to be contrary to the public interest, it seems premature to legitimise now an agreement that is not considered optimal.

A major attraction in banking networks is the scope for price fixing likely to be contrary to the public interest. The ACCC sought (in 1997) to require amendment of the CECS rules to require banks to implement efficient pricing principles but now says it received no support for pursuing that objective. Notably, the Reserve Bank, now nearing completion of its study of interchange fees for debit card and credit card transactions, "considered that there was insufficient information to allow a judgment on this matter" -- their position may be clearer soon. Notably also, other disclosed votes 'against' were lodged by Coles Myer, Telstra and the ASX -- not usually a preferred electoral subdivision for resolving public policy issues about networks. The NAB and Commonwealth Bank "considered that interchange fees should continue to be set through market forces and that no regulatory oversight of interchange pricing was justified" -- but, as sponsors of the proposal, they would say that wouldn't they. It is not evident that the general public interest was properly considered.

The acquiescence of the ACCC in respect of the CECS banking industry agreement points up the lack of accountable responsibility for protecting the public interest in the way the banking industry operates. The draft determination flags that the public interest may be enhanced if the Reserve bank were to use its powers of intervention in bank transaction systems.

This general climate of regulatory forbearance is not good in any event. Importantly, however, it risks an eventual destabilisation of the local banking industry, as the authorities in the UK are, for example, increasingly aware. Free trade in financial services and modern communication technologies make it less relevant whether transaction accounts are conducted in local bank branches or in processing centers overseas managed by international banks of undoubted financial standing.

Generally it makes sense for Australia to take opportunities as they arise to ensure the Australian banking industry operates on a footing that is in the public interest and likely to be durably competitive in the 'new' international economy. One may have hoped the ACCC would have made a better fist of this opportunity -- asking for the additional powers it needs to get a more optimal outcome or, alternatively, negotiating with the Reserve Bank under their 'memorandum of understanding' to use its powers to the same end.

EXTRACT 9

JULY 2000, DISCUSSION PAPER

"BANK NETWORK TRANSACTION FEES"

CONTINUED MONOPOLISTIC COOPERATION

The prevailing credit card schemes -- Visa and MasterCard -- are cooperative industry network arrangements with a contentious feature. Uniform interchange fees averaging 1% of purchase values are paid to credit card issuers. Uniform pricing arrangements are also in place for network transactions in the BPay scheme as well as for EFTPOS and ATM transactions.

The banking industry in Australia wants to extend credit-card interchange fee structures to other products -- debit cards now* and eventually electronic money products like Mondex.

It is in the collective interests of banks to be members of network credit card schemes, such as Visa and MasterCard. These and like schemes cooperatively monopolise the business, charging retailers and customers interchange fees on credit card transactions -- and other network products -- that are excessive in relation to the costs of providing the services.

Visa and MasterCard cannot pay different interchange fees to card issuers lest members only issue the card that attracts the highest fee -- if there were competition for network business the result would be increases in interchange fees against the public interest.

Generous interchange fees have a perverse effect, encouraging banks to withhold (and deter the use of) cheaper and better transaction services. For example, banks prefer credit card transactions that return them high interchange fees, rather than debit card transactions that do not*. Banks discourage customers making debit card transactions by charging them explicit fees for them -- while promoting credit card transactions (misleadingly) as fee free. Similarly the BPay facility which also has hidden fees is promoted against the cheaper, pre-authorised direct debit system.

The upper limit on interchange fees for network transactions is set by the cost of customers and retailers using alternative services -- usually cheque and conventional cash transactions that are costly for customers to use. Cheque and cash transaction services are also expensive for banks to provide. However, banks' costs of providing these services are not usually recovered directly -- and consequently cheques and cash are overused. Banks' costs for cheque and cash transactions are largely covered by cross-subsidies originating in the under-payment of interest on deposits -- including the substantial tax break associated with tax-free bartering of "free transactions" in lieu of taxable interest on transaction account balances.

-- the tyranny of the status quo

Once unreasonable network-pricing arrangements are well established -- as they are with credit cards -- it is difficult to re-establish them on a sounder, more equitable footing. If credit card issuers were deprived of the current interchange fee revenues -- now some $600 million p.a. in Australia -- the consequences for bank share prices would be noticed. And credit card interchange fees is just one aspect.

Against that the industry seems to be offering to continue providing, often free of charge, wastefully costly cheque and cash transactions unless they are permitted to

charge excessively high fees for better, more efficient network services -- debit cards and Bpay direct transfers (and, eventually, electronic money).

--a dangerous house of cards

Maintaining the status quo with credit card interchange fees and even extending it to debit cards, may be a short-term option but fallout from the eventual revolution is likely to be notable indeed.

The idea of a revolution in the transaction service industry is likely to first come to fruition in Europe. The retail transaction industry in the UK (akin to that in Australia) is vulnerable to a takeover by other European banks that rely mainly on direct transfers and debit cards and largely eschew cheques and credit cards. The market for phone, internet and point-of-sale transactions in the UK is now potentially contestable and, not surprisingly, the UK authorities are moving to put more durable commercial foundations in place.

Free trade in financial services and the globalisation of retail banking markets is not something that the authorities responsible for financial stability can reasonably ignore. Looking ahead it will be preferable if the foundations of Australia's retail transaction networks are solid and not the fragile foundations of monopolistic price setting propping up a house of cards.

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-- no interchange fees at all?

Both retailers and customers benefit from network transaction schemes -- any card, any place. At issue is whether the beneficiaries could be charged separately and the interchange fee dispensed with i.e. retailers pay merchant sponsor banks for acquiring the transaction and card users pay the card issuing banks for facilitating the withdrawal and transfer of funds.

However, merchant sponsor banks may feel entitled to a switching fee for delivering the transaction to the paying bank; and paying (card issuing) banks may feel entitled to a separate fee from the retailer (via the merchant sponsor bank) for paying up. Interchange fees may be the commercial "glue" that keeps the network together.

That there may be a basis for a small net interchange fee on network transactions is not the main issue. Rather the debate is about whether the elements of cost reckoned in the assessment are reasonable. In this context, a recent UK review of retail banking practices was very sceptical of the cost elements banks claimed to justify interchange fees on credit card transactions -- and rejected outright banks claim for retailers to cover the cost of any free credit banks chose to give to their customers.

The case for interchange fees in established networks is not strong. Merchant sponsor banks can recover their switching costs in fees charged to merchants. The remaining issue is whether card issuers would withdraw from the network if they were (collectively) denied fees sourced from retailers and relied instead on fees paid

directly by their customers. It is unlikely that card issuers would withdraw from an established network risking a loss of customers then unable to access their funds when shopping.

It will be interesting to see if the RBA/ACCC seek to justify uniform interchange fees remaining in established networks for credit card, BPay and "foreign" ATM transactions.

More generally this is not a new question. The community already relies on networks to deliver, among other things, a range of print and broadcast media services and a range of privatised utility services for transport, telephones, water, electricity, gas etc. There may be examples of payments being made from upstream players in networks to downstream players for delivering network services to their customers -- if so, those examples may be relevant (and vice versa).

EXTRACT 10

NOVEMBER 2000, LETTER TO AFR

"TIME BANKS GOT A GRIP ON FEES"

The pressure on banks' credit card schemes is building internationally. The European Commission recently put Visa members (among others) on notice that their "collective price agreement" on interchange fees is, prima facie, contrary to the anti-trust rules of the European Commission. That adds weight to similar conclusions reached this year in the UK and Australia.

The NAB's Mr Cicutto says the credit card arrangement is of long-standing, but that is no defence of an agreement not registered with the trade practice authorities for assessment against 'public interest' criteria. Would Mr Cicutto be similarly prepared to enlighten the wider community about the pricing arrangements underpinning the banks' BPay scheme that was introduced in 1997?

EXTRACT 11

NOVEMBER 2000, DISCUSSION PAPER

"RETAIL BANKING -- WHAT NEXT? 10 QUESTIONS"

Over the past few weeks the principal regulators of the retail payments system reported on some issues arising from the 'study' of credit card interchange fees and other matters and in the annual report of the Payments System Board. Banks' 'social obligations' have also been discussed in the media. There have been related developments overseas.

Some of these issues will be discussed when the RBA Governor meets with the Parliamentary "Banking Committee" on 1 December.

Who now accepts responsibility for what?

The legislation allocating responsibility for different retail payments system matters is reasonably clear but some apparent residual confusion between the regulatory agencies remains.

Among other things:

- the Australian Securities and Investment Commission has accepted responsibility for policy issues about bank fees that are related to "conduct and disclosure" matters but not for assessments of the 'quantum' (or level) of banks fees and charges;

- the Australian Competition and Consumer Commission has reportedly said that it is powerless to investigate bank charges, but that allegations of collusion between the banks to fix fees would result in an immediate investigation by the ACCC;

- the Commonwealth Government was reported to have considered holding a broad inquiry into the matter (banks fees) but, according to the ACCC Chairman, "they have said there won't be one".

This would seem to leave the onus on the Reserve Bank for overseeing the level of bank fees, except as they may be fixed by the industry collectively and inappropriately.

Not only card networks

There is a range of retail banking and payments system issues needing attention apart from 'cards'.

Among other things:

- many feel that the major banks' no-card BPay network scheme is likely to have some elements of pricing policy akin to those found unacceptable in the credit card network. Some reading the RBA/ACCC report on 'interchange fees' would have been surprised to be told on page (i) of report, that "interchange fees are unique to card networks";

Question 5.

Are interchange fees levied on BPay transactions?

.....

The credit-card report

Though long overdue and long in production, the eventual report of the study of interchange fees in banks' card transaction networks was a milestone. It was the first report prepared and published by a central bank that was roundly critical of bank credit card schemes and related matters.

Having looked, the Reserve Bank found the (un)expected evidence of ***"gouging going on"*** and some scope to revise an earlier assessment ***"that the community is not saying that they are horrified".*** As well, the report exposed abuses of market power by 'pillars' of our society.

That said, however, it was disappointing that the Reserve Bank (and the ACCC) could not bring themselves to clearly state the distilled essence of their study -- that is, in my view,

> **the credit card product is now more properly regarded as a redundant contrivance against the public interest that should be displaced by debit cards to which a line of credit might be attached and in respect of which transactions no interchange fees would be payable.**

Four brief extracts -- from an unnecessarily complex report -- are reproduced on the 1 page attachment to this paper: these assessments written in the Bank's own hand would reasonably have allowed a conclusion of redundancy to be drawn.

Having done so would have obviated debates on, among other things:

- the "cost" of the unnecessary "free credit" forced on credit-card customers;
- the nonsense of a "credit card only" rule for purchases over the phone and internet (when the card cannot be present); and
- point-of-sale security, as PINs and secure 'card present' protocols replace manual 'signature' authorisations that are conducive to fraud.

Much the same view would also seem to be held by the competition authorities in Europe and by commentators on the situation in the UK. Relevant court cases in the US drag on.

Even so, having exposed bank credit card schemes and related matters to be against the public interest, one might reasonably question any further delay in dealing with bank industry behaviour that is so contrary to the community interest.

Question 7.

What will be done -- and when -- about credit card schemes and the related matters exposed?

Similarly, though this report did not address the BPay matter explicitly, it did do so implicitly and the BPay matter should be addressed promptly.

BPay

Like other bank transaction networks BPay is potentially a very beneficial development for the Australian community. More so once it is developed to allow one-off funds transfers initiated by phone and internet in substitution for costly and

inefficient payments made by cheque.

As it stands BPay is mainly substituting as a higher cost and less efficient alternative to the direct-entry, direct funds transfer system for making regular payments, especially of utility bills.

Like credit card schemes, the BPay arrangement typically involves four parties to a payment transaction. The customer "payer" phones their bank "the account issuer" requesting a debit be made to their account and the proceeds transferred to the biller, "the payee", through the payee's bank acting as " the acquirer" of the payment as agent for the payee.

The BPay organisation has not put on the public record the detail of the pricing arrangements for BPay transactions, especially if the account issuer retains an "interchange fee", before funds are passed through to the acquirer and payee.

The regulatory authorities should ask for these details and, depending on the responses, either reassure the community that the BPay arrangement is in the public interest or otherwise take appropriate action to ensure that it will be.

It is also possible that the 'ownership' and 'participant' structure of BPay and related membership and participation fees has "examinable" elements. Perhaps these arrangements reflect the relative market power of the BPay scheme owners and lesser "participating members".

In thinking about BPay it is worth bearing in mind that the customer pays for the phone call, then does all the work -- punching in the numbers -- 'talking' to a computer that automatically accumulates payment instructions that are probably processed overnight over the direct entry system anyway. The BPay system is a very low cost service for banks to provide that could be being overcharged for twice, if customers are also charged BPay transaction fees.

Question 8.

Does the Reserve bank intend to study costs and revenues in the Bpay scheme, consistent with the work done on banks' card network schemes?

In short, the general idea of the BPay network is a good one but its implementation probably less than optimal at the moment -- especially its role in substituting for direct funds transfers rather than cheques, and its likely excessive profitability.

.....

-- a political challenge

This rosy prospect is additionally dependent on national political leadership able to persuade the community generally that substantial reforms of retail banking operations are essential.

In debate are reforms that will be beneficial to the community in the short-term, but not before the collective hearts and minds of the middle-class welfare community would be arrested by the apparent consequences of explicit, full-cost, prices for transaction services. Explicit, no-tax-break prices that would then be paid by the well-off but, conversely, no longer paid by the less well-off in the community that then alone, would be entitled to have their transaction costs 'subsidised'. A good deal of trust would be required to convince the community that it would shortly have a better and cheaper retail payments system and overall, be much better off.

Building that political trust would probably require:

- the full and frank disclosure, by the Reserve Bank, of the true 'high' cost of the retail payments system now;

- a clear explanation of how the community does now pay every cent of those excessive costs, usually in 'hidden' ways that the community does not understand; and

- establishing the credible prospect of a better, cheaper transaction system once the banks are required to recover their costs in explicit prices.

It would, of course, help this process if the banks were both stopped from overcharging for credit card, BPay and other network transaction services and required to return to the community purse some of the money taken by the conduct of these businesses on inappropriate -- and possibly illegal -- terms.

The chagrin of bank shareholders would hopefully be expressed in appropriate ways to the management personnel of banks responsible for taking the money from the community purse.

.....

THE ESSENCE OF THE RBA-ACCC 'CREDIT CARD' REPORT

Key ingredients for distilling the essence from the report include these extracts:

> *Debit and credit cards are a convenient means of payment ..... however, the two instruments are different. A debit card is a method of accessing a transaction account..... funds (are) taken from that account at the time the transaction is made. Such accounts might include an overdraft limit .....a debit card provides a pure payment service..... A credit card, on the other hand, provides a payment service and a credit facility; the latter usually involves an interest-free period before the account needs to be settled and a pre-approved line of credit, often called a revolving line of credit, on which users pay a rate of interest. (P. 8)*

> *Removal of the interchange fee would have implications for one card product -- the Visa branded debit card. This card .....allows the cardholder to choose to press a 'debit' button and use a PIN, or a 'credit' button and sign for the*

transaction..... whichever button is selected, the funds are drawn from the customer's deposit account. The interchange fee flow is quite different. If the debit button is selected, the issuer pays a flat interchange fee to the acquirer ..... If the credit button is selected, the acquirer pays the issuer the much higher, ad valorem interchange fee set for credit cards by Visa scheme members..... Not surprisingly, (issuers) encourage their cardholders to select the credit button..... By encouraging customers to select the credit button, issuing institutions are being over-compensated for what is, to all intents, a debit card transaction.(P.70)

A major consequence of current interchange fee and access arrangements in Australia is that the credit card network has been encouraged to grow at the expense of a less costly alternative, the debit card. (P. 76)

In summary, the pricing of retail payment services in Australia, in which interchange fees play an integral role, is distorting the payment choices facing consumers. The beneficiaries are credit cardholders using the credit card purely as a payment instrument .... and financial institutions which ..... earn substantially higher margins from the provision of credit card services than from debit card services. (P. 78)

To my mind, the distillable essence from these conclusions is:

the credit card product is now more properly regarded as a redundant contrivance against the public interest that should be displaced by debit cards to which a line of credit might be attached and in respect of which transactions no interchange fees would be payable.

Just why the Reserve Bank could not clearly see and say the essential conclusion probably reflects the history of this matter not being properly dealt with previously.

EXTRACT 12

DECEMBER 2000, OPEN SUBMISSION TO: THE ECONOMICS, FINANCE AND PUBLIC ADMINISTRATION (EFPA) COMMITTEE;THE RESERVE BANK OF AUSTRALIA;THE AUSTRALIAN COMPETITION AND CONSUMER COMMISSION

"CREDIT CARDS REGULATORY ACCOUNTABILITY"

With a couple of years experience it is now reasonable to propose more effective arrangements to oversee the regulation of transaction services provided by Australian banks.

The latest evidence is the 1 December discussion of payments system matters between the Governor of the Reserve Bank (also Chairman of Payments System Board) and the EFPA ('Banking') Committee of the Commonwealth Parliament. Though this Committee process is well intentioned, good intentions are not enough.

The issues are illustrated by the way the regulatory framework has long failed to deal properly with the banks' conduct of credit card schemes and the subsequent Parliamentary oversight of the regulators has also failed to deliver the accountability for regulatory ineptitude that the community expects. This assessment is not a criticism of the EFPA Committee -- it cannot be expected to compensate for fundamental regulatory shortcomings.

The EFPA Committee will 'report' in the autumn session of Parliament. It is within its brief to propose that the Parliament considers a different approach to the public-interest regulation of retail transaction services.

-- latest developments

In the latest developments, the Reserve Bank has threatened to 'designate' (and regulate) credit card schemes, so as, it says, to avoid the delay and expense it foresees in the ACCC continuing its price-fixing action against credit card schemes in the Federal Court.

Inexplicably, the Reserve Bank did not signal that any action on its part to regulate credit card schemes would be equally subject to judicial review.

It could be expected that the banks would seek 'judicial review' of any Reserve Bank directives that did not suit them and the same legal issues would need to be dealt with in the same courts and with the same delay and expense.

This attempt at a regulatory hijack by the RBA should be rebuffed.

Inept regulatory approaches suit the banks. Against a maximum-ever Australian penalty of $26 million recently imposed for a price fixing offence, the banks are probably 'making' this much each week from various unauthorised schemes involving pricing agreements that are, on the face of it, illegal and against the public interest. Spending a few million dollars on legal fees to make hundreds of millions while the resolution of the issues is frustrated is good business for the banks.

The law can be an ass, but it can also be changed.

A few years ago when a bank shareholder insisted on two board seats, rather than the one 'preferred' by the bank supervisor, the RBA secured specific legislation to get its way and 'adler' the shareholder. One could ask why the RBA (and ACCC) has not similarly sought banking legislation that would 'outlaw' interchange fees that are not specifically authorised by the ACCC. Simply turning the tables in this way would see banks doing the asking for authorisation of interchange fee proposals on public interest criteria. As things stand the regulators appear to be inept and the banks ignore the trade-practices law with impunity, reaping rewards unfairly.

It is time for the banks' determined misconduct of credit card schemes to be 'adlered'.

Why is it so?

The recent focus on banks' credit card schemes is something of a sideshow.

It has been well known on the inside of the regulatory bureaucracies -- the Reserve Bank and the Australian Competition and Consumer Commission -- for at least the last decade, that bank credit card schemes are 'wrong'. That they operate against the public interest with the support of a price fixing agreement that would never be authorised on its current terms.

Turning up the heat on credit card schemes over the past 18 months was designed to remind the regulatory authorities of their need to address a matter that had got out of hand. Left to their private inclinations, it is not clear that anything would have been done. Forced into the open, one (or both) has chosen to be inept.

Long-standing confusion about which regulator is responsible for doing something effective about credit card schemes continues.

Both these regulators are party to a 'memorandum of understanding' about the use of their overlapping powers and responsibilities -- an agreement that is yet to resolve apparently deep seated misunderstandings and bureaucratic power plays.

These regulators' recent public posturing -- each separately 'threatening' banks -- is a regrettable display of public point taking rather than effective coordination. Each regulator appears to want the other to do 'something' while neither is actually effective in using and coordinating the legislative authority that each has, or could have if they asked the Parliament for it.

The Parliament could sensibly decide to bypass the question of -- 'which of these two regulators is more powerful?' -- and create a new Payments Commission regulator superior to both.

On the face of it both regulators would be happy if the banks were to obviate the 'threats' and accept the very public, and often repeated, invitation to negotiate authorisation of their credit card schemes.

Some banks appear to have 'agreed' and are conducting a review of their credit card schemes, presumably to frame an application for authorisation in January 2001.

These banks may, of course, waste the time and frame an unacceptable application for authorisation before joining 'the other' bank in defending court proceedings initiated by either the ACCC or the Reserve Bank.

Bet on this outcome -- the banks would be 'mad' to give in quickly. Their 'superiors' at Visa and MasterCard would be very disgruntled by any voluntary surrender in Australia. Delay is the game -- and banks play this game well. The banks still have all the time-consuming options open to them.

The regulators have only threats. Sometimes the threats are supplemented by supine remarks like,

"I think it is up to the banks to decide which of the paths they are going to go down (RBA 1 December)"

-- remarks apparently unmindful that from the banks' perspective, both the 'confront' and 'conciliate' paths will probably lead to the same tactical delaying game in the courts.

Confronting either the ACCC or the Reserve Bank in the courts is a sensible tactic for the banks -- it accentuates the embarrassing delay while they stand up the regulators. Eventually, banks will be driven to the table to negotiate authorisation but by then having set the stage to minimise the concessions they will be required to yield. And this is where the plot thickens. The following explains.

The worrying prognosis

Notwithstanding that the essential elements of bank credit card schemes were well known to the regulators for a decade, the eventual response was for both to 'collaborate' in the preparation of a report by the RBA on credit card schemes and related matters -- especially interchange fees.

It is reasonable to infer from events to date that the ACCC decided to prosecute the credit card case but were then 'persuaded' in terms of the memorandum of agreement with the RBA, to agree to a 'joint' study. If the ACCC had been confident of this 'study' process there would have been little need to concurrently announce a formal trade-practices investigation.
In the event the inference of ACCC misgivings would have been well founded. The RBA did the 'study' on its own apparently. The so-called 'joint' report undermined the authority of the ACCC.
The preparation of this report by the RBA took some 18 months. During this time the banks would have taken revenues of more than $1 billion to which they were not reasonably entitled. The Australian community has paid a very high price for an unnecessarily complex report, the detail of which very few can comprehend - a report that would have preferably been written a decade ago and written more simply then or now.

The superficial credibility of the report was enhanced by the two-decimal-point accuracy of cost and revenue estimates for credit card operations. The 'accuracy' is spurious given the generally accepted futility of 'objectively' allocating the common costs banks incur in providing a wide range of services using common staff, premises and processing systems. The duplicated 'costs' banks incur operating the substitutable debit card system are especially relevant in this context.

Most credit card scheme costs are discretionary and are inflated by the use of outmoded technology e.g. fraud costs, and by unnecessary 'giveaways' like 'free' credit for which the real cost to banks is grossly overstated. One way of reckoning the 'cost' of banks providing 'free' credit to credit card customers would have been to value the matching benefit to the beneficiaries -- this simple audit was not done. Why not?

The Reserve Bank says it is waiting until it gets all the responses in from affected parties -- retailers, utilities, other billers and consumers -- before taking their next

steps. There is unlikely to be any substantial response from 'affected parties' that have silently borne the brunt of the banks collusive behaviour for decades. The people rely on competitive markets for 'protection' in the normal course. Where, as here, a market for network services cannot be competitive, the people rely on the trade practice regulators to ensure the game is played fairly. Not only was the trust in 'rely' misplaced for decades -- the 'affected' are now asked to comment on a late call.

Moreover the RBA Governor has largely pre-empted alternative views, describing the report as "very thorough" and "as probably the best study of its kind anywhere in the world" and taking "an enormous amount of work". Simple commonsense aside, any local challenger has the job ahead. Nonetheless, methinks the Governor of the Reserve Bank doth protest too much. Spare me such self-praise.

The other 'joint' author of the report has said nothing by way of self-praise.

-- about the report

Among other things it is possible that a rather different historical perspective of the Chapter 1 "Origins …of the Study" will surface one day.

The RBA version of the history is, not surprisingly, self-servingly designed to do four things:

- one, to attribute the start of the interchange fee study to a recommendation in the 1997 Wallis Report -- a proposal that they could not source to any submission from the Reserve Bank that is 'on the record';

- second, to absolve the RBA of responsibility for not previously addressing the issues properly. It could have done so under the auspices of the Australian Payments System Council for which it provided the secretariat and ex-officio Chairman and reported to the Treasurer-- now it says that in 1995/96 the APSC Report simply examined "mechanics" and "rationales commonly put forward for pricing structures" about credit card schemes;

- third, to go one-up on the ACCC by politely referring to previous efforts of the ACCC affiliate, the Prices Surveillance Authority, that reported on credit cards in 1992 and 1995. (One supplementary report of the PSA due to be published in 1996 was unfortunately withheld in the wake of the change of government); and

- fourth, to go two up on the ACCC by noting that only the RBA had the power to obtain information on credit card costs and revenues -- information that "has at all times been kept confidential to the Reserve Bank" and underpinned their control of the drafting of the 'joint' report.

You would wonder why the ACCC appears to have gone along with this process and if the ACCC will hold the line in the logical aftermath -- see below.

You could, however, safely bet that there would be some very interesting 'file notes' of conversations about the 'joint' study and its aftermath between the chiefs and indians in the RBA and the ACCC.

Also consider, for example, two other points.

First, a major element in the credit card debate is the appropriate initial incidence, as between retailers and banks, of the 'cost' of providing unnecessary free credit to card users over a so-called "interest-free period". Notwithstanding that the concept of an interest-free period is now best regarded as an unnecessary contrivance, the Reserve Bank in their final 'analysis' skirted the issue before **'deciding'**,

*"… **in the absence of any objective criteria**, a reasonable benchmark might be to include up to half the cost of the interest free period in the interchange fee".*

(This decision was, however, an improvement on the RBA's previous effort -- APSC Report 1995/96 -- when it implicitly endorsed, without qualification, the banks preference that " ..the merchant is expected to contribute (at current levels) to the costs of the card issuer extending credit to customers".)

This 'decision' is, on a contrary view, simply unsound -- at best it reflects a weakness of intellectual character. It is also at odds with the more sensible 'between the lines' message in the report that credit card accounts should be displaced by debit card accounts with a line of credit.

Coming at the 'logic' of this decision by analogy, the other unnecessary cost 'giveaway' in credit card schemes -- loyalty reward points -- is dismissed from consideration in the report because it is not a 'resource cost'. I give up. Only those that pay their credit card accounts in full by the due date are entitled to any interest-free 'rewards'. The money to so pay on time usually comes from deposit accounts on which, effectively, no interest is paid by the bank holding the deposit -- a simple 'knock for knock', offsetting funds swap with no material 'resource cost'.

Second, page (i) of this report on interchange fees says ".. interchange fees are unique to card networks." -- an assessment at odds with what other insiders know of the Bpay, card-not-present transaction network scheme for bill payments. A significant oversight if the odds favour the 'mistake' view.

-- a second chance for the ACCC

Beyond that the RBA, on 1 December, said

" the only logical conclusion for the banks is that they should go down the path of authorisation. If they go down that path and they make various concessions and come back with a new way of doing these things that the ACCC judges to be in the national interest, then that particular one of the three card schemes would have been resolved."

Now consider what the banks will propose once they condescend to come to the table (25 years late) to negotiate the terms of an application for authorisation of interchange fees that will be 'acceptable' to the ACCC.

You bet -- the banks will rely on the report prepared by the Reserve Bank, exploiting its circumlocution to press for favourable interpretations of things they want -- especially components of 'interchange fees' that the RBA has endorsed.

Game, set and match to the Reserve Bank, apparently.

The ACCC may be wondering what happened. When they do understand they will be asked to 'authorise' a new credit card agreement 'in the public interest'. And the ACCC may have to authorise it on a test of 'net benefit' to the community, rather than testing the public benefit of the separable elements of a curate's egg.

The Parliament may be unaware that it gave more power to the Reserve Bank to regulate trade practices in this field than it gave to the primary trade practices regulator -- the ACCC -- that in the end has to make the decisions. The Parliament may also like to reconsider the limitations of 'net benefits' tests on the 'public-interest' powers of the ACCC when authorising industry network agreements.

The banks would be beside themselves (as is usual). Once they (very slowly) concede a few 'concessions' they are still on a nicely priced winner backed by the Reserve Bank, the self-appointed senior 'judge' of the race.

In case the banks were not clear about what the Reserve Bank was saying to them in the report, the RBA Governor et al has been spelling it out for them. Among the remarks made by the Reserve Bank at the 1 December hearing' were riding instructions for the banks like:

- *if we (the banks) make a few modifications to it, it will be in the national interest;*
- *make various concessions and come back with a new way of doing these things;*
- *in the study, one thing we did do was try to work out what the fee structure would look like if you applied the methodologies which are used overseas; and*
- *we want a response from the industry and we will work with them …*

This is astounding. What happens when the overseas regulators deliver in a few months their foreshadowed changes to the way credit card schemes work overseas (see below). Where is the comparable support for those that may have a very different point of view about the need for interchange fees? Why are only the 'accused' being promised help from the judge?

The ACCC, on the face of it, will have the final say about the terms on which interchange free arrangements are authorised. However, one cannot help feeling that, having lent its name to the Reserve Bank report, the objectivity of the ACCC is now compromised.

Still, one never knows until the 'Fel man' sings -- and he may well be peeved by the run of recent events, he certainly should be.

-- a takeover play by the RBA?

Among other things the tone of the Reserve Bank report and subsequent comments is consistent with the RBA having made a successful takeover of the role of the ACCC in regulating bank trade practices.

The RBA said on 1 December that -- if the ACCC action is to 'take years' and to get 'bogged down' -- *we would have to go back to the Payments System Board and consider whether we would be prepared to let that happen.* A little later the Reserve Bank said -- *if we thought that were going to happen we would designate it* (i.e. directly regulate the credit card system).

This bureaucratic bravado is,

- firstly, ill founded -- because the banks have been waiting to seek 'judicial review' of any Payments System Board directives that they did not like, and that judicial review would take much the same time and resources as the ACCC action: or

- secondly, it is worrying if it implies the Reserve Bank has a mandate to negotiate an 'agreement' that will both be in the public interest and so suit the banks that they will accept it without demur and not seek 'judicial review'.

This line of thought needs to be checked. It is not preferable to the alternative approach of amending legislation withdrawing banks' right to levy any network interchange fees at all unless they are specifically authorised by the ACCC.

The banks could then be given six-months to obtain any necessary approvals.

-- the appeal bench

Commonsense may still prevail anyway.

The competition authorities in the UK and in Europe more generally have put banks in those countries on notice that prevailing arrangements for credit card interchange fees are unacceptable. Some European countries have proscribed interchange fees for many years.

The situation in the UK will not clarify until after the election due mid 2001. The debate in the UK has gone underground in the wake of the Cruickshank report in March 2000.

The Cruickshank report was remarkable for its simple clarity in identifying the soft regulatory treatment banks have received as a consequence of their 'close relationship with government' under the 'old regulatory contract". Noting the (familiar to us) telltale signs in official statements that begin "The government is working with the banks to…" and "The government has invited the banks to … ". Cruickshank went on to make the sensible recommendation that any future regulatory 'dealings' with the banks on transaction service matters be conducted in a new, Payments Commission, framework that is no longer dependent on 'official' parties to the old contract.

Just how the UK government will resolve the obvious conflict of 'official' interest in

central banks balancing 'bank safety' with their 'discretion' to sanction soft income streams for banks will be watched by many. The UK has to deal with bank credit card schemes to fit its banks to survive in a united Europe.

One week after the release of the RBA report on credit cards, **the European Commission** foreshadowed making its decision on interchange fees in the first half of 2001. The UK authorities will be alert to this.

In announcing its intention to challenge credit card interchange fees the European Commission said the credit card scheme operators have

"…. not so far put forward any convincing reasons showing that the interchange fee fulfills the cumulative conditions for an exemption under the EC anti-trust rules, such as that they would be indispensable for the functioning of (credit card schemes)".

In plain English, this sensibly means that prevailing interchange fees for credit card transactions are neither appropriate nor necessary and will probably not be permitted to remain in place.

Ultimately there will be an international correspondence in the way credit card schemes operate (or don't operate) and arrangements in Australia will fit the dominant international consensus. What will the Australian regulators do if the European Commission were to proscribe interchange fees in credit card schemes? How would they explain a 'revised' decision?

One cannot, of course, rule out that the authorities in other countries may reach a similar view to that taken by the Reserve Bank -- but they have foreshadowed that they will not, and the RBA Governor seems to have taken a risk.

Those who would like to have a side bet on the unfolding of this game in Australia could do no better than back an expectation that nothing of consequence will happen until the outcome of the 'war' in Europe is clearer.

Alan Fels is the wild card.

End Piece

As noted, the debate over credit card schemes was always a sideshow. It was about standing up the regulators and that has been done. And as the show developed a side game emerged with elements of a power play between the competing regulatory authorities -- one has stood the other up. The Parliament could deal with this nonsense.

The real game has yet to unfold -- it is about the fundamental reform of retail transaction systems, worldwide. Big bucks are at stake. Big banks are at stake.

On the basis of our regulators poor performance in dealing with credit card schemes, the Australian community has good reason to be concerned. The playing out of the real game may also be delayed and not enjoyable to watch -- and meantime the community will continue to pay, excessively.

Unfortunately, the well-intentioned arrangements in place to ensure the retail banking game is played properly are not working. Private and conflicting interests of at least one of the regulators are impeding the process of developing sound public policy.

A very different approach is called for. Among other options, the Parliament could consider the establishment of a 'Payments Commission' on which present regulators would be represented but which they would not control. An independent Payments Commission would be more likely to ensure that both regulators pursued their legislated responsibilities with a clearer sense of public purpose.

While ever this current farce continues, Australians' comfortable perceptions of cultural shortcomings only in the governance of the financial institutional structures of other countries, are at risk. Australia has a very clearly identified shortcoming or two of its own in this area -- so far it has only been shown that our culture cannot cope effectively in fixing it up.

EXTRACT 13

JANUARY 2001, NOTE

"UK: RETAIL PAYMENTS POLICY"

The UK Treasury recently issued a "consultation document" about regulatory reforms planned for their retail payments industry, following the Cruickshank Report. UK banks are about to be dealt with purposefully.

This development was not widely reported in Australia. A copy of the 'executive summary' and the Minister's press release (as well as this note) is attached. The complete document "Competition in Payment Systems" is at "hm-treasury.gov.uk".

The document is a credible committment to deal with fundamental shortcomings in the operation of the retail payments system in the UK -- especially the collusive misuse of market power by banks participating in payments network arrangements for transaction cards, ATMs etc.,

In the UK, the primary regulator of retail payment systems will be the Office of Fair Trading (OFT) -- the counterpart competition authority to Australia's ACCC. The decision and related restructuring of the OFT, is widely accepted as consistent with the recommendation to establish a Payments Commission in the UK to promote competition and efficiency. Importantly, the role of the Bank of England will be largely confined to 'other' issues associated with financial stability and oversight of payments settlement infrastructure.

Implications for Australia

This is likely to be a significant document for Australia because the policy issues and political context are so similar. Further reform of the regulatory arrangements for retail payment systems in Australia is on the political agenda.

A sticking point in Australia is likely to be the 1998 decision to establish the Payments System Board within the Reserve Bank. At the political level, the Government may feel committed to defending its relatively recent decision. In my view, however, this has not been a satisfactory arrangement. More importantly it is likely that such an arrangement is fundamentally flawed -- as, in my view, the recent Reserve Bank report on credit card schemes, and its aftermath, has shown.

The significant contribution by the UK to this debate is to articulate the reason why central banks cannot realistically be given responsibility for both 'financial stability' and 'competition and efficiency' in retail banking. (In the mid-1990s a similarly insightful UK paper ("twin peaks") was the catalyst in the separation of bank supervision from the central bank in Australia and the UK.)

In essence, central banks' preoccupation with financial stability inclines them to favour uncompetitive banks whose solvency is underpinned by excessive 'soft' profits inherent in conducting transaction accounts -- in particular, deposit accounts on which interest is not paid and collusive price-fixing for network transaction schemes. In short, one cannot expect central banks to deal properly with banking competition issues, because only central banks write cheques to bale out failing banks.

There is, of course, no reason why competitively efficient providers of transaction services cannot also be stable banks or specialist non-banks. There is, of course, good reason why providers of transaction services should be competitively efficient. Without regulatory reforms we will continue to have inefficient and overpriced retail transaction services (e.g. cheques and credit cards) and we won't have the cost effective innovations (electronic money) so necessary to the development of modern economies.

Promoting efficiency in Australia's retail payment system is not a job we can expect the Reserve Bank to do well -- that is what the UK says.

EXTRACT 14

JULY 2001, LETTER TO AFR

'BANKS DEFEND CREDIT CARDS'

Spare a thought for the discomfort of the Reserve Bank under fire from banks "Credit card inquiry was 'flawed'"(AFR July 4). On my assessment, any discomfort of the Reserve Bank is thoroughly deserved. Savour the thought, there is a way to go yet.

The Reserve Bank (and ACCC) long accepted bank credit card schemes without demur knowing that the price-fixing of interchange fees, among other things, was contrary to the public interest. There was always a risk the Reserve Bank would face the consequences of its previous regulatory forbearance. That risk crystallised, in spades, last October in its 'credit card' report.

The banks stand to 'lose' annual revenues of the order of $1 billion when stopped from

fixing interchange fees contrary to the public interest in credit card and other network schemes. The banks are fighting to hold ill-gotten ground -- 'hired guns' are confusing the debate in Australia with a prolix amalgam of economic and legal argument. Reading the bankers' defence is harsh and unusual punishment but for the Reserve Bank, exquisitely appropriate. The Reserve Bank, already compromised in this contest, is 'far from home', among other things.

When the Australian people understand just how the banks' credit card schemes have taken advantage of them for many years, they will fairly be looking to bring to account the 'forbearing' regulators that shirked their task. A 'banking' royal commission is long overdue.

Pending all that, those interested in the public policy debate about credit cards may save a good deal of time by considering the question: "How is a credit card different to a debit card to which a line of credit is attached?". In the correct answer are the words ' it is not different in any material respect'. Other key elements of the answer include that debit cards are not susceptible to fraud and debit card transactions, being completed immediately, require no 'free' credit to be financed by either card issuers or merchants. Equally important, there is no reason to preclude debit cards from either international or over-the-phone transactions, or even claw-back provisions for unsatisfactory transactions.

Most important of all, however, is the Reserve Bank's own assessment that for debit card transaction networks -- "it does not see a continued need for an interchange fee... ".

The question is whether the Reserve Bank will now say this clearly to the banks -- preferably adding, as a 'reward' point, a riposte that the credit card product is now redundant, that it is simply a contrivance against the public interest.

EXTRACT 15

MARCH 2001, DISCUSSION PAPER

"CARD GAMES 2001"

The ACCC has reportedly deferred to the Reserve Bank in the quest to regulate bank credit card schemes.

An interesting question, however, is whether Mr Fels has played an 'ace' or a 'wild card' in this protracted 'cards' game between competing regulators.

I favour the wild-card option and the following explains.

Being 'nice' about it

..... we could take today's press reports at face value and simply accept that the ACCC believes the RBA is better placed to prosecute the banks for the excesses inherent in their credit card schemes. On this view, the Reserve Bank will accept the

responsibility and use the powers of the Payments System Board promptly and effectively to regulate banks credit card schemes in the public interest.

If so, Mr Fels may have played an 'ace' against the banks.

But, being 'honest' about it

..... I do not believe that is the case at all. Some evidence in an already protracted regulatory imbroglio is to the contrary. Perhaps Mr Fels has regained the initiative.

My commentary on issues about credit cards circulated in December suggested that the ACCC had been overwhelmed by the Reserve Bank,

- firstly, by the Reserve Bank dominating the preparation of the 'joint' report on credit cards that appeared 'hard' but was actually soft on the banks and,
- secondly, by the Reserve Bank foreshadowing to a Parliamentary Committee that it was planning to use the powers of the Payments System Board to force changes to credit card schemes (because it 'feared' the ACCC court action would be ineffective).

Mr Fels could be seen to have now 'called' the Reserve Bank to account.

It was at least interesting that the Reserve Bank reportedly "declined to comment yesterday" -- one may have thought they would not have been taken by surprise by an ACCC announcement that, on the face of it, was consistent with their preferences.

It is probably not irrelevant in all this that Mr Fels is due to appear before a Parliamentary Committee next Friday, 30 March, where it may be expected that he will be asked about credit card matters among other things.

Interesting times ahead

The Reserve Bank is not a fresh player on the field in this game -- it has been there all along, even if reluctantly. Along the way the Reserve Bank has expressed views on credit card schemes on the record.

It is a reasonable inference from developments to date that the Reserve Bank is likely to be a softer mediator of issues about interchange fees than the ACCC. Among other things, given the views expressed by the Reserve Bank in its credit card report and subsequently in discussions with the Parliamentary Committee, it is likely to be constrained in its demands on credit card scheme promoters in ways that the ACCC may not have been.

A hard-edged, public interest benchmark would be a view that credit cards should be displaced by debit card accounts with a line of credit and no interchange fees at all. If so the public interest may have been better served by the ACCC doing the authorising of credit card schemes on its criteria rather than leaving it to the Reserve Bank.

The Reserve Bank is now a little exposed.

In part the assessment of the Reserve Bank dealing with credit cards will be made in

Europe by counterparts of the ACCC -- in the UK in particular. The competition authorities in Europe have foreshadowed a rather tougher stance on interchange fees than our Reserve Bank has.

In part also the assessment of the Reserve Bank approach will be made in Australia. In the longer-term, however, it is unlikely that credit card schemes will operate on markedly different terms in different regions of the world.

The Reserve Bank may of course wait until the situation in Europe is clearer.

Whatever way it now unfolds in Australia the ACCC are probably in the preferable position -- the case they would have prosecuted in Australia will be prosecuted in the UK and Europe by their trade-practices counterparts. The ACCC gets a free ride.

The ACCC may also eventually get wider powers in Australia to deal with network pricing schemes.

Before that can happen, however, Australia perhaps has to find out if the Payments System Board arrangements are capable of dealing effectively with trade-practice and competition policy issues in the retail banking industry, as distinct from managing payments settlement arrangements which is the natural habitat of the Reserve Bank. It is worth noting that in the UK the government there has decided to give the credit card job to the competition authorities rather than the Bank of England.

As suggested in the December paper, the banking industry has been waiting for the Payments System Board to flex its muscles. The closer any regulations proposed by the PSB get to the public interest the more likely it is that the banks will challenge any PSB decision in the courts -- as they challenged the ACCC. Indeed any regulatory proposal of the PSB that did not precipitate a legal challenge from the banks would probably be questionable on public interest grounds.

Whatever way one looks at it, the weights have been raised for the Reserve Bank.

Unfortunately, however, whatever way one looks at it the public interest has been shortchanged by ineffective regulatory action and the prospect of a continuing stand-off between the regulators and the banks.

Being sensible about it

..... one may have thought that there was a better approach to regulating retail transaction networks than awaiting the outcome of the manoeuvrings of the competing regulators. This process is proving costly for the general public -- to the enjoyment and enrichment of the banking industry.

One may have thought that these regulators might have jointly reached a view about the shape of appropriate regulation for transaction network schemes; the legislative powers they might need to give effect to it and a joint approach to the Parliament seeking such effective powers.

In essence, the Parliament could proscribe interchange fee arrangements in transaction

network schemes that had not met appropriate public interest criteria set by the ACCC or the Reserve Bank or both, conjointly. The onus could be placed on the banking industry to show that proposed pricing and other agreements underpinning transaction network schemes are in the public interest and otherwise show cause why existing agreements should be permitted to continue in effect.

The point may be semantic but it would seem to make a difference if the banks were required to have prior permission to act collusively rather than putting inappropriate collusive arrangements in place and then defending an alleged right to do so.

One would like to think that time is up for ineffective regulatory action on bank credit card and like schemes. Instead we have the unedifying prospect of a long running farce continuing into the foreseeable future.

EXTRACT 16

MAY 2001, DISCUSSION PAPER

"BANKING BACKDOWN"

.....

(b) credit card schemes

Over many years the Reserve Bank could hardly have made it clearer that it did not wish to embroil itself in the debate about bank fees. However, instead of accepting that attitude, in 1998 the Parliament gave the Reserve Bank a new Payments System Board and responsibility for competition and efficiency in the payment system, among other things. Even after it was given this policy responsibility for banking 'pricing' matters, the Reserve Bank continued to wriggle out of it, suggesting either the ACCC or ASIC do the job. In mid-2000 both these agencies said, publicly, that they did not have the authority to regulate bank fees, but that the Reserve Bank did.

The ACCC did launch a prosecution of banks for price-fixing in credit card schemes but, without clear legislation, it was destined to be frustrated in the courts. Eventually the ACCC decided to give up the price-fixing prosecution provided the RBA would take on the job.

And that recently came to pass -- the RBA has said it will 'fix' the credit card system by the end of 2001.

.....

(b) credit card schemes

A figure of $1 billion is well in the ballpark as an indicator of the annual 'take' by banks as a result of inappropriate pricing in transaction network schemes for credit card, BPay and ATM and EFTPOS transactions.

The attendant misbehaviour of banks has been clearly understood by the banking and competition authorities for many years but no effective corrective action has been taken and no clearly effective powers have been sought from the Parliament. In the latest round, a further four years have now elapsed since the Wallis Committee clearly said that credit card schemes were against the public interest. Further delay -- unfairly 'earning' banks $1 billion per annum -- is in prospect before the Reserve Bank makes it's decisions. And the game could go on as the Reserve Bank's decisions are subject to judicial review.

The point at which the community would be entitled to protest such political and administrative bumbling has well and truly passed.

And more is yet to come.

When the Reserve Bank, after another 'extensive consultation process', finalises its regulatory proposals for credit card schemes later this year it will be too late to complain about the banks being again given very soft handling by a regulator preoccupied with banks' comfortable profitability underwriting their solvency. The Reserve Bank, primarily responsible for the October 2000 official report on credit cards, foreshadowed in that report what it will regard as appropriate criteria for costing and setting interchange fees for credit card transactions. The community has grounds for concern about the Reserve Bank's stated intentions.

The time to complain is now -- or at least shortly after the election.

The appropriate starting point for policy on **any** industry price-fixing agreements is a blanket prohibition, except as the industry obtains **prior** approval that a pricing agreement would be necessary in the public interest. It is not essential that banks continue to have the benefit of an agreement on the setting of substantial, uniform interchange fees in the credit card transaction network. Banks participating in credit card schemes could recover their costs directly from retailers and cardholders.

For starters, the concept of "free credit" (and other 'reward' giveaways) as a cost to be recovered in pricing credit card transactions should be eschewed from any regulatory approval of uniform pricing agreements. So also should "costs of fraud" associated with counterfeited 'signatures' -- a redundant transaction authorisation technology.

The community also has reason to be concerned about the Reserve Bank's intentions to deal with 'credit card schemes' separately from the broader range of consumer electronic transaction facilities. Among other things the so-called 'credit card' is best assessed as redundant, contrived and inferior relative to customers' debit cards, save only for the addition of an overdraft, line of credit. Equally contrived is the required conduct of a separate credit card 'account' for customers to perform certain (high-fee) transactions over the telephone or internet.

More generally, what does the Reserve Bank intend to do about the banks' BPay scheme that has look-alike, transaction interchange fee arrangements? Also, when does the Reserve Bank intend to press its view that interchange fees in the EFTPOS 'debit card' system are inappropriate?

.....

(b) credit card reform

The die is now cast for the 'reform' of credit card schemes in Australia. Leaving the RBA as lead manager of the process is a gamble that few other countries would take. One can only wait with trepidation for the formal codification of a decision that the RBA has already sketched out -- while hoping that a wind of commonsense will blow from Europe.

END PIECE

For cant and hypocrisy it is hard to beat the retail banking regulators.

The hyperbole accompanying the recent regulatory backing and filling about 'fixing' the rorting associated with bank credit card schemes had all the familiar hallmarks. Not least the pious references by the 'reforming' regulators to expected growth in the number of participants issuing credit cards.

The community has been fed this line about **expected** new competition in providing retail transaction services for the past two decades. Not only has such new competition not eventuated, the retail banking industry has become ever more concentrated with ongoing pressure for big-bank mergers.

The 'promise' will not be realised this time either. The 'promise' has no substance. This is a false promise. There will be no substantial new issuers of credit cards. **Repeat,** there will be no substantial new issuers of credit cards -- and no one would sensibly believe otherwise. **We are misled.**

The apparent failure of the banking regulators to understand why beggars belief.

Both the Reserve Bank and the ACCC seem to be saying that if only the membership rules for the Visa and MasterCard schemes were changed to admit 'non-banks' as members, then some 'non-bank' companies with national retail distribution networks would rush to issue credit cards. That is most unlikely to be so.

Banks with well established access to substantial transaction account deposits on which, effectively, no interest is paid are uniquely advantaged in the provision of all transaction facilities be they credit cards, debit cards, cheques etc.

Unless and until the unique (and government protected) access of only the largest national retail banks to cheap deposits is corrected, there will be no new entrants into the retail transaction industry. There will be no substantial non-bank Visa and MasterCard issuers even if the membership rules for the schemes were relaxed to allow it.

On the contrary, there is more likely to be fewer Visa and MasterCard issuers once interchange fees are reduced. Bank spokesmen gave the truer assessment of prospects for 'numbers' of credit card issuers. They said smaller banks (including credit unions

and building societies) now issuing these credit cards would find the business much less attractive once the interchange fees were reduced, (even by as little as the Reserve Bank is likely to propose).

The major banks in Australia have always run the credit card game in their own interest. It suited them to create a situation (sham competition) where it was useful for small players to be seen to issue credit cards and enjoy an attractive interchange fee. A fee, incidentally, effectively considerably less than that taken by the major banks that also dominate the transaction acquirer business (and thus pick up the 'floating' 0.4% commission paid for credit card transactions acquired electronically. This 'floating' commission fits with the arrangement in Australia for an interchange free to be paid by issuers of debit cards to the acquirers of EFTPOS transactions.)
It is very likely that the relative importance of credit-card issuers other than the major banks has declined markedly since the mid-1990s because attractive loyalty rewards could only be attached only to credit cards issued by the major banks. Perhaps the Reserve Bank could be asked to update the relevant statistics on the distribution of credit card business that were first published in an article in the Reserve Bank Bulletin in May 1995.

This sorry saga has a way to go.

EXTRACT 17

OCTOBER 2001, REGULATION COLUMN IN "CFO" MAGAZINE FOR DECEMBER 2001

"CARDSHARPERS FEEL THE HEAT"

The Reserve Bank is unexpectedly in a position to make and, more importantly, explain a judgment with potentially far-reaching consequences for retail banking worldwide. Whether the ubiquitous credit card is to 'go' or be given a new lease on life when the RBA delivers its decision on bank credit schemes, is the moot point.

Credit cards define convenience in retail banking: a few thousand 'readies' on the plastic in the pocket is a comfort wherever one is. Nonetheless, credit card schemes have been in the dock for a decade or so, on charges of price-fixing, waiting for an effective prosecutor. As the wait has dragged on, banks made a welter of a good thing and credit card transactions have grown rapidly: a once minor problem is now less tractable.

In Australia, the Reserve Bank is on the case after the competition regulator, the ACCC, backed away from prosecuting banks in the courts for want of effective legislative support. By contrast, in the UK, it is the competition regulator (OFT) that has been augmented and put on the credit-card job and, given perceptions of its conflicts of interest, the Bank of England was relegated.

Whether the credit card agreement between banks should be nailed in the public interest is one focal point. Another is whether banks would then attach a line-of-credit

to debit card accounts, so filling any gap left by the displacement of credit cards. The stakes are high and the industry lobbying accordingly intense.

Not surprisingly, price-fixing means 'high' prices and bank credit card schemes and related arrangements are excessively profitable. This, unbeknown to customers misled to believe that credit card transactions are 'free' of charge. The 'excess', taken mainly as fees from retailers, runs to some $1 billion per annum in Australia (and $A 50 billion per annum worldwide). Those underwriting the solvency of banks in the last resort would not lightly contemplate withdrawing such featherbedding from banks' revenues. On the contrary the Reserve Bank (and APRA) very sensibly prefers banks to be able to recover quickly from any 'setbacks' -- and soft, cartelised revenues are proven effective in trading out of difficulties.

At first glance the community also may appear to benefit from giving banks a soft run. Any overcharging means higher bank share prices and, as bank customers indirectly own bank shares held in superannuation funds, these swings and roundabouts may be considered of little consequence. In return bank customers are spared the angst of bank failures, as are taxpayers more generally if otherwise broken banks were to be bailed-out from the public purse. Oh for a little more featherbedding in the general insurance industry, one might say.
Would that this was so -- the reality is to the contrary.

Banks grown dependent on false profits are vulnerable. Any official condoning of bank price-fixing for credit card transactions is misguided unless all countries do the same: not impossible perhaps, but not yet the case. Banks defendent on false profits are also prone to commercial paralysis -- to be wary of innovations like electronic cash that may erode the benefits of their credit card agreement.

The revolution in communications technology and the commitment to free trade in financial services renders almost irrelevant the location of transaction account administration. The issue of EFTPOS debit-cards internationally is eminently practicable: local retailers may eventually hold in their hands the future of credit card schemes, and the excess profits flowing to member banks. The issue of electronic cash cards for global internet trading (without credit cards) is perhaps an even more practicable competitive threat.

Putting aside all the debating points about 'fairness', the moot point about credit cards will likely be resolved by competitive brute force. Retail banks in the UK especially look vulnerable to incursions from Continental Europe facilitated by a common-currency. A possible concern for Australian banks is that the European banks could cut their competitive teeth on a small, self-contained market.

In any event, whatever the Reserve Bank may soon decide may not be the end of the debate. An RBA decision against credit cards can be appealed in the courts -- akin to a defence against an ACCC prosecution. Conversely, if the Reserve Bank were to endorse credit card schemes substantially unchanged (as the European Commission recently did), the way would be open for the ACCC to rejoin the case. A new ACCC case could be framed against the banks' BPay scheme for bill payments: it is said to include a provision for kickbacks, akin to an interchange fee, to be paid to banks holding the paying customer's account.

If the ACCC is to be rejoined, one might only ask that the Parliament first reinforce the trade practices law to proscribe pricing agreements that have not been approved by the competition regulator. The current situation, where banks secretly enter into objectionable price fixing agreements and then frustrate their prosecution, humiliates the ACCC and offends the general community.

Bank credit card schemes live in interesting times, whatever happens next.

EXTRACT 18

14 DECEMBER 2001, NOTE

RESERVE BANK REPORT: CREDIT CARDS -- QUICK REACTIONS

A report on credit cards was released today by the Reserve Bank and is available at rba.gov.au.

The report warrants careful perusal and thoughtful responses. Nonetheless I had a couple of quick reactions.

In considering your reaction to the report, bear in mind that the direct costs of producing it were substantial for the Reserve Bank and all those involved in writing and presenting their submissions. On a quick read, there is nothing much of practical consequence by way of conclusions and recommendations that could not have been determined equally confidently some years ago. And bear in mind also that the benefit to the banks of the delay in developing a proper response to their collusive price-fixing behaviour runs to some $1 billion per annum in Australia (and some $A50 billion worldwide).

Another six months, another $500 million for the banks, is in prospect. Even then the banks are very likely to appeal any actual decision in the courts where they will be trading a couple of hundred thousand dollars a week on big-hitter lawyers for the benefit of keeping $1 billion per annum.

This process is an absolute farce. It does not reflect with credit on the Reserve Bank or anyone else involved. The Parliament needs to act decisively and stop it.

Nothing has actually been done or is about to be done

The community has reason to object to a public policy process that is so clearly ineffective.

The process of reviewing bank credit card schemes has been on foot for some 4 years that the RBA openly acknowledges and some five years prior to that that it does not. During this time nothing practically effective has been done to rein in the excesses of credit card schemes -- indeed, on the contrary, on the RBA's own admission the 'problem' has flourished to the benefit of the banks and the detriment of the general community.

Even now the prospect is for further delay, for further consultation before any practical step is taken. And, as noted, it cannot be ruled out that any attempt by the RBA to actually do something will not be frustrated by the banks using the avenues of judicial review open to them (as they did to frustrate the ACCC).

This situation is entirely inappropriate and unsatisfactory -- it reflects shortcomings in the development of effective public policy to deal with price-fixing by banks against the public interest.

The onus is surely on Parliament to deliver effective trade practices legislation.

Banks seem to be special

One might wonder if public policy would tolerate collusive price-fixing arrangements, modeled on the kind banks are now engaged in, in a range of other industries. Other industries that might 'benefit' from uniformly pricing elements of 'networked' distribution arrangements include those with largely homogeneous products and services -- for example, ready-mixed concrete; armoured-car cash distribution; courier services etc.

One can be fairly sure that such collusive price-fixing would not be tolerated -- one fairly wonders why banks alone are permitted to do this.

To get there, one wouldn't start from here

The proper pursuit of efficiency in retail payment systems would not start as the Reserve Bank did, from a presumption that credit card schemes have a durable place.

Ideally, one would like to think that the Reserve Bank and its Payments System Board would pursue its objective of efficiency in the retail payment system somewhat independently of established arrangements.

One would not, for example, expect the Reserve Bank to be facilitating the growth of the cheque payment system, because cheques are patently inefficient; one worries that Reserve Bank's easy access to profits on the currency note issue discourages it from fostering more efficient electronic-money substitutes. The potential worth of policy reviews is devalued if the review process 'starts from here' and supports the status quo.

In this vein, one would not expect the Reserve Bank to presume, as it seems to have done, that credit card product has a durable future.

Rather one might have expected the Reserve Bank to assess credit card schemes in the broader context of transaction card arrangements generally, including debit cards.

A crucial question -- " why a line of credit is not attached to debit cards?" -- does not seem to have been posed. The outcome of this credit card study would seem to have been prejudiced by constraining the context of the review and only asking questions about credit card schemes.

This artificially constrained 'credit cards only' focus not only offends commonsense, it ignores what appeared to be a fairly clear direction from the parliamentary committee to which the Reserve Bank is apparently accountable. (Equally important, will be the press reports of the way in which the Treasurer or his 'agents' may have been encouraged to lean on the Reserve Bank in a meeting with Visa representatives just prior to the election.)

No clear practical import of substance

The principal recommendations of the report were widely 'leaked' in advance of the formal publication of the report. They included 'opening up' participation in credit card schemes to 'others' and abolishing the requirement of the scheme promoters that retailers do not (sur)charge a different price for credit card transactions.

Notwithstanding the 'weeping, wailing and gnashing of teeth' that these recommendations are likely to engender in the weekend press, there is no reason to expect either recommendation to have any meaningful, substantial practical impact if indeed the proposals ever come to pass.

For one important thing, all those 'non-bank' institutions said to be knocking on the door to enter credit card schemes have had their chance for past two years or more and not taken it. Some two years ago APRA amended the ownership rules for banks so as to allow a non-bank to wholly own a banking institution subsidiary that would automatically have been an eligible issuer of MasterVisaCards. None of the non-banks nominated as potential members of credit card schemes have shown any inclination to do so. And none will -- the barriers to entry to retail banking and credit card schemes have nothing much to do with the rules of the MasterVisaCard schemes. The Reserve Bank never talks about the unwritten barriers to entry into banking that are effectively administered by the Australian Tax Office.

For another thing, as reported in volume II (the commissioned report) the overseas experience is that where retailers are permitted to charge extra for credit card transactions they usually don't. At best the ability to surcharge will protect retailers from exploitation by customers seeking to pay large bills by credit card -- my expectation would be that the option of surcharging would only be taken up for bill payment transactions over $1000.

In short, the main 'recommendations' are unlikely to have any practical substance -- but that will not stop extensive discussion in the media as if they might have practical substance. Stand by for pages of nonsense.

The more important "recommendation" about making transparent the setting of credit card transaction interchange fees has the appearances of a useful process but until this process, and the eligibility criteria, are more fully explained, I am reluctant to draw any comfort from them. In any event when, last year, the Reserve Bank assessed credit card schemes in the broader context of transaction card payments generally, it could reasonably have been inferred from that report that there was no place for uniformly fixed interchange fees for either credit card transactions or debit card transactions.

The fact that the Reserve Bank envisages a process for legitimising interchange fees for credit card transactions at all is, in the broader context, questionable.

But that is where you get to if you start from here and are determined to do 'circle work'.

'Time's up' for quick reactions.

EXTRACT 19

DECEMBER 2001, REGULATION COLUMN IN "CFO" MAGAZINE FOR FRBRUARY 2002

"CARD CASE IS A CORKER"

The promised review of national competition policy -- of the competition provisions of the Trade Practices Act and its administration -- is getting underway. There are implications for this review in the experience of the Reserve Bank and the ACCC in bringing banks to account for price-fixing agreements underpinning their credit card schemes.

A riveting implication is that Australia's trade practices legislation is inadequate for protecting the community against the gouging that has accompanied agreements between banks to fix prices. For too long, either no one said so, or no one listened when they did.

The ACCC prosecution of credit card schemes was frustrated when denied 'discovery' of banks' secret agreements and then aborted because legal manoeuvring would have precluded a timely decision from the Trade Practices Tribunal. The Reserve Bank, however, conducted its deliberations under new legislation relating to payment systems -- and will finalise its decisions about the same time as the competition policy report is presented in August.

There is a coincidental tension here. Many fear that the Reserve Bank will be left impotent, as the ACCC was, when banks seek judicial review of its decisions. For contrived complexity, and the 'purchase' of due-process delays, the credit-card case would be a corker. This threat of a legal challenge would best be overwhelmed now and the onus of showing consistency with the public interest placed on those that would agree to fix prices.

A principal conclusion of the review of competition policy might be that any agreement to fix prices is simply proscribed, unless the agreement has, at the cost of the applicants, been previously assessed to be in the public interest, to the satisfaction of the ACCC.

There are many corollaries to a conclusion of this kind.

One relates to the global context of commerce, global brands and internationally integrated marketing. The problems with credit card schemes -- Visa and MasterCard

-- are quintessentially international. It is preferable that they are dealt with correctly and consistently across countries. So far, Australia is close to dealing correctly with credit card schemes but reasonably requires international support. It will be interesting to watch related developments in Europe and the United States, especially if the UK follows Australia, as expected. The recent establishment of an International Competition Network (ICN) is welcome but no substitute for immediate international action on credit card schemes.

Another corollary relates to dealing promptly with breaches of the trade practices law.

For bank credit card schemes, secrecy about the agreements initially obstructed official recognition of their consequences in Australia. However, when the issues were recognised, regulatory responsibility was confused and, by the time the appointed authorities were cooperating effectively, credit card schemes and related misconduct had become a major problem. A clear allocation of regulatory responsibility for competition policy is essential. For consistency, the ACCC should perhaps always be the primary competition regulator and ultimate authority, including for the banking system (as in the UK).

One bad trade practice begets others. Banks allowed free rein, enhanced credit card schemes by both unfairly rewarding 'free' credit card use (including an off-line 'debit' card variant) and discouraging transactions using the better EFTPOS system. Moreover, banks separately developed a bill payment scheme -- BPay -- that includes an objectionable transaction interchange fee. The problems with correcting banks' trade practices are not over by a long chalk.

A final corollary concerns penalties for breaches of acceptable trade practices. At the least, offenders could be required to surrender the cumulative benefit of illegal price-fixing: at best there would be exemplary penalties to discourage outlaw behaviour. In Australia the damage done by credit card schemes to the competitive environment in retail banking may never be repaired -- the value of this damage and the associated unjust enrichment, runs to billions of dollars. It is an injustice unlikely to be redressed because, to do so, may inadvertently damage bank customers.

In circumstances where the damage done by offensive trade practices can neither be repaired or appropriately penalised, the individuals responsible for causing it could be imprisoned. As it is, the individuals ultimately responsible for the credit card agreements are among the most highly paid in the community and they have acted with impunity. The competition policy review could be complemented by a judicial inquiry into 'who' did 'what' in the retail banking industry -- and who let them. Such an inquiry might underwrite the sense of criminal sanctions on bad business behaviour, and the inappropriateness of regulatory forbearance.

In the course of the review of Australia's competition policy, faults, real or imagined, might be contended about the stewardship of the ACCC Chairman, Alan Fels. Whatever, he has been a beacon in Australia for building practical recognition of the potential contribution of laws protecting competition. He has given us a valuable foundation for legislative and administrative reform

EXTRACT 20
MARCH 2002, DISCUSSION PAPER

"CREDIT CARDS: RBA CONSULTATION DOCUMENT"

Useful as it may be, the Reserve Bank's 'Consultation Document' on bank credit card schemes can only be read properly in the context of its sorry prior history; its uncertain place in the broader scheme of reforming the retail payments system and its possibly shaky legal footing. Beyond the 'Consultation Document' itself there is a richer story here that is still unfolding.

-- well done, at last, now do it.

Taken on its own, the Reserve Bank's Consultation Document (CD) on credit card schemes is commendable, mainly for the proposed limits on 'eligible costs' that card issuers may recover in transaction interchange fees -- and one may fairly wonder what material costs, if any, will be deemed 'eligible'.

One can also appreciate the Bank's proposals to both allow new entrants (access) to the schemes and to allow merchants to recover (surcharge) the additional costs of credit card transactions. However, neither of these complementary proposals is likely to be of much practical import. This is especially so if lower interchange fees do reduce both the incentive to be a card issuer and the additional costs to merchants that might be recovered as surcharges. The 'Commissioned Report' prepared by Professor Michael Katz, was also welcome -- particularly the demolition there of the contrived defences mounted by the promoters of credit card schemes.

Taken together, the Bank made a useful contribution to resolving policy issues of global relevance and should now proceed to put the standards in place. Please do it -- no backsliding.

The following discussion is under the headings of' 'the sorry history', 'the broader scheme of things' and 'legal authority'.

1. THE SORRY HISTORY

The Reserve Bank understood well that bank credit card schemes were offensive for many years in the 1990s but chose to obscure the situation and do nothing about it. However the open disclosure, in 1999, of this 'secret bankers' business' for the first time put issues on the table in a way that the Reserve bank could no longer ignore.

Under pressure to properly address credit card schemes, the Reserve Bank has done so slowly and reluctantly, and at considerable unnecessary cost to the community. Nonetheless, the Reserve Bank may now, finally, be ready to run a good race -- it seems to be on the right track, in the starting stalls and facing the right way -- but the lawyers may hold up the start.
The Reserve Bank has not always been on the right track. The 'lost decade' of the 1990s is still to be accounted for by the Reserve Bank. The following gives some clues about where to look.

1991 - 92

The spotlight fell on credit card schemes in 1991 when, among other things, the Prices Surveillance Authority (PSA) conducted a review of credit card schemes ahead of allowing annual fees to be charged for issuing credit cards. In the Reserve Bank, the Australian Payments System Council was addressing related issues (ineffectively) and work was also being done to re-cast the statistical collections about transaction card activity into their present format.

One way or another the PSA was led a merry dance by the banks' 'evidence' that their credit card schemes had been unprofitable for the previous 15 years but were then 'edging into the black'.

The banks' evidence to the PSA was coloured by the imaginative 'transfer pricing' of services provided within banks to their credit card business units, so as to erode and disguise the otherwise excessive profitability of these schemes. The Reserve Bank did not make a submission to, nor give evidence to, the PSA inquiry but it did liaise with PSA staff. In the event, however, the PSA report in October 1992 was constrained to relatively narrow issues associated with 'annual fees'. At that time (9 October 1992) the PSA undertook to address the 'price fixing issues' in the context of its ongoing surveillance of credit card schemes. It was not done.

The re-casting of the Bank's 'transaction card' statistical collections was designed to show transaction activity on credit cards with that for debit cards. The expectation was that by juxtaposing activity data for these functionally very similar products it would expose the excesses associated with credit card schemes. The draft statistical collections were cleared with the banks CEOs and, among other things, provided for the disclosure of revenues from fees flowing to issuers of credit cards and from issuers of debit cards. However, just prior to the collection commencing, it was decided in the Reserve Bank that the elements relating to revenue collections be deleted.

The publication of the transaction card statistics commencing in the May 1995 'Bulletin' was less effective without this complementary information contrasting the revenue flows. The public disclosure of the relatively very profitable character of credit card schemes was not achieved. The Australian community subsequently paid a high price for the chosen weakness in the design of this statistical collection.

'1995'

In 1995 it was not 'politically correct' to be identifying the obvious excesses of credit card schemes and the 'clever' if not outright deceptive, misleading and 'gouging' behaviour associated with the marketing of credit card products.

It is what happened in the Bank around this time, in terms of not dealing properly with issues associated with credit card schemes, that most needs to be examined in the light of the more correct attitudes now prevailing in the Bank. It is now approaching mid-2002 -- some seven years later -- that the issues are, hopefully, about to be dealt with properly. The community paid dearly for the Reserve Bank's failure of intellectual character in this respect in the mid-1990s.

By the mid-1990s existing problems with credit card schemes were being exacerbated with 'clever' marketing approaches. Customers intending to borrow on their credit card accounts were offered a credit card without annual fees or an interest-free period but with the attraction of a (marginally) lower but still high lending interest rate. Beyond that, it is now well understood that giving 'rewards' to credit card use was a mechanism promoting the overuse of credit cards as a transaction medium to the benefit of some card issuers. Concurrently the 'minor' banks, building societies and credit unions were recruited as issuers of a hybrid product (Visa Debit). This product purported to be a debit card but issuers encouraged it to be used in 'credit card' mode so as to reap the high transaction fees -- improperly advertising that "this was a way to avoid transaction fees". More generally card issuers withdrew 'benefits' -- for example, backdating (high) interest charges to the date-of-purchase if money owing on a "free period" card were not paid in full by the due date. Generally a well-recognised problem -- credit card schemes -- was getting worse rather than better.

The clear illustration of the Reserve Bank's shortcomings in this context at this time is the Annual Report of 'its' Australian Payments System Council released in late 1996. The initial intention to use this report as the vehicle for exposing the excesses of credit card schemes (and the benefits of debit cards) was abandoned. In its place was substituted a bland description that simply accommodated banks' practices without insightful analysis or serious question. The report said *"no attempt has been made to pass judgment on current practices"* and went on to describe the way transaction card services were provided by banks in terms that implicitly put an official imprimatur on what banks were doing. This 'dynamited' the hope that the Wallis Committee would be armed by the Reserve Bank to encourage reform of this element of the retail payments system.

Consider the following.

This 1996 report relegated to a noncommittal footnote a bland description of the even then known-to-be-bad product, Visa Debit. The 2001 Consultation Document now says *" The Reserve Bank has advised Visa that this .. (product) ... has no place in the Australian payments system"*. This could have been said without reservation in 1996. It should have been said then. It was not said.

About the 'principle' of interchange fees for credit card transactions paid by merchants and recovered in retail prices, the 1996 report was quite culpable. Having identified the funding requirement for 'free period' cards and attributed the benefit to merchants, it went on to say *"Thus, the merchant is expected to contribute to the cost of the card issuer extending credit to customers. That is, the interchange free represents the merchant's contribution to the card issuer"*.
The Reserve bank was given a second chance to properly analyse this issue in its October 2000 report on debit and credit card schemes. The Reserve Bank then 'conceded' that customers as well as merchants were beneficiaries of 'interest-free' periods but said: *"in the absence of any objective criteria, a reasonable benchmark might be to include up to half the cost of the interest-free period in the interchange fee"* (paid by merchants). Half right was not right.

Given a third chance, the Reserve Bank has now finally answered the question

correctly in the Consultation Document. The telling words were: *"In the Reserve Bank's view, since the provision of the interest-free period is a matter exclusively between individual card issuers and their customers, passing the cost of the interest-free period to merchants through interchange fees would not meet the Reserve Bank's principles for interchange fee setting".*

-- intellectual integrity

As between 1996, 2000 and 2001 the relevant principles for analysing the relevance of 'free credit' to interchange fees did not change. The 'analytical errors' in the 1996 and 2000 reports are more correctly seen as evidence of the lengths to which the Reserve Bank went to protect the banks. A $ billions 'mistake' ! -- who pays?

The obvious "Bob-the-Builder' counter argument, against merchants paying for 'free credit' given by banks to their customers -- that home builders do not pay banks commissions on loans to homebuyers -- though readily accepted now, was not at all acceptable in 1996 and was only half acceptable in October 2000. The Reserve Bank judgment of this issue in 1996 and 2000 is now -- six years later -- seen to have the character of analytical recalcitrance that beggars belief. It did then, too.

The contemporary significance of this abandonment of intellectual integrity in the Reserve Bank cannot be understated. In 1996 a formal inquiry into the financial system was underway -- the Wallis Committee -- and looking for submissions about appropriate reforms to the banking industry, including the retail payments system. The 1996 report of the Australian Payments System Council was as close as the Wallis Committee got to a submission from the Reserve Bank on retail payments system matters -- and, as we now know, that 'submission' was manifestly inadequate. Those in the Reserve Bank that might have made a more forthright private submission to the Wallis Committee were counseled against taking that course. Nonetheless, enough of the underlying truth of these matters got through to enable the Wallis Committee to recommend a review of credit card schemes, particularly interchange fee arrangements.

This brief anecdote about the inappropriate development of payment system policy in the Reserve Bank, circa 1990-2000, does not of course do full justice to the down and dirty detail. To anyone with a reasonable comprehension of what happened -- and what did not happen -- this episode does not reflect at all well on the character of the Reserve Bank as an important repository of community trust.

If the purpose served by formally reviewing this sorry history was to repair and restore the intellectual integrity of the Reserve Bank's work in this area, it would be time and effort well spent. The lesson is unlikely to be learnt, however, unless and until the failure and its related consequences are acknowledged and redressed. The Reserve Bank might now like to give consideration to doing this.

In summary, the performance over the 1990s of an important part of the Reserve Bank's responsibility to the Australian community fell far short of what was required and what could reasonably have been expected -- and it was deliberate. The long and drawn out process of recognising the way credit card schemes inappropriately re-distributed many $ billion from bank customers to banks was, for the community, a

very expensive educational process for the slow and unwilling learners in the Reserve Bank. Among other things, the amount of money involved is well in the ballpark of issues being addressed in the context of the HIH Royal Commission. There is a strong case for a separate public inquiry.

Still the wheels continue to turn slowly. The Wallis Committee reported in April 1997 and it has taken some five more years for the 'responsible' regulatory authorities to ponderously come near to properly addressing the credit card issue. Moreover, having become bogged down with the mishandled credit card matter, the Reserve Bank has been unable to perform properly its broader responsibilities for payments system reform.

2. THE BROADER SCHEME OF THINGS

-- nothing much really doing at the RBA

Since the establishment of the Australian Payments System Council in 1984, the Reserve Bank has had primary responsibility for public policy affecting the efficiency and soundness of the Australian payments system. This allocation of responsibility was underscored by the passing of the Payment System (Regulation) Act in 1998, and by the associated establishment of the separate Payments System Board in the Reserve Bank**.** This was akin to a lavish 'new start' allowance to the mis-employed payments-policy staff in the Reserve Bank.

Making credit card schemes a focal point of the reform of the retail banking and payment system was always a 'sideshow', a means to an end -- a simple way to expose the shallow insincerity of the 'commitment' to reform the retail payments system. Nonetheless it is an important issue because the bad character of pricing practices associated with credit card schemes was so clear as to make inexplicable the initial 'denial' and subsequent lengthy delay in bringing those schemes (almost) within a proper public policy framework.

The Reserve Bank's failure to address these issues properly over such a long time highlights concerns about the Reserve Bank's approach to payments policy development and administration -- concerns that are reasonably ongoing. The last 'annual' report of the Payments System Board was released eighteen months ago, in October 2000. There has been no real effort made to bring the community up-to-date with the development of the payment system subsequently.
Putting aside the generally brief and unstructured discussions of payment system issues with the Parliamentary 'Banking' Committee (EFPA), no speeches have been made in the normal course by either the Governor or senior, payment-system policy officers of the Bank. Being unwilling to appear in public is a worry.

In the late 1980s and early 1990s it was customary for the Bank to take opportunities to speak publicly about the development of the payment system and related policy issues -- but it is not the custom now. The last public speech about retail payment system issues given by a senior Reserve Bank officer, was at a hastily contrived (and poorly attended) 'payment system' conference in June 1999, just prior to the breaking of the 'cash for comment' saga involving the Australian Bankers' Association. The June 1999 speech "The Role of the Payments System Board" given by the Deputy

Chair of the Payments System Board is mainly memorable for its closing 'cricketing' analogy,

"Those who expected -- or feared -- that the (Payments System) Board would begin to swing lustily as soon as it reached the crease can be reassured that it is more interested in building a long and carefully constructed innings. Payments system evolution is that sort of match!"

This revelation of the studied determination in the Reserve Bank to do nothing at all quickly about reforming the payments system was unfortunately, apparently, quite sincere. The promise has been kept to the letter and the reference to a concept related to 'quick' was redundant. Whatever has been going on in the Reserve Bank on payments policy, it is 'not cricket'.

The credit card 'sideshow' has somehow become the main event and seems likely to remain so. Those subscribing to a deeply held view that 'justice has not been done until the lawyers have been paid' would be salivating, unable to believe how useful an ass can be. Simply fixing the ass, 'the law', is apparently too easy.

-- much really does need to be done, however

The contrast of the 'nothing much doing' at the Reserve Bank with the pressing need to deal vigorously with a range of retail payment system issues, could hardly be sharper. And we have no up-to-date report of what has been happening -- only what should have been happening about credit card schemes a decade ago.

There is a raft of payments-policy issues that should have been dealt with resolutely by the Reserve Bank while everyone seems to have been watching the credit card fire. Among the issues:

- **BPay** needs to be dealt with. **BPay** is a scheme modelled on banks' credit card schemes but more offensive, if only because it was launched in 1997 in defiance of the growing disquiet about 'interchange fees'. The promoters paraded the scheme to the media as 'cleared' with the Reserve Bank and ACCC when it was not and then disregarded the Reserve banks ineffective 'wish' to be properly informed about the scheme;

- the probabilities are that the **direct debit**, the cheapest and most efficient instrument for regular retail bill payments (but least profitable) has continued to languish as 'relatively unpopular' because it is not marketed effectively by the banks and the Reserve Bank has been unable to deliver on its plans to promote acceptance among billing companies and the wider community;

- the probabilities are that the **cheque** continues to be grossly overused by small businesses notwithstanding that it is the most expensive means by far for making retail payments;

- in the past 18 months, banks commenced offering a very cheap payments facility over the internet -- **pay anyone, anywhere, anytime** -- but as far as the public record goes the Reserve Bank has yet to bring this innovation and related policy

issues (e.g. industry standards) to the attention of the wider community. The community takes reassurance from the Reserve Bank putting its imprimatur on bank payment schemes (and this **pay anyone** scheme seems to be so deserving -- more so than credit card schemes in 1996);

- the use of **debit cards** has continued to lag because the false and contrived popularity of the banks' credit card schemes overwhelms them in the public mind. A long overdue resurgence in the growth of debit card usage is the counterpart of the Reserve Bank 'fixing' banks' credit card schemes. Preparatory to that, it would be pleasing to see the Reserve bank deliver on its judgment that transaction interchange fees have no place in the debit card network. Above all it would be enlightening to have an assessment from the Reserve Bank as to why banks do not offer an 'overdraft', line-of-credit with customers' debit card accounts. [As an aside, it is almost perverse for the Reserve Bank to 'move' on credit card schemes before fixing the interchange fees situation for debit card transactions. Smaller banks and credit unions may be 'broken' by not getting interchange fees for fewer credit card transactions while continuing to pay interchange fees for more debit card transactions];

- the option for customers to access their **debit-card** accounts over the phone (as a credit card account may be) is not offered nor are the various automatic 'protections' against 'disputed transaction's and 'failure to supply' that come with credit cards -- an EFT code-of-practice designed to protect customers is apparently used as a barrier to giving these concessions to the customers; and

- the prospect of a widely useable **'electronic currency'** as either 'stored value cards' or as anonymous 'internet money', seems to be as far away as ever notwithstanding the should-be redundant, conventional technology of paper notes and metallic coins.

All of these areas of useful policy development are apparently 'deferred' while the seemingly never-ending chase goes on for the elusive credit card bandits.

3. LEGAL AUTHORITY

Underpinning credit card schemes in Australia is an arrangement between the member banks that fixes a price for credit card transactions -- the interchange fee -- in ways that return excessive profits to member banks.

This arrangement has been in place for many years notwithstanding a general belief that collusive price fixing against the public interest is prohibited. On the face of it, the community has been let down by ineffective law yet, over many years, there is no record of calls for legislative reform from the responsible authorities, including the Reserve Bank. The situation reasonably calls for both explanation, reassurance and practical demonstration that appropriate legislation is now in place.

The legal footing

The Reserve Bank effectively took over the prosecution of the credit card case in December 2000. Then, in the course of an appearance before the Parliamentary 'Banking' Committee, the Bank alluded to weaknesses in the ACCC prosecution of banks under the trade practices law and foreshadowed its intention to step in, using the new law relating to the regulation of payment systems. The Bank did not, however, allude to the likelihood of a legal challenge to any standards it might 'impose'.

Since then also, there has been no intimation by the Bank of any anticipated weaknesses in the payments system legislation of the sort that were expected to frustrate the ACCC's 'price fixing' prosecution. It would be disturbing if the implementation of the Bank's proposed standards, were also to be frustrated now by legal maneuvering -- and nothing had been done to identify and fix deficiencies in the law.

As the record stands, the community has the implicit assurance of the Reserve Bank that the payments system law is adequate. Much as one might hope that is so, the banks do not seem to share that view.

Catcalling bankers

For the most part the release of the Consultation Document appeared to be well received by the media and the wider community. There was probably a bored sense of deja vu as both had been walked around much the same 'outrage/promises' course a few times in the past couple of years without practical consequence. Nonetheless the sense that something potentially useful had been done by the Bank was evident in the shrill catcalling protests of the bankers and scheme promoters likely to be affected when the draft standards are imposed.

The subsequent public discussion has been one-sided. The rhetoric from the bankers' side of the street is of uniformly low-grade, protesting 'loudly' against the Bank's proposals but without posting any considered written defence of the banks' position.
What captured attention was the alacrity with which the bankers went on the front foot to the media making shallow, derisory and contradictory remarks that could be construed as disrespectful of the Reserve Bank (and the Parliament). What did not capture attention was any public response from the regulatory authorities to this public display of disrespect -- at the minimum banks might have been asked to put up -- a considered, thoughtful response -- or shut up.

Public displays of one-upmanship are done for a purpose. The general community will be disappointed if this catcalling behaviour were subsequently seen to have scored when the game is decided and this shallow disrespect subsequently rationalised in a legal challenge to decisions by the Bank.

Taken at face value, the bankers' public display of disrespect is perhaps indicative of banks having advice that the legal footing on which the Reserve Bank stands is unsound. One hopes not. Perhaps, however, they will play for 'delay' anyway -- that is a real worry.

Review of trade-practice law

The legislative and regulatory framework needs to be made sound.

In the lead up to the November election, the government promised a review of the trade practices law and its administration to be completed by August 2002. Though the timetable has 'slipped', presumably the review was a 'core promise' and will proceed. One might expect that the credit card matter would be a useful case study for anyone reviewing the effectiveness of Australia's trade practices law and its administration.

No doubt both the ACCC and the Reserve Bank will make submissions in the review process. Imposing standards on credit card schemes will sharpen Reserve Bank thinking on these issues.

One question on the table will be whether to fix the trade practices law so as to avoid a repeat of the situation where the ACCC prosecution of banks for price-fixing credit card services was aborted. Similarly the Bank has probably been considering its legal authority in the context of an expected appeal against a decision to implement standards for credit card schemes.

Taken together there is a question about the most appropriate regulatory authority for trade practices matters in the retail banking industry -- the Bank or the ACCC.
Hopefully a genuine quest for effectiveness will override any 'self-interest' otherwise likely to colour the preferences of these agencies.

One approach to strengthen the trade practices law, and avoid protracted appeals, would put the burden of proof on parties to agreements fixing prices. Such agreements could simply be proscribed unless the relevant trade practice authority has approved them. The current situation is not tolerable -- ie: banks agree to do things against the public interest (and do those things) but, when challenged, appeal their right to do so while continuing to do those things.
The law may be an 'ass' at times, but there is no need for 'us', or our representatives, also to be.

END PIECE

The view that interchange fees in credit card schemes are unfair and underwritten by an 'illegal' price fixing agreement between members of credit card schemes is widely held by informed observers around the world. Remarkably, however, the arrangement continues in place, practically untouched. It is well past the point where the community is entitled to an explanation of why the appointed regulatory authorities -- the ACCC and Reserve Bank -- have been so ineffective and submissively powerless. Why have they continued to 'soldier bravely on' like a David against a Goliath with a 'sling shot' but without a sense of urgent determination. Preferably they would have requested proper support from the Parliament to make these undesirable arrangements clearly illegal, rather than 'probably illegal, but we can't ever prove it'. Give us a break.

And the story about sensible, policy-led reform of the retail payments system has hardly begun. The Reserve Bank is yet to even strike a blow on the big game --

weaning the major banks off their dependence on the tax-avoiding barter inherent in the 'swapping' of 'no-interest' deposits and over-priced loans for 'free' transaction services. With interest rates now at a cyclical low, it would have seemed an ideal time to take up this policy challenge. No chance, apparently -- too much work not to be done.

There should be no mistake about the importance of this next step. Unless and until the Reserve Bank summons the courage to deal with this issue, all the pious talk about 'competition' and 'new entrants' in the business of issuing credit cards and in retail banking more generally, is just so much claptrap. There has already been too much insincere nonsense talked about retail banking for too long.

The best chance of bringing the banks to heel in respect of their credit card schemes and tax-avoiding barter deals, may well be the 'Al Capone' route. It would be a simple and correct step to make taxable in the hands of the customer 'recipients' all of the income-in-kind delivered by way of 'free credit' on credit card accounts and 'free services' on transaction accounts. This simple, direct and eminently defensible approach would put the banks on the back foot immediately. It should be done.

[A very feasible complementary policy would protect the poor and disadvantaged against the banks' predictable retaliatory impost of high fees on basic banking accounts now free-of-charge.]

EXTRACT 21

MAY 2002, DISCUSSION PAPER

"PAYMENTS POLICY: SUB JUDICE"

The Reserve Bank meets the Parliamentary "Banking" Committee (EFPA) on 31 May. The discussion will probably touch only briefly on payments system policy issues, a full year since the previous skimped discussion. Key elements of credit-card policy are yet to be 'finally' decided by the Reserve Bank, and then the debate will move to the courts. Rest assured nothing is likely to be done about matters 'sub judice'. Déjà vu.

An inquiry into the trade practices law is getting underway and offers hope of stronger laws against price fixing, including by banks in respect of their credit card and BPay schemes.

All up, the Australian community could be fairly dissatisfied with the performance and lack of accountability of those responsible for reforming retail banking and payment systems. In the five years since the 'Wallis' banking inquiry, the problems in the retail payments system have generally got worse. Insincere rhetoric has been the constant backdrop to an interminable process of 'studies', 'consultation reports' and further 'ongoing consultations' mainly with industry executives affronted by the intention, finally, to assert the public interest. A quite separate policy authority could usefully specialise in retail banking issues for a few years.

The underlying tragicomedy with credit cards is unerringly moving to the frustration of promised reforms in the courts. At some point the Australian community might ask that the law on trade practices be strengthened to preclude the continued abuse of its best interests. It would be a fair question. Hopefully that question will be put repeatedly to the ACCC Inquiry.

One of the quaint characteristics of parliamentary committee processes is the opening exhortation to witnesses to not mislead the Parliament. It may be instructive for some researcher to consider answers to similar questions in a related sequence of parliamentary committee hearings. Some clues are given in the 'appendix'.

1. CREDIT CARDS -- A TOPICAL ISSUE

Pending a legal challenge to any decision that the Reserve Bank may make about setting interchange fees for credit card transactions, the Reserve Bank is momentarily sitting pretty on a document proposing effective action.
The Reserve Bank would be surprised to find itself on the front line against the global credit card industry. The competition authorities in the UK and Europe have left it to Australia to make the 'card' yards.

Make no mistake, the Reserve Bank consultation document, if implemented, would rip the black heart out of credit card schemes globally -- other countries could not ignore, and would sensibly welcome, the Australian action. Moreover the Reserve Bank's related intention to rule out interchange fees for debit card transactions conceptually destroys the preferred fallback position of the retail banking industry, to abandon credit cards once comparable interchange fees are attached to debit card transactions.

Ignoring bygones, the Parliamentary "Banking" Committee would appropriately congratulate the Reserve Bank on the way its consultation document proposes dealing with interchange fees in credit card schemes -- but then quickly move to the real issues.

(Under no circumstances should the Parliamentary Committee dwell on the dummy passes masquerading as 'surcharging' or 'new entrants' in the RBA consultation document. Nor should any credence be given to the tantrums put on over recent months by either our banking industry 'leaders' and the visiting hit men, from Visa and MasterCard acting for the global banks milking the global community with these schemes.)

-- the legal challenge

Good intentions are never enough, good works are also necessary.

By now the Reserve Bank should have a view about the legal footing on which it stands, of its chances of making stick a decision about regulating interchange fees for credit card transactions. What does it think about the adequacy of its enabling legislation? Views about the legal foundations for payments system policy are about to be made clear anyway and, if they are shaky, this opportunity for the RBA to ask

the Parliament for effective legislation should not be missed. The public will be listening for the question and the answer. A following question might inquire, as appropriate, why the 'alarm' was not raised previously.

The inquiry into the trade practices law will bring this issue about ineffective trade practices law into the open. Ideally the prospective 'use' of legal processes to defer the implementation of reforms to interchange fees would have been headed off earlier. If the credit card matter languishes in the courts, those effectively on trial will include the Parliament, and its advisers that failed to put effective trade practices law in place.

At a minimum, arrangements that fix prices should be proscribed unless they have the prior approval of the competition policy authorities and then only to the extent necessary to maximise the community benefit of the arrangement.

Having made a grandstanding display of bureaucratic bravado in December 2000 to takeover the prosecution of credit card schemes, it will now be an acute embarrassment if the RBA's payment system law is similarly exposed as ineffective and they did not know. The irony will not be lost on Alan Fels and the ACCC, now making a comeback after being 'benched' from the prosecuting team.

2. BPay STINKS TOO

The re-entry of the ACCC to the debate on bank 'price fixing' not surprisingly concerns the banks' BPay bill payment scheme. The timing of the re-entry suggests the ACCC is thinking the RBA is about to 'get bogged down in the courts' with the credit card matter and exposure of BPay may usefully underwrite a call for more effective trade practices law. It should.

BPay is more offensive than credit cards if only because it involved banks quite recently in a plan to put in place a uniform pricing arrangement already regarded as inappropriate. Moreover the banks developed the BPay scheme outside the policy framework, APCA, that was put in place to protect the community against such objectionable initiatives. The development of BPay in 1997 confronted the authority of the Reserve Bank -- and the banks got away with it. Wish the ACCC well.

BPay is based on the credit card network model. BPay, like credit cards, is basically a good product except that, like credit cards, it has an objectionable interchange fee built into the pricing contracts. It was objectionable also that the banks developed the BPay facility to substitute for an established service (direct debits) that was inherently better and cheaper but not marketed effectively because it was less profitable.

Calls for the authorities to bring banks to account for their BPay scheme repeatedly fell on deaf ears. No statistics are collected and published for BPay transactions. It is never really mentioned. Details of the scheme are 'secret' rather than transparent. BPay has been allowed to stay and prosper when it should have been reoriented in the public interest. As should credit card schemes.

It would be useful for the Parliament to ask the Reserve Bank to share what it knows about BPay and its pricing arrangements -- and then ask why nothing has previously been said.

3. OTHER ISSUES

The 'other issues' are of course the same issue -- the ineffectiveness of policy processes for dealing appropriately with the retail banking industry.

There is a litany of well-intentioned pontificating about what should happen that stands in sharp contrast to the nothing-really-doing reality of not reforming the retail banking industry -- about the inefficient, overpriced transaction services that underwrite banks' excessive profitability (and a quiet life at the RBA and APRA).

With the meter running at some $1 billion p.a. for the credit card rort alone, it is far better being a banker-owner of the 'cab' than the paying-passengers stuck at the regularory traffic lights for the past 5 years already.

The latest recitation of this litany was in the third annual report of the Reserve Bank Payments System Board -- released on Easter eve, some six-months late.

-- on with the game

Moving beyond credit card schemes, an appropriate agenda for the 31 May hearing would include both the contents of the third (2001) annual report of the Reserve Bank's, Payments System Board and some policy issues not mentioned in that report.

The general tone of this six-months-late report is laboured and tedious: it is repetitive of issues still outstanding that should have been resolved years ago.

Among other surprising things, there is no mention of the pre-election posturing of the banks to 'restore free-of-charge banking transactions' to those without the minimum deposit balances (or loans) required to be given exemptions from paying transaction fees. No comment on how this 'free for all' does not fit sensibly with the 'lecture' on the importance of explicitly linking prices to costs -- and the preference for the 'needy' to be subsidised directly by government.

The best way for the general public to be appraised of the significance of this Payments System Board report would imagine an audience of bankers and policy makers listening to extracts read aloud from the report. People laughing to death (many deservedly) would be wonderfully illustrative.

The direct debit system still languishes notwithstanding that Reserve Bank has long declared it to be the most highly efficient payment instrument. Blissfully unknowing that the banks have no intention of making this system work as it should, the Payments System Board wistfully "looks to financial institutions to play their part in promoting the use of this highly efficient payment instrument". The Board, apparently unthinkingly, "remains committed to improving customer safeguards" as embodied in its Charter for Direct Debit Customers that is apparently largely ignored. Spare my days.

The Payments System Board seems not to appreciate that banks developed **the BPay system** to displace 'direct debits'. The apparent clarity with which the Reserve Bank now sees how credit cards displace debit card transactions, belies its inability to 'see' the displacment of direct debits by the much more profitable BPay scheme. The BPay scheme also has a uniform interchange fee underwriting its excessive profitability. There is not even the stated intention at the Reserve Bank to 'study' the banks BPay scheme -- the mind boggles at this intellectual inconsistency. Thankfully the ACCC now has the BPay scheme on its 'investigative' agenda.

A little later in the report, following a '101' style lecture on the importance of prices reflecting relative costs, it is noted that " successive Australian governments have made a strong commitment to promoting competition and this is echoed in the Board's mandate in the payments area". It was once proposed that towards the mid-1980s, a room '101' might be made available for those peddling such patently insincere dogma. The actual results of this 'strong commitment' are there for all to see -- and the clamour is swelling for 'two good' and 'four bad'. (Pillars, that is)

At some point the considerable distance between good intentions and the blinding reality of inefficiency in an uncompetitive retail banking system becomes difficult to reconcile with a supposedly sincere effort to properly inform either Parliament or the wider community.

Further on the report repeats a conclusion of the October 2000 card transaction study -- that "there was no convincing case for an interchange fee in Australia's **debit card payment system**". Eighteen months on, one wonders why there still is an interchange fee in Australia's debit card payment system. The answer beggars belief. The Board wanted to "emphasise that … the initiative for reform in the debit card market is... in the hands of industry participants": that is in the hands of those behind the current scheme that endures against the public interest. There is little comfort in the observation that "the Bank has now begun to work with industry participants to consider options for change".

Having seen, with the credit card matter, the gap between the Bank 'beguning' something and even approaching effective action, the community might reasonably despair. The RBA inaction on BPay is similarly cautionary. Not surprisingly, the always-objectionable **VisaDebit** card continues to be widely used notwithstanding that it was eventually assessed by the Reserve Bank to have "no place in the Australian payments system".

What is going on here?

And there are omissions. One of the more exciting current developments in retail payments systems is the development of **internet funds transfer** schemes that literally allow everyone to pay anyone, anywhere, anytime -- provided only that the payer knows the account numbers of the payee. This system, capable of replacing the cheque, needs the well-informed coordinating influence of industry standards and the considered official endorsement of the monetary authorities -- I could see no mention of it. Much the same goes for **'electronic currency'** capable of substituting cheaply and effectively for conventional currency. A commercially viable, electronic cash scheme continues to be elusive with pilot schemes disappointing expectations. Little

wonder there was a 'tech wreck' when a 'new economy' capacity to deliver goods and services was not matched by the capacity for customers to pay for them using 'old economy' technology. Apparently, nothing much is going on here either -- and this is the supposed future.

End piece

The latest 'annual' report of the Reserve Bank's Payments System Board should be acknowledged as a final straw.

At some point the community can fairly say, enough is enough. It can reasonably demand acceptance that the regulatory framework in place simply is not delivering acceptable outcomes for retail payment systems. It is time for a new start, a different approach -- more effective legislation and more effective policy developed by a policy agency not confused by an 'obligation' to protect the banks.

Ideally a redistribution of responsibility for payments system policy would be accompanied by tax policy reforms. The payment system should be cut off from its dependence on the tax-avoiding bartering of 'free' transactions for 'free' deposits. The attendant cross-subsidisation of payment system costs from the deposit and lending, intermediation operations of banks is a major reason why the market does not work as it should. Simply stopping this bartering would work wonders with banks' attitudes and payment system efficiency.

Take that prop away from the banking system and Australia would have progressively cheaper and better payment facilities.

This is widely known but 'never' said -- on the contrary the community is continually misled. A new policy agency would soon 'know it' and soon promote needed reforms.

The Parliamentary Committee hearing on Friday 31 May could gently expose the nonsense inherent in current arrangements.

APPENDIX

HOW THE CREDIT CARD STORY DEVELOPED

One useful approach to appreciating the studied ineffectiveness of public policy approaches to the retail banking industry is of course an analysis of the transcripts of previous 'hearings' of Reserve Bank views put to the Parliamentary "Banking" Committee.

Commencing in December 1998, the Committee has had two opportunities each year to 'hear' the Reserve Bank address payment system policy issues (except for this current financial year when there will be only this one hearing on 31 May). Credit card schemes are a topical focal point among a range of possibilities.

-- pre-Cruickshank

Prior to the release of the UK 'Cruickshank report' in March 2000, the Reserve Bank was largely dismissive of concerns about credit card schemes. In December 1998, responding to a question about a lack of competition in credit card schemes, the answer was, "No. We do not have any responsibility for the banking sector per se". The clear impression given to the Committee was that credit card schemes were not in the Reserve Bank's range, but may have been the business of some other policy agency.

Mid-1999, just before the 'cash for comment' scandal broke, was the high point of RBA hubris. The timing was impeccable. In June 1999, the Reserve Bank played a 'trump card' releasing a major policy statement and supporting documentation, one day before a scheduled meeting with the Committee that was duly overwhelmed.

This pre-emptory strike triumphed the tritely true but largely irrelevant observation that 'bank margins had fallen by more than bank fees had increased". A qualification was 'accepted', that some -- the non-borrowing poor -- may have been net losers now a once 'free service' had its subsidy withdrawn. However, a prospective role for the regulation of bank fees and charges was dismissed (using the 'margins' evidence) prior to an acknowledgment that "if there was gouging going on .... the situation would be different". (The regulatory tide turned the following month when the banks were revealed to be having a lend of the community -- 'cash for comment')

Implicitly, apparently, it was not then known that 'gouging' was going on but the dawning was getting close. In September 1999 the ACCC launched an action against the banks for 'price fixing' and was 'joined' in a process of 'studying' credit card schemes with the RBA.

By November 1999 the tide had turned -- not least because the Committee was then briefed better on payments policy issues, including the mechanics of the bank credit card rort. The previously lauded triumph of 'margins over fees' was put in a sensibly broader context and the reduction in margins correctly attributed to "massive cuts in costs" (largely shifted to Australia Post and customers denied 'branch' services). More importantly the RBA noted "a huge increase in transactions using credit cards" and went on to say "we are sufficiently interested in this subject that we have started a study of it through the Payments System Board ... ". One can only wonder what the RBA previously saw when they read the credit card statistics they had been collecting for some years.

-- post Cruickshank

The 'Cruickshank Report' of a UK banking inquiry in March 2000, was reasonably insightful and forthright in its analysis of banking policy issues -- especially credit card interchange fees. However, it was also notable for clearly articulating the consequences of what it called the 'old contract' between the Bank of England and the UK banks. Under the 'old contract' the broader public interest was subordinated and banks were given the feather-bedded luxury of a non-competitive regulatory regime protecting their profitability, in exchange for doing what they were told and keeping banking politics relatively cool. Not unlike the situation in Australia, so to speak.

The upshot was that the Bank of England lost responsibility for banking industry policy to a reconstituted Office of Fair Trading (the UK's ACCC). Australia's Reserve Bank could see this writing clearly on the wall and faced the embarrassment of losing a policy responsibility (for payment system competition and efficiency) it had only just been given. Its attitude changed quickly. Ironically, in the event, the UK's OFT is yet to strike a blow against credit card schemes. As of now, the main impact of the Cruickshank recommendations has probably been on the the Reserve Bank of Australia. Fairly ironic.

When the Parliamentary "Banking" Committee again 'heard' from the Reserve Bank in May 2000, the first question on payments policy issues was not surprisingly about the implications of the Cruickshank report for Australia. Suddenly, credit card schemes had become "a very interesting subject" to the RBA and it was "simply trying to find out what is going on and what the flows of fees are" -- although the community should have contained their expectations because it was concurrently said to be "intensely complicated". These encouraging signs were nonetheless qualified later in the hearing when it was commented that: "We are not a consumer protection agency at the Reserve Bank".

Left unsaid was that enough detail of the excesses of banks' credit card schemes had been sufficiently well known for some years to warrant strong regulatory action that was never taken. The study was touted as 'new'.

Things about credit cards were clearly moving quickly and when the 'hearing' of the RBA was rejoined in December 2000, it was against the backdrop of the then recently published report on transaction-card schemes prepared in the Reserve Bank but published jointly with the ACCC. Among other things, which agency was responsible for competition policy issues about credit cards was said to be 'fuzzy'. By then of course the Reserve Bank had more or less decided to take over the prosecution of credit card policy issues with the banks, ostensibly because the prosecution launched by ACCC was about to "get bogged down legally". All this came to pass at Easter 2001 when the RBA 'designated' credit card schemes and the ACCC conceded the transfer of this responsibility. Remarkably, the RBA never mentioned to the Banking Committee that is own powers were untested and likely to be challenged, as the banks had always promised. (As noted, the ACCC is about to re-enter this debate through its 'investigation' of the banks' BPay scheme modeled on the credit card arrangement, complete with an interchange fee)

-- one question at a time

By May 2001 the game was on in earnest. Among other bon mots -- "credit cards are the biggest issue at the moment" -- was tendered as an explanation of why needed action was not being taken to follow up previous assessments that the customers were also being creamed by excessive fees for ATM and debit card transactions.

The "Banking" Committee was not impressed, very sensibly asking then for "a total policy approach" and subsequently issuing a press statement headed "Reserve Bank told to get its act together" -- and requesting that interchange fees on ATM and

EFTPOS transactions be fixed 'as soon as possible". The Reserve Bank was not accommodating on the day, or subsequently. That apparent disregard of Parliament is reasonably a matter of some concern -- especially when the previous history of mishandling this 'total policy' matter reveals so much to be desired. A concern likely to be reinforced shortly by the probable exposure of the Payments System legislation as inadequate to the task of promptly delivering what the Reserve Bank regards as good public policy. Alan Fels would be wryly amused.

The Parliamentary Committee is about to realise that it has been 'yes ministered' -- a costly, pointless legal stoush will further delay a properly coordinated and effective approach to regulating the retail payments system. Time slips away -- and the money keeps rolling in, for the banks.

One could say that it is appropriate for the Reserve Bank to make decisions independently about its payments policy responsibilities, as with its monetary policy decisions. Against that stands a long history of inaction on issues about competition and efficiency in retail banking. The Parliament had every right to ask for a 'total policy approach'. And beyond that there can be a fine line between independence and insolence.

The debate rejoined

It is a long time between drinks in this policy wasteland -- and the public thirst is apparently never to be satisfied. Dawdling ineffectiveness begs the question of any resolute intention to bring the retail payments system to order about its efficiency and competitiveness.

A couple of questions should have been asked and answered some years ago,

- first, should the trade practices law proscribe uniform pricing agreements that have not been cleared by the competition policy authority?; and

- second, why is a line of credit not offered on debit card accounts?

We live in hope.

EXTRACT 22

MAY 2002, REGULATION COLUMN IN "CFO" MAGAZINE FOR JULY 2002

(An article lamenting the way lawful authority has been disparaged by misusing commercial power is expected to be published towards the end of June. A copy will be provided in due course)

EXTRACT 23

JUNE 2002, RBA AND PARLIAMENTARY COMMITTEE

"A GOVERNOR UNEASY"

The Reserve Bank met with the Parliamentary Banking (EFPA) Committee on 31 May, and the discussion turned to the pending confrontation with the international credit card schemes. The transcript suggests the Governor was a little uneasy. On the last page of the transcript his response to two questions included the deflective and patronising remarks -- **"Your question is a good one"** and **"It is a good question".** The Governor's responses to these and other questions on payment system policy issues do not warrant the same accolade.

-- a Governor under pressure

Predictably, the Governor, and Chairman of the Payments System Board, is under pressure on payment system policy. The Reserve Bank, in December 2000, before this same Committee, undertook to take on the international credit card schemes single-handedly. In doing so the Reserve Bank effectively grounded the ACCC, then labouring without effective legislation in its prosecution, for 'price fixing', of the Australian bank issuers of credit cards. In doing so the Reserve Bank did not then acknowledge its own vulnerability to a legal challenge, and it seems to be still in 'denial'.

The Reserve Bank could have used its weight to press for effective trade practices legislation and bolster the ACCC -- by choosing to go it alone, the Reserve Bank may now be seen as having spent another two years in a bureaucratic quagmire.

Australia still needs effective trade practices law. The current review of the trade practices law will hopefully drive effective legislative reform. Hopefully also the Reserve Bank will condescend to make an effective contribution to the case for this much-needed legislative action -- to ensure the ACCC has effective authority over anti-competitive trade practices, including in the banking industry.

-- a Governor overconfident?

The superficial impression created by the Governor about the Reserve Bank's authority over credit card schemes, was one of overwhelming, if not overweening, confidence.

In building the impression of an unassailable facade, the Governor remarked on the carefully developed policy work designed to bring the credit card schemes to heel -- **" Our next paper is actually going to be the outcome. It is not another discussion paper. It is going to say 'As a result of these discussions, these are changes that are going to be made".**

A little further on in the proceedings the Chairman of the Parliamentary Committee observed that -- (once the Reserve Bank decides) **"There is no right appeal at this**

stage" and went on to politely inquire whether "we" should be concerned about the lack of a right appeal.

On cue, the Governor said he was not really concerned about a right appeal -- reiterating his view that **"... we have done the most thorough and public examination of this subject that has ever been done anywhere in the world. If you were to have an appeal process, presumably you would have to be expecting someone to be doing an even more thorough and detailed examination than we have done, and I cannot conceive how it would be possible or how long it would take."**

This sense of a Solomon-like, adjudicating umpire operating beyond reproach in splendid bureaucratic isolation was nicely captured in Governor's opening remarks to the Committee. Having said about the credit card matter that ".... **we will release our findings, some time after the end of June"**, he went on to say that **" ..... we at the Reserve Bank have not engaged in public debate on this subject, even though others .... have been quite vocal".** What the Governor did not say was that the only group that had effectively said anything substantial by way of response to the Consultation Document was the banks that have been doing a good imitation of a rabbit in a trap. Nor did the Governor note some timely media editorialising with which he would have been in very grateful agreement.

A little later this sense of benign oversight gave way to a little chagrin -- the Governor identified the Australian Bankers' Association as the self-serving publisher of a letter highlighting the plight of the smaller banks likely to cease offering credit cards to their customers.

-- the numbers are about to go into the frame

Some big bets have been placed here -- and the horses were already in the home straight. The announcement of the Reserve Bank's decision ("the outcome") is imminent. And so presumably is the reaction of the international credit card schemes, as represented in Australia by the 4 Pillars.
Even casual observers would be astounded if there were no appeal against decisions of the kind foreshadowed by the Reserve Bank. The Governor may well get the opportunity to appreciate how an appeal might be conceived and how long is the 'forever' it would take. Appeals are sometimes about buying time -- and continued access to revenues much more than the lawyers charge.

In all the circumstances one would have liked to hear that the Governor has placed a 'saver' bet on the commonsense of strengthening the trade practices legislation.

The one platform from which an appeal could not be successfully mounted would be the platform on which the general community stands. In the Reserve Bank we now trust -- fingers crossed.

-- has there been a 'ring in'?

While one would like to perish a particular thought, it has tended to recur. It is conceivable, however hardly, that the negotiation process between the banks and the

Reserve Bank has entailed some plea bargaining designed to keep the matter out of the courts, but possibly at the expense of allowing some concessions against the broader public interest. Something like this appears to have happened in Europe a year ago when a previously clear intention to substantially outlaw interchange fees in credit card schemes there was abandoned for a draft agreement requiring only marginal and delayed reductions.

At a couple of points in the Governor's recent testimony there were hints of recanting positions taken in the 'Consultation Document' issued by the Reserve Bank last December. There was one unsettling exchange. The Committee turned its attention to the credit card matter and the Chairman sought insights into the way that the Reserve Bank's thinking may have changed since December. In response the Governor said some of the arguments being put forward now were **'different'**; that **"there are some newer ideas which have come up in the second round..."** and **".... the differences between the parties will be smaller than when we started".** This exchange begged a couple of other questions that were not asked. We are left on tenterhooks.

There was another cautionary exchange as well. Responding to a suggestion that the banks may have been engaged in price-fixing, the Governor semantically substituted **"... the key price in the system is collectively set"** and eschewed the term **'price-fixing'** favoured by the ACCC and its competition authority counterparts abroad when assessing credit card schemes. The Reserve Bank is not into looking back for a number of good reasons.

Among the reasons may be a concern about the possible imposition of penalties designed to reclaim from banks any gains ill-gotten as a consequence of illegal 'price-fixing' in credit card schemes. Collectively any such 'penalties' for the banking industry would run to enough billions of dollars as to bring a blush to the cheek of any central-bank Governor. The USA courts recently legitimised a retailer class action against bank card schemes where the nominal stakes run to some $100 billion.

Our Reserve Bank would not do the European crawl-back -- would it?

-- not really comfortable at all

(i) why are credit card schemes profitable?

An underlying unease characterised the Governor's 'confident' talking about payments matters -- not least when responding to a question about credit card interest rates being 'high'. The no doubt careful briefing about credit card transaction schemes being excessively profitable because of the uniform (if not 'fixed') interchange fees, tended to get forgotten under pressure of an indirect question. The Governor said **"If everyone paid back during the interest-free period, clearly they (banks) would not be making much money out of the credit card system"**. Incorrect response.

This response does not appreciate that a preferable alternative to the credit card is a debit card with a line of credit 'overdraft' attached. In that event, it is unlikely that the interest rate charged for such personal 'overdrafts' would be materially different to that now charged for credit card debt. Practically, the most obvious effect of fewer credit cards (apart from no interchange fees) would be an offsetting reduction in both

bank deposits and bank loans, because customers would draw down their transaction account deposits before drawing credit from the overdraft facility. As things now stand with credit card schemes, the customers able to pay back during the interest-free period do so mainly using funds held in transaction accounts on which they are not being paid interest of any consequence. It is 'tit for tat'. Any alleged revenue consequences for credit card schemes are mainly a consequence of contrived transfer pricing arrangements purely internal to banks artificial accounting systems -- accounting systems that have been misused to take various public authorities for a few laps of the dance floor when trying to understand credit card profitability.

Make no mistake, the excessive profitability of credit card schemes reflects interchange fees primarily and other elements of merchant service fee agreements. Lending interest rates are a separate matter.

(ii) the BPay racket

Almost as an afterthought, the very last question on the day was about BPay: in particular -- has there been any liaison between the RBA and ACCC with respect to BPay? (-- aspects of which the ACCC was said to be looking at).

"It is a good question" said the Governor in an uncharacteristic display of understatement. The next useful remark -- **" It (BPay) involves an interchange fee."** -- was a formal admission for which we have waited a very long time.

And then it got interesting. The Governor opined that someone had made a complaint to the ACCC about BPay, and **"They have to follow up any complaint that is made to them".** He then said**, "I have not spoken to them (the ACCC) about it".** Left unsaid was that the Reserve Bank does not have to follow up complaints made to it.

One can only wonder why not. The BPay matter has been simmering for five years. The relevant public policy issues about BPay are almost identical to the features of credit card schemes now agreed to be objectionable. All this has been publicly suggested repeatedly, and in correspondence, for some years. One might reasonably wonder why it has only now become imperative that a complaint be followed up -- and by the ACCC. One might equally wonder why some merchant beholden to the banks has had to complain before something is done to redress an objectionable situation long clearly understood to be so in both the Reserve Bank and the ACCC. Equally relevant, there have been repeated assurances about effective ongoing liaison between the RBA and ACCC, reflecting the 'memorandum of understanding' on the administration of overlapping responsibilities. What happened to that understanding?

The most sensible perspective on, and result for, the BPay matter is that it is resolved automatically along the same lines as the credit card matter. Nonetheless, for that resolution to be achieved promptly "some time after the end of June", one might have expected the Reserve Bank to be making some preparation. Some authority obviously needs to make detailed inquiries and propose policies requiring the banks to reform the terms on which BPay is offered to billing companies and participating member banks. I am pleased the ACCC is doing this -- at long last.

Surprisingly, none of this urbane commonsense was evident in the Governor's

response -- and one regrets the Committee ran out of time to inquire why he **"had not spoken to them about it"** given that the story had been topical for some weeks.

Perhaps next time the Committee meets with the Governor there will be time for some lingering reflections on BPay. There sure should be. Stay tuned to this story.

End piece

The are a few answers about to be given to some long burning questions about credit card schemes and retail banking policy matters more generally.

Having banished the thought that the Reserve Bank would now back down, or water down, its proposed 'effective abolition' of interchange fees for credit card transactions, it is near time for a game of 'who wants to be a millionaire?' Among the contestants are many lawyers convinced that justice will not be done until enough lawyers have been paid. Worldwide there are some well known high rollers each with a lazy billion or more per annum at stake, and they want the wheel to spin for a few years yet before the game is up. Bet on an appeal being lodged -- and savor the thought of the Reserve Bank Governor going through the process of actually conceiving it.

That said, the more productive game is now likely to be played out before the committee reviewing the trade practices legislation. Given that closing date for submissions is 21 June, one can only pray that the Reserve Bank Governor will make a 'saver' submission arguing for effective trade practices law, against the possibility of some misplaced confidence in **"our next paper is actually going to be the outcome"**.

Someone's credibility is about to be dented -- and may I generously hope that it is mine.

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Peter Mair 15 June 2002