**SUBMISSION TO RESERVE BANK REVIEW OF CARD PAYMENTS REGULATION**

**PETER MAIR – APRIL 2015**

**REGULATING CARD-PAYMENT PRICING**

The benchmark proposition here is that, were simple ‘fixed’ transaction fees to replace ad-valorem (% based) fees for retail banking transactions, there would be not only no ready rationale for controversial surcharges on credit card purchases but the competitive efficiency of the retail payments system more generally would be improved.

While perceptions can become confused with the passage of time, the de facto proscription of ad-valorem transaction fees was mooted initially by the RBA itself in December 2001. Reforms proposed then would have excluded any allowance for ‘free credit’ in the transparent costs eligible to be recovered in interchange fees. In the event, inexplicably and not explained, a too-generous cap of some 0.5% was set for these fees effective 2003.

The cap remains but, observed on an ‘overall’ basis, it accommodates a game where much higher impositions are levied on some purchases in exchange for flyer-point ‘rewards’ to premium card holders.

The upshot for many years now has seen the RBA – and the wider community -- outpointed by major banks playing with the regulatory framework when offering credit card and like facilitie**s** on excessively profitable, cartel-like terms.

The sense of the major credit card schemes being offensive in their operation – especially excessive interchange fees -- is apparently widely appreciated by banking and trade practices regulators but any corrective intervention has been both tentative and of modest aspiration – that regulatory reluctance needs to be explained.

In short, whatever justification there may have been for ad-valorem interchange fees when the product was in its embryonic and early development stages has surely ceased to apply to what is now such a mature and ubiquitous product.

It is time to put a stop to such systemic exploitation and the following makes the case for doing so.

**The indictment of credit cards**

While it is comfortable to always have a few thousand at the ready in the pocket, it is not necessary that a transaction facility with a line of credit be linked to a conventional credit card.

On the contrary, the conventional credit card product is now best assessed as a redundant contrivance distinguished only by the levying of an ad-valorem interchange fee on transactions. The very same piece of plastic in pockets is typically also a debit card enabling EFTPOS purchases and ATM access that attract only small fixed transaction fees if any. Those needing credit could have an overdraft line of credit attached to a debit card and it is indicative of cartel pricing that access to credit remains tied to credit cards.

Put more sharply, conventional credit card schemes are now simply a self-serving racket run by banks.

Among other things:

* The ‘free credit’ proffered is essentially illusory – not only do users in continuing debt not get any ‘free credit’ at all but those paying the whole balance before the due date are most likely doing so with funds held in a deposit account on which no material interest is paid. It is a contrivance to require separate credit card accounts.
* Purchases with credit cards which are ‘fee free’ to customers actually attract excessive fees, paid by merchants but inequitably recovered in inflated retail prices charged to all – as well, customers wanting to minimise any fixed fees for EFTPOS purchases are sensibly likely to use the credit card. This ‘competitive’ card fee structure is perverse.
* The indictment of systemic misbehaviour known to be deliberately profiteering was initially associated with so-called ‘scheme debit cards’ – effectively ‘no credit’ credit cards as customer purchases would always be funded from balances already on deposit. Banks pocketed ad valorem interchange fees at credit card rates.
* Associated ‘traps’ for credit card users include excessive fixed penalty fees for ‘late payments’ which only compounds the sting of backdated credit charges levied at excessive interest rates – to say nothing of the prospect of undisciplined customers overspending and carrying expensive debt. The commercial brutality of the penalties for actually using credit card debt facilities belies the name of the product – banks would be wary of customers needing to borrow at credit card interest rates and inadvertent late-payers are given no concession for idle funds in matching deposit accounts. Such uniform gouging is again indicative of a cartel denying competition.
* The basic racketeering indictment is only underscored by the proffering of ‘flyer points’ for purchases using premium cards for which the interchange fees are loaded mainly at the expense of merchants in high-margin retail operations – this gaming of the ‘cap’ is offensive. Conversely, when merchants surcharge excessively, card issuers, complaining loudly of ‘profiteering’, demand caps on merchant surcharges while ignoring their own misbehaviour. The community loses.
* So also offensive is the further refinement of a racket that combines bank-cards with T&E charge cards. These schemes -- AMEX/Diners -- are a contrivance for tax-avoidance, converting an unfairly ‘loaded’ tax-deductible business expense into tax-free personal income in the hands of the named card holder. Proscribing ad-valorem fees for card transactions would end this contrivance of personal ‘rewards’ financed by loading business-fees.
* New fronts for exploitation have opened in the guise of ‘travel cash’ and other variations of pre-funded ‘cash-cards’ attracting ad-valorem fees on card loads and overseas purchase and cash-out transactions.
* ................. and one can only wonder about the implications of ‘tap and go’ enhancement of the functionality of credit cards exclusively............whatever the potential for the cartel-like VMC duopoly to substitute ‘card currency’ for conventional cash, with attendant erosion of seigniorage, the dominance of VMC schemes globally is an impediment to the commercial development of competing electronic-cash technologies.

**Why does the racketeering continue?**

The indictment of the major credit card schemes as racketeering gathered strength and credibility from the development of the electronic payments technology and substitute products that exposed the exploitation locked into the mirror-image cartel-like nature of the dominant schemes.

Presumably the ever-growing dominance of the VMC schemes globally gives them and their bank associates considerable commercial power and political clout – the messy regulatory compromise in Europe accepting ad valorem interchange fee caps for both credit card and debit suggests it is not easy to get out of the ad valorem game. Australia could and should take the initiative to do so.

Locally also, presumably, there is lingering ‘protection’ of the interchange fee racket flowing from joint venture provisions allowing collective price setting practices.

Whatever, one cannot also help thinking that it suits the banking regulators to allow banks to have access to these excessively profitable arrangements at the expense of the wider community. Viewed in this light, the racket becomes almost a de facto enhancement of the capital of the banking system. Put differently, allowing the credit card racket to continue endorses a discretionary regulated ‘tax’ unfairly imposed on the community without any justification – a tax imposed by a self-declared ‘reluctant regulator’ but one not owning up to being a reluctant de-regulator and corrector of unintended consequences of other regulatory shortcomings.

This thinking is only endorsed by the associated appalling regulatory nonsense that allows major banks ‘alone’ to engage in bartering arrangements – free transactions for interest free deposits – at the massive expense of sustaining an insurmountable barrier to entry to ‘new banks’ and ensuring the ‘death by takeover’ of any erstwhile competitor with pretensions to viability.

This ‘no’-cost deposit base is now running towards one trillion dollars.

Why is retail banking run like a cartel? -- Banking regulators also like it like that, apparently.

.........and that, so far, says nothing of related consequences -- the now substantial (and, at times, massive) tax evasion associated with the not-taxed, income-in-kind of underpriced services; the misuse of associated excessive profits in retail banking to plunder wealth-management and other business opportunities; the predictable inefficiency of a retail payments system operating so perversely without any semblance of explicit cost-based prices.

Australia is paying a high price for the privilege of its major banks and banking regulators enjoying the quiet life of operating and overseeing a commercial cartel protected by discretionary de facto regulation that is ‘unlegislated’, ‘unwritten’, ‘unseen’, and ‘unspoken’.

Australia is not alone: consumers globally are routinely abused by banking arrangements and regulatory settings that are similarly exploitative and nonsensical.

What happened to ideals of regulatory integrity?

**Locked into an unspoken deception**

An obvious ‘clean slate’ regulatory response to the current distorted market mess with credit cards would start from the premise that fees charged for retail banking transactions would best be fixed fees reflecting the costs of providing the transaction. Implicitly there would be no ‘ad valorem’ fees akin to the current interchange fee arrangements or potential substitutes, such as ad valorem fees linked to merchant card-sales revenue. Merchants would recover their costs of card-sale transactions – including fees paid to banks – from sales revenue or possibly surcharges reflecting the small fixed fees paid to banks.

In the face of such prospective simplicity it is difficult to understand the need for such discursive exploratory expositions of the claimed policy challenges as set out in the Murray Committee report and the related RBA discussion paper nominating ‘issues for consultation’.

Murray Committee processes were opaque – nothing was disclosed about its consultations. It now seems, comparing its report and the related the RBA discussion paper, that some common ground was agreed with the RBA about the need to address issues with credit card pricing -- even so it also seems that simplicity was not an objective of the resolutions explored.

Addressing details of the many contrived possibilities so floated for ‘reform’ in these papers would only compound the prospect of mind-boggling regulatory complexities. I won’t.

To re-state a relevant conclusion of the Murray Committee, a regulatory regime proscribing such ad valorem transaction fees would likely *‘improve clarity, enhance competitive neutrality, improve the efficiency of price signals and reduce cross subsidisation’*.

The ‘official’ reform proposals floated for discussion apparently assume that there is a continuing need for ad-valorem fees – any such ‘need’ has not been established. In seeking to reconcile this ‘locked in’ mentality one can only think, Irishly, that we would not start from ‘here’ to get where we want to be.

The RBA should explain clearly the rationale it sees, if any, for ad valorem transaction fees for credit cards – and why banks do not simply offer a line of credit with debit-card deposit accounts.

Put differently, as I see it, there is no continuing role for the conventional credit-card product when an overdraft line of credit could be appended to a conventional debit card product – mostly banks would not even need to issue new cards.

Nietzsche may sensibly say ‘the credit-card should be dead’: sensible regulators would kill it.

**End piece**

I am no admirer of the prevailing regulatory regime for retail banking in Australia or our usual reference group of other like countries.

The convoluted and dissembling character of any discussion of retail banking regulation here and abroad is fair warning of a need for scepticism when considering official reform proposals and Jack Horner like, self-congratulatory claims of how well they have done so far in regulating the retail banking and payments system. A banking cartel running amok with the support of the regulators is not the best outcome.

A sense of deliberate deception is only reinforced by the realisation that the regulators and the regulated are the major beneficiaries of the otherwise patent nonsense entrenched in the current regulatory environment.

If the way things are is the way they are intended to be, then the ‘responsible’ regulatory authorities have much to explain much more transparently than has ever been done in recent memory. There is clearly no intention to do this.

Whatever, if there is any genuine commitment to addressing the damage being done by credit card schemes specifically, the character of the discussion would be so very different to what has been paraded as the ‘relevant issues’.

The proscription of ad-valorem fees for retail banking transactions, effectively first mooted by the RBA in 2001, should be reconsidered. With modern PIN authorisation technology and automated account monitoring keeping credit card ‘fraud’ to manageably low levels, and the similarly sophisticated management of settlement risk there is hardly any rationale for charging ad valorem fees of any consequence for credit card transactions.

Proscribing ad valorem fees for credit card transactions would remove from the table most issues about associated regulatory policy.

Please proscribe such ad valorem fees – or, please, clearly explain any continuing need for them.

Peter Mair 14 April 2015