SUBMISSION TO COUNCIL OF FINANCIAL REGULATORS

STORED VALUE PAYMENTS FACILITIES

Why….. ever……anywhere ……hasn't any so-called stored-value payments facility, with broad functionality, come to more than passing prominence?

The context for that question is a too narrowly defined concept of purchased and stored-value payments-facilities -- it abstracts from established stores of value routinely exchanged in transactions.

Practical concepts of routine payments facilities embrace value stored as currency, in bank accounts, linked bank cards, linked credit limits and, now, the link to a tap-n-go chip technology that so practically approximates e-cash.

Some twenty years back the Mondex stored-value arrested attention globally, even more so when the Bank of Japan recruited IT specialists to combine Mondex with Digicash, then another ambitious digital payments innovation. All this came to naught – and MasterCard took Mondex out of the game.

More generally, even limited SVF schemes, like transport cards, with credible ambitions to embrace other small cash purchases at transport hubs, have not attached commercially viable extensions.

For starters, one answer to 'why not' is that there was no need and no viable market.

The best (and only) prospect was for the development and adoption of one dominant global technology for e-cash. Broad-based international cooperation and coordination between monetary authorities never happened. Even the prospect of a national proprietary scheme having the critical mass prerequisite to a successful innovation may not be credible.

In the event the successful practical commercial achievement of an e-cash vision for a stored value facility belongs to the mirror-image Visa and MasterCard schemes now entrenched globally as a de-facto cartel.

THE BANKCARD CARTEL

On reflection it is inexplicable that the VMC credit card cartel was for so long been protected and cosseted by regulatory forbearance -- in the US and UK and Australia and Canada among other commercially dependent and compliant countries in that reference group.

As is, the VMC credit-card schemes and associated debit-card complements have taken first-mover advantage in the use of pay-wave & tap-n-go functionality. On the face of it their competitive dominance, beyond continental Europe and China, is unassailable and eventual global dominance cannot be ruled out.

There are some signs of national side-plays not likely to trouble VMC promoters. Some countries have separate EFTPOS card schemes but, in Australia for example, tap-n-go payments are processed and priced as 'credit card' transactions. As well such national schemes may be strategic plays by local owner-banks to protect local franchises. On another tack retailers may route transactions to alternative acquirers but changed scheme participation fees may restore the cartel character.

Whatever, the 5-year history of very buoyant prices for Visa and MasterCard stock is hardly indicative of any looming credible threat – on the contrary.

Put differently, almost anywhere in the developed world these days there is no need for conventional cash currency and no sensible traveler would leave home without a couple of VMC credit cards almost universally accepted. Prospectively, universal debit-cards are also right on the money.

This reality, this prospect should have the rapt attention of financial regulators globally.

SOME DISTURBING HISTORY

It is looking likely that central banks are about to repeat, with the VMC cartel, a mistake made with major-bank transaction accounts, starting in the 1930s.

Precluding the payment of interest on transaction account deposits was an initially benign deception in troubled times to bolster bank solvency.

That aim was compromised. Banks and customers soon gamed the system with a tax-avoiding barter scheme -- swapping 'free deposits' for cross-subsidized 'free banking' but leaving residual 'free profits' in banks hands.

Eventually, what was once benign became a destructive competitive force in the wake of deregulation and high interest rates in the 1980s.

In short, the 'free profits' residual in the hands of banks surged globally, unleashing competitive power allowing major bank beneficiaries to destroy the competitive environment in markets for retail financial services. This was nowhere more so than in Australia as the cosseted Pillars laid waste to the state banks, the foreign banks and the new building-society banks as well as retail insurance, stock broking, et al.

This was disgraceful. The problems were eventually compounded by the defective 1988 BIS guidelines ensuring 'bank capital **<u>in</u>**adequacy' and an eventual global financial crisis.

Still to come were the consequences of ‘low interest rates’.

The once benign mistake of the 1930s, having destroyed the competitive environment with high rates, was now -- is now -- working perversely to undermine bank capital positions and the moral and ethical culture in banking and retail financial services.

In short, the profits and solvency of retail banks was long partly underwritten by the capitalized value of the ‘rents’ taken as ‘free profits’ from ‘free deposits’. Low interest rates pulled this magic carpet of entitlement leaving major banks as exposed and vengeful as a wile e coyote.

WHY DO IT AGAIN?

Leaving what remains of the actual and prospective currency-of-the realm in the hands of the VMC cartel may now be considered too silly to contemplate.

There are two angles to this question.

One, however it happened, it may be that VMC now run the game and will continue to do so.

The other is about regulators not repeating the ‘free deposit’ / ’free profits’ mistake -- i.e. not allowing VMC to knock off the remaining ‘seigniorage’ on the currency issue that belongs in the public purse.

Putting the ‘one’ and ‘the other’ together suggests that the issue of any form of ‘currency’ – including tap-n-go substitutes be made subject to a special bank-tax regime to preclude profiteering at the expense of the community.

The sense of doing this, even in Australia, goes back to the mid 1800s when the states started taxing the issue of banknotes by the private banks.

The plain nonsense of **not** doing so goes back to the 1930s but, illustratively, it reached its zenith in the 1980s (see above).

It was a major mistake to not see what was happening, as nominal interest rates rose, and not address the competitive disruption -- on the contrary, so-called deregulation aided and abetted the destructive consequences of the undue enrichment of major banks.

MEETING THE CHALLENGE

Ideally the international brotherhood of central bankers would develop a global plan to deal with the commercial capture of seigniorage and return ‘free profit’ entitlements to the public purse everywhere. Alas their form guide is appalling.

Australia should nonetheless go it alone and set good example.

The prospective mechanics of that are probably obscure, complex and challenging.

At the very heart of any sensible approach would be the imposition of a special ‘seigniorage-tax’ on those – major banks – issuing currency substitutes including ‘transaction account deposits’, payment cards and ‘e-money’ cards. The ‘free profits’ now flowing to major banks and VMC promoters should in future be returned to the public purse.

There are tactical issues – starting with a full and frank explanation to the community of the need for wholesale reform. Reforms would sensibly see the demise of ‘free banking’ and the establishment of explicit user-pays full-cost related pricing of retail payments services.

Beyond that it is likely that one useful and sensible initiative would see an end to the tax-avoiding barter scheme now entrenched in the economy’s primary store of value, transaction account deposits on which no material interest is paid.

The income-in-kind ‘paid’, as free and underpriced banking services, instead of taxable interest income, can be made accountable for income tax purposes by deeming taxable interest to be paid at the ‘cash rate’ on customers’ daily deposit balances.

Complexities may lie in the approach needed to ‘tax’ and otherwise regulate VMC e-cash operations to protect the entitlement of the community to the remaining seigniorage otherwise likely to also be captured by the schemes and participating banks.

The time to do these things will never be better than now -- before interest rates start to rise.

HIGH DENOMINATION BANKNOTES

Currency, banknotes in particular, is a quintessential stored-value payments facility.

Taking ‘currency’ out of the game would make more likely the commercial development of alternative stored-value facilities and e-cash more generally.

All retail payment instruments are more or less convenient variations of funding payments from a store of value (including a credit limit).

The frontline to this end is increasingly occupied by VMC, including now for small-value e-cash purchases.

In Australia, and some comparably developed countries, it is increasingly remarkable that continuing high demand for high denomination banknotes contrasts with their ever more evident redundancy as a circulating payments medium.

The role now being played by high-denomination banknotes is mainly as zero-coupon bearer-bonds misused for facilitating tax-evasion and black-market activities.

Another role for currency notes in Australia, and other countries, is as the source of 'seigniorage' funding central bank operations -- this as opposed to standard budget provisioning for funding central bank operations in the same way as other public policy agencies.

There are evident public policy incongruities in this arrangement and the consequences extend to impediments to the development of retail payments facilities including ever more sophisticated variants of stored-value as the base.

PUBLIC POLICY ISSUES

If the focus of thinking about stored value payments facilities is simply as a raft of proprietary schemes with limited functionality then the public policy issues are of little consequence and mainly concerned with a suitable regulatory and consumer protection framework. None will be of any national material consequence.

The plot thickens once the focus shifts to the way banking authorities have inexplicably allowed the development of currency substitutes to remain in the hands of commercial banks and associated payment scheme promoters.

There are sobering lessons in the historic consequences of this forbearance. Now there is the newly pressing prospect of a global e-cash innovation linked to VMC scheme operators and participating banks.

Central banks are sensibly wary of bitcoin-style payment innovations but, apart from a watching brief, apparently have no real interest in being a product issuer either individually or collectively internationally. That reluctance could be considered 'disappointing' if the likelihood is for some variant of blockchain technology eventually having a dominant retail payments application.

For the moment, however, the appropriate focus and concern lies with the practical reality of the global VMC cartel extending its dominance, not least taking conventional currency out of the retail payments game with a consolidated package of credit cards and debit cards with tap-n-go payments approximating e-cash.

Given that prospect, the next sensible public policy initiatives should aim to both reclaim the seigniorage being lost to transaction account deposits and similarly head off the comparable looming consequence of e-cash developments displacing low-denomination note and coin.

Putting in place a properly functioning price system in the market for retail banking and payments services may be a very welcome and intended consequence.

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