PREAMBLE FOR COMPETITION POLICY REVIEW

What follows is the text of my second round submission to the 'Murray Inquiry' into the Australian financial system; it complements my initial submission to that inquiry which was, in turn, the basis of my first submission to this review.

In explanation, I note that, as both these policy-reform initiatives are essentially concurrent and overlapping, it is sensible for each to have regard to the issues raised in submissions with the other.

This perspective is especially relevant in the wake of the FSI largely sidelining 'competition' and 'regulation' issues following the surprising but apparently pre-emptive assessment by the Murray panel that the financial system is generally 'competitive and well regulated' (beyond some apparent preoccupation with 'too big to fail' concerns about the four-pillars).

This general view is, I contend, not widely shared and there is considerable and burgeoning evidence to the contrary – especially in the consumer protection arena.

In short, if the Murray panel is not inclined to address these matters then many will be hoping that the 'Harper' panel will.

That said, it may be too much to expect the Harper panel to engage in detailed assessments of the elements of the financial system. Rather, the hope may instead be for revised competition policy benchmarks that will, in application, embrace the financial system.

In a letter to David Murray dated 30 September, I wrote in part:

Apart from the implications of general community concerns, independent observers making submissions want regulators made more accountable – one option is to restructure and reorient the Council of Financial Regulators (CFR) to ensure regulators, individually and collectively, work co-operatively with an independent governing board and expert secretariat.

An alternative proposal to address regulatory complacency is being floated by the Competition Policy Review: in essence, it would institutionalize, within the ACCC, an independent market-studies body "to examine the competitive dynamics of particular markets in a systematic way".

The essential commonality is about expert independent market studies driving assessments of regulatory performance.

So, in the context of the interim views of the Harper panel, my endorsement is for institutionalizing arrangements for the independent expert assessment of competitive outcomes informed by 'market studies' revealing bad regulation underwriting market failure .

To support that endorsement, the following draws attention to some particular matters – tax-avoiding bartering, inappropriate joint venture concessions for price fixing and the conflict of interest entailed in having the Reserve Bank 'responsible' for both the efficiency of the retail payments system and while relying for current funding on the 'seigniorage' from a grossly inflated national currency note issue.

Competitive and well regulated? – as I said to the Murray Inquiry, I do not think so.

REGULATORY FAILURE -- IS REGULATORY REFORM TO BE DENIED?

STRIKE TWO: IT'S TIME FOR PLAIN TALK

Setting the scene – the elements of an indictment

The interim report of the Murray Committee, reviewing the Australian financial system, admits some preconceptions likely to blur its vision and compromise its credibility.

Consider these *'Observations'* in the executive summary:

The banking sector is competitive.......

Australia's regulatory structure has served us well.......

Australia generally has strong well-regarded regulators.............

...........Australia's regulatory coordination mechanisms have been strong...........

Regulators' mandates and powers are generally well defined and clear.............

Now, not only do these preconceptions not reflect attitudes in the wider community, past and recent evidence is clearly to the contrary. Put more sharply, such preconceived assessments, not being correct, have no right to linger for much longer in the collective mind of this committee.

Wondering why the committee would choose to be so peremptory prompts a suspicion that the focus of its work is intended to be limited to a few key issues, including superannuation (too costly) and banking conglomerates (too-big to fail) along with some changes of emphasis - the limits of 'disclosure' -- and a role for a commercial bond market.

In short, the portents are for this committee to table some useful proposals but on a couple of particular issues only. If so, that prospect is very disappointing when there is a pressing need for wider ranging fundamental reforms – not least to the regulatory framework.

This second-round submission to the committee reiterates and reinforces some primary themes which, so far, seem to have been disregarded. That is disappointing – more so to a wider community looking for a better deal across the board.

[An appendix notes naiveties in the interim report questioning the credibility of the process.]

David Murray: ‘asking’ or ‘answering’ the key questions (or not)?

One concern with this inquiry is about the chairman necessarily shifting his mindset from a career-defining obligation to pursue shareholder interests to meet a very different obligation to the national community, one sometimes directly opposed to those same shareholders.

Such misgivings surfaced ahead of the inquiry being formalized but the Treasurer’s intention to put David Murray in charge of the inquiry was apparently determined at its embryonic outset.

So far the inquiry has been a bit of a black-box, lacking the transparency of ‘on the record’ reports of discussions with those deemed deserving of the private attention of the committee. Who asked what questions, of whom, and what answers were given?

These musings invite speculation around the maxim that those commissioning inquiries have confident expectations of the outcome, always. No one is given a clean slate.

The Murray Committee has one chance only to speak unwelcome truths to power and its chairman is well placed to reflect soberly on a legacy to which he contributed substantially.

It is not clear from the interim report that that will be done – on the contrary.

‘NO COMPETITION’ AND ‘POOR REGULATION’ – TWIN VALLEYS

Observations of the committee -- that the Australian financial system is ‘competitive albeit concentrated’ and that ‘the regulatory regime works well’ -- stand in sharp contrast to the very different understanding of many if not most in the wider Australian community.

Corollaries include, first, if the competitive process is not working, there is a role for direct regulation to correct market failure – and, second, for those that assess the regulatory framework to be in disarray, as is daily revealed in even sycophantic media, there is a clear need for fundamental reform of the regulatory framework.

Firmly held community beliefs should not be blithely dismissed simply because they are not properly articulated and unlikely to get a run when they are.

It is not as if appropriate regulatory responses will necessarily entail unrolling miles of fresh red-tape. On the contrary, market failure and its attendant exploitation thrive in a red-tape environment.

Two basic regulatory responses

....would do much to correct the present situation.

One response – the overwhelming need -- is about regulatory accountability and establishing an independent regulatory coordinator for the retail financial system to ensure it. Such ‘accountability’ should be an automatic process continually marking performance against objectives and not some occasional discretionary disciplinary event.

An appropriate co-ordinating body might be known as the ‘New’ Council of Financial Regulators. Its governance would best be placed in the hands of an independent board serviced by an expert independent secretariat. Membership of the Council would be expanded to include the ACCC and, among others, make provision to occasionally embrace the Australian Tax Office.

Importantly, the scope of a 'New' Council would be broadened to ensure 'merits review' of the performance of all member agencies. In particular, 'merits review' should embrace the RBA's presently specifically 'exempted' performance in a range of responsibilities well beyond its role in setting monetary policy.

Implicitly also, the establishment of a New Council would substitute for the ineffective role of various parliamentary committees nominally having performance review functions. This is not to say that some parliamentary committees investigating particular problems have not been very effective -- some have been. The basic concern here is about the likely independence, and relative competence of backbencher members asked to bring poorly performing regulators to book in a public forum. Usually, they cannot and don't do it.

A related reforming response,

....compensating for entrenched barriers to competition and accompanying monopolistic exploitation, would see players in retail financial markets voluntarily agreeing to supervised co-operation to deliver explicit pricing and product-quality outcomes 'as if' the markets were competitive – all overseen by and agreed with the Council as the regulatory coordinator for the retail financial system.

-- fundamental regulatory reform[1]

A founding charter of a NewCFR could make clear the intention to summarily address key issues and proscribe outright entrenched behaviours that are exploitative or otherwise offensive to community standards.

Appointing an independent board advised by an expert secretariat would allow issues of 'accountability', 'cooperation' and 'coordination' to be addressed in a collegial framework. Appropriate co-operation, newly in the public interest, would hopefully displace very evident problems attending separate regulatory fiefdoms pursuing conflicting private agendas under varying degrees of influence from powerful industry lobbyists.

It is envisaged that participants in markets for retail financial services would subscribe to a code of ethical behaviour – a benchmark 'golden rule' obligation if you like allowing adjudication of complaints in low-cost dispute resolution schemes. Practically, market participants, found by their peers to have misbehaved, would be required to compensate the customers they disadvantaged – as presumably *Which Bank* is now doing. Given that there is already an embryonic push to sign-up key players making personal commitments to an industry code, a more general expectation is no longer an idea from the left-field.

.... the present regulatory framework is not working well

Not to overstate it, any idea that the present regulatory framework is working well has no substantial foundation. Too much evidence is starkly to the contrary and the risk of future forbearance so great that it needs to be headed off at the pass. This inquiry is the pass.

[1] The 'unaccountable' independence of the RBA would embrace only monetary policy decisions.

For example, ASIC was recently publicly humiliated and 'sentenced' to the prospect a slow and agonizing death, hastened by concurrently scheduled funding cuts. Conversely, the community is fairly demanding that the job ASIC was supposed to do is reallocated to a regulator with the intelligence, competence and commitment to do it cost effectively – and to complain loudly if it is not properly resourced to do it. ASIC has run its race in consumer protection – it ran dead.

The US addressed these same issues by establishing a new consumer financial protection bureau and any local counterpart would be part of a New Council of Financial Regulators.

Beyond that the community is left wondering 'what happened' to an ACCC riding shotgun on the (un)competitive business of providing financial services. Worse, and unseen because the RBA is explicitly exempted from 'accountability', is the deeply entrenched inefficiency and monopolistic exploitation that has come to characterize the market for retail banking and payments systems for which the RBA, while the appointed regulator, is a self-proclaimed 'reluctant regulator'.

The RBA, charged to promote competition and efficiency in the retail banking and payments system, has simply declined to do so. Beyond monetary policy[2] , the RBA should be required to share these broader responsibilities with complementary agencies in a 'council' framework.

More generally, it is also simply not true in general that Australian regulators are 'strong and well regarded' in a regulatory framework that has 'served us well' with 'strong coordinating mechanisms' between regulators with 'well defined mandates and powers'. The opposite is too true too often.

The prospect of the Murray Committee disregarding this reality is unacceptable.

-- regulation conducive to inefficiency and unfairness

It is an ongoing national shame that no 'inquiry' or 'independent reviewer' has put squarely before the Australian community the basic operational mechanics of the market environment for retail banking and payments services. For the past 50+ years and ongoing, Australia has seen only the growing dominance of the corporate conglomerates known as the 4-Pillars.

Nor is it ever frankly acknowledged that this outcome is the consequence of bad regulation.

The Murray Committee did not fill this gap in its interim report – more pointedly, nor did the Reserve Bank in the 250 page 'snowball' it lobbed at the Committee as its 'submission'.

The RBA could have been expected do better

....and, when it did not, asked to do better.

In particular, one might have thought the RBA was 'on notice' to provide a more thoughtful response to the question 'why did the new foreign banks fail?' which was put to the governor

[2] ....including the issue of the mostly-hoarded, zero-coupon, bearer-bonds masquerading as high-denomination Australian currency notes but mainly aiding and abetting tax fraud.

at a senate committee inquiry in 2011: his dismissive response at that time was called 'nonchalant' by the senator not respected.

In the same general context, it would hardly be unfair to ask the RBA about progress with its history project – 1975 to 2000 – presumably still on foot almost a decade after being commissioned.

This 'history' may never surface. An objective commentary on the performance of the RBA through the 1980s would necessarily expose incompetence at that time and point up ongoing and unaddressed shortcomings.

As is, the policy approaches needed to ensure the retail banking and payments system is competitive and efficient seem to be beyond the ken of the RBA.

In respect of the 'nonchalance' displayed at the senate and still not redressed, it would be disturbing if the studied silence of the RBA was relying on a 2006 decision of the then treasurer to 'confirm its exemption from independent merits-review processes'. This general exemption goes well beyond monetary policy decisions and was directly contrary to a recommendation of a Productivity-Commission-like panel reviewing the regulatory landscape.

Subsequently the 'house' economics committee no longer asks questions about the RBA's management of the payments system. What's to hide?

The inappropriate entitlement to unquestioned 'independence' (beyond monetary policy matters) is shielding the RBA from accountability for a raft of poor consequences that may have been avoided had it faced the prospect of independent merits review by the Productivity Commission.

It is of passing interest here also that the RBA has not put a submission to the Harper Committee now embarked on a review of competition policy.

'Absolutely unacceptable'

is the well deserved response to this general stone-walling disdain for a community wanting a fair go, entitled to a reasonable explanation of what happened and grown tired of bankers and regulators and the politicians they advise, parading the prospect of 'competition' and 'consumer protection' where there has been little if any -- and similarly bleak prospects for any either.

Someone – this Committee in particular – needs to speak up.

.............some brief reiteration

[NOTE: Without labouring the points, brief chapter and verse on barriers to entry and impediments to competition and efficiency more generally, in markets for retail banking and financial services, is contained in my first submission to this inquiry.

Key points include:

- The predictably disruptive consequences of the 4-pillars having unaccountable access to the soft income earned on the -- currently $900 billion+ -- 'interest free' deposits in transaction accounts held mainly with them. At a minimum all customers should be deemed to have earned, and required to declare, taxable interest income on these deposits calculated at the 'deeming rate' for age-pensioners.
- The de-facto cartel-like domination of VMC branded credit-card products exploits 'joint venture' price-fixing privileges -- a deceptively marketed product, the credit card, is ever more a redundant contrivance that should have been displaced by debit

cards linked, as appropriate, to an overdraft line of credit. The ‘outlawing’ of any and all transaction fees charged, to customers, merchants or transaction acquirers, as a % of purchase values should be high on the final list of the committee’s recommendations.

- In respect of the retail payments system more generally the RBA decided to be a ‘reluctant regulator’ when its Payments System Board was established and has delivered on the threat to a fault. A poor performance, bordering on dereliction, and extending back over some 30 years and more would not stand even cursory scrutiny of its merits by any independent assessor of the community’s best interests.]

Accordingly ‘absolutely unacceptable’ similarly colours the prospect of the Murray Committee disregarding the need to explain how the 4 Pillars came to be ‘too big’ and will continue to be ever more dominant, and exploitative, unless their market power is restrained.

‘Hidden’ regulation – never mentioned, secretly buried but still very effective

As a day-to-day practicality it is fair to say that some little known regulations are affecting the retail financial system in ways that perversely underwrite the dominance of the banking conglomerates known as the 4Pillars.

These are the regulations which the 4Pillars never want repealed.

(i) the bartering tax break

In the normal course the Tax Office would take a dim view of commercial arrangements to deliver something valuable ‘for nothing’ while actually giving valuable ‘income in kind’ that is ‘not declared’ and not subject to income-tax. Banks do this with their customers routinely – valuable transaction services are provided ‘free’ (or underpriced) in exchange for ‘free’ (non-interest bearing) deposits in transaction accounts – currently some $900 billion+.

Not only is the associated tax-avoiding rorting of the public purse offensive in itself but more so are the consequences of allowing the 4Pillars to do this. Banks’ soft earnings on the ‘free deposits’ – overwhelmingly the 4Pillars -- far exceed any cross-subsidizing ‘loss’ on underpriced retail payments services. The leftover ‘surplus’ in turn feeds the 4Pillars’ ammunition box which finances destructive ‘competitive’ attacks on erstwhile competitors. With the high interest rates of the late 1980s, this process wiped out the then new foreign banks, the state banks and, soon after, the crossover building society banks.

There is a reason why the 4Pillars have an unassailably dominant position -- but ‘no one’ explains. The eventual contribution of the Murray Committee will be deficient if it does not.

(ii) joint-venture price fixing

The trade practices law allows participants in joint ventures, operating ‘in the public interest’, to collectively fix uniform prices and participants in various retail payment schemes enjoy this privilege.

Start-up payment ventures needing co-operation in the public interest become a very different proposition when the ventures mature and the cooperation becomes exploitative collusion against the public interest – e.g. credit card schemes.

The “Dawson” review of trade practices law in 2003 sensibly proposed to outlaw price fixing likely to substantially lessen competition and to require joint ventures to limit price fixing to the extent they could show was ‘reasonably necessary’. Dawson wanted to guard against joint venture agreements designed as a cover for anti-competitive arrangements.

In the event the Dawson reforms were not made and 4Pillars-ventures continue to fix prices in credit cards schemes and other retail payment arrangements in ways, and at levels, that would not be considered ‘reasonably necessary’.

Importantly also, this opportunity was not taken to restore the ACCC to a role in overseeing competition in retail payments systems. The ACCC would almost certainly have been tougher on the 4Pillars than the RBA. Ideally, in a more collegiate regulatory framework the RBA and ACCC would work cooperatively to better protect the public interest.

The 4Pillars would not want any change to ‘RBA only’ regulation of retail banking and payments – and that is itself a very good reason for making the suggested ‘Council’ changes to the regulatory framework.

Superannuation industry structures – a default role for the Future Fund

Superannuation industry structures unfortunately reflect historical origins in an exploitative, commission driven life-insurance industry. The subsequent emergence of a retail superannuation industry in private hands was the first time since federation that a major innovation in the financial system was not guided and tempered by a government-owned player balancing a fair go for the customers with sound commercial principles: *‘Which Bank’*, once the peoples bank, was a classic example.

Industry super funds have taken a moderating role akin to a government-owned player but the retail superannuation industry is still unsteady on its feet as recent policy roller-coasters and exposures of its inherent failings have illustrated.

It is not too late to reclaim a lost opportunity and one initiative would see the Future Fund reoriented as a national default fund able to play a balancing role in a still developing market.

END PIECE

The apparent temptation for the Murray Committee to ignore problems -- evident and entrenched -- with the retail financial system should be resisted.

There can be no presumption that problems ignored by this committee now will be better addressed by the Harper Committee reviewing ‘competition policy’ or the prospective ‘tax white paper’ or, worse, left festering until another inquiry is convened to address them .

Very real problems with the competitive environment and regulatory framework cannot be dismissed in unfounded ‘observations’ – they need to be dealt with.

Peter Mair

6 August 2014 and endorsed on 14 November 2014 to the Harper Review

APPENDIX

INTERIM REPORT: APPARENT NAIVITIES

The interim report will presumably stand 'as is' but it is worth suggesting 'corrections' at a couple of points lest the misperceptions also colour the final report.

It is fair to say that these shortcomings – some quite fundamental – are disappointing and could have been avoided with appropriate editorial assistance during the drafting process.

Competition

The first full paragraph on page 2-4 is naively text-book deficient and seems intended to rationalize an overly concentrated retail financial services sector. It fails to mention (or understand) the destructive consequences of the tax-avoiding 'bartering' and 'joint venture price-fixing' ensuring the dominance of the 4pillars and precluding any meaningful prospect of new entry to retail banking.

The deficiency carries over to the 'dot points' at the bottom of 2-5. See also CANBIs below.

American Express cards are not credit-card 'competitors'

The suggestions that 'Amex' [and 'Diners Club'] cards [2-23 ff] are competitors with credit cards issued by Visa and MasterCard are conventional enough and encouraged by the associated regulatory debate.

Even so, thoughtful reflection would suggest the debate is more than a little contrived.

'Travel and entertainment' cards, like Amex, are notable for two characteristics – the high transaction fees paid by merchants that underwrite generous reward-point schemes for card users. Now, because most spending with such cards is 'business expenses' but the tax-free 'rewards' are usually taken by card-users personally, the process is essentially one about converting a tax-deductible business expense into a tax-free personal income bonus.

In short, quite apart from the proposal that all ad-valorem interchange fees on retail payment transactions be proscribed, the market foundation for Amex and like cards would be undermined if the value of rewards was declared and taxed as personal income. Put differently, as currently operating, Amex and like cards are best assessed as tax-avoiding rackets than 'competing' in any meaningful sense with conventional bank credit cards.

Market power – ACCC

The acknowledged inaction of the ACCC in respect of the 4pillars (page 2-21) is not because nothing needed to be done – rather it is because around 2000 when the ACCC did intervene in the debate on credit-card pricing, it was unceremoniously shouldered off the field by the RBA which effectively acted to condone the 4Pillars' continuing exploitation.

Insurance sector

I have no expert understanding of the insurance sector (page 2-38) but suspect that, like banks, the prospects for competition are diminished as a consequence of using ‘soft earnings’ on accumulated reserves to cross-subsidize unfair competition.

More generally the use and misuse of technology is allowing insurance retailers to ‘dice and slice’ individual policyholders in ways that unfairly allow big-guy v. little-guy monopolistic discrimination and exploitation.

Housing and the age-pension means test

If any national community was as addicted to a ‘destructive substance’ as Australians are to housing, there would have been direct regulatory action to discourage it. The entrenched incentives to over-save in housing assets (page 2-52) need to be addressed more forthrightly.

And check with ‘Fred’ as outlined below for the destructive strategic retirement-income options on offer unrestrained.

Tax equality for bank-deposits.... (but not FOR CANBI’S)

The main problem arising in the tax treatment of bank deposits (page 2-80) is the way banks are able to use tax-avoiding bartering with CANBIs (current accounts not bearing interest) to underwrite their unassailable dominance of retail banking and well beyond. ‘No one’ ever recognises this -- but the chairman would be well aware of the role of CANBIs.

As for super funds’ growing role in holding bank deposits – is this in the best interests of fund members or sponsoring banks?

One is tempted to propose the exemption from income tax of all interest paid on bank deposits – the overall consequence would likely be entirely beneficial to the community but in ways that would horrify the 4Pillars (the fallout would also be instructive for whoever drafted this naive commentary on deposit-interest taxation in the interim report).

This commentary seems oblivious to the implications of CANBIs for denying competition in retail banking – and for rorting the public purse.

CANBIs exempted from tax on associated the income-in-kind now run to almost one trillion dollars – ponder the implications – make a horror movie featuring the 1980s banking crisis.

Consumer protection framework in financial services (page 3-50)

It is about time for some plain talk.

Illustrations flow daily about ‘consumer protection’ failing the community all accompanied by a cacophony of calls from offenders for ‘cutting-red-tape’ deregulation.

Participants in markets for retail financial services should be put on notice that any dealings that do not pass a 'golden rule' test will be set aside and any damage compensated by offenders.

"Would you like this to be done to you?" is a question which most answer correctly quickly.

Hoarding [and Housing]

Reproduced towards the end of the report [4-14] is a misunderstood anecdote about some apocryphal 'Fred' maximizing his age-pension entitlement: as recorded -- 'Fred' withdraws $100,000 from his superannuation funds 'for an overseas trip' but, in the wash up, after his means-tested age-pension goes 'up' and his (depleted) super pension goes 'down', he is only $21 a week worse off in current income.

The more likely story is that 'Fred', puts the 'overseas trip' somewhere else – a not-spent $100,000 can be 'parked' as a non-declared loan with trusted friends or 'under-the-bed' as part of the $50+ billion in high denomination notes hoarded and undeclared across the national community.

Lest we summarily 'convict' Fred, and putting transactions costs aside, a comparable outcome could be pursued by Fred shifting assets from 'superannuation' to 'housing' exempted from the age-pension means test and then drawing back an income stream from a reverse mortgage. Not only legal but inexplicably encouraged.

The committee should speak up on this nonsense – possibly even shout: not only is the encouraged behaviour unfair it is very likely to be associated with growing risks of instability attending individuals, and lending banks, becoming grossly overweight in their exposure to overpriced housing.

.......as a concluding remark

.... it is simply not true that the present regulatory framework is serving us well -- without fundamental reform the prospects will remain bleak.

Peter Mair

6 August 2014 and endorsed on 14 November 2014 to the Harper Review