

PETER MAIR / SUBMISSION TO SENATE STANDING COMMITTEE ON ECONOMICS

## **CREDIT CARD SCHEMES**

### **EXCESSIVE FEES AND INTEREST CHARGES**

Presumably the Reserve Bank is about to conclude its current review of credit card schemes and announce reforms to credit-card regulations.

Most likely, Australia will be brought into line with the current EU standard – no regulation of interest rates charged but a reduction of the maximum, ad-valorem, interchange-fee paid by merchants -- from 0.5%, on average, to a hard cap of 0.30% for all transactions (and an overall regulatory framework that keeps other service fees within reasonable limits.).

Limits on retailers surcharging credit-card transactions may be tightened – but that begs the question of why banks can overcharge for credit card transactions with alacrity but third parties cannot? No one should be permitted to overcharge -- the excuse to do so would be addressed if there were no % ad-valorem fees for credit card transactions.

Ideally Australia would go further than the EU and outlaw all ad-valorem fees for these and any other transactions.

It is unlikely that the RBA will move to regulate interest charges on credit card accounts.

#### **.....some background**

About 30 years back, banking regulators globally realised that the credit-card schemes of Visa and MasterCard (VMC) were operating inappropriately – deceptive marketing and monopolistic price-setting including excessive merchant fees and interest charges.

Now, 30 years later, banking regulators have required only modest reforms and are still to deal resolutely with a de-facto cartel which, fairly, is ever more clearly seen to be a racket affronting the global community as well as the local community and regulatory authorities.

The focal points of ‘inappropriate’ are excessive transaction interchange-fees, and other service fees paid by merchants, and excessive interest rates charged to customers rolling over credit taken.

The challenge -- to explain this anomaly – has a few elements, including:

- seeing credit cards in context
- it is not the worst racket
- is it the price of a politically shielded ‘free-banking’ culture ?
- the global dominance and market clout of the VMC schemes
- community indifference to self interest
- community ignorance and misplaced trust
- a living redundant contrivance
- is regulatory reluctance inexplicable?

Put sharply, VMC credit-card schemes are a redundant profiteering contrivance condoned by banking regulators -- and this is a key question – are the major banks to blame for taking advantage of their market dominance, or, are the regulators at fault for not outlawing the blatant marketing deceptions of scheme promoters and better protecting the public interest?

Put a little differently, the credit-card power brokers – the major banks, the VMC schemers and the banking regulators – do what they like because they just can. The only price signals given about credit cards are perversely deceptive bad ones – deceptive offers of things for ‘free’ that practically translate to, secretly, ‘very expensive and very profitable’.

So, once more unto the breach it is, always in the confident expectation that the regulatory tide will eventually turn and these offending schemes will be absorbed into a more benign EFTPOS debit-card regime albeit enhanced with a line of credit for eligible customers.

- **credit cards in context**

When a clearly recognized global problem – the VMC credit card racket -- remains almost untouched 30 years on, it is clear that some powerful interests are engaged in protecting it.

The powerful interests are member banks participating in monopolistic VMC schemes and compliant banking regulators.

Simply put, VMC credit card schemes should have been displaced by debit cards as payments technology embraced the electronics now allowing ATM and EFTPOS access to savings -- any ‘credit’ should be made available as an overdraft line of credit accruing interest as it was used.

They were not displaced – their popularity surged.

The competitive challenge from ‘debit cards’ was rebuffed by aggressive promotion of credit cards. The assault included -- customer fees only for using debit cards; transaction acquirer fees ‘paid by’ instead of ‘paid to’ issuers of debit-card; flyer-point rewards only for using credit cards; illusions of free-credit; the withholding of internet and phone functionality for debit-card transactions; allowing signatures, not requiring PINs, only for credit cards and – almost fraudulent – the promotion of a hybrid card (Visa debit/MasterCard debit) that made ordinary debit cards unattractive to customers not wanting credit.

Practically, credit cards were made compulsory.

It is worth asking why – understanding the broader context.

- **not the only racket but among the worst**

Overall context is relevant.

The inclination to be critical of credit card schemes is appropriate – but it is not the worst profiteering by retail banks that is condoned by regulators.

This honour belongs, in spades, to the business of conducting bank transaction accounts.

Ponder the consequences of banks, mainly the 4 aces, now holding some \$1,000 billion -- that’s one trillion dollars – in transaction deposit accounts on which no interest of material consequence is paid to depositors but which, invested by banks, returns market-rate revenue to banks.

The wide ranging consequences of that include income tax is not paid, on, currently, some \$30 billion interest that is ‘not paid’ explicitly.

This tax-avoiding barter dealing underpins the inefficiencies attending a free-banking culture in the community. Banking services are provided as untaxed income-in-kind, either free or under cost-price – to say nothing of the competitive clout that the 4 aces get from the surplus, unaccounted ‘free’ earnings available to run competitors out of town, including for super-fund operations.

[Imagine what competitive-market damage was done when market interest rates were much higher, like 15%+ in the late 1980’s -- the 4 aces ran amok.]

If abuse of the community in this way and on this scale is condoned by the RBA, condoning the credit card racket is consistent and hardly surprising.

- **a ‘free-banking’ culture**

The most likely explanation for the persistence of racketeering with credit cards and transaction deposit accounts is the unique compatibility of two entrenched attitudes – one, the community does not want bank fees and the other, the regulators do not want to risk bank failures.

The protected, monopolistic profitability of retail banking -- the 4 aces – ensures there will never be any new retail banks bringing more risk to the system and that any losses among these majors can be quickly recovered – the banking regulators, RBA/APRA sleep easy.

For the customers – taking free transactions instead of interest on deposits in transaction accounts entails substantial tax avoidance and an illusion of apparently ‘free banking’. This nonsense is then compounded by the deception of allowing ‘free’ credit-card transactions for the customers while overcharging the retailers, who bury high bank fees in higher prices for everything for everyone. Out-of-sight and out-of-mind ensures a comfortable ignorance.

The regulators that should be fearlessly frank and independent in the public interest will never say these things openly because to do so might suggest dereliction in the past and require action to correct it in future.

- **dominant market power**

Electronic transaction cards are now essential -- it is comforting to have safe access anywhere to money on deposit and often some \$‘thousands’ in credit limits on bits of VMC plastic accepted by retailers, in person and over the internet, in Australia and overseas.

VMC credit-cards evolved from a more primitive, manual/hard-copy, 1960’s technology which saw bank schemes displace in-house, monthly-statement, store-credit plans. One card for all saw banks negotiate with retailers to pay % service fees, saving the cost of running their in-house schemes. Eventually, however, even domestic-bank schemes, like Bankcard, became redundant as VMC became the dominant mirror-image schemes globally.

The VMC baby, grown like topsy, became a monster -- the one-ton gorilla – and, along the way, regulator condoned abuses only enhanced the market power of the VMC cartel making these cards indispensable. One element of this regulatory failure concerns the joint-venture concessions, allowing price fixing, in the trade practices law – credit card schemes operate as co-operative joint ventures. Members can agree to do what they like, collectively.

Moreover, just as regulatory clouds were gathering, VMC sprung another surprise, globally. New, tap-and-go, convenience lets the smallest purchases be put on the credit card, but only on the credit card. Unchecked, this initiative will eventually see VMC credit-cards challenge the relevance of conventional currency for making 'cash' purchases – and the sovereignty of national monetary authorities.

Substituting cards for cash is to be encouraged but not on terms that protect customers' need to hold a credit card – this convenience should be attached to debit cards.

- **community indifference**

Only credit-worthy customers get credit cards but, having got one, customers need to carefully manage their use of it. One obvious risk is about drifting into rolling debt when the bill is not paid in full by the due-date – and yielding to that temptation sees the touted '55 days free credit' become a sting in the tail as interest charged at usurious rates is backdated to day-of-purchase.

Ideally this decision would be a self-education experience but the lesson is not always learned. Even so, empathy for 'high interest rates' must be tempered by the contributory negligence shown by indifferent customers knowing better – not even moving card-debt to lenders with lower interest charges.

One corollary is that banks are wary of customers happy to borrow and borrow even more at such high cost – apart from indifference this willingness may signal a borrower in trouble.

- **community ignorance v. misplaced trust**

Credit cards offer customers, mainly illusory, prospects of personal benefits – apparently free transactions, tax-free flyer-point rewards and apparently 'free credit' – all the costs of which are actually recovered from overcharged merchants and ultimately paid for by all in the community, collectively. Conversely, banks unnecessarily withhold from debit cards the functionality to be used, card-not-present, over the phone and internet.

The beneficiaries of this deception are issuers of VMC credit-cards – their profit take is excessive.

In defence of the ignorant, however, the community would reasonably expect the regulators to expose deceptions, otherwise ensure fair-dealing and outlaw tricks-of-the-trade.

This trust in the regulators has been misplaced: the customers collectively do not know that they should be protesting about banks playing them off a break -- customers not using credit cards do not protest about retail prices being loaded to recover the high cost of fees paid by retailers on card sales; the customers do not seem to appreciate that 'free transactions' for them means the retailer pays high fees; the customers do not seem to appreciate that 'free credit' is an illusion when they pay their account on time in full using funds already on non-interest bearing deposit with the same bank. The rotting that should be proscribed is not even clearly exposed.

Regulators have let the community down – they should come clean.

- **a redundant contrivance**

Hopefully it is now clear enough that the continuing prominence of credit card schemes is an indictment of the regulatory will to ensure fair play and protect the public interest – assuming, of course, that the relevant public interest is not only about featherbedding the profitability, and underwriting the solvency, of retail banks at great public expense.

All that can be done with a credit card can be done better and more cost-effectively with a debit card – the only required addition being a link to a line of credit for credit worthy customers.

And that has long been the case.

[As an aside it is necessary to deal with so-called travel and entertainment charge-card schemes branded Amex and Diners. The affront to the community inherent in these schemes should be dealt with resolutely. The distinguishing practical function of these schemes is to convert inflated business expenses into untaxed personal income, delivered to the card holders as flyer points to use at their discretion personally. Both these schemes would cease to exist if and when the ATO required recipients of the flyer-point income-in-kind to declare it as income and pay tax on it. That is all that needs to be said about these rackets – never get intrigued into debates about 3-party and 4-party schemes.]

- **regulatory reluctance**

It is similarly well beyond time that the RBA, as the primary regulator of the retail banking and payments system, was directed to be a less reluctant regulator and be more resolutely determined to rein back the excesses of the retail banking fraternity and their associates like Visa and MasterCard and some local clones like BPay.

The elements of the racketeering are easily identified – see above.

That said one would need to listen to advice about the possibility of any problematic practical consequence if local regulatory reforms were, however desirable in principle, likely to have disruptive implications for local payments arrangements or for international transactions here or elsewhere. We may already be captives of a VMC gorilla holding us for ransom.

Equally, members of political committees may need to tread warily in a minefield that has already claimed some courageous forebears – unless and until the RBA comes clean about the way the retail payments system works, the community will continue with kneejerk rejection of any idea that customers pay explicit full-cost prices for banking facilities and payment services.

Put plainly, it is the RBA that has let the community down while the bankers run trucks through gaps in the regulatory fence – the trucks are full of undue enrichment.

Peter Mair 17 July 2015