# RETAIL BANKING : RESTORING COMPETITION

A renewed role for the ACCC in the banking policy arena, both welcome and overdue, should extend to its membership of a reconstituted Council of Financial Regulators.

Some 20 years back, the ACCC played a critical role in Australia being world-first to regulate, with a 50% cut, the permitted ad valorem interchange fees charged on transactions by credit card schemes. That's good form for another run on this track.

My reservations, if any, about the issues-paper for the retail-deposits-inquiry only reflect uncertainty about any limits there may be on the scope reasonably open to the ACCC. Preferably the 'ministerial direction' would have been left in broad and general terms. As is, any restriction intended by the formality of the detailed directions is not clear. That's a concern.

Suggestions that the inquiry is primarily about customer-confusing Ts&Cs, ('tricks and cribs') in product terms and conditions affecting interest paid on savings-deposits, raise a different concern. That suggests lessons from the misconduct royal commission were not learned or are not remembered. Such continuing uniform misbehaviour should already have been dealt with by the banking-regulator set.

It may be now or never to correct deposit interest rate policies set by major banks collectively and passively condoned by regulators.

## PREAMBLE

For some decades now its has been pointless to talk about competition of much consequence in retail banking in Australia.

Called out as a major mistake, the main-theme in this submission reflects the still rolling-on consequences of the botched deregulation of retail banking through the 1980s. Some deregulation then sure, but destructively falling short of sound policy overall. A shortfall still not corrected.

The all-up reality, on the contrary, was to unleash an uncontrolled regulator-gifted force endowing the major banks with an unassailable competitive advantage. This mistake underwrote the destruction of the already fragile competitive environment in Australian banking and retail financial services beyond. The dominance of the copy-cat 4Pillars in Australian banking remains beyond any competitive challenge.

The mistake, not corrected, undermines the stability and efficiency and fairness of retail banking.

**– a major mistake**

In short, at a time of high inflation and high nominal interest rates, 'regulation' allowing (even requiring) banks to not pay interest on deposits in transaction accounts ensured windfall profits to major banks holding most of these 'free' deposits. A predatory rampage followed.

Locally, the 4Pillars soon absorbed all substantial local competitors in banking and retail financial services more generally. That the 16 foreign banks, then newly licensed, did not survive either has never been explained – they came and went unremarked. Asked, the RBA declined to say why.

The outcome for retail banking remains akin to a de facto cartel. The 4Pillars play a copy-cat game so taken for granted as executives move seamlessly between them. The only unknown in this game is if one will slip up.

In effect, the Pillars are constructively nationalised: the four are embodied as one in a protected, government-guaranteed, ownership and operational framework that defies sensible belief. There can be fewer Pillars but not more. All-up, the Pillars are collectively too-big to fail while excessively profitable. Their collective solvency is underwritten by astonishing regulatory-rent concessions and, beyond that, unlimited recourse to the public purse.

If the systemic flaws now entrenched are to be corrected, retail deposit interest rates are the focal point of reform –as is, material interest is <u>not</u> paid on most transaction-account deposits.

**– major consequences still unfolding**

This major-mistake in the 1980s set the local financial system on the path to a banking crisis that unfolded in Australia, circa 1990. The comparable mistake globally, coupled with flawed bank-capital regulation through the 1990s, precipitated the 2008 global financial crisis. The system then rolled on through a pandemic induced 'zero' nominal interest rate regime before sharply higher nominal interest rates, and lower bond values, have refreshed the instability.

The associated resurgence of regulatory-rents -- higher earnings on 'free' deposits – is concurrently lining the coffers of pillar-predators eyeing off competitors. Further consolidation locally cannot be ruled out.

This *main-theme* is set out in a range of complementary submissions to current and past inquiries. These submissions are published (or will be) – in particular the disappointing 2018 Productivity Commission inquiry into competition in financial services, submissions to the recent RBA review, of only some governance processes, and another to The Treasury's ongoing strategic review of payments system policy.

Separately, the review team at ACCC has been encouraged to give the 'main theme' attention consistent with the scope allowed in the ministerial direction.

As is the conduct of retail banking could hardly be less competitive and, as is, the industry can only ever become more concentrated. Retail banks with viability issues are only ever absorbed by surviving competitors. Erstwhile competitors with prospects are taken over.

The historical story in Australia is both dramatic and still unfolding. The recent sales, to major banks, of Citibank (retail) and Suncorp-bank are illustrative. The shakeout is probably not over.

Developments globally are daily reminders of instability unfolding in ways that preclude leisurely hearings about discretionary mergers takeovers and 'amalgamations' – *force majeure* dictates outcomes, predators can contrive *force majeure*.

Will yet another formal review and inquiry be unable to, or again choose not to, address the critical issue defining retail banking?

The ball is in the ACCC's court – competition or monopoly?

## IS THE ACCC FREE TO INQUIRE OR DIRECTED NOT TO?

Long experience cautions against expectations that financial system inquiries in Australia will be free-ranging and independent. Long experience is to the contrary,

…..... no less so in respect of the main-theme in this submission.

In short, no official inquiry or parliamentary or regulatory scrutiny over some 40 years has made any forthright assessment of the consequences of major banks not paying material interest on deposits held in day-to-day transaction accounts generally. There have been many such opportunities to do so over decades but it has not been done. One might ask why – the fair question sensibly extends to the brief now put to the ACCC.

So, putting the question squarely in the light of the ministerial direction to *'inquire into the market for the supply of retail deposit products*' :

***…..... is the ACCC free to consider and assess the prevailing uniform practice of the major banks to <u>not</u> pay a material rate of interest on most deposits held in day-to-day transaction accounts …..... and the corollaries,***

- i) ***exploiting an unfair competitive advantage by cross-subsidising <u>their</u> supply of banking and transaction services either free of explicit charge or under-priced relative to costs?; and***
- ii) ***consequently, unfairly engaging in the bartering of 'free services for free deposits' on terms which allow 'income' to be undeclared – i.e.: otherwise taxable income is paid in-kind, not quantified or disclosed.***

The answer to the question may not be revealed until the ACCC finalises its report. Nonetheless, undaunted, and with the clear intention of leading the witness, a literal reading of the ministerial direction seems to allow the ACCC the discretion to consider the question and address the issues.

In support of this assessment, the following summary inferences from the terms of the ministerial direction may be relevant.

Direction 6 (b) (i): apparently allows consideration of fees and charges not paid by account holders.

Direction 6 (b) (c) apparently opens the door to review 'supplier strategies and approaches' about setting interest rates on all retail deposits categories -- including not paying material interest on transaction-account deposits.

Direction 6 (d) would sensibly embrace both express and implied 'terms and conditions' of supply (including no interest paid on deposits and 'free-services' supplied).

Direction 6 (e) concerning price and non-price competition for retail deposits – apparently allows consequential inferences recognising the unassailable competitive advantage the major banks enjoy as a consequence of being permitted to barter, tax-free, free-services for free deposits. This anomaly underwrote the wholesale destruction of the competitive environment in the wake of the botched deregulation after 1982. This anomaly is now resurgent as rising interest rates are increasing the 'regulatory-rent' margin on the majors' 'free deposits' now around $one-trillion.

Put sharply, is the ACCC permitted to address the presently entrenched, and wholly deceptive, culture of 'free banking for all'. A major national industry is operating without any semblance of a proper pricing regime governing the supply and demand for its services.

## THE ECONOMICS OF RETAIL BANKING IS CORRUPTED

Much as this submission, and the brief given to the ACCC, is about 'the supply of retail deposit products', the fundamental and underlying problem has very different overall dimensions.

In short, in the normal course, the regulatory-rent endowments gifted to the major banks are far more than enough to cover their 'loss-leading' supply of retail banking services either 'free' or under-priced relative to costs.

Accordingly, the broader focus is on the major banks use (and misuse) of their 'surplus' profits flowing from their collective decision – to not pay interest of any consequence on deposits in transaction accounts.

Put squarely, as is, the conduct of retail banking is fundamentally corrupted. Regulatory-rents presently gifted unfairly to the major banks properly belong, as interest paid, in the hands of their customers to be spent as they choose – including, as they may choose, on properly priced banking services.

An illustrative distinction can be drawn between commercial banking and central banking.

The issue of banknotes to the community is essentially a retail banking business. A banknote is the tangible 'passbook' record of a deposit with the central bank, pure and simple. Banknotes, however, have a special characteristic – because the holders of these 'deposits' are anonymous interest cannot be paid on banknote-account balances.

Even so, like other banks, central banks invest the proceeds of banknote-deposits and make a profit which – unable to be distributed to holders of banknotes – is eventually paid into the public-purse of the Commonwealth. It is a natural-tax paid into the national coffers where it belongs.

The distinction to be noted here is, of course, that commercial banks know which customers hold deposits with them – they could choose to pay interest at a fair market rate on customers' deposit

account balances. Banks collectively choosing 'not to pay' is the issue fairly on the table.



When interest is not paid on customers deposits with banks it is still the equivalent of a tax – but it is a tax levied by commercial banks at their discretion. There is nothing natural about it at all.

Putting aside 'tricks' that confuse and deceive their customers, banks do usually pay interest on deposits lodged for fixed terms and on deposits in savings accounts unable, or unlikely, to be used for making day-to-day transactions.

Conversely, however, interest is typically not paid (at any material rate) on most deposits in day-to-day transaction accounts. The distinction is mainly relevant for the consequences of interest not being paid by the major banks holding the great bulk of the deposits in transaction accounts.

One concern implicit in the main-theme presented here is that the major banks' profit endowment, from 'free deposits', can be volatile, as nominal interest rates can swing quickly through a wide range. Another is that the use (and abuse) of the profit-endowment, being at the discretion of the banks, is generally in the commercial interests of the banks and not in the public interest.

All-up, it is beyond sensible belief that the banking regulators have passively accepted this outcome – for decades: this notwithstanding the damage that has been done to the retail financial system -- to its stability, to its efficiency to its competitiveness, to its basic fairness.

Put differently, as is, the retail banking system is unstable, inefficient, not competitive and unfair.

## POTENTIAL FINDINGS AND RECOMMENDATIONS

Big bucks are on the table – deposits running to trillions and interest not paid well into the billions.

Whatever might sensibly be done, nothing done precipitately would be sensible.

That could translate to a statement of regulatory intent coupled with a plan for phased implementation to allow properly planned acceptance, anticipation and eventual adjustment.

The regulatory challenge is to find a way to restructure retail banking and payment systems to correct the present mess. One way or another it is sensibly inevitable to think in terms of banks paying daily interest at a market rate, at least the cash rate, on all deposits – including deposits in transaction accounts.

One corollary is about the community being carefully informed so as to accept the implications.

On the bright side, all would welcome additional interest income running, overall, to the tune of some $30 billion annually. For many that welcome would be muted somewhat by the obligation to pay tax on the interest income.

On the other side, there would be the fear of new and higher explicit bank charges for account keeping and transaction services. That would translate to political-anger if the community had not been brought on board and the banks fed the fear. [Recall the bankers' shameful and unrestrained weeping and gnashing of teeth in 2017 when a levy of little moment was put on the major banks.]

The needed reform could be done, it should be done and all would be better off if it were done.

## LORD MAKE ME PURE BUT NOT YET

The preferred path proposed here for the ACCC – substituting competition for regulator-condoned monopolisation in the supply of retail deposit products – faces both practical

and political challenges of no small moment.



There is a risk that 'politics' has already compromised the findings open to the ACCC but the directions given seem open to allowing an objective assessment on a broad front.

If so, resolving the practical challenges becomes the next step – a step that risks a feedback loop where apparent 'impracticality' will dictate a political direction to take no further steps.

That short-circuited circular reasoning may explain why nothing has been said or done, so far.

The end game in that playbook might crystallise the eventual reconstitution of the retail payments system as a public utility – no bad thing perhaps given the de facto reality already.

Taking the public utility route – probably a regulated public-private partnership of sorts – would presumably address the present misappropriation, and mismanagement in private bankers' hands, of the earnings on the 'free' digital deposits that are now the currency of the realm.

That route would still be messy and politically contentious – it could prompt the re-emergence, now as stand-up comedians, of the lobby group once known as 'the free enterprise banks'.

## NEW TECHNOLOGY – NEW REALITIES – NEW PRACTICALITIES

The history of regulating retail banking and payment systems has been a simply scandalous display of regulatory discretion feather-bedding the operation of major banks -- deliberately fostering and condoning their market power and misconduct while denying any credible competitive challenge to their domination.

That spilt-milk is perhaps best just cleaned up unremarked and the table reset afresh – with no milk.

Technology has changed the way retail banking and payment systems operate – cheap digital technology has displaced the costly tangibility of cheques transported nationally, of notes and coins now in terminal decline, while remaining routine bank-branch payment functions are being subcontracted to post-offices serving the bank-collective.

As an aside the ACCC might ask the banking regulators for access to their modelling of commercial banking operations that illustrates the way the costs of providing routine banking and payments services have been changing over recent decades.

The concept of a blank-look might well be given new meaning – who would want to know that?

Whatever, the possibility of a regulatory revolution in this context may not be off the table.

Along the way a raft of more and less attractive policy options have been canvassed in submissions readily accessible to the review team at the ACCC at their discretion.

## END PIECE

What more can one say to the ACCC?

Not much. The fundamental issues corrupting the conduct of retail banking are openly on the table.

The ACCC has a brief to inquire, assess and propose reforms to address the circumstances corrupting *' the market for the supply of retail deposit products*'. It will or it won't.

On the hopeful side is the previous inclination of the ACCC, when permitted, to have a proper crack at policy issues in the retail banking arena.

The option is now open for the ACCC to fire another shot that will be heard around the world.

Peter Mair 7 May 2023