

DECEPTIVE TERMS OF REFERENCE

The submission '*Coming Clean*' was a first step -- bringing to attention a policy mistake in the 1980s now mainly responsible for the structural, cultural and regulatory shortcomings bedevilling the Australian financial system.

Ahead of a more forward looking submission, some shortcomings with the 'terms of reference' given to the Commission for the inquiry, are fairly exposed.

The brief given by the government it is deceptive – couched in political double-speak-- and it risks compromising the independence the Commission, worryingly so if drafts were 'cleared' with the Commission.

The government could have simply said that entrenched problems in the operation of the retail financial system are obvious enough and it would appreciate the Commission's assessment of the shortcomings and how reforms might reorient the system to better serve the public interest.

Instead, the government cast the terms of reference in terms that gilded a dead lily – in football parlance: if asking the Productivity Commission to run a 'competition' inquiry is not just a dummy pass to avoid a royal commission, it is a hospital pass.

I expect it to become ever clearer that 'competition' has little to do with the way out of the mess. Rather, the low-interest rate regime now puts a time lock on the door to doing anything bar managing and protecting the viability of the financial system until some semblance of normality returns to interest rate settings.

DARK HUMOUR

Working through the announced 'Scope of the Inquiry', undertones of dark humour compromise a brief given to the Commission that could be read as charge sheet for various derelictions of duty.

- 1. consider the level of contestability and concentration in key segments of the financial system (including the degree of vertical and horizontal integration, and the related business models of major firms), and its implications for competition and consumer outcomes*

Spare my days – what is not already well known? The government and the regulators have long known that our retail financial markets are incontestable -- being too concentrated, overly integrated vertically and horizontally and, implicitly, so uncompetitive as to make poor outcomes for consumers inevitable. Asking the Commission to consider such self-evident scenarios mocks a regulatory regime that should have recognized and addressed such obvious shortcomings long ago.

2. examine the degree and nature of competition in the provision of personal deposit accounts and mortgages for households and of credit and financial services for small and medium sized enterprises

This request condemns regulators who should have been alert to the special character and implications of banks holding ‘personal deposit accounts’ – on which interest is not paid – and the associated dominant position so gifted to the 4Pillars. The regulators may like to come clean about mistakes made and the consequences.

Similarly, about the markets for housing loans, commission driven mortgage-broking and small business financing -- the regulators have questions to answer. These flawed market environments should already have been recognized and fixed.

Truth told, the regulators were apparently dedicated to fostering a system with 4Pillars and little else – a system that, semantics aside, is effectively nationalized, albeit with the trappings of shareholders and separate entities.

3. compare the competitiveness and productivity of Australia's financial system, and consequent consumer outcomes, with that of comparable countries

Comparison of the Australian system offers little hope. The usual reference-group countries are in much the same situation – not least Canada and the UK – having made the same mistakes. As with other systemic shortcomings internationally, it is fair to ask why the Bank for International Settlements also failed on this front – failed to recognise that national financial systems would be destabilized by high and low interest rate regimes, unless major-bank monopolization of interest-free deposit business was defused. Scandinavian nations were alert to this challenge and handled it more sensibly.

At home and abroad the lingering impression is of governments and regulators, and the regulated captors of both, basking in a quiet life of lazily-monopolistic aspirations and entitlements -- until a day of reckoning comes, as it has.

4. examine barriers to and enablers of innovation and competition in the system, including policy and regulation

The regulators would well know that the barriers to entry to retail banking have been so unassailable for so long as to leave no doubt that ‘no entry’ and ‘no competition’ is their preferred and declared policy stance – all contrary to a litany of misleading pledges to promote competition.

As for circumstances disabling competition and innovation, regulators have resolutely protected entrenched cartelization by fostering the attendant free-banking culture and card-scheme exploitation -- protection so wholly inimical to efficiency and fairness in the operation of retail payments system.

The Reserve Bank itself is conflicted and compromised in balancing its nominal responsibility for payments system efficiency with its operational dependence on off-budget funding from profits on its note issue business -- a business now almost exclusively based on \$50 and \$100 note denominations, both redundant and mainly hoarded to facilitate tax evasion and black-market activity.

5. prioritise any potential policy changes with reference to existing pro-competition policies to which the Government is already committed or considering in light of other inquiries.

This is beyond the pale – anyone having a passing familiarity with ‘existing pro-competition policies’ and ‘commitments’ of this government would be excused for some rollicking thigh-slapping.

This current coalition government, and its immediate relations, has been resolutely committed to completely contrary positions. Consider their zealous dedication to handicapping industry super funds – a dedication so contrary to the community interest, and so favourable to the interests of the 4Pillars, that regulators should have called them out.

That inducement to rollicking reactions is only compounded by a follow-up direction that flies in the face of reality:

.....to have regard to the Government's existing wide-ranging financial system reform agenda and its aims to:

- *strengthen the resilience of the financial system*
- *improve the efficiency of the superannuation system*
- *stimulate innovation in the financial system*
- *support consumers of financial products being treated fairly*
- *strengthen regulator capabilities and accountability.*

The government has, of course, no credible reform agenda and not even a glimmer of understanding of what happened. Beyond that there are few options for doing anything much for the time being bar proscribing the most egregious abuses of customer trust (e.g. funeral insurance) and establishing a regulatory-oversight body to identify and correct failures of regulatory commitment and competence.

The cricketing strike being over, we wait for the Commission to stand its ground and, first, kook this complete and utter tripe over the clock tower, beyond all bounds where it belongs - - before, second, opening a devastating bowling attack by conducting an inquiry that will put responsibility for the current mess squarely where it belongs..... on the government and the regulators now ducking and weaving a tangled web.

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