deferit

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Submission to Regulating Buy Now, Pay Later in Australia Options paper – November 2022 ("Options paper")

We welcome the opportunity to provide our feedback on the Options paper.

1 About Deferit

The below background is necessary context for this submission as we refer to our product in relation to the questions which Treasury seeks feedback on. We also include underlying data and statistics to demonstrate customer behaviour and the impact our service has on consumers which Treasury has encouraged stakeholders to include in their response.

1.1 Deferit is a budgeting tool that helps people pay their bills. We have a core social mission to help people pay their bills and avoid paying late fees to billers. Deferit pays the amount that the user chooses directly to the biller and the user repays Deferit in four equal fortnightly instalments with no interest. We operate an open loop payment platform (no merchant partners are required).[1]

1.2 Deferit does not advance any funds directly to customers. It is solely a budgeting tool for non-discretionary items. Customers are unable to buy anything with Deferit. As such, Deferit does not increase the debt levels of its users (as the bill is already due). In essence, we do not offer any 'buy now' in our service but rather a 'pay later' feature for bill payments.

Overview of our product

Product structure and limits	• Users are given a continuous credit contract with a maximum limit of $2000. First-time users are paced through the continuous credit contract at a lower limit. For example, a first-time user might only be allowed to use $300 or $400 of a contract until they establish and prove a positive payment history.

[1] As such we have no merchant fees and the billers we pay have no potential fees to pass on to the end consumer.

	• Treasury noted that some BNPLs give unsolicited credit limit increases. Our product works in the reverse, we pace the user through their credit contract from a reasonable base level and the maximum limit never changes. Furthermore, if a user's behaviour displays indications that their financial situation has changed, (e.g. by extending payment dates), our service automatically responds and adjusts their limit downwards.
Fees	• $9.99 a month if the credit contract is being used. The fee does not change depending on the amount of credit provided under the credit contract. If a customer falls behind on a payment the monthly fee does not accrue. Customers can use Deferit credit for as many bills as they like up to their credit limit. • Deferit has a processing fee of 1.5% + 20c on payments. • No interest, no late fees, no establishment fees, or early payment fees. The above two are the only fees charged.
Repayments	• 4 x fortnightly instalments, with the first instalment taken upfront. A user can move/customise payment dates by up to 14 days in their account portal at their discretion. Deferit charges <u>**no**</u> fees to move payment dates.
No revolving debt	• Unlike a credit card, no revolving of overdue debt is allowed. We do not seek any penalty fees on overdue debt. • If a user is in arrears on any payment, they are unable pay any new bills through our platform and therefore unable to hide hardship from a particular bill provider. As we are on a 14-day payment cycle, the product has a quick feedback loop and users can't accrue large amounts on the platform.
Budgeting platform	• The Deferit platform is used by consumers as a budgeting tool to manage their lifestyle and cashflow alongside everyday expenses. Our customers are generally on weekly or fortnightly income cycles and the ability to align their payments with their income cycle is greatly beneficial compared to the various billing cycles a single consumer may have across all their billers. • The typical customer uses our product to pay bills for ~3.07 various billers, demonstrating the utility of Deferit as a bill budgeting tool for multiple bills and and providers.
Affordability assessment	• Deferit conducts full credit checks on all new customers. In our experience, a consumer's credit history and in particular their credit score is a statistically

	significant proxy for a person's creditworthiness and their ability to repay the bill. Based on our internal loan data, a credit score alone is a sufficient predictor of a consumer defaulting in the future. We've paid over $291M of bills on behalf of over 110,000 Australians to date using underwriting methodology utilising the credit score. • Deferit assesses all customer bills as part of a specialised underwriting procedure. This is unique to our product as we request the customer upload the PDF or an image of the first page of their bill invoice. When we see any indicator that a customer is in hardship on the actual bill, we deny the bill deferral and refer them to get in contact with their bill provider to seek assistance. We also make the customer aware of the National Debt Helpline contact details, noting it is a free, independent and confidential service. We encourage customers to interact with their bill provider and make them aware of support and hardship options which may be available from their provider. We advocate hardship solutions offered by billers and have a strict responsible budgeting code of conduct.
Consumer support	• Deferit has a robust hardship policy for our customers. It allows customers to pay the debt back based on their financial circumstances and over a period that matches their financial circumstances with no penalty fees. We always provide hardship assistance when requested. • Deferit has a dispute resolution procedure in place that is compliant with RG 271. We are also a voluntary member of AFCA.
Writing off debt	• If a consumer cannot pay us back, we write-off the debt and do not report defaults to credit reporting bodies. We never sell consumer debts to any third parties. • As such, there is no negative financial consequence if a consumer cannot pay us back.
Deferit does not support	• Any form of credit (credit cards, loan payments, buy-now pay later accounts etc). Debt collection bills are also not accepted on the platform. • Groceries • Discretionary transactions / retail

Our product's differences to a traditional BNPL can be summarised as follows:

Issue	BNPL	Deferit
Increase debt levels?	**Yes**	**No** People already have a bill to pay
Impact	Encourage **spending** for discretionary items	Assists with **budgeting** for non-discretionary items
Late fees?	**Yes**	**No**

Internally as an organisation we do not see ourselves as a BNPL product as our goal is to help people pay their bills on time rather than encourage spending / increase order value at retail merchants.

2 Should BNPL type products be barred from certain industries?

2.1 Treasury has a section in its Option Paper which is titled "Unsolicited selling, advertising and using BNPL for essentials."

2.2 In this section concerns are raised around using BNPL for utility bill payments amongst other things. Treasury has specifically asked for examples of industry behaviour and to support these views with underlying data.

2.3 We note consumer groups have raised concerns around BNPL and utility bill payments, in particular requesting that BNPL should not be allowed for energy bills.

2.4 We first note Treasury's comment in the Option Paper which is highly relevant to our market positioning in this sector, namely that:

> *… The BNPL industry is not homogenous, and different providers offer a range of diverse products. **As a result, the nature and severity of the issues vary from product to product, and from provider to provider**. [Emphasis added in bold]*

2.5 Our product is extremely specific and differentiated to a traditional BNPL as already outlined.

2.6 We submit that consumer group's request to exclude pay later type options from certain sectors (such as energy) is inconsistent with regulating these products, destroys free market principles and would create consumer harm. We note that credit cards, which are already regulated, are allowed to be accepted across many industries including energy. Credit cards are allowed this privilege because the legislature has set principles enshrined in legislation which ensures that they are offered appropriately to customers with certain protections. It would be anti-competitive to let regulated credit cards be the only credit payment method allowed for energy but exclude newly regulated products that have no interest, and in some instances, are a cheaper source of credit for consumers to pay for such bills.

2.7 Treasury should be seeking to regulate BNPL type products to level the playing field and ensure safeguards and protections are in place for consumers. Free market principles should then prevail, and consumers should have the choice on which product they would like to use which creates an efficient and competitive system.

Data on industry trends

2.8 In addition to the above, our data also shows that our specific product has a very positive effect on consumer payment behaviour in the non-discretionary category including in the energy vertical.

2.9 Based on our transaction data from inception we've paid 1.64M unique bills worth $291M for over 110,000 Australians. Based on this data:

- 77% of our customers use Deferit to pay their bill before the due date (showing they are trying to get ahead, not pay late fees and budget for their bills in advance);
- 80% of our customers who had an overdue first bill originally went on to pay their next bill on time with Deferit (demonstrating that our platform helps consumers to get ahead of their bills);
- we've saved our customer base over $30M in late fees from their billers by helping them pay their bill on time; and
- around 82% of customers use our digital tools to reschedule their repayments at least once, demonstrating true budgeting behaviour and financial control.

2.10 Specifically in Energy:

A tier 1 electricity retailer conducted an impact analysis of their customers who used Deferit to pay their bills. We have summarised key findings in the below diagram, which indicates positive changes in customer payment behaviour. This data analysis involved 8500 accounts.

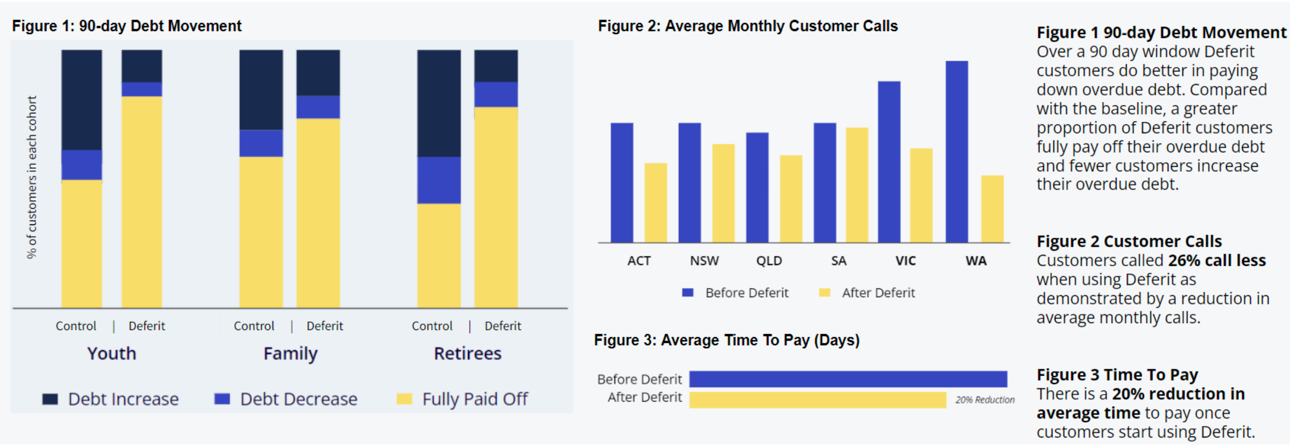

Figure 1 Tier 1 energy retailer analysis of Deferit

2.11 We consistently observe NPS scores of 87+ and we have a positive standing in the public domain, with high ratings and commentary across multiple review channels:

- 4.9/5.0 on Google (4003 reviews)
- 4.8/5.0 with 18,000 likes on Facebook (265 reviews)
- 4.8/5.0 on the App Store (4,654 reviews)
- 4.5/5.0 on Google Play (7,214 reviews)

We conducted a customer survey conducted in May 2022 to explore why Deferit is used is a popular payment method for a large telecommunications provider. We've listed some customer responses, which provide insight into benefits (reference to the provider name has been removed).

- 'Keeps me ahead of my with bills with puts my mind at ease'
- 'My bills are quite large and sometimes fluctuate. Deferit helps me keep in control which helps great with unexpected bills'
- '…bills are always due a few days before the mortgage is. Mortgage is always priority'
- '… With deferit it is really easy, just take a screenshot of the bill, upload and pay an instalment and you're done.'

3 Data supporting credit checks as an effective way to onboard customers

As already indicated, our internal data suggests that a credit score is a statistically significant predictor of default and can be used as an appropriate initial underwriting methodology for a product of our nature. We've underwritten $291M of bill payments to date on our platform and using proprietary models that include the credit score as input have achieved historical loss rates under those of the personal loan, credit card, and listed BNPL sectors. This demonstrates that the right customers are being onboarded to the product.

After onboarding, the customers repayment history with us provides an even stronger indication of the suitability of our product. If a customer misses a payment to Deferit, the platform prevents any further bills from being uploaded until this is rectified. Our service is not effective for being used as a means to "kick the can down the road" as the four instalment payments are due on a 14-day cycle.

Traditional finance providers are under no obligation to assess the suitability of the transactions the customer is entering into today (generally they do their underwriting at time of application). We assess the suitability of our users at onboard and in relation to each specific bill they defer (i.e. on a transaction basis).

Questions which Treasury has sought feedback on

3.1 Are the guiding principles appropriate and fit for purpose to inform the development of a BNPL regulatory framework? What other factors should be considered?

We submit that Treasury should also consider the following as a guiding principle for a new regulatory framework for BNPL:

> *It should consider the potential benefits of the product weighted against any potential detriments, such that products with low potential detriment are not encumbered in the same way as a product with a high potential detriment*

For example, referencing our specific product:

- it does not increase debt levels for the consumer;
- is a low value credit contract / debt does not revolve;
- helps consumers pay off bills that they need to pay (i.e. the financial obligation already exists);
- it has no negative financial consequences for a consumer if they are unable to pay back;
- it has no late fees or penalties; and
- it empowers customers to manage multiple obligations in one platform instead of engaging various providers for support options.[2]

[2] In a customer's own words from our survey: 'No needing to call companies to organise payment plans, no being put through 10 different people, no being put on hold.'

It seems inconsistent that such a product should be regulated in the same as a way BNPL type product that increases debt for the consumer and is a high value credit product. This type of product can cause detriment and should be subjected to a more rigorous underwriting process under law.

However, onerous tests in relation to low level products and specifically our product is not productive because regardless of someone's income they still need to pay their bill (a pre-existing debt). We can delineate who is an appropriate customer for our product based on their credit score initially and the bills they are uploading.

To illustrate why this is important: a consumer may be worse off by not being able to access our service. For example, the average late fee in the utility sector ranges from $13-15. Car registration (one of our core categories) offers steep discounts worth hundreds of dollars in some states like Queensland. Our monthly subscription is $9.99 and is stopped/not recouped on defaults. We waive any unpaid subscription fees in our hardship plan or write-off procedures. A customer can therefore be worse off being late to their biller and not accessing our service.

Furthermore, our business has no moral hazard to onboard defaulting customers, consider this example to illustrate:

> *A consumer has a $200 utility bill they need to pay. If they don't pay their bill they get a $12 late fee from the biller. However, if they use Deferit and then don't pay Deferit their net position is +$12 saved late fee - $9.99 Deferit subscription fee + $200 Deferit pays bill - $50 first instalment = $152.01 in the positive as there are no consequences if they don't pay back.*

The above clearly shows, as a business, there's no benefit in us trying to acquire consumers that are unsuitable for the product due to the way our unit economics are structured. We lose money on defaulting customers. Many short term low value BNPL companies would be in a similar position.

Our product is therefore *appropriate* for people who can pay us back and this is a distinct concept to the income they generate as the initial test. For example, what level of income is required to pay a bill? Everyone needs to pay them regardless of which walk of life they come from – someone on a lower salary potentially has the same energy bill as a higher earner and should not be disadvantaged by their economic situation if they have a good capacity to repay via their credit score. In such a case, these consumers, who may be excellent budgeters, would be prejudiced by an income test. A user's payment history gives us a clear indication of whether they're good at making payments or not and therefore allow us to respond and adjust the limit that may be suitable for them. We do agree that if the credit score outlines a high risk, then an income assessment is the only appropriate avenue and should be conducted and this is enshrined in our current underwriting procedure. However, such an income test may not be suitable as the first port of call at onboarding.

As such, we ask Treasury to build in this principle which will guide a waterfall test based on the type of products which are being offered.

3.2 We further submit that this principle is not an ideal:

> *It should consider the existing regulator arrangements for comparable regulated credit products, such as credit cards, small amount credit contracts (payday loans), consumer leases, and other types of personal loans.*

Treasury has indicated that the legislation never considered BNPL type products when it was constructed. The reason behind this Option Paper is to ensure a regulatory framework that is suitable for these products is imposed.

It should be noted that the underwriting methodologies which the legislation imposes for these traditional products were constructed decades ago when these traditional products were created. It may therefore not be an appropriate overlay for new digital products. These products should be given their own test and overlay which is appropriate to protect consumers without destroying the customer experience which creates a more competitive ecosystem with traditional finance (and therefore benefits consumers).

We therefore submit that this principle should be amended to:

> *It should consider **the outcomes** created by the existing regulator arrangements for comparable regulated credit products, such as credit cards, small amount credit contracts (payday loans), consumer leases, and other types of personal loans.*

Invariably Treasury should aim to produce the same outcome of consumer protection for BNPL products (which invariably depends on the type of product – the potential benefits/detriments); however this is distinct concept to imposing the same regulations.

4 Of the three options below, which option do you think is most appropriate? Would you change any aspects of that option?

We believe the guiding principle behind these options should be that regulatory controls should be tailored to the type of BNPL product and the elements of lending practice most likely to cause potential consumer detriment. We therefore submit the following:

Options	Appropriate
Option 1 - Strengthening the BNPL Industry Code plus an affordability test	We submit Option 1 is appropriate for low value short term BNPL type products ($2000 or less in credit limit and less than 3 months payback). We note that suitability for each transaction should also be considered in this Option 1 test (i.e. underwriting is performed at a transaction level as well). Under this option, we support the industry code being developed further to address issues highlighted in the treasury paper such as complaints handling, chargebacks and disclosure requirements (albeit the Product Design and Distribution Obligations already address product disclosure and are enforceable by ASIC).
Option 2: Limited BNPL regulation under the Credit Act, including licensing and scalable unsuitability test	We submit Option 2 is appropriate for high value long term BNPL type products (>$2000 and > than 3 months payback).
Option 3: Regulation of BNPL under the Credit Act	We submit Option 3 is essentially a form over substance option. Options 1 and 2 can appropriately protect consumers interests while Option 3 is seeking to place an archaic overlay that is suited for traditional finance over new digital and innovative products. It will create a cumbersome and expensive licensing regime for operators and create higher barriers to entry which could ultimately lead to the end consumer having to pay a higher cost for these services and adds no substantive value to protecting the consumer.

5 Other considerations

We lastly note the section in the Options Paper “Excessive consumer fees and charges, including default fees.” In that section Treasury indicates:

> *Many BNPL providers already operate under a legislated fee cap exemption in the Credit Act and charge fees less than $200 in the first year, and $125 each year thereafter (not including late payment fees) which often include fixed fees for establishing and managing BNPL accounts.*

We note that this legislative fee cap has not been indexed for inflation over the years and provides a very competitive price band for innovative finance products to be offered to consumers at a low cost. The issue here is that some BNPL providers are imposing late fees or default fees which in addition to this legislative fee cap might be excessive for consumers. We also note that the Treasury lists effective interest rates for some of the BNPL products (29.32% for Zip and 28.25% for Afterpay etc) and then references the effective interest rate of a credit card as per the RBA at 19.94%. This may not be a like for like comparison as a credit card may have a 19.94% annual interest rate, but it operates on a compound interest basis, therefore it has a much higher effective interest rate as consumers are paying interest on interest. Credit cards also have late fees which is not factored into this lending rate and overall a customer may end up having to pay more when using a credit card.

Whilst our product does not contain any late fees, we are of the view that the BNPL code which offers to cap late fees is a good consumer protection. These late fees are fixed amounts and do not compound. We believe that this a good solution to protect consumers and how they are to be capped is a matter for drafting.

Should you have any further questions or require any further information, please let us know.

Yours sincerely,

J Hirsowitz

Jonathan Hirsowitz, CEO of Deferit