

**RESPONSE TO THE OPTIONS PAPER:
REGULATING BUY NOW, PAY LATER IN AUSTRALIA**

Submitted by email to: CreditReforms@Treasury.gov.au

CC: Stephen.Jones.MP@aph.gov.au

Submitted by:

The Finance Industry Delegation

Contact: Phillip Smiles

Ph: (02) 9975 4244

Mob: 0403 054 729

INDEX

Content	Page
Introduction	2
The “dark” side of BNPL	2
Why so long for this BNPL review?	3
What others have said	4
Statistics	5
Question 1	8
Question 2	9
Question 3	9
Supplementary comment – Questions 1 and 2	10
Issues with Options 1 and 2	12
How easy is it to impose appropriate regulation on the BNPL sector?	13
Conclusion	14

FINANCE INDUSTRY DELEGATION
RESPONSE TO OPTIONS PAPER:
REGULATING BUY NOW, PAY LATER IN AUSTRALIA

Introduction

The Finance Industry Delegation (the Delegation), founded in 2011, is currently supported by 153 credit providers (lenders) who are substantially regulated by the National Consumer Credit Protection Act 2009. They are described in that Act and its Schedule, being the National Credit Code, as Small Amount Credit Contract lenders (SACC – with loans to \$2,000) and Medium Amount Credit Contract lenders (MACC – with loans between \$2,001 and \$5,000). Although not specifically given a title in the legislation, credit providers providing loans from \$5,001 and anything up to \$30,000 are referred to as All Other Credit Contract providers (AOCC).

All Delegation supporters are non-bank/non ADI lenders and all face buy now, pay later (BNPL) as a significant competitor. Most are small and medium sized business enterprises, sizes that make up over 98% of the industry sector, and none are publicly listed companies.

These lenders observe the realities of BNPL credit provision every day from the perspective of examining loan applicants' bank statements, when carefully assessing their potential to service the loan applied for (as SACC lenders are mandated to do for the previous at least 90 days, and all other lenders are indirectly obliged to do to satisfy their mandated enquiry and verification responsibilities). Delegation supporters are generally reporting that between 5% and 10% of the applicants are attempting to refinance a multiple of existing BNPL transaction repayments.

The supporters of the Delegation consider BNPL to be nothing more than another loan, with a different title, involving a credit provision company providing the loan funds and its merchant credit representative undertaking the little amount of interface with customers that is required in the current totally unregulated credit circumstances. This is in contrast to the Delegation's supporters, who are extensively regulated and face the substantial and unjust impost of mandated compliance costs, the absence of which for BNPL companies gives them a substantial competitive financial edge, particularly as most of their consumers are of similar classes of people. Most of these consumers have or will borrow from lenders as well as BNPL companies – without the mandated and essential protection the NCCP Act provides.

The legislated opportunity for ASIC to have powerful, very comprehensive and persuasive control of Finance Industry Delegation lender supporters, in regard to credit matters, is not available at all for the BNPL sector and, because of this unavailability, the negative impacts of BNPL products on vulnerable consumers has now become a socio-economic disaster.

The “dark” side of BNPL

As the Options Paper has noted, these totally unregulated BNPL arrangements are covered by an exemption to all good credit governance currently provided by section 6(1) of the National Credit Code, including the responsible lending regime. With BNPL, there is no suitability/affordability assessment required, no regulated control on repayment amounts, no regulated control on the number of transactions and the BNPL credit provider does not have to have an Australian Credit Licence - thereby avoiding all the responsible lending credit legislation and regulations.

This where defaulting BNPL consumers are now paying fees that constitute some 40% of the finance companies who offer this product's gross income and where consumers' bank statements being presented to Delegation supporters, by customers seeking a SACC to pay off their BNPL obligations, frequently have up to 18 current BNPL transactions listed, with Delegation supporters reporting even greater numbers on occasions. We invite the reader to study the appendices to the Min-It Software submission that demonstrate this serious situation.

In addition, with retailers paying the finance companies between 5% and 7% of the gross sales price and thereby being encouraged to retain or establish a higher mark-up to cover the finance costs, and with repayments being generally over 6 weeks, the effective interest rate the consumer is indirectly paying is up to 60.66% flat per annum. This is in the same range as the price and responsible lending regulated SACC (at 68%). Even the consumer advocates, after initially stating that BNPL was a good thing because the consumer was not charged interest, have now woken up. As previously mentioned, BNPL is just another form of SACC lending, generally with a 6 to 8 week term and fortnightly payments.

Inherent in the BNPL transaction is a payment arrangement that commences exactly one or two weeks after the purchase being financed. This contributes to a major budgeting challenge for

many BNPL consumers. Unlike the regulated lending of all Delegation supporters, where repayments are due on the following relevant paydays, consumers gain a clear periodic picture of their financial obligations and they have the opportunity to meet their repayment obligations on the days when their income is received. Their budgeting involves a clear indication as to the amount of income left over. However, BNPL consumers have money being deducted from their bank accounts at various and numerous times by the BNPL companies and frequently have no idea what their aggregated BNPL obligations amount to. That is a significant reason, along with a lack of substantial and appropriate assessment of affordability that Delegation supporters are required to make, why BNPL default rates are very much higher than those suffered by the credit regulated lender.

As discussed later in this submission in some detail, regulated credit providers report that, in general, 15% to 29% of all credit applications involve consumers with numerous existing BNPL obligations.

It is not insignificant that APRA has expressed concern about the need for banks to be aware of the BNPL phenomena when assessing applications for home loans. APRA has focused on the extent of BNPL use and its aggregated impact on loan affordability. Following publication of APRA's concerns, the writers received reports from regulated credit lenders that some banks have started to refuse to lend home loans to BNPL consumers, while others had their loans' officers demand that applicants return when they could demonstrate that they no longer had any BNPL commitments over the previous 90 days.

Members of the Delegation's focus groups report instances of consumers being in default with their payments to one BNPL company, yet being granted credit by another BNPL company, and that not all BNPL companies are keeping to their publicly announced credit limits for aggregated BNPL transactions.

Why so long for this regulation of BNPL review?

The Finance Industry Delegation considers that this review of regulating BNPL has been a disgracefully long time in coming.

This is in an environment where, for 9 years, SACC providers have been subject to targeted, almost continuous regulatory consideration and they and MACC and AOCC providers have been substantially regulated by the establishment of a major and very detailed regulatory regime. This regime has been built on the platform of the generally applicable responsible lending credit regime that commenced in 2010 and was enhanced by the commencement of major additions in 2013. Despite the passing of the original National Consumer Credit Protection Act in 2009 with Ministerial intention that it had application to all non-bank lenders - BNPL companies have escaped any credit regulation, even though a BNPL arrangement is simply a credit contract by another name.

For 7 years until 2020, when a few others expressed concern and a Senate Committee expressed some interest, one of the writers of this submission - representing the Finance Industry Delegation - and Haydn Cooper - initially representing the Financiers Association of Australia and then his company, Min-It Software - have been almost alone expressing experientially based and research based concerns about BNPL finance to relevant Ministers, backbench committees, Senate Committees and Review Panels, and to ASIC officers at meetings, round tables, hearings and in submissions - all to no avail. During that period only one senior ASIC officer sought information from the non-bank credit provider sector - but nothing happened thereafter.

The level of ignorance initially adopted by consumer advocates who welcomed BNPL credit as "good credit" at a 2015 Small Amount Credit Contract Review Panel roundtable stakeholder meeting, and then again by one leading consumer advocate at a 2020 Senate Committee public hearing - because "it did not charge interest" - and the level of ignorance adopted by government as a whole, was profound and fundamentally negligent. As part of this negligence, the maintenance of higher retail margins to pay for the BNPL facility was never recognised as the "interest" cost to which the consumer had been subjected.

At least with loans, regulated by the National Credit Code, only the borrowing consumer pays the permitted fees and charges (SACC loans) and, for other non-bank regulated loans, the statutory fee applicable to MACCs. Further, for all non-small amount credit contracts, the annual cost rate (the "interest" as most now refer to it) is also paid by the consumer taking out the loan. With BNPL every consumer purchasing from a participating retailer, whether they are utilising a BNPL arrangement or paying by other means and if they are not familiar with bargaining - as most are not - are contributing to the BNPL "interest" charge.

The Delegation is pleased that brief mention of this critical issue was included on page 27 of the Options Paper. This is the first official acknowledgement of this feature of BNPL of which the Delegation is aware.

It is not hard to create a regulatory regime for BNPL transactions. As we indicate at the conclusion to this submission, the addition of 8 lines in Section 6 of the National Credit Code and amendment of possibly 2 definitions in Section 204 of the Code, with the addition of no more than several words, is all that is required.

Despite this and responsible Minister Stephen Jones making statements of his concern early in his appointment to the role, the opportunity to include the issue in the recently passed Financial Sector Reform Act and similar draft legislation being championed by his Coalition predecessors and independent MPs, commencing 2016, was never addressed.

A cynical assessment would note:

- (a) That the “big end of town”, big banks and others - traditionally protected by governments of all political persuasions and government departments - have invested in BNPL companies, while small amount credit contract lending and most medium amount contract lending has been deserted by the banks for nearly 20 years - leaving entrepreneurs without “big end of town” connections to be the lenders.
- (b) That personnel previously working for the Coalition Government as advisers at Ministerial level, or for Government authorities during the Coalition Government years, have been recruited by at least one BNPL company and joined lobbyists with close ties to the Coalition Government on the payroll of BNPL companies in general.
- (c) That a series of Coalition Treasurers and Prime Ministers swallowed the nonsense claim by BNPL companies that they were “Fintech” companies, deserving special non-regulated treatment as business pioneer developers when most, if not all, were using computer software programs less sophisticated than most Small Amount Credit Contract and other lender companies had been using for many years - and still do.
- (d) That the original champions of responsible lending and the consequent passing of the National Consumer Credit Protection Act in 2009 - commencing in 2010 (the basis for the Commonwealth responsible lending regime) and its amendments in 2012 - commencing in 2013 (additions creating regulatory recognition of the separate classes of loans), ALP Ministers Nick Sherry, Chris Bowen and Bill Shorten all claimed that the credit legislation was designed to cover all forms of credit. This claim has been ignored ever since.

Delegation supporters are bemused that, despite this protection, no BNPL company in Australia has ever declared a profit and most are now drowning in default debt.

The Delegation is impressed with the explanatory content included in the Options Paper. However a fourth essential option, albeit invited, has not been included (see later in this submission).

Delegation lender supporters have asked why their competitors are totally unregulated under the credit laws, while they face ever more regulation?

What others have said

As openly revealed in this submission, on behalf of its supporters the Delegation has a vested interest in seeking to have identical credit regulation applicable to BNPL as that applying to non-ADL lending companies.

However, it is important to stress that the delegation is not alone with this concern and the chorus of others demanding regulatory action concerning BNPL, even those without any vested interest, is growing louder.

Examples of this non-vested interest chorus include:

The Delegation’s concern now being supported by the leading consumer advocate organisation, the Consumer Action Law Centre. On 20th February 2020, the ABC reported that the Centre’s Senior Policy Officer, Patrick Sloyan, had apparently commented to a Senate Committee then investigating BNPL companies, that *“They’re not regulated, like other credit providers and we think there should be a level playing field... we’re concerned that providers are invoking a halo of innovation and are falling through the gaps and that means they’re not subject to the same regulatory requirements as other companies... That’s a big problem because that means consumers are left in the lurch if something goes wrong”*.

Consumer Action Law Centre Chief Executive and one of Australia's most high profile consumer advocates, Gerard Brody, now says:

"It's a failure of our government to ensure people are treated fairly and have consistent consumer protection no matter where they shop and where they get product from".

Consumers were at "real risk of harm" using BNPL providers.

"I think it is becoming such a ubiquitous and widespread product – everywhere we turn there is buy now, pay later – and it is really concerning that these providers like Afterpay aren't subject to the same safeguards as other financial products".

(news.com.au, May 18, 2022)

"If you are a licensed credit provider (as all SACC lenders are) in Australia, you get a licence from ASIC. You are required to have an internal disputes resolution process and abide by certain standards. You're also required to be a member of an external dispute resolution scheme, the Australian Financial Complaints authority... The BNPL providers aren't required to do any of that".

(Intheblack, 1 May 2019)

Patrick Veyret, senior adviser for consumer group Choice, states:

"One in five people have used a BNPL service to pay for household items like groceries and rent in the past year".

"We've heard from financial counsellors who assist people with debt that some people have 10 or 11 (BNPL) loans".

(ABC News website, 4 May 2022)

Professor Lucas Walsh, Research Fellow Beatriz Cordoba and Researcher Blake Cutler, from the Centre of Youth Policy and Education Practice, Monash University, commenting on Australian Youth Barometer research findings in December 2022 on theconversation.com, "...as incomes fail to keep up with cost of living - the high use of BNPL should ring regulatory alarm bells".

In June 2022, APRA informed the banks that they should assemble information on BNPL to report accurate debt-to-income ratios to the regulator.

In the week commencing 16 December 2022, both ING and Macquarie Bank informed brokers that the banks would be including BNPL commitments in their assessments for their respective home-loan serviceability tests. ING commencing 19 December, Macquarie commencing 3 January.

Based on 819,415 BNPL consumers in 2021, the University of Sydney Business School released a study on 22 December 2022 indicating that 10% of BNPL consumers were at "high risk" of financial harm, that the average age of consumers was 33, that 40% of BNPL users had more than one account and that those with more than one account were likely to be "from lower socio-economic areas receiving government benefits and had high credit card and personal loans usage rates". 23% of consumers were found to be at a risk level above "low risk" of missing 3 to 4 payments over the next 12 months.

Statistics

The Delegation provides the following statistics and associated comment on an indicative basis, given that time and resources have had to be allocated to 4 major submissions over the last several weeks and time for a preferred forensic verification of all the statistics quoted was simply not possible.

Collectively, these statistics emphasise how significant the BNPL sector now is - a significance that cannot continue to go un-credit regulated.

As the Options Paper on page 6 notes, the Reserve Bank of Australia has reported that, in the 2021-22 financial year there were approximately 7 million "active BNPL accounts" involving \$16 billion in transactions.

These figures for a credit unregulated sector must be compared to those of a highly regulated (and soon to be further regulated) sector - SACC loans. In the same year it is estimated that there were 480,000 SACC borrowers, with a total loan book of approximately \$1.2 billion.

Default rates indicated by parties involved with BNPL, known to the Delegation, have ranged from 20% to an anticipated 40%. Taking the 'at best' lower figure of 20% as applicable to the whole of the BNPL sector that means, in 2021-22, defaulting consumers owed BNPL companies something

in the region of at least \$3.2 billion, with most BNPL companies reported as having simply written off their default debts. Although two very small lenders had higher rates (12% and 20%, and therefore an abnormality), the highest default rate amongst the other lender participants in the Delegation's SACC lender focus group, including the very big and medium-sized companies, was reported as 6.9%. Applying this figure to the SACC industry sector as a realistic, at worst, average - with SACC lenders being the predominant competitor to BNPL - the amount consumers owed all SACC lenders during the same year, before collection activities were commenced, was \$0.08 billion.

The Reserve Bank also reported that the 2021-22 figures for BNPL were up 37% on the previous year. From the observations of Delegation lenders, the first half of 2022-23 is also showing substantial growth on the 2021-22 figures.

Further, the BNPL sector's size is anticipated to increase dramatically when the key content of the Financial Sector Reform Act and a promised Regulation commences mid-2023. This commencement will result in the decimation of the SACC lender sub-sector, with a decline of at least 70% in SACC loan availability.

The Options Paper at page 25 states that, for BNPL, "*consumer usage is concentrated around low value short term BNPL business models*". These models are addressing the same market as the SACC loans provided by the relevant competing lenders.

The age ranges revealed by the AFI survey, reported on page 25 of the Options Paper, are not dissimilar to the age ranges associated with the lenders currently lending under the National Consumer Credit Protection Act (Smiles Turner industry and consumer research 2012, 2015, 2022). While BNPL consumers are dominated by people 18 to 34 years of age, Delegation supporter lenders note the 20% increase in 35 to 54 year old consumers from March 2021 to March 2022, reported in the Options Paper. From their observations of potential consumers approaching them for loans, the Delegation's supporters report that this rate of increase appears to be continuing. Their observations are that more people in all age groups are using BNPL credit and the increase is substantially higher than that applicable to their credit regulated lending.

The previously mentioned Australian Youth Barometer annual studies reveal:

- (a) 27% of people 18-24 used BNPL in the last 12 months to August 2022.
- (b) 53% said they had used BNPL at some stage.
- (c) 90% reported that they had experienced financial difficulties at some stage in the year, up from 82% the previous years.
- (d) 30% of those in financial difficulties had used BNPL "very often" in the previous year.
- (e) "About half" of those surveyed in 2021 agreed that BNPL had a negative effect on young people's financial behaviour.

In March 2021 an AFIA survey found 44% of those aged 18-24 and 52% of those aged 25-35 had used BNPL. The March 2022 survey revealed increases to 55% and 58%.

The terms of the BNPL transactions are prescribed according to a 62 day (maximum) limitation included in Section 6 of the National Credit Code, giving the business model its exemption status. Most approved BNPL transactions have terms from 28 days to 42 days. Those offered by Delegation lenders, for similar small amounts, range from 28 days to 364 days.

The average terms of small amount credit contracts offered by Delegation lenders participating in recent focus groups convened by the Delegation, range from 28 days to 252 days, with 80% of the responding lenders having an average figure of at least 84 days. That gives most borrowers at least twice as long to pay off a SACC, as opposed to a BNPL transaction.

SACC loans are averaging from \$400 to \$1,500 for participating lenders in the Delegation focus groups and, from their bank statements, aggregated total BNPL current transaction indebtedness for most BNPL consumers appears to be at least in a similar range. The impact on net incomes per income payment is much greater for BNPL users (leaving less for living expenses) than SACC borrowers, who have longer to spread their payments and therefore pay less out of each pay packet (and have proportionately more to spend on living and unexpected expenses).

The Options Paper reports ASIC research indicating that 19% of BNPL consumers surveyed "*cut back or went without essentials to make BNPL payments*". Delegation supporters report another financial stress indicator - the number of consumers applying for a loan to consolidate and manage the repayment of all their BNPL transactions.

Given the dominance of BNPL transactions involving credit of under \$2,000, the Delegation established a SACC lender focus group. In October 2022 one of the focus group participants reported the maximum BNPL numbers observed on consumers' bank statements ranged from 7 to 60, with other participant's numbers including 12, 15, 20, 25 and 45. This is while the current SACC regulations presume that anything more than two SACC loans in the last 90 days is unaffordable and illegal.

As indicated above, research also showed:

1. 1 in 5 Australians have now used BNPL for groceries and/or rent. This is at least 9 times more than SACC borrowers.
2. By 2019, 2.5 million Australians had used BNPL arrangements with just one company - Afterpay. Note that this is 5 times the total number of SACC borrowers annually.
3. In 2021, 1 in 7 people had more than 20 BNPL loans.
4. ASIC has recently reported that 44% of BNPL customers have incomes of less than \$40,000 per annum.
5. BNPL companies have fee charging rates that include 30 cents per transaction, plus 4% to at least 6% commission. Note that 6%, on a 6 week loan, is 51.99% flat interest per annum. SACC interest is a regulated 4% flat per month, or 48% per annum.
6. In May 2022 BNPL finance opportunities were arranged with a number of butchers, hairdressers, restaurants, IGA, Foodworks and United Petroleum, for loans up to \$500, with significantly expanding the reach of BNPL.
7. While SACC lenders in the focus group are reporting minimum loans of \$100 to \$500, BNPL will lend numerous loans of anything like \$40 to the one consumer, with the opportunity for consumers to sign up for multiple transactions totalling considerably more credit than SACC lenders would approve.
8. In September Bunnings Warehouse announced a BNPL arrangement had been negotiated.
9. The Reserve Bank of Australia is now flagging changes in the rules to allow retailers to pass the fees charged by BNPL providers onto consumers.
10. For the 2021-22 financial year, BNPL companies all reported losses. Payment analyst and chief executive of McLean Roche Consulting, Grant Halverson, estimates last financial year the Australian industry's loss totalled \$1.05 billion. From company reports, Afterpay lost \$156.3 million and Zip lost \$652 million. A significant proportion of these losses is due to consumer defaults.
11. This is the "debt spiral" consumer advocates are concerned about.
12. These figures are much bigger than even the largest SACC lender's loan book.
13. Associated with the loss factor are BNPL companies reporting 14% to 40% of their total income being generated by default fees (unassessed for loan affordability - consumers unable to repay their BNPL loans).
14. In March 2020, a major investor in Afterpay published a report anticipating a 40% (all loans) default rate. The majority of the Delegation's SACC focus group reported default or bad debt rates of between 2% and 6.9%.
15. Significantly, the largest lender participating reported the 6.9%. For those 2 lenders participating in the focus group with rates above the 6.9%, one small lender reported 12% and one medium sized lender reported 20%.
16. Afterpay charged late payment (default) fees capped at \$68 and 25% of the transaction amount. SACC lenders charge an average \$35.

The Delegation has also established a general lenders group to explore the impact of BNPL transactions as observed by non-bank lenders offering loans of up to \$30,000. In December 2022 this focus group reported the following:

1. The percentage of loan applicants with at least one current BNPL transaction revealed on their bank statements - the different respondents indicated 80% to 95%. One medium sized lender noted that with older consumers it was approximately 50%, but with consumers under 34 it was 90%.

In the earlier SACC lenders-only focus group, two very small lenders, with very specific target markets, reported 10% and 50%, while the largest lender participating (one of the biggest in Australia), reported 80% and the rest of the participating companies reported 90% or more.

2. For those consumers with BNPL transactions on their bank statements, different focus group participants reported:
 - Between 5% and 100% had 1 to 5 transactions.
 - Between 10% and 90% had 6 to 10 transactions.
 - Between 5% and 80% had 11 or more transactions.
3. The largest number of current transactions (BNPL contracts requiring repayments during the term of the loan applied for), evidenced in consumer loan applicant consumers' bank statements by the participating lenders, was 60 - with all but two lenders reporting numbers of 15 or more.
4. The percentage of consumer applicants with current BNPL transactions indicated on their bank statements, seeking loans from the regulated lenders to refinance their BNPL obligations to reduce weekly/fortnightly aggregate payment amounts, varied dramatically from lender to lender, with one who lends from approximately \$10,000 to \$30,000 reporting 5%, one who lends an average of \$400 reporting 80% and the rest of the lenders reporting between 15% and 29%. Only one small lender reported 0%.
5. Refusal of loan applications from consumers with current BNPL repayment commitments that was largely, if not entirely, due to BNPL transactions on their bank accounts, predominantly ranged from 40% to 85%.
6. The focus group participants commented that it was not uncommon to see BNPL consumers overcommitted, with 30% and more of their net income going to repay BNPL commitments.

Delegation focus group discussion included comment that it was a systemic matter and, before approving BNPL transactions, BNPL companies did not demonstrate any obvious attention to establishing that the consumer had a buffer, or sufficient discretionary income to rely on after meeting their BNPL financial obligations.

The BNPL companies have claimed self regulation will be adequate. The above figures demonstrate the lack of substance to such claims. Their recently adopted Code does not make any attempt to adopt the stringent responsible lending regime imposed on SACC lenders. While BNPL companies have installed controls excluding consumers from further borrowing when they have missed a payment on a current loan, none have any affordability rejection rates. Contrast this to participants in the focus group, with the majority reporting rejection of SACC application rates at 60% or more, some medium sized lenders as high as 90% and the larger lenders at 75%.

Given the number of BNPL transactions that SACC lenders are seeing on consumers' bank statements, provided by a number of BNPL companies, the Delegation is anything but convinced that the current self regulation regime and associated industry Code are being observed by the majority of BNPL companies.

Question 1

Can you provide examples of other areas of consumer harm or industry behaviour this paper has not discussed.

The practice of BNPL companies to "*readily write-off bad debts and generally not report defaults to credit reporting bodies*", noted on page 13 of the Options Paper:

1. contributes to the BNPL sector's lack of profitability;
2. encourages consumer credit irresponsibility;
3. will lead to a blow out in vulnerable consumers facing further financial stress when the companies are forced by their shareholders - and their falling ASX share prices - to attempt serious debt recovery; and
4. significantly reduces the efficacy of Australia's credit reporting regime leading to lenders, BNPL companies and others, extending credit without the knowledge, or the opportunity to gain such knowledge, that the relevant consumer has reneged on their BNPL obligations and are probably unsuitable to be offered further credit of any kind, in accordance with the National Consumer Credit Protection Act and sound commercial credit practices.

Because of many of the BNPL companies' precarious financial situation, with investors' funds - not profits - propping the companies up, the medium and long term opportunity for participating companies to adequately compensate consumers or, when necessary, offer refunds when purchased goods are returned to the retailer, is threatened.

As noted in the Options Paper, the existing BNPL industry sector code of ethics has no enforcement mechanism, no fines for ignoring it and no legal status that can invite ASIC or court attention. Perhaps implied, but not stated in the Options Paper, the far more comprehensive responsible lending regime - detailed and imposed by the National Consumer Credit Protection Act - has the legal status of law, does involve ASIC as the policeperson and is considered by the courts.

Significantly, as the Options Paper reports on page 9, the Commonwealth Bank of Australia (with its \$200 million investment in its BNPL subsidiary), PayPal and "*some smaller BNPL providers*" have not signed up to the BNPL industry voluntary code. Unlike the competing SACC arrangements, BNPL consumer disclosure documentation is totally unregulated by the National Consumer Credit Protection Act and does not provide any of the detail that lender's contracts have to provide. That means BNPL consumers do not have any comprehensive documentary content help when making their BNPL decisions, in stark contrast to the content help provided by the lenders' mandatory consumer disclosure documentation.

The substantial consumer disclosure documentation of the lenders, including but not limited to the credit contracts, is not available via BNPL transactions. Overall, consumer information is comparatively very limited for BNPL transactions. The Delegation notes this lack of transaction transparency is recognised in the Options Paper, but there is no recognition of the critically important and comprehensive information available to consumers of lenders' credit products, allowing fully informed decision making if the consumer reads the material provided - as opposed to very limited information the BNPL sector offers, which cannot be an aid to fully inform the consumer about the BNPL transaction into which they are about to enter.

Not all BNPL transactions drive increased business for merchants. While the Delegation recognises the encouragement for impulse, unplanned buying created by BNPL credit unregulated opportunities, there is also a current lack of research regarding the situation where consumers are simply bringing forward purchases that were to be made in the future.

Question 2

What are the main contributors of consumer harm?

The delegation is particularly concerned about the following:

1. As indicated under the sub-heading "Statistics" below, Delegation supporters report a significant number of instances where consumers applying for loans have bank statements that patently demonstrate it is more than "*some BNPL providers (who) ignore a consumer's financial circumstances, including whether they have sufficient income to meet BNPL payment obligations*" (Page 12, Options Paper).
2. It cannot be overlooked that BNPL companies offering almost automatic increases in spending limits to consumers who have successfully repaid their BNPL debts to date, is no different to offering a continuing credit contract. However this is without any applicable credit regulation, including new and higher repayment affordability - in contrast to the responsible lending regime imposed on lenders who offer continuing credit contracts.
3. The "frictionless" sign-up process applying to BNPL companies, noted on page 17 of the Options Paper, with basic information requested - if any - beyond ID, is in stark contrast to the very comprehensive responsible lending assessment process, mandated by credit law, that is imposed on lenders - with the substantial enquiry and verification of consumer information required.

Question 3

What evidence supports this view?

1. The thousands of bank statements Delegation lenders examine each week that reveal harmful excessive BNPL consumer transactions and the associated unaffordable repayment obligations;
2. this information is included in the application and assessment reports of the many applicants for Delegation supporter lenders' loans who face a BNPL debt trap, that include other

information provided by consumers as well as bank statements. The Privacy Act discourages the provision of examples in association with a publicly available document; and

3. a number of the statistics included in this submission.

Supplementary comment – Questions 1 and 2

Question 1

Question 1 demands a consideration of other BNPL environment factors that may have been mentioned in the Options Paper, but without important characteristics being examined.

The Delegation considers that the following must be considered when examining the answers provided to Question 1.

The following is the Delegation's brief summary as to what must not be overlooked as progress is made towards the essential regulation of the BNPL industry sector. The issues are not presented in any particular order.

1. The statement on page 6 of the Options Paper, insofar as it includes BNPL companies, is fundamentally inaccurate. The Paper reads, "*In recent years, advancements in technology have enabled credit businesses to build a profitable market for free or low cost credit and credit-like arrangements fitting within the low-cost continuing and short-term credit exemptions*".

The BNPL credit business model has been developed within the credit exemptions, however:

- (a) we remind the reader that no advancement in technology is involved. Lenders have been using very similar computer software programs for at least 20 years;
 - (b) the BNPL sector is not profitable. We remind the reader that none of the BNPL companies in Australia have ever reported a profit; and
 - (c) apart from the "hidden" extra retailer margins contributing to the BNPL fees, as the Options Paper notes, "*Most BNPL products charge service fees, such as account establishment fees and account keeping fees*".
2. In the currently unprofitable industry sector circumstances, the costs to the BNPL companies of any imposed regulatory regime could be a sensitive issue - just as it has been for the lenders with whom they compete.
 3. Consumers do not have the advantage of a well publicised and comprehensive membership of the Australian Financial Complaints Authority (AFCA) with which to lodge complaints. While some BNPL companies have joined AFCA, AFCA does not have the National Consumer Protection Act-created support to make decisions on the affordability assessments of BNPL companies, nor demand that consumers of the BNPL companies have their debts waived.
 4. There is no universal and consumer friendly arrangement for refunds when the consumer returns the goods to the participating retailer for good reason.
 5. Detailed responsible lending rules, generally adopted by the lender sector and robustly enforced (at times by ASIC), are substituted with a much weaker set of principles contained in an industry code to which not all BNPL companies have signed, and there is no compulsion mechanism - including fines - to abide by their code, for those companies who have signed.
 6. As the Options Paper partially recognises, there is no compulsory and detailed consumer assessment, including consideration of the consumer's financial situation, verification of information and consideration of the needs and objectives of the consumer, nor is there any record of that consumer assessment, as required for lenders of non-bank credit contracts. These are assessments that are inspected during annual compliance reviews and by ASIC-demanded audits. This lack of assessment means systemic issues adverse to BNPL consumers go unchecked and uncorrected.
 7. The Options Paper on page 4 fails to recognise that the improved financial inclusion for consumers offered by BNPL companies does come at a cost, as discussed earlier in this submission. Retailer margins are higher to cover the BNPL fees and all consumers, however they pay for their purchases, are paying more. The non-BNPL consumer is subsidising the BNPL consumer and/or contributing extra to retailer gross turnover.
 8. It is unfortunate that, prior to the publication of the Options Paper, Treasury appears to have overlooked any involvement of lenders in its "*targeted consultations*" on "*Regulatory issues in*

the BNPL sector" (page 4, Options Paper). As indicated above and under the sub-heading "Statistics" later in this submission, lenders are seeing the serious and negative impact of the BNPL sector daily - via the bank statements that potential borrowers offer when applying for a regulated loan.

9. None of the problems of BNPL companies, nor the hardship handling and complaints listed on page 13 of the Options Paper and applying to BNPL, are faced when dealing with most lenders. With lenders, if necessary these are overcome without cost to the consumer or, where there is an exception, are lodged with ASIC or AFCA, with their powers of enforcement and penalties supported by credit law. Consumers are repeatedly informed of these complaints lodging opportunities in mandatory regulated lender disclosure documentation, which is compulsorily given to every consumer.
10. Concerning full disclosure of conditions and costs - lenders face a mandatory regime of consumer disclosure documentation where everything is presented to the consumer in writing and the lender is obliged to explain their contracts to the consumers.

Question 2

(a) *Are the guiding principles appropriate and fit for purpose to inform the development of a BNPL regulatory framework?*

Answer: yes.

(b) *What other factors should be considered?*

Answer:

1. That BNPL companies are increasingly competitors of SACC, MACC and AOCC lenders and no government can justify the continuing maintenance of a comprehensive regulatory regime impacting on one competitor, while failing to impose a similar comprehensive regulatory regime on the other competitor.
2. That the possible forthcoming recession and the commencement of further regulation of SACC lenders mid-2023, will exponentially increase the demand for BNPL transactions.
3. As the Options Paper discusses in part, that BNPL is now a sector offering a financial product to fund not just smaller discretionary purchases, but general living expenses and purchases up to \$30,000 in value.
4. That, while there is disclosure of retailer/merchant fees charged by most BNPL companies in their business documentation - but not in any documentation readily available at point of transaction, for the consumer to make an informed decision - there is no consumer explanation available as to how much extra the retailer/merchant is marking up the price of their product to cover the BNPL company fees.

(c) *Of the three options below, which option do you think is most appropriate?*

Answer: Option 3, with very important amendments. In other words, a fourth option.

The Delegation notes the appropriate recognition of what an industry code of conduct should entail, in the description provided in the Option Paper.

(d) *Would you change any aspect of that option?*

Answer: Yes.

The option adopted must offer the same consumer benefits that the responsible lending/ National Consumer Credit Protection Act regulatory regime offers consumers of SACCs, MACCs and AOCCs (i.e. all non-bank regulated lending).

There is no acceptable rationale for offering different levels of consumer protection and the Delegation reminds the reader that the Act was introduced with the Ministerial intention that it would cover all credit.

Consumers face the same risks of vulnerability and getting involved in debt traps.

The option must also impose the same regulatory environment on both the lenders and the BNPL companies. There is no acceptable rationale for offering different levels of mandatory regulation to the different competing areas, both of whom are appealing to the same sectors of the general public and both of whom are providing credit facilities - regardless of the branding and descriptions adopted.

It is not Government's role to give a financial advantage to one sector, as opposed to another, by differentiating the extent of regulation and unfairly burdening one competing sector with compliance costs not faced by the other - while both sectors offer products with the same or similar consumer dynamics, requiring standard government control.

One difference of concern is the proposed elimination of any consideration of merchants being considered credit representatives of the BNPL companies.

This cannot happen. Merchants carry out the same tasks as (authorised) credit representatives of credit provider/lender companies and these are explicitly referred to in the Act.

Further, ASIC supervision is enhanced for the credit representatives of lenders, because the lender has to register these representatives with ASIC. The current lack of registration of retailer/merchant representatives of BNPL companies with ASIC, on the basis of ASIC supervision alone, should not continue.

Without such inclusion, there is a major hole in the regulation of BNPL companies, creating major consumer detriment, because there would be a continuation of the lack of consumer assessment control and responsibility at the retailer's premises where the entire transaction is being finalised for the consumer. It is this point of sale assessment that is central to the effective and responsible regulation of the BNPL sector.

Allowing consumers to set their own spending limits, without evaluating enquiry and verification, is also untenable. These limits must be established by merchant assessment according to affordability of repayments, on behalf of the BNPL companies.

Further additions to what is proposed could include the recognition of BNPL being a continuing credit contract, if the current policies of some of the BNPL companies to increase consumer credit limits over time are to continue. Consideration of the companies actually offering what is basically a continuing credit transaction arrangement could be recognised with the BNPL companies undertaking a commencement comprehensive assessment, identifying the ultimate credit limit, and then building this into their continuing credit contract conditions - such as a stepped arrangement in terms of reaching the maximum credit limit, based on the earlier BNPL transaction under the contract being successfully repaid by the consumer.

To address the issue as to who pays and what is paid for BNPL arrangements, considered earlier in this submission, the concept of the merchant surcharge replacing the higher retail margin and being a cost passed on to the BNPL consumer is both competitively fair, and appropriate as a true disclosure of BNPL charges.

BNPL companies should be contributors to the ASIC Industry Funding Scheme, the proposed Compensation of Last Resort, and the Financial Counsellor Funding Levy Schemes - in the same way as lenders are expected to do - for competitive neutrality and to assist ASIC expenses in the necessary supervision of BNPL.

A subsidiary issue, but highly relevant to consumers' equitable treatment no matter how they choose to pay for their transaction, is to free up any current regulatory impediment to transparency associated with different payment models, with retailers disclosing different retail prices according to how they are paid, or simply transparently adding the BNPL company fee to a generally applicable and promoted retail price.

Issues with Options 1 and 2

What do you think are the issues with the other two options?

Answer re. Option 1:

Not all BNPL companies have signed up to the Code.

What has been undertaken to establish that the BNPL sector can genuinely manage and impose the Code? Accepting the self serving BNPL statements of effectiveness is not tenable without independent audit.

Why should ASIC have to continue to give special treatment to BNPL?

When will lenders be offered the same opportunities?

The specific requirements for checking affordability are already in the National Consumer Credit Protection Act.

Replacement of comprehensive assessment with reference to a credit score places great reliance on the efficacy of the credit score methodology used, and ignores all the other elements of assessment considered by ASIC as essential in ASIC Regulatory Guide 209.

Why are the essential requirements for lenders not regarded as essential for the BNPL sector's credit offerings?

Why would ASIC regard reliance only on a credit score as inadequate for lenders, but acceptable for BNPL companies?

How can the non-application of any responsibility for verification of information for BNPL be justified, when it is a mandatory and critical requirement for lenders?

BNPL consumers have repayment obligations in exactly the same way as lenders' consumers, except for payment dates. All consumers of both sectors' products have to be able to afford their transaction.

There is little need for a Code, all that is required is already in the National Consumer Credit Protection Act. As the Options Paper states, Codes can simply add additional industry sector applicable obligations.

Answer re. Option 2:

Again, why should BNPL only face limited regulation, when the consumer dynamics are the same for BNPL as they are for lenders regulated by the Act?

Again, the reliance on "a tailored version" of responsible lending obligations is nonsense.

The Delegation emphasises - BNPL companies are offering a credit product by another name. The consumer detriment fundamentals are exactly the same as those associated with the lenders' credit products.

The level of risk associated with BNPL products is comparable to the lender's products. Same needs for credit, same consumer base, same opportunities to not be able to meet contracted repayments.

The option of not recognising that merchants are credit representatives of BNPL companies is absurd. They carry out the same tasks that authorised credit representatives do for lenders. Tasks and responsibilities that are addressed in detail in the Act and easily applicable to merchants - albeit merchants may not welcome their new status and BNPL companies would no doubt dislike having the responsibility of supervising their credit representatives' compliance behaviour - just as lenders have to do with their credit representatives.

Again, the nonsense of assuming the adoption of a Code, with all the difficulties of enforcement, the challenge of acceptance by all BNPL companies, negotiation to establish a satisfactory Code and to introduce changes later, and to address the proposed mix of partial National Consumer Credit Act content with the content of a Code is easily avoided by applying all of the provisions in the Act to the BNPL sector.

How easy is it to impose appropriate regulation on the BNPL sector?

The answer to this question is – very easy. It simply requires additions to Sub-section 6 of the National Credit Code and a definition to be found in Section 204 - a total of 14 additional lines.

BNPL arrangements take advantage of an exemption provision in the National Credit Code that was never intended for such a purpose. This exemption provision states:

"Provision of credit to which this Code does not apply:

Short term credit.

1. *This Code does not apply to the provision of credit if, under the contract:*

- (a) the provision of credit is limited to a total period that does not exceed 62 days; and*
- (b) the maximum amount of credit fees and charges that may be imposed or provided for does not exceed 5% of the amount of credit; and*
- (c) the maximum amount of interest charges that may be imposed or provided for does not exceed the amount (calculated as if the Code applied to the contract) equal to the amount payable if the annual percentage rate were 24% per annum".*

The amendments to the National Credit Code necessary to exclude this exemption of the National Credit Code and the rest of the NCCP Act from applying to the BNPL model are very few and are as follows.

Addition of a new Sub-section (3) - *“Notwithstanding, sub-section (1) of this Code does apply where a fee or charge is payable by a merchant or retailer to the credit provider, in association with a transaction involving a consumer purchasing a good or service from the merchant or retailer that is funded by a credit facility involving the consumer repaying the third party credit provider”*.

Addition of a new Sub-section 6(4), being - “And” out, (d) becoming (a) and (e) becoming (b).

In the new (b), 3rd line - change *“are imposed directly”* to *“must be imposed directly...”*.

Then, also in the definitions’ section -

Add to Section 204(1), *“Short term credit - see Section 6”*.

Addition of sub-subsections (d) and (e) to section 6(1) – being

“And

- (d) Apart from the fees, charges and interest provided for in (b) and (c), a short term credit contract must not impose or provide for fees and charges that are not a fee or charge payable in the event of a default in payment under the contract; and*
- (e) the credit fees and charges and interest, detailed in the relevant short term credit contract that the consumer signs and/or in any relevant contract signed by a third party for the provision of credit to a consumer, are imposed directly upon the consumer and not, regardless of description, upon any other party that may be associated in any way, directly or indirectly, with the transaction”*.

Conclusion

The Finance Industry Delegation looks forward to participating in the proposed further consultation process.

We thank you for considering this submission.

Phillip Smiles LL.B., B.Ec., M.B.A., Dip.Ed.

Lyn Turner M.A., Dip.Drama

Coordinators

Finance Industry Delegation