Min-It Software

Submission: Regulating Buy Now, Pay Later in Australia

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Introduction

Aside from the software provided in-house, specifically by or for franchised organisations, Min-It Software is a leading supplier of loan management software to non-ADI credit providers, both in Australia, New Zealand, South Africa and the United States. These clients range from lessors, small lenders offering anywhere from $300 - $10,000, other lenders offering larger amounts, typically $5,000 - $50,000 or more, car financiers, home mortgage providers and those offering business loans from $50,000 to millions of dollars.

None of our clients are now members of any industry association.

Background Information and Comment

This isn't new. We've told you about this issue – repeatedly – for the past 7 years

Since 2016, when we first brought this product to the attention of the SACC/ Consumer Lease Review Panel, we have repeatedly advised Treasury and various Senate Committees [1]that the Buy Now Pay Later ("BNPL") model was a problem. Back then, we provided the SACC Review Panel and Secretariat with a dozen or so bank statements of consumers that had over 15 simultaneous BNPL contracts. They didn't want to listen.

In Melbourne, at a Senate Committee Inquiry reviewing the introduction of a Bill, despite the then founders of Afterpay stating they imposed limits on consumer borrowing, we

[1] For example, see Min-it Software – Financiers Association of Australia joint submission: Inquiry into credit and financial services targeted at Australians at risk of financial hardship, dated 09 November 2018, Min-it Software – Financiers Association of Australia joint supplementary submission: Inquiry into credit and financial services targeted at Australians at risk of financial hardship, dated 14 January 2019, Min-it Software – Financiers Association of Australia joint submission: National Consumer Credit Protection Amendment (Small Amount Credit contract and consumer lease reforms) Bill 2019 (No2), dated 21 February 2020, and Min-It Software submission: Senate Standing Committee on Economics – National Consumer Credit Protection Amendments – Financial Sector Reform Bill 2022 [Provisions], Financial Services Compensation Scheme of Last Resort Levy Bill 2022 [Provisions] and Financial Services Compensation Scheme of Last Resort Levy (Collection) dated 09 October 2022.

provided further proof the BNPL providers were simply handing out credit without any regard for affordability by supplying more assessments. No one listened.

It is remarkable that the consumer advocates have been pushing for these reforms, as we are mindful of their comments at the Melbourne meeting of the SACC Review Panel on 21 October 2016 where one of them stated that BNPL was "good credit" because "there was no interest or fees payable".

BNPL is a 'fintech' credit product that started here in Australia and now, worldwide, has caused and still causing consumers massive amounts of financial stress and huge losses for those offering it[2]. The advocates have obviously had a change of mindset, given the large amount of detriment that's now affecting not just society's vulnerable but many that wouldn't otherwise be classed as this as they hold well-paying jobs.

These consumers have fallen victim to the Machiavellian design of this credit product, aided totally by previous Governments' desire to boost the economy. By inference, the Government would obtain additional tax revenue through pandering to Millennials' desire for instant gratification. The "I want it now" mentality that soaks up discretionary income to boost retail turnover was just what past Treasurer's demanded.

It's quite cathartic to say that we told you so; we haven't changed our stance on this product at all.

[2] See Sharples,2021. Buy now, pay later providers reveal millions in losses, News.com.au, 26 November 2021. Available online https://www.news.com.au/finance/money/investing/buy-now-pay-later-providers-reveal-millions-in-losses/news-story/a0cf57f1fb85b440cda6066322e6065d, accessed online 22 December 202 .where she reported that in 2019-2020, **Afterpay announced a $156.3 million loss**, up 700% on the previous year. **Zip reported a $652 million loss**, up 3000% and her article Buy now, pay later provider Klarna Australia reports 'catastrophic' loses of **$56m in 2021**, News.com.au, 31 October 2022. Available online https://www.news.com.au/finance/business/banking/buy-now-pay-later-provider-klarna-australia-reports-catastrophic-loses-of-56m-in-2021/news-story/9169d91767e4c8bf5164bc7c09930831 accessed 22 December 2022.

We will supply the 5 partial assessments referred to in the Table of Contents by a separate, confidential submission. These were obtained from one client but we could have supplied hundreds like them, from many of our clients. They are not unique and do not represent the odd extreme case. These assessments are typical of clients' spending norms.

What they reveal is that BNPL has allowed consumers to become addicted to retail therapy. Behavioural therapy is typically the most common treatment for addictions as it's a treatable disorder. The question we must ask is if Government is prepared to treat this addiction with the cold turkey requirements, we suggest in Option 4 rather than one of the softer options being presented now in Options 1 – 3 inclusive. We suggest anything other than Option 4 merely prolongs consumer agony and is likely to increase poverty.

The options

The options paper makes the assumption that the BNPL model currently in use will remain as it is now. We do not believe that this will necessarily be the case. Given the large losses being incurred by BNPL providers, it would not be unreasonable to believe that there will be some shareholder discontent and demand that more action be taken to recover at least some of the losses being incurred.

Whilst there is a large similarity of BNPL to SACC loans, the methodologies used make it more akin to a credit card contract. If the BNPL providers were to supply a card, it is arguable there is a methodology that would allow them to remain exempt from the Credit Act because of ASIC's administrative decision many years ago not to require an ACL for products that are exempt from the NCC. In doing so, it may be possible to continue with the model almost as it exists right now except, they could charge consumers a higher missed or late fee than they do currently and take enforcement action to recover or sell the debts in a far more aggressive manner. Implementing at least one of the options as suggested could be rendered ineffective in an instant. ASIC's new Product Intervention Powers, which based on activity to date have had relatively little success in stopping consumer harm quickly, would then have to recommence and we ask how many more consumers are going to be affected in the meantime?

Partly as a result of this and for the additional reasons given below, we disagree on all of the options listed. With the most obvious option not mentioned, except in a most cursory manner which we suggest is deliberate, we have chosen not to specifically answer the questions raised in the Options Paper. Instead, we will comment on each option listed, state why we reject them and call for implementation of a fourth, more onerous option.

Option1 – **Strengthening the BNPL Industry Code plus an affordability test**

Credit is credit, regardless of whether it's one day, one week, one year or longer. It's whether it becomes regulated or not that's the issue. We reject this option as the options paper states there would be "[n]o requirement to obtain and maintain an Australian Credit Licence" ("ACL"). There is also, arguably, a conflict of interest pertaining to the Australian Finance Industry Association ("AFIA") as it's likely the Code of Conduct will also require that associations' membership.

We consider the requirement to hold an ACL as essential.

Option 2 – **Limited BNPL regulation under the Credit Act, including licensing and scalable unsuitability test**

We reject this option as it is stated that whilst an ACL would be required, with the BNPL provider either holding an ACL itself or it acting as an Authorised Credit Representative ("ACR"), there is **only** a "a requirement to comply with most general obligations of a licensee" but not **all** requirements.

Credit is credit, regardless of whether it's one day, one week, one year or longer. It's whether it becomes regulated or not that's the issue. We consider the requirement to hold the BNPL provider to meet **all** ACL requirements that apply to other lenders as essential. As stated above, we regard the BNPL product as being little different to a SACC or credit card contract. There are already some BNPL providers imposing a credit limit of $2,000. This is the identical upper regulatory limit applied to a SACC. With consumer advocates continually attacking that product despite the fact that there is far more widespread detriment and indebtedness arising from the BNPL product, we see no reason why at least similar additional requirements as applying to SACCs should not be equally applicable to BNPL. Rather than scaling back the legislated and regulatory controls that apply to other credit products as is suggested, there is no morally valid reason for not doing so for the BNPL product.

There is a slight inference contained with the options paper that suggests this is the option being considered the most as it would still allow the BNPL providers to trade freely with some regulatory oversight. In regard to the consumer setting its own credit limit, we suggest industry will regard this as nonsense if Responsible Lending Obligations are to be adhered to in some way. As we will show, if consumers elect to use not just one BNPL provider, then unless the credit limit is to be recorded on the individual's credit files, each individual BNPL provider may not know whether the limit set has been exceeded. Again, consumers must take on personal responsibility rather than having it firmly put up on lenders.

Option 3 - **Regulation of BNPL under the Credit Act**

The consultation paper does not specify exactly what the amendments required "to regulate BNPL products and services" under the Credit Act would be. We see that as manifestly uninformative. It is clear that Treasury has some ideas, based on what is being disclosed, as to what these changes are likely to be if this option was the one proceeded with.

Notwithstanding this is an options paper, the failure to comprehensively detail what the changes are likely to entail is a major departure from previous consultations. Given that BNPL has prospered primarily from the lobbying by those with close ties to former Prime Ministers and Treasurers, it suggests that there may be further political interference to ensure that the impact of the legislative changes may be watered-down. If this occurred, the end result would be the measures, whilst having some impact, aren't going to be really that onerous on the actual BNPL providers and have little effect on the model used. To use a medical analogy, we regard that as extremely problematic as it addresses symptoms but not the cause.

That said, there will be a number of BNPL providers expressing concern at a possible intention to cap fees for charges relating to missed or late payments that could be applied, together with additional disclosure requirements. Aside from the methodology they would have to use to comply with the latter, arguably, a $7 – $10 late or missed payment fee with an upper capped limit that many providers currently apply isn't that great. It probably reflects the lack of work actually done to collect the debt. These fees are a direct consequence of the consumer failing to take personal responsibility for their purchasing habits and we would suggest that any attempt to cap these fees may result in more losses. If BNPL providers were to undertake more recovery work, they would want to be able to recover their costs as other credit providers do.

Aside from the issues the Options Paper describes, there are a number of other problems this paper does not adequately identify.

Inability to consolidate BNPL debts

A number of our clients have previously provided BNPL consolidation loans. That has now ceased because no sooner than the individual BNPL debts are consolidated into a more manageable loan repayment, the consumer immediately restarts using the BNPL products. Their need to continue using it to boost their spirit is akin to an insatiable appetite, influenced through social media and peer pressure. For lenders, even though such loans are more suitable for the consumer, the risk of subsequent default becomes too great and it is almost impossible to meet legislated responsible lending obligations.

The only real way a consumer can get out of the situation is for the consumer to seek bankruptcy or a Part IX debt agreement.

Inflation

The Australian Finance Industry Association commissioned a report [3]on BNPL and this is available on its website. According to this report, the greatest benefit that BNPL offers is choice, both for the consumer and retailer. Retailers can offer BNPL as a payment methodology and in doing so, it has an impact on the businesses' operations and cost of doing business. For the consumer, it affects how, when and where and at what cost is paid for the goods or services.

From anecdotal evidence, we have been advised some BNPL providers are increasing the merchant fee charged. Equally, retailers are also increasing the price of goods to cover the increased merchant fees charged by the BNPL providers. This affects all consumers, regardless of how they purchase goods and services, and contributes to inflation. Considering BNPL covers all manner of goods being purchased, from petrol, groceries, pub and restaurant meals, jewellery, to services such as vehicle and boat repairs, etc., even to purchasing cars, it has a wide-ranging effect that affects almost every single product for sale.

If retailers and service providers cover their BNPL expenses by adding at least 5% to every single product or service to cover the typically 4% merchant fee, every single Australian is impacted each and every time they shop, regardless of whether the goods and services are actually paid for using BNPL. No one asks the question "Who's going to notice?". Due to the COVID-19 pandemic, we have all noticed the cost of goods have been steadily rising. The excuses range from the war in Ukraine to supply chain issues. BNPL has therefore become an easy recipe for retailers and service providers to make additional profit that attracts little Australian Competition and Consumer Commission ("ACCC") interest.

At a time when the Reserve Bank of Australia ("RBA") is trying to reduce inflation, allowing BNPL providers and/or their merchants to increase merchant fees or profit is counter-intuitive. There is no mention in Option 3 of whether there is to be any attempt to limit such fees. Given the recent passing of the Financial Sector Reform Bill 2022 that proposes to

[3] AFIA, 2021. The Economic Impact of Buy Now Pay Later in Australia. Available online https://afia.asn.au/files/galleries/AFIA_BNPL_Research_Report.pdf accessed 22 December 2022.

limit the amount of a repayment payable by a consumer for a SACC and consumer lease, it is imperative that some form of cap is introduced to limit the amount of fees able to be charged by the BNPL providers to merchants.

Government cannot adversely comment on inflation and the RBA's efforts to reduce it without taking any action on curbing consumer spending.

Payment defaults

Established lenders have seen the true outcome of BNPL spending on the bank statements of would-be borrowers. The number of loans being offered currently has reduced from pre-pandemic levels because not only does BNPL makes more traditional loans unaffordable with ongoing BNPL purchasing but consumers give priority to BNPL payments. In particular, those offering personal and vehicle loans have felt the brunt of BNPL with a substantial upswing in dishonoured or late payments. Home mortgage repayments have not seen the same marked increase in payment defaults as consumers seek to retain a roof over their heads given the difficulty in securing rental accommodation in the current market.

If consumers do not keep up with their BNPL payments on the due date, their spending ability is curtailed by suspension of the account until it's brought up to date. As noted above, a modest late payment fee is also charged. To avoid that occurring, many consumers use wage advance companies together with a variety of BNPL providers so that it allows them to continue spending by robbing Peter to pay Paul.   See the examples in the Appendix to be supplied confidentially for more details and comments.

Innovation

Fintechs are seen as innovators that disrupt traditional mainstream credit providers by using technological processes to reduce operational costs. In doing so, they profess to make credit more easily obtainable and affordable. As a result, enamoured governments believe they should be given regulatory leeway to develop their models as they see fit. As long as retail spending is not curtailed, there are some in government that really don't care as long as GDP is on the rise.

We must disagree with this stance because as we are noting with BNPL, the horse has long since bolted. The damage is already evident and it's time to rein it in.

We remind Treasury that, back in 1994, when payday loans were first created in the US and payday lenders replaced the illegal loan sharks, this product was equally seen as innovative. Look what the consumer advocates think of that product now.

Diminished reality

By splitting the cost of goods or services into 4 payments, consumers lose the true value of money. Instead of an item costing $400, it becomes "it's only" $100 a fortnight or $50 a week. The perceived cost of what the consumer purchases is diminished to what the outgoing repayment is and in doing so, the consumer loses sight of its real cost. This also stops being discretionary spending. These payments become ongoing commitments in the same manner aa a debt spiral. It's little wonder that so many are now refused home loans. For those consumers seeking a home mortgage loan, almost all brokers and bank staff now inform potential home purchasers to clear all their BNPL debts and to not engage in any BNPL activity for at least 90 days prior to making an application for a home loan mortgage so it doesn't show on the bank statements. If the consumer has every intention to resume their old spending habits after getting the mortgage, consumers should be held to account and face the consequences of their actions as they've arguably engaged in misleading and deceptive conduct.

Wage Advances

We have previously stated that if the exemptions under the NCC are causing an issue, then the legislation should be amended. Given the Options paper proposes to amend the Credit Act in some way for at least 2 options, the opportunity to bring other credit providers using the same exemptions as BNPL providers that cause as much consumer detriment must be contemporaneously undertaken.

The options paper proposals do not include any attempt at regulating wage advances ("WA") used by non-beneficiaries. This is a financial product that is not covered by section 6(11) of the NCC and which have become a true 'payday' loan. All these credit providers use NCC exemptions sections 6(1) and 6(5).

There are many credit providers offering this product that require full payment on the next payday, though we are aware that some will allow the consumer to spread the recovery over a fortnight. We draw your attention to the fact that there are also some WA providers that combine it with a BNPL product.

All is not rosy for these providers, though, despite their huge outgoings. Many of their borrowers are facing hardship, either as a result of mortgage or rent increases as well as general cost of living increases. Their clients are not your typical "Aussie battlers" or those deemed "desperate and vulnerable" but quite often hold down well-paying job. We are advised many are public servants. To show how bad the situation has become for them, we are aware that there are a number of WA companies offering a form of hardship arrangement that sees consumers repaying their debts at $5 a week. We forecast this situation will only get worse post-Christmas, once the BNPL bills start to hit and there are school uniforms and fees to pay.

The WA provider typically charges a flat 5% of the advance as a fee but we are aware of one small WA provider that is seeking how it can also utilise the ability to charge up to 24% interest as allowed for by exemption 6(1) because the returns are diminishing. This company provided in June last year over 210,000 wage advances yet this company cannot be regarded as a major supplier. It indicated that the 5% flat fee it currently charges doesn't generate sufficient income to cover their lost income arising from non-payment and it's squeezing their margin.

When one looks at a consumer's spending habits from the 5 assessments contained in the Appendix, it is abundantly evident that these credit providers are actually the ones providing the funds for BNPL payments. Since almost every one of these BNPL consumers uses one or more WA companies, the consumer draws down the maximum amount each provider will allow for the same pay period. As the attached examples in the Appendix show, some consumers have used up to 4 WA providers to obtain an advance prior to their payday. Some even elect to take multiple advances. Using these companies allows the consumer to pay the required repayment(s) on the due date because unlike most loans and consumer loans, payments are not aligned to their pay days. This becomes a truly vicious debt spiral they cannot escape from.

If consumer advocates had spent as much time and effort in bringing this issue to Treasury's and ASIC's attention as it has done in castigating the SACC and Consumer Lease providers based on allegedly past maladministration, many would not be in the position they are currently in. January 2023 will see consumers feel the full impact of their spending leading up to Christmas and as we have stated, traditional lenders are going to be unwilling to assist them. Stand by to see BNPL providers announce even greater losses.

Our Option 4 – **What the industry sector wants to see**

As we have stated above, we regard options 1 -3 as having no merit for the reasons given. With the amount of detriment that the WA and BNPL providers have created for traditional credit providers, our clients want to see:

1. Repeal of the NCC section 6(1) exemption; and
2. Repeal of the NCC section 6(5) exemption; and
3. A new definition under s.5 of the Credit Act specifying that BNPL may incorporate the issuance of a card but charges a third party (the merchant) a fee for providing its service; and
4. A Requirement that BNPL and WA providers require full compliance with the Credit Act. That means they hold either an ACL or operate as an Authorised Credit

Representative under a lender holding an ACL and at a minimum, have similar restrictions to those applying to credit card contracts; and

5. No special Regulatory Guide provisions that see any reduction in Responsible Lending Obligations or Loan Suitability Requirements than those applying to all other credit providers and in particular, SACC and consumer leases; and
6. A requirement that BNPL and WA providers must pay every levy imposed on other credit providers.

In conclusion, we must remind Treasury of a comment by Carl Packman[4] that the success of payday lending occurred when wages were not keeping up with inflation and banks were (and we will add, still are) less willing to lend to vulnerable individuals. The same can be said now of BNPL. As he states, "[f]or the sake of squeezed households who are resigned to more and more dangerous debt, it is high time the government and banks took a look at what they can do to stop this next financial crisis hitting consumers hardest."

The hypocrisy of the situation, though, is that it's the banks providing the funds to those credit providers that have created this situation.

[4] Packman, C, 2012. *The rise and fall of payday lending*, Searching Finance Ltd.

Appendix - Assessment Examples

Details supplied confidentially.