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Dr Tony Richards
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Dear Dr Richards

Review of Retail Payments Regulation: Issues Paper November 2019

The Australian Finance Industry Association (AFIA) welcomes the opportunity to provide a response to the Reserve Bank of Australia's (RBA) Review of Retail Payments Regulation Issues Paper (the Issues Paper).

AFIA Background

AFIA represents over 100 providers of consumer, commercial and wholesale finance in Australia, ranging from retail banks, finance companies, credit card issuers, and Fintechs, including buy now pay later (BNPL) providers (for more information about AFIA, please see Annexure A to this submission).

AFIA's role as an industry body is to drive industry leadership and represent members' views, facilitate self-regulation through industry codes, and to work with the Federal Government, financial regulators and other stakeholders to promote a supportive environment for industry to compete, innovate and offer products and services that meet customer needs.

Our guiding principles seek to build the settings to:

- Promote simple, convenient, innovative and affordable credit to finance Australia's future, including maximising access to credit for customers able and willing to service their commitments and minimising the likelihood or incidence of customers entering into unsuitable credit contracts;
- Foster competition and innovation in Australia's financial services industry, which enables our members to grow, expand and thrive as key participants in lending and other markets; and
- Generate greater financial and economic participation by consumers and small businesses in Australia's financial system and economy and improve social participation as a means to create financial wellbeing.

To do so, we focus on the key drivers that provide positive customer outcomes, foster competition and innovation within industry, and facilitate financial, economic and social engagement by both customers and industry.

Our Submission

AFIA and its members consider that the RBA has, to date, effectively exercised its powers with respect to the payment system and that it is meeting its obligations in relation to controlling risk in the financial system, promoting the efficiency of the payments system and promoting competition in the market for payment services.

We support the RBA's approach to the regulation of the payments system, which favours self-regulation, with the RBA only intervening where the industry is unable to address a public interest concern, and where the industry is unable or unwilling to address the Bank's concerns.[1]

We believe it is important for competition and innovation to be driven through market forces and customer demand, supported by evidence-based policy. Regulation should be used to foster an appropriate environment in the advent of a market failure or when interventions are required to achieve optimal outcomes for customers, businesses, the financial system, and the broader economy, and where those interventions are deemed economically necessary and beneficial.

We note that the RBA's movement to regulate credit card surcharges was because of concerns of a market failure with the emergence of monopolistic conditions of designated card systems and the impact this was having on merchants and customers. Apart from concerns with the impact on the payments system, there was regulatory and public concerns regarding lack of customer choice and competition.

AFIA and its members note that in determining the public interest, the RBA focuses on ensuring the payments systems are financially safe for use by participants, are efficient, competitive and do not materially cause or contribute to increased risk to the financial system.[2]

AFIA and our members support the RBA's viewpoint presented in their submission to the Senate Select Committee on Financial Technology and Regulatory Technology where it indicated that:

- It would like to "ensure that new players in the payments industry are able to compete fairly and that there are no unwarranted restrictions on their participation in payment systems".[3]
- the RBA also "strives to have a regulatory regime that is technology neutral and best able to support competition and innovation in the payment system" and are in full support of this.[4]

Our submission focuses on the RBA's Inquiry into Surcharging, which is the focus of section 3.4 of the Issues Paper. We understand from the commentary within the Issues Paper that the RBA is looking for industry views on two matters being:

[1] See <https://www.rba.gov.au/payments-and-infrastructure/payments-system-regulation/approach-to-regulation.html>.
[2] *Ibid*
[3] Reserve Bank of Australia, Submission to the Senate Select Committee on Financial Technology and Regulatory Technology, December 2019, p. 1
[4] *Ibid*

- Whether the current surcharging framework is working well; and
- If it is appropriate for the current surcharging framework to be extended to BNPL services.

The question as to whether it is appropriate for the current surcharging framework to be extended to BNPL services is currently one that is a focus for our members – in particular our BNPL providers and credit card issuers. Potentially not unsurprisingly, these two groups have divergent views on whether the BNPL sector should come under the RBA's surcharging framework.

The payments and credit landscape are dynamic, and we expect there will continue to be an evolution in terms of products, services and providers in the short term.

With this in mind, AFIA was worked with our BNPL members to develop a draft BNPL Code, currently out for public consultation, with comments due on 11 March 2020[5].

We believe there is a competitive marketplace and regulatory intervention is likely to negatively impact business models, products and services operating in the BNPL sector and adversely impact on the cost, efficiency and availability to merchants and customers.

However, we recognise the need for the BNPL sector to establish best practices to ensure greater customer safeguards, including disclosure and conduct practices, as well as better standards of engagement between merchants and their customers electing to use BNPL products. We believe self-regulation has an important role to play.

AFIA would be pleased to provide the RBA with an update regarding our public consultation and after the close for submissions.

We also note that all payment methods come at a cost, cash handling involves costs, debit and credit card products involve costs, and BNPL products involve costs. The benefits of these products vary and can include additional, shared or embedded benefits. The benefits of these products must also be a factor considered as to whether regulatory intervention is appropriate or necessary and to what purpose it is intended.

Recommendations

In considering if it should extend the surcharge framework to BNPL products, the RBA should consider:

1. The impact of the value proposition to BNPL customers, namely that these products provide a simple, convenient and low-cost way of making payments for goods and services;

2. The growth in use of BNPL services and the impact it may have on credit cards and other payment methods, and whether allowing the current framework to remain as is, will result in an uneven playing field across payment methods, with credit card use potentially significantly declining and other payment methods outside the surcharging framework increasing in use;

[5] The BNPL Code sets consumer protection standards for the BNPL sector and addresses the recommendations from the Senate Economics Committee in February 2019 and ASIC's Report 600 in November 2018. www.afia.asn.au/bnpl

3. The impact to the retail sector if, as a consequence of the surcharge framework being extended to BNPL products, customers no longer see BNPL products as a low cost and 'interest/fee free' method of purchasing goods and services through instalment payments, and stop using those products, which may in turn decrease revenue and economic activity in the retail sector;

4. The diverse business models and fee structures cross the BNPL sector, where fees paid by merchants to BNPL providers are for services provided by BNPL providers to retailers and merchants that include additional services, including cashflow management, marketing, data analytics and CRM tools;

5. The approach taken when addressing the complexity of card payments process in the taxi industry, particularly, where a cap on surcharges was applied, in order to be closer to the actual cost of providing payments services in taxis;[6]

6. How the extension of the surcharging framework would be applied across the diverse business models in the BNPL sector, with some BNPL providers targeting more frequent small amount products, and other BNPL providers offering payment solutions for less frequent higher value purchases – retailer and customer behaviour and use is very different across the range of BNPL products and services, and therefore surcharging is likely to artificially impact on the price of the goods and services and the BNPL infrastructure with the shift in retailer and customer behaviour and use;

7. Whether buy now pay later is in fact a payment method (similar to a debit or credit card) or if it is instead a deferred payment option (aka 'digitised lay-by' involving instalments for customers, with the benefit of upfront access for customers and lower shelf costs for retailers) that is very different to a debit or credit card;

8. If the extension of the surcharging regime to BNPL providers is deemed appropriate, whether other payment solutions should also be included in the regime, particularly where these allow customers to defer payment on goods and services such as utility bills – e.g. PayPal and BPay;

9. The impact of the surcharging framework and additional regulation on a new sector and corresponding effects on customer choice, product innovation and competition, including the impact on existing BNPL providers and their evolving business models as well as new entrants and barriers to entry;

10. The additional business services and benefits provided to retailers and merchants using BNPL services and whether it would be fair to pass these costs through to customers;

11. The existing legislation that regulates BNPL products and services (such as the *Australian Securities and Investments Commission Act 2001);* and

[6] See https://www.rba.gov.au/payments-and-infrastructure/review-of-card-payments-regulation/conclusions-paper-may2016/excessive-surcharging.html

12. The AFIA draft BNPL Code currently being consulted upon.

Questions

How do merchants and other stakeholders view the benefits and services that BNPL models provide?

UBS has undergone research which estimates that the BNPL sector currently accounts for $7 billion in retail spending (excluding food) in Australia. UBS has forecast this spending to increase to $12 billion in two years. Additionally:

- It is estimated that as many as 30% of Australian adults (5.8 million) use BNPL services;
- There was a 250% in BNPL user growth in 2018; and
- BNPL products are used as a financial management or budgeting tool – in fact, ASIC Report 600 noted that BNPL providers take steps to help consumers stay in control and make informed decisions about their purchases and repayments through notifications, online accounts and mobile apps[7].

AFIA's members include BNPL providers, credit card issuers (i.e. banks and other financial institutions) and other industry participants. We are in a unique position to provide a response from different perspectives about how our members view the benefits and services of BNPL products.

BNPL providers partner with retailers and merchants to provide the BNPL product to their customers to make purchases for goods and services. The partnership with retailers and merchants is commercial in nature and is in essence a business to business service offering for which the retailer or merchant pays the BNPL provider a fee – that fee is generally on a cost-per-transaction basis and reflects the different business models of the BNPL provider, which also reflects the different product propositions of the retailer or merchant (including volume, low through to higher value goods and services, etc).

BNPL members believe that the offering is a product or service, and not a payment system. Therefore, a surcharging framework would not be appropriate for BNPL products, due to there being a range of different types of BNPL products, with each having different operating costs, target market propositions and services for the benefit of the merchant or retailer, in addition to the payment method provided to customers. This is different from credit cards where, for example, the clearing process does not vary significantly in cost between issuers. Furthermore, these members maintain credit cards do not have any significant differences in operating models (their variances comes from the attached reward programs and/or loyalty offerings), which is different from BNPL products and services, whose operating costs and system processes are varied and the usage by customers is more variable across the different BNPL products.

On the other hand, other AFIA members believe that BNPL services are equivalent to a payment system. Therefore, these members view that in order to promote competitive neutrality and reduce the potential of cross subsidy of one group of customers by another, there is a need for consistent application of the surcharging framework to all participants in the payments system.

Benefits for retailers and merchants

The service provided by the BNPL provider to the retailer or merchant is not simply a product that the retailer or merchant is able to offer to its customers to make it easy for them to pay for their goods and services, but also:

- Leverages the 'lay-by' approach to sales of goods, without the retailer or merchant incurring the costs of holding the goods until final payment and/or undertaking additional administration if a customer misses any payments;
- Allows merchants (many being small business owners) to improve cashflow management by receiving upfront payment;
- Offers, for some, a CRM-like system to suppliers to manage customer orders;
- Sees the BNPL product integrated or plugged-in with and to the retailer or merchant to allow for a frictionless experience for their customers (customers use the product only when they purchase an item, which differs from credit cards where they need to sign-up to access credit on an ongoing basis);
- Provides a marketing platform for retailers and merchants and for other suppliers of goods and services;
- Leverages the customer support department of the BNPL provider, as each BNPL provider fields enquiries from consumers on retailers or merchants;
- Increases sales to partner retailers or merchants by enhancing the consumer retail experience; and
- When negotiating the merchant fee, each BNPL provider takes into account various factors, including charges from e-payment providers, fraud prevention services (including AML/CTF checks), cost of funds through funding arrangements to service each transaction, and other underlying costs[8].

Benefits for customers

In terms of customers, the value of the BNPL product is that:

- It is a no-cost or low-cost method of paying for goods and services by deferring payment for purchases and instead making instalment payments over even periods;
- It is being used as a cashflow and budgeting tool, allowing customers to retain their money in their bank account longer as well as a putting in place a plan to manage the instalment payments for their purchases, which they know upfront and with certainty at the point of purchase; and
- It is innovative and a frictionless point of purchase method of payment

[8] In the 2015-16 Review of Card Payments Regulation, the RBA considered it appropriate to make changes to the draft standard to allow for five elements that would allow a modest broadening in the cost of acceptance in addition to the average cost of acceptance in annual statements from the merchant's acquirer or payments facilitator. The five specific items that a merchant could add if they were relevant are: (i) fraud-related chargeback fees paid to the merchant's acquirer or payment facilitator; fees paid to any other payment services provider for (ii) terminal rental and servicing, (iii) gateway services and (iv) fraud prevention services; as well as (v) any cost of insurance for forward delivery risk on accepting cards. See https://www.rba.gov.au/payments-and-infrastructure/review-of-card-payments-regulation/conclusions-paper-may2016/excessive-surcharging.html

How do the costs of payments received through BNPL services compare with the cost of traditional credit card payments?

In response to this question we address both the cost to the consumer of using BNPL products or a credit card, and the cost to retailers or merchants.

For consumers, the BNPL product is in essence provided to the consumer as a no-cost or low-cost method of making a purchase and deferring the payment over instalments. While BNPL providers vary in terms of fee structures which include establishment fees, account keeping fees, payment processing fees and missed payment fees, those fees are generally low (i.e. $1 weekly account keeping fees, or $10 late payment fees that are generally capped). Common to all BNPL providers is that there is no interest charged to consumers. This component of BNPL product differs significantly to credit cards in that with credit cards, in all cases, interest is charged on unpaid balances.

In terms of retailers or merchants, as noted above – the fees charged by BNPL providers to retailers and merchants are simple, on a per transaction basis and is a percentage of each transaction or a flat fee and reflects the services that are provided by the BNPL provider to the retailer or merchant. Importantly, the fee structure depends on a number of factors including the volume of BNPL arrangements used by the retailer or merchant, the risk profile of the retailer or merchant, the types of goods and services offered by the retailer or merchant, and the additional business services received by the retailer or merchant.

Certain BNPL members also note that the continuing credit exemption of the NCCP applicable to their business model is important to retain, otherwise this could impact on the fee structure for retailers and merchants and/or the cost of goods and services for their customers.[9]

There is not only a significant difference between BNPL products and credit cards, but also a meaningful difference between the various BNPL products. As a result, our BNPL members believe the application of the surcharge framework on BNPL products would negatively affect competition in the marketplace. Additionally, it would allow data-based service providers to leverage market share, where they partner with payments providers, rather than integrate these services for retailers and merchants.

Whereas, several of our credit card issuer members support the application of the surcharge framework to BNPL products, as it allows the retailer or merchant to signal to customers whether a particular payment was more or less costly. These members are of the viewpoint that implementing this principle consistently across the payment systems would minimise the risk of customers using low cost payments methods to cross-subsidise customers choosing to use high cost payment methods.

Overall, AFIA members support clear disclosures to customers regarding the product features and costs to the customer. We note that additional disclosures are contained in the draft BNPL Code.

[9] *National Consumer Credit Protection Act* 2009 schd 3, s6(5)

Has the recent entry of additional BNPL providers influenced merchant fees for BNPL services?

AFIA members as a group are not privy to the individual commercial arrangement's members have with partner retailers or merchants with respect to fees, and therefore are unable to make direct comment.

However, we note that BNPL products are experiencing growth, with a number of new participants entering the BNPL market. For example, AFIA is in dialogue with a number of new BNPL providers as part of the development of the BNPL Code. ASIC's Report 600 noted that BNPL market is diverse, evolving and growing rapidly[10].

BNPL members believe the increase in participants and competition in the BNPL market will be a natural influence and effect on fees and charges.

However, credit card issuer members are of the view that even in the event there is an increase in participants and competition in the BNPL market with the entry of additional BNPL providers, by allowing the right of a retailer or merchant to surcharge for BNPL services, it will increase transparency in the cost of payments, promote efficient customer choices, and assist retailers and merchants. These members believe that there has been excess surcharging and reforms are needed to ensure retailers and merchants have easy-to-understand information on the cost of acceptance.

Do all BNPL providers have binding no-surcharge rules or are merchants able to negotiate on these?

The arrangements between BNPL providers and their partner retailers and merchants are commercial in nature, and therefore these contractual arrangements are confidential.

We note several important points:

1. The law imposes various restrictions on the charging of certain fees and the forms of their contracts, and BNPL providers must comply with those legal restrictions, including through the contractual arrangements in place between BNPL providers and their partner retailers and merchants; and
2. That the RBA has cited a number of examples that there are instances of where retailers and merchants have levied a charge on customers to use the BNPL product.

As noted above, certain BNPL members relying on the continuing credit exemption of the NCCP are generally unable to negotiate the no-surcharge rule, and in the event that surcharges can be passed on, they will likely no longer be able to rely on the exemption, as it only allows for BNPL providers to charge fixed fees.

Are some BNPL services viewed as a 'must take' payment method for particular market segments or transaction types; that is do merchants feel that they cannot refuse to accept BNPL for fear of losing business?

[10] See ASIC's Report 600 Review of buy now pay later arrangements, December 2018, p. 4

AFIA does not represent retailers or merchants. However, we are not aware of retailers or merchants feeling like BNPL products are 'must take' payment methods. There are a number of BNPL providers operating in Australia, which provides choice to retailers and merchants seeking to offer their customers alternative ways to make payments for their goods or services.

BNPL members state that their products are elective and are not designed to replace cash, credit cards, BPay, and other payment methods. These members believe the growth in BNPL reflects the value that these products provide retailers or merchants and their customers – it is easy and cost-effective to use for customers, it is frictionless and it offers additional benefits and value to the retailer or merchant.

However, credit card issuer members do not accept that 'must take' is a distinguishing factor. These members believe that BNPL services will soon approach the volume of other payment methods, and therefore it is important to promote transparency in the cost of payments and ensure consistency across the payments systems.

Is the surcharging framework working well? Are there any changes that should be considered?

As noted above, there are divergent views across our membership as to whether the surcharging framework is working well.

Is there a case for policymakers to require that BNPL providers remove any no-surcharge rules, consistent with earlier actions in regard systems that applied such rules?

We believe the RBA should carefully consider whether regulatory intervention is justified, necessary of economically beneficial. There are mixed perspectives that need to be assessed, including:

1. The implications of requiring BNPL providers to mandatorily remove no-surcharge rules. BNPL products are products that offer customers a different way to make a payment with the main product offering being that the product is a no-cost or low-cost method of deferring payment. Therefore, the requirement to remove the no-surcharge rule would fundamentally change the product itself.
2. The implications of allowing the no-surcharge rule to remain, noting the advanced growth of BNPL services and the effect it may have on competition across different payment methods.
3. The additional services provided to retailers and merchants, and whether it is fair or reasonable for customers to have these costs passed through directly, where these services are for the benefit of the business.
4. The impact on cost, efficiency and availability of BNPL products for customers and retailers or merchants, where regulatory intervention results in reconfigurations of business models which increases costs and/or reduces efficiencies for customers and/or retailers or merchants.

In establishing the revised surcharging framework as an outcome of its 2015-2016 review, we note a key consideration for the RBA was consumer protection and addressing a market failure. We understand that there was a concern by the RBA and by the ACCC that certain retailers or merchants were charging consumers excessive amounts to take certain payment methods which in turn pushed the price of products and services significantly higher for consumers. therefore, the policy concern was around price of products that consumers pay and if that price is a fair and reasonable price. As noted previously, a

key consideration for the RBA now is the diversity of BNPL business models, some which provide payment deferment for low-cost goods and services, such as clothing, and others which provide payment deferment for higher cost products, such as solar products.
As previously noted, BNPL providers provide a service to retailers or merchants which they charge for, and a no-cost or low-cost method of payment deferment to customers. The way in which BNPL providers charge retailers or merchants is on a cost per transaction basis (generally a percentage each transaction that the merchant has with a customer that uses a BNPL product as a method of payment) and other factors relevant to the particular business.

Also as previously noted, BNPL is an emerging sector with very different business models providing customers with solutions for different product needs and merchants and retailers with different value-add services. We note that the introduction of AFIA's BNPL Code of Practice, a world-first, will impose requirements that go above and beyond the existing legislation to introduce additional consumer protections, while ensuring competition and innovation across the BNPL sector.

AFIA requests the opportunity to meet with the RBA to discuss our submission, provider further details about the different business models, and to facilitate further consideration of the issues with our members.

Should you wish to discuss our feedback further, or require additional information, please contact Chalisa Parekowhai, Associate Director, Policy at chalisa@afia.asn.au or 02 9231 5877.

Kind regards

Diane Tate
Chief Executive Officer

Annexure A

The Australian Finance Industry Association (AFIA) is the voice of a diverse Australian finance sector. AFIA represents over 100 providers of consumer, commercial and wholesale finance in Australia which includes:

- major, regional and mutual/community owned banks;
- providers of consumer finance, including home loans, personal loans, consumer leases, credit cards, buy now pay later services, and debt purchasers;
- providers of land finance, including residential and commercial mortgages and bridging finance;
- equipment financers, including commercial equipment financing ranging from agri-equipment to small ticket equipment financing;
- motor vehicle financiers, including consumer motor finance, novated motor finance, small business motor finance and heavy vehicle finance;
- fleet leasing and car rental providers; and
- providers of commercial finance, including secured and unsecured loans and working capital finance to businesses, including small businesses.

AFIA's members range from ASX-listed public companies through to small businesses providing finance, which operate via a range of distribution channels, including through 'bricks and mortar' premises (physical branches and other outlets), via intermediaries (including finance brokers, dealerships, retail suppliers), and through online access or platforms (traditional financial institutions and fintechs).

AFIA's members collectively operate across all states and territories in Australia and provide finance to customers of all demographics from high to low-income earners and to commercial entities ranging from sole traders, partnerships and across the corporate sector in Australia.

AFIA's members provide a broad range of products and services across consumer and commercial finance, a snapshot of these include:

- consumer: home loans, personal unsecured loans, revolving products (including credit cards and interest free products coupled with lines of credit), personal secured loans (secured by land or personal property); consumer leases of household assets (including household goods, electrical/IT devices or cars) and buy-now, pay later services;
- commercial: land, asset or equipment finance (finance/operating lease, secured loan or hire-purchase agreement or novated leases); business finance and working capital solutions (secured loans, online unsecured loans; debtor and invoice finance; insurance premium funding; trade finance; overdrafts; commercial credit cards), together with more sophisticated and complex finance solutions.

For further information about AFIA, please see here.