Submission to the Senate Economics Committee
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Senate Standing Committees on Economics
PO Box 6100
Parliament House
Canberra ACT 2600

A Submission from AfterpayTouch Group to Economics Legislation Committee on the proposed Treasury Laws Amendment (Design and Distribution Obligations and Product Intervention Powers) Bill 2018 (revised exposure draft legislation)

Summary

- Afterpay is an Australian founded company, listed on the ASX, that has now launched in New Zealand, the United States and shortly in the United Kingdom.
- Afterpay promotes responsible spending and seeks to offer a credible alternative to credit products. Afterpay's popularity has been consumer driven.
- Since its inception, Afterpay has supported regulatory certainty for its unique business model that has benefited millions of Australian consumers. Afterpay has and will continue to work cooperatively with government, regulators and industry stakeholders.
- As recognised by ASIC, Afterpay is different to other "buy-now-pay-later" products. ASIC has said that companies like Afterpay do "not meet the definition of credit within the National Credit Code" as we "extend funds without charging fees or interest."
- Our product is predominantly used as a budgeting tool by our users:
  - Unlike credit cards and personal loans, Afterpay's business model is based on revenue that comes from merchants not from the consumers
  - Afterpay is free to consumers who repay on schedule (which is true of 95 percent of payments) and consumers are never charged interest
  - The only charges that ever accrue to consumers are late fees. However Afterpay's total late fees are lower than the costs it incurs when consumers don't pay on time (e.g. bad debts and administrative costs). This means Afterpay, unlike other services, is incentivised to promote responsible use and discourage late payments
  - Afterpay actively discourages late payments. Consumers are prevented from making a new purchase if they have an overdue payment - a feature which prevents consumers from getting into a revolving cycle of debt
- Afterpay supports extending ASIC's intervention powers as it will further increase public confidence in our product and ensure additional consumer protection is provided in the case that our product is used in an unintended manner.
- The Government of New Zealand has chosen to *not* include Afterpay in local credit regulations and will regulate buy-now-pay-later products through intervention powers.

Introduction

In this letter, we refer to the proposed design and distribution powers, and the product intervention powers, separately.

Afterpay is challenging the traditional credit industry as it makes the vast majority of its revenue from merchant fees, rather than the consumers. We look forward to government continuing to recognise a service that has proven to be an important alternative to traditional payment methods for millions of Australian consumers and both as a lead generator and a driver of employment for thousands of Australian retailers and small and medium-sized business (SMBs).

There has been some discussion around the regulatory status of Afterpay and other "buy-now-pay-later" products in the marketplace. Since its introduction into the Australian market, Afterpay has opted into the Credit and Investments Ombudsman dispute resolution service; Afterpay is subject to various product regulations and ASIC has the power to regulate customer terms under unfair contract terms legislation. Afterpay is also regulated by and complies with Anti-Money Laundering laws and general consumer protections in the Australian Competition and Consumer Law.

However, Afterpay recognises its business model was not fully envisaged by existing law, as is the case with many new technologies, which is why we have proactively engaged with government and industry groups in order to demonstrate our positive customer outcome results, identify areas of market-based and/or regulatory concern and achieve better regulatory certainty. Something that is important for our business's position not only in Australia but in the other overseas jurisdictions where there continues to be a level of regulatory uncertainty, particularly New Zealand, the US and the UK.

We have been actively involved and continue to be supportive of ASIC's review into the buy-now-, pay-later industry as we expect it to highlight the key differences in the services offered across our emerging industry.

The Arden Government in New Zealand has recognised Afterpay's model as different to traditional credit. The government has recently announced that they have chosen not to include products like Afterpay under local credit regulations for reasons including that there is very limited evidence of harm to date. They have said that they may wish to broaden their powers to be able to intervene should harms be identified.

In a recent paper from the New Zealand Minister for Commerce and Consumer Affairs the following recommendations are made:

> *52 A number of new products have been introduced into the credit markets in recent years that have the features of consumer credit contracts but fall outside the strict definition in the CCCFA. These include interest-free 'buy now pay later' products such as **Afterpay**, PartPay, Laybuy and Oxipay.*
> *53 Consumer advocates and some lenders have raised concerns about these products being unregulated by the CCCFA. <u>**There is very limited evidence of harm from them to date, and the products are already subject to protections under the Fair Trading Act**</u>. <u>**I do not consider they should be brought within scope of the CCCFA at this time.**</u>*
> *54 However, in light of the rate of innovation in the credit markets, **I propose to create regulation-making powers to adjust the scope of the CCCFA to address harms that arise from new, unregulated products in the future.** These powers could be used to address avoidance, and also to clarify the treatment of particular credit products (for example, to clarify that a new product is not a consumer credit contract). These powers would be similar to the designation power the FMA has under the Financial Markets Conduct Act. This enables FMA to declare that a product is a regulated financial product and also to declare that product is not a regulated financial product.*

Similarly, in Australia, ASIC has deemed that Afterpay does "not meet the definition of credit within the National Credit Code" as we "extend funds without charging fees or interest."[1] However, in their submission to the Treasury they said:

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[1] P. 29, ASIC Submission to Treasury, August 2018 re: Product INtervention Powers https://static.treasury.gov.au/uploads/sites/1/2018/09/c2018-t312297-Australian-Securities-and-Investments-Commission.pdf

> *"we think the product intervention power should extend to all ASIC Act products. We consider that there is a need for a comprehensive product intervention power that covers all financial products and credit products within ASIC's regulatory responsibility. As discussed in Section A, products regulated under the ASIC Act but not the Corporations Act or the National Credit Act are currently subject to the least regulation, resulting in a lower level of protection for consumers accessing these products, and the potential for regulatory arbitrage."* [2]

In summary, Afterpay is supportive of the general sentiments underpinning the proposal for ASIC to be given product intervention powers in recognition of the need for strengthened consumer protection measures in relation to products that fall within ASIC's regulatory responsibility but are not regulated by either the Corporations Act or the National Credit Code (i.e. "ASIC Act only" products"). We are also supportive of the concept outlined in ASIC's subsequent proposal (in their August 2018 submission to the revised exposure draft) for this power to be extended to cover all (rather than specified only) "ASIC Act only" products - which would include Afterpay. However, we request further information and consultation on the detailed design of the intervention powers in order to determine our final position on the proposal.

About Afterpay

Afterpay is an ASX listed company that employs some 350 personal, mostly in Sydney and Melbourne with offices also in the UK, US and NZ.

Afterpay is a modern-day payment service that encourages and rewards responsible spending. The Afterpay model, in essence, works by allowing consumers to purchase goods and services using simple, interest-free instalment plans, available at participating merchants – either online or in-store. Consumers pay in four equal instalments in accordance to a fixed payment schedule (over 6 or 8 weeks).

The overwhelming majority of Afterpay's revenue is not derived from consumers but from merchants who pay Afterpay a fee to offer their customers flexibility in paying the cash price for goods and services. **Goods and services do not cost a consumer more if they are paid for, on time, using Afterpay.**

Afterpay account limits start low (most purchases average less than $150) and only increase with a positive repayment history. A proprietary fraud and real-time repayment capability check is employed at the time of each and every order. This is a sophisticated algorithm-based technology which identifies likely risk spots both within consumer groups and by product. As a result, up to 30 percent of order requests are not approved (up to 50 percent for first-time users). The sophistication and accuracy of these checks has ensured a default rate on purchases of less than two per cent. **Crucially, if a customer doesn't pay on time they are suspended from the service and are not permitted to make another purchase until their account is up to date – thereby preventing customers from accruing revolving debt.** Afterpay's interests are clearly aligned to the customer, we charge retailers and not the customer and we are economically incentivised to only deal with responsible customers who regularly use the service.

[2] P. 28, ASIC Submission to Treasury, August 2018

Afterpay has recently expanded our service to dental care. We know that millennials have one of the lowest participation rates in private health and general dental is not covered by Medicare. Our first partnership is with Primary Dental and it has proven extremely popular, with thousands of patients opting to pay via the new method since launch.

Primary Dental CEO, Michelle Aquilina said about the partnership: “Primary has responded to patients seeking greater access to affordable services. With cost being the greatest barrier to patients for dental procedures, they now have the ability to do so through the Afterpay service.”

One of the themes that have been discussed widely in the advent of the Royal Commission into Financial Services was the alignment of incentives between consumers and those selling certain financial products. At Afterpay, we are proud of the fact that our business model sees that we benefit when a consumer is paying on time, not paying late fees and becomes a repeat customer. Traditional products in the marketplace incentivise consumers into revolving in debt to gain profit. Unlike other financial products, Afterpay’s business model takes the opposite approach, its product and terms are simple to understand and do not include lengthy and confusing contractual arrangements.

Afterpay has embedded consumer protection into business practices in a way that is compliant with federal and state consumer law. Afterpay is registered with Credit & Investments Ombudsman (transitioning to the Australian Financial Complaints Authority) and offers a Financial Hardship Policy for any customers who presents with financial difficulties. We have clear policies and processes around responsible spending, complaints and financial hardship.

Afterpay has proactively engaged with all major consumer groups, and as a result, introduced several new measures including a review of the Financial Hardship Policy and Privacy Policy, highlighting budgeting tools ASIC TrackMySpend, Choice – Budgeting Software and the National Debt Hotline on the Afterpay website, and providing a prominent link on Afterpay’s home page to a responsible spending information page.

An important outcome of proactive contact with consumer groups has been the offering of a direct line of communication between Afterpay and financial counsellors, should any hardship cases or complaints be presented to them. This process also aims to resolve such matters in a timely manner.

A recent internal deep dive of Afterpay data found that 77 percent of users say they use Afterpay to help with budgeting and 86 percent use a debit card to purchase items. This analysis also found that 95 percent of Afterpay payments incur no late fees, and 78 percent of Afterpay users have never paid a late fee.

Afterpay **late fees are not designed to generate profit for Afterpay** and are a genuine estimate of Afterpay's loss incurred as a result of late payments. We describe late fees in greater detail below.

In addition, Afterpay joined the Credit & Investments Ombudsman’s scheme in August 2016. Since then, the Ombudsman has received only 49 complaints (across over 2.3 million active customers) regarding Afterpay, most of which have been resolved directly with the customer and did not require the Ombudsman to investigate further.

'Traditional' Credit

Unlike credit products, and as we indicate in the above description of the Afterpay product, there is no cost to the consumer for the Afterpay product when used in accordance with its terms. It is simply a purchase of goods or services at a clear and readily identifiable market price (namely, the retailer 's normal cash purchase price), over time. There is no cost linked to the time value of money in any way whatsoever with the Afterpay product. Further, the repayment period is short, the instalment obligations are simple and clear, and there are budgeting benefits in better scheduling payments to available funds.

In these ways, the risk to Afterpay customers from using our product is greatly limited and clearly differs from risks of regulated credit which may be offered at a significant cost (e.g. a credit card) or credit which falls outside the NCC but where significant other costs (e.g. establishment, administration or other fees) accrue to the consumer. Afterpay's product is **not** one where a consumer is at risk of incurring significant costs of credit, which suggests enhanced consumer protection is not needed.

Our users advise us they predominantly use the service as a budgeting tool. The average outstanding balance on Afterpay is low, with 90 percent of accounts owing less than $500 and 75 percent of all accounts owing less than $350. This compares to the average credit card debt of our $4,200.[3]

We note that Afterpay is a credit facility for the purposes of the broad general consumer protection provisions (for example in the areas of misleading or deceptive conduct or unconscionable conduct) of the Australian Securities and Investments Commission Act 2001 (Cth) (ASIC Act). Compliance with the ASIC Act is well recognised by Afterpay and existing ASIC powers are already appropriate to deal with any infringement of such provisions under the ASIC Act.

Late Fees

Unlike traditional credit products, it is in Afterpay's financial interest for customers to pay on time as Afterpay predominantly benefits from the merchant fee, not from customer debt. Late fees apply when customers do not pay on time but are designed to act as a disincentive to such default. Afterpay late fees are not designed to generate profit for Afterpay and are a genuine estimate of loss incurred as a result of late payments. Late fees do not incur interest and customers cannot make further purchases while payments are outstanding.

This means that a consumer who misses a payment cannot get deeper in debt by buying more goods and services using Afterpay, unlike a credit card or small amount lending product where interest on missed payments can compound.

[Average transactions are low ($150) and repayment periods are very short (every two weeks) and cannot be extended. Additionally, there are strict account limits in place. Suspending customers from using the Afterpay service at the first potential sign of payment difficulty (i.e. a missed payment) substantially limits the potential harm to customers and ensures that only people who are responsible use the Afterpay service on a recurring basis.]

[3] Finder's State of the Credit Market Report 2018
https://www.finder.com.au/state-of-the-credit-card-market-report-2018

Late fees are capped at 25 percent of a customer's purchase order, or $10, with $68 being the maximum that can be charged. Even the worst case late fee option for consumers see them pay less than other products in the market.

As a business we economically benefit more if there were no late payments (and hence no late fees), which translates to proactive customer-centric business behaviours like upfront and recurring notifications as well as other practices to prevent late fees from occurring in the first place.

Design and distribution obligations

Design and distribution obligations were recommended in the Financial System Inquiry Final Report 2014 (Murray Report) to reduce the shortcomings of the existing framework which relies heavily on disclosure and appropriate financial advice. The Murray Report's recommendation is based on the assumption that the information disparity between consumers and product issuers may lead to adverse consumer outcomes, particularly in the case of complex financial products where disclosure may not sufficiently inform a consumer of the risks involved with a financial product. The Australian Government first proposed amendments to design and distribution obligations in an April 2018 exposure draft, followed by the release of a 2018 revised exposure draft of the Treasury Laws Amendment (Design and Distribution Obligations and Product Intervention Powers) Bill 2018.

The Afterpay product is very simple in its terms and operation and readily understood by a consumer. A consumer uses Afterpay to pay in four equal instalments the cash purchase price (and no more) for goods or services provided at the time of purchase. It is a simple sale by instalment, without additional charges if the product is used as intended. The Afterpay product has none of the complexities or potential for risk to consumers that the proposed design and distribution powers are intended to avoid (e.g. hybrid investment products).

We note that these design and distribution powers were recommended to "decrease the number of consumers buying products that do not meet their needs" (page 204 of the Murray Report). In the case of Afterpay, it is highly unlikely that Afterpay would "not meet consumers' needs", as the consumer readily understands her or his retail purchase transaction, the terms of Afterpay's product are simple and clear (in offering additional flexibility in making payments for goods and services and without additional charges) and alternative credit options (e.g. credit card purchases) are recognised, and readily able to be compared, by those consumers at the time they may acquire the Afterpay product.

Consistent with our April 2018 submission to the first exposure draft, Afterpay continues to maintain that the design and distribution powers are neither intended or needed in the case of Afterpay's product.

Product Intervention powers

Afterpay users are protected by a number of existing safeguards as has been highlighted in this submission, and by the extensive system of laws and regulations (listed below) that we already comply with:

- Corporations Act 2001
- Intellectual Property (Trademarks Act 1995, Patents Act 1990, Copyright Act 1968)

- Anti-Money Laundering and Counter-Terrorism Financing Act 2006
- Privacy Act 1988 / Australian Privacy Principle (APP) guidelines
- Competition and consumer protection laws
- Spam Act 2003
- Workplace and Industrial Relations laws (i.e. Fair Work Act 2009)
- Discrimination federal and state laws
- Australian Securities Exchange (ASX) Operating Rules
- Australian Securities and Investments Commission (ASIC) Market Integrity Rules

Notwithstanding this, we recognise that our business model was not fully envisaged by existing law, as is the case with other new technologies.

The revised exposure draft proposes a product intervention power for specified “ASIC Act only” products, and we note that this may not capture some buy-now-pay-later models such as ours. ASIC’s submission subsequently proposes the power be extended to <u>all</u> ASIC Act products - thereby capturing Afterpay - in order to ensure coverage of all existing and future products (and their delivery models) as they arise, giving ASIC an ability to respond to potentially new sources of consumer detriment.

Afterpay recognises that the provision of such a power to ASIC would promote higher levels of consumer trust in newer services such as ours, and afford consumers an additional layer of protection whereby they can feel confident the regulator has the ability to investigate and potentially intervene in response to problems that are causing or could cause harms to consumers.

Afterpay is committed to responsibly providing and delivering our product, and our customer outcomes results provide overwhelming evidence that our product is being used responsibly and safely by the vast majority of users. We have systems in place to support any customers experiencing financial difficulty or hardship. Our existing safeguards and standards highlight our customer-centric and regulatory mindset. We also recognise the dynamic and evolving market we are operating in and are committed to working with Government and regulators to inform ongoing deliberations about modern, fit for purpose regulatory frameworks that respond to market developments.

While we support the general sentiment underpinning ASIC’s proposal for a product intervention power to be extended to all ASIC Act products, the proposal is for a very broad power, to be made by regulation. There is insufficient detail at this stage as to what types of market problems ASIC could investigate (i.e. the scope of issues to which this power could apply); the evidence base required to be established to justify any intervention; the types of “targeted interventions” that could be taken; under what conditions (and what process of consultation) a condition or solution might be revoked by ASIC, or extended or varied (with Ministerial consent) beyond the up to 18 month period suggested; and whether the power could be used in such a way as to apply the design and distribution obligations to parties even where these have not been applied to those parties by the legislation itself. We would welcome further consultation on these issues.

Conclusion

In the case of the proposed design and distribution powers, Afterpay maintains that our product is neither the type of entity nor the type of product which has been suggested or is intended to be subject to these proposed powers.

In relation to the proposed product intervention power, Afterpay supports the general sentiment behind this proposal including ASIC's proposal that it be extended to cover all 'ASIC Act only" products (which would capture Afterpay) - however, requests further information and consultation on the detailed design of the power.

We are committed to an open and transparent business model, to continuing strong engagement with Government, regulators, consumer advocacy groups and industry groups, and welcome any further questions.

For further detail please don't hesitate to contact our Head of Public Policy, Damian Kassabgi:
[redacted]

Yours sincerely

David Hancock
Dir. Group Head
Afterpay