



Regulating Buy Now, Pay Later in Australia Options Paper

The Treasury

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Westpac Banking Corporation
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WE ARE

 GROUP

Executive summary

Westpac Group (**The Group**) welcomes the opportunity to provide comment on the consultation paper examining the regulatory framework options for Buy Now, Pay Later (**BNPL**) in Australia. We strongly support the application of credit regulation to the BNPL sector. This is an overdue reform that will address an issue of consumer protection that remains outstanding, as the current suite of responsible lending obligations (**RLOs**) do not apply to BNPL products.

Of the three options proposed for consideration, we support Option 3 as a starting position from which to regulate. This aligns with our view that responsible lending obligations should apply to BNPL products as they have the potential to contribute to financial stress. We also think it is imperative for BNPL liabilities to be included in the credit reporting regime.

It is our position that the Government's legislative reforms to the BNPL sector should:

- require BNPL providers to hold a credit licence;
- address the gap in consumer protection;
- correct the credit reporting regime 'blind spot' that presently exists; and
- achieve regulatory consistency across like-for-like credit products.

Option 2 as the baseline for regulation risks creating an inconsistent regulatory standard for credit products, as the suite of full RLOs will continue to apply to other similar credit products (which may have lower repayment obligations, and therefore lower potential for harm).

In any case, it is vital for any RLOs applying to BNPL products to necessitate 'in practice' credit checking to adequately address the issue of consumer protection and ensure products are not offered to customers showing signs of overcommitment.

As a final point, we note the options paper provides minimal detail on the legislative changes required to give practical effect to the reforms. To ensure there are no unintended consequences associated with making changes to the *National Consumer Credit Protection Act 2009 (Credit Act)*, we ask that industry continue to be engaged during the legislative drafting process.

Box 1: BNPL and customer hardship: Westpac's experience

BNPL has changed the credit landscape for customers in Australia. Initially, BNPL was offered by retailers for discretionary products, but increasingly we see consumers using BNPL options to pay for essential services.

Because BNPL providers are not generally required to assess the credit worthiness of customers, it is possible for consumers to be provided with amounts exceeding their capacity to repay. This is especially a risk for customers on tight budgets.

Within the Group's Customer Assist function, we see customers resorting to BNPL facilities to help them get by their day-to-day expenses, which can exacerbate their financial situation.

More than 50 per cent of customers who speak to us about hardship solutions also have a liability to BNPL. By contrast, ASIC's BNPL Update suggests 6.1 million open accounts represent up to 30 per cent of the Australian adult population, noting consumers who had accounts with two or more providers were counted more than once in this statistic.¹

A common refrain is that BNPL will typically only involve the provision of small amounts of credit. While this is usually true, an accumulation of BNPL accounts can have a snowball impact for customers in a vulnerable financial situation. In addition, the short repayment periods for BNPL can often necessitate large repayment obligations over a short period of time.

Given research indicates that "18 per cent of BNPL users surveyed have missed a BNPL repayment in the past 12 months"², we are supportive of a transparent framework for fees and charges, as is expected of other credit providers.

Our internal customer data suggests customers who have 2 or more BNPL accounts are more than twice as likely to be in arrears (more than 60 days past due) on their credit card.

A requirement to conduct a suitability assessment, which includes credit checks, would ensure a BNPL product is not offered where it would be unsuitable for that individual.

Application of RLOs to the BNPL sector

We agree reform should be based on the below principles outlined in the Options Paper:

- improve consumer protections;
- allow for innovation and new market entrants;
- respect the competitive nature of the market and the interests of consumers, merchants, and providers in the BNPL sector;
- consider the arrangements for comparable regulated credit products, and
- be practicably enforceable by a regulator such as ASIC.

¹ Buy now pay later: An industry update, ASIC Report 672, November 2020

² https://afia.asn.au/files/galleries/AFIA_BNPL_Research_Report.pdf

Credit laws have developed over time and are calibrated to allow consumers to derive the benefits and convenience of credit within a framework that places responsible lending obligations on credit licensees. The ability to smooth payments over a short period is clearly an innovation that consumers see value in, evidenced by the sharp uptake of BNPL products. As a guiding principle, regulation should not unnecessarily restrict the flow of credit to consumers, as long as that credit is provided responsibly.

At its most fundamental level, responsible credit involves providing a customer an amount they are assessed to be able to afford. As is the case for credit cards, at a minimum, BNPL providers should be required to:

- make reasonable inquiries about a consumer's financial situation; and
- make an assessment about the suitability of the product.

Presently, it is permissible under the BNPL Code of Practice (**The BNPL Code**) for a teenager on the day of their 18th birthday to purchase a product for up to \$2000 without any assessment of their income, so long as they aren't considered a 'vulnerable customer' and meet the 'suitability assessment criteria', none of which relate to the consumers ability to repay.

By way of comparison, for someone to obtain a \$2000 credit card, a bank would need to determine the consumer's income, liabilities and that they would be able to repay the amount equal to the credit limit within three years.

Box 2: Steps required for regulated Credit Providers to assess credit

In issuing a traditional credit card, a lender needs to make reasonable enquiries to understand the borrowers:

Requirements & Objectives:

- this includes ensuring the product is not unreasonable and will not create future financial hardship.

Capacity to repay the credit facility:

- which includes assessing the borrower's income, expenses, and existing liabilities. To ensure this information is accurate, lenders will typically verify a customer's declaration by using a range of internal and external data sources such as payslips, bank account transactions, benchmark tables and data from Credit Reporting Bodies.

It should be possible and desirable for a regulatory framework that aligns with Option 3 to accommodate more explicitly the scalability of obligations as they apply to *all* lower risk credit products. For example, the steps required to verify a consumer's financial situation could be scaled.

There should be a more explicit articulation in the regulation and guidance notes of areas of proportionate application of the regulation. This should be explicitly defined based on the inherent risk of both the facility and the customer, that harm might be done. However, this should be applied consistently across like forms of credit noting that the monthly repayment obligation on a \$1000 purchase on a credit card may be \$40 while a corresponding

purchase on a BNPL product could be \$500 over the following month. Customer risk grows with multiple BNPL facilities which may each have relatively high, if only shorter term, repayment obligations.

While we are strongly supportive of BNPL reforms, the Government should seek to ensure the BNPL reforms do not have unintended consequences. For example, licensed providers of interest-free instalment periods attached to credit cards regulated by credit legislation should be able to continue to provide those instalment features without new requirements.

Unsolicited credit limit increases and BNPL debt paid with credit

Credit reforms undertaken in 2016 prohibited unsolicited credit limit increases on credit cards, and banks are unable to approach consumers offering credit limit increases. We note that the proposals presented in the Treasury options for BNPL in relation to unsolicited increases are less stringent than the current approach applied to credit cards. We support prohibiting BNPL providers from marketing unsolicited increases to a consumer's spending limit. An unsolicited credit limit increase on a BNPL account has the potential to affect the consumer's borrowing capacity elsewhere or tempt the customer to take on higher levels of debt, which may have unexpected negative consequences for the consumer.

According to the Australian Finance Industry Association's (AFIA) survey data, around 22 per cent of BNPL users use a credit card to make repayments.³ This ability to pay off a debt facility with another debt facility is unusual, as it is presently not possible to pay off credit card debt directly through another credit card, due to the potential for this to create a 'debt cycle'. For these reasons, the Group supports a prohibition on BNPL providers accepting credit cards as a payment method.

Addressing the credit reporting 'blind spot'

The present limited ability of BNPL providers to engage with the credit reporting regime through the contribution of repayment history information has led to a credit reporting 'blind spot' as we can't 'see' all of these obligations through the credit bureaus.

BNPL providers are also not currently obligated to review a customer's credit record or check for the presence of other BNPL facilities when making lending decisions.

In addition to ensuring lenders can make decisions based on all relevant information, including BNPL in the credit reporting regime would allow consumers with a positive repayment history to demonstrate their suitability when being assessed for other credit products, such as mortgages. This is likely to benefit young people with limited credit history on traditional credit products.

It is therefore our position that:

- BNPL providers should be required to hold an Australian credit licence which will also allow them to submit additional credit reporting information such as repayment history information.
- The RLOs applied to the BNPL providers should necessitate engagement with credit reporting bodies, *i.e.*, create an 'indirect obligation' for credit checking.
- The upcoming review of Australia's credit reporting regime should consider expanding mandatory reporting beyond the large ADIs to others, including BNPL providers.

³ https://afia.asn.au/files/galleries/AFIA_BNPL_Research_Report.pdf

The AFIA report notes that there are almost 6 million active accounts, with consumers spending close to almost \$12 billion through BNPL services⁴. This represents a potentially sizeable cohort of lending presently missing from Australia's Comprehensive Credit Reporting (CCR) regime. We note the requirement to review the CCR regime by 1 October 2024 and recommend this process considers expanding mandatory obligations beyond the large ADIs to other credit providers.

Credit checking is essential for preventing inappropriate lending to vulnerable customers and addressing the issue of multiple accounts being taken up by individuals where this is an unsuitable outcome.

Defining 'lower risk' products and customers

Once there is an ability to assess risk through credit checking, a scalable approach for the application of RLOs contemplated in existing regulation could be better defined in regulation, and then explained in guidance notes, to avoid unintended impacts to customers and the industry.

Consideration should be given to how to achieve a consistent regulatory framework across all lower risk lending where lower risk could be considered a function of both the risk of the lending facility and the risk of the customer.

Lower risk facilities could be considered as a function of the size of the required repayment, e.g. a monthly repayment obligation of <\$200 per month would be considered a much lower risk facility than an obligation of say >\$1000 per month. We would consider the size of the monthly repayment requirement to be more relevant than the size of the limit per se.

Lower risk customers could be considered on the basis of a credit bureau record suggesting a low inherent credit risk or low levels of existing debt or BNPL facilities (if recorded) on the bureau relative to declared income. Low risk customers could also be defined as having high levels of liquid assets relative to the size of a new credit limit.

In the context of BNPL, poorer credit scores, limited credit history, high repayment obligations from the BNPL facility, or pre-existing BNPL facilities may be an indicator that full verification is required.

We are happy to participate in helping define "lower risk" lending thresholds based on our experience.

As more proportionate responsible lending obligations are considered, it may also be appropriate to reconsider the treatment of undrawn limits. This is particularly relevant to BNPL and currently affects credit cards where lines are used to facilitate consumer payments. Under current regulatory guidance and industry code, credit providers are expected to assess a customer's ability to pay assuming all historical revolving credit cards are drawn - even if the customer has a history of low utilisation or the lines are long-term inactive. The outcome of this approach has constrained the supply of credit and creates a burden and stress for customers trying to get a mortgage (limiting affordability and requiring documentation of closed lines).

While it is appropriate to assess new lines assuming they are fully drawn, assuming all existing cards and BNPL facilities are maxed out (despite historical customer behaviour) is overly burdensome for customers. If this obligation is not addressed for all revolving lines, BNPL limits will have a significant impact on the customer's ability to get other forms of

⁴ https://afia.asn.au/files/galleries/AFIA_BNPL_Research_Report.pdf

credit. Likewise, the process for getting BNPL facilities would likely be slowed down materially as is the case today for other forms of credit.

Strengthening the BNPL Code

Whether the Government elects to pursue Option 1, 2 or 3, the BNPL Code will require revision to reflect the context of the new regulatory framework. The current BNPL Code is inadequate to protect customers as the sector grows.

A revised and strengthened BNPL Code should be uplifted to an ASIC-approved standard, and cover matters such as support for customers affected by domestic violence, coercive control or financial abuse.

The time for regulatory action is now

AFIA research indicates that while still in its infancy, the BNPL sector is growing rapidly. According to its June 2022 report, BNPL payment adoption is projected to record a 24 per cent compound annual growth rate during 2021-2028, with gross merchandise value increasing from \$10.2 billion in 2020, to \$72.5 billion by 2028⁵ – a figure that's more than the entire general government sector expenditure of the Queensland Government last year.

As noted in the Options Paper, ASIC's Consumer Monitor monthly survey report for quarter 1 of 2022, found 19 per cent of BNPL consumers surveyed cut back or went without essentials to make BNPL repayments on time.⁶ Increasingly, Australians are experiencing cost of living pressures across the economy at levels that have not been seen for some time. This only underscores the need for appropriate regulation to sit across all credit products, and for this framework to be introduced in a timely manner. Without a responsible lending framework in place that creates an obligation for credit checking, the BNPL sector has the potential to become a financial landmine for consumers struggling with the rising cost of living.

⁵ https://afia.asn.au/files/galleries/AFIA_BNPL_Research_Report.pdf

⁶ <https://treasury.gov.au/sites/default/files/2022-11/c2022-338372-op.pdf> (noted at page 11)