6 March 2024

Mr Alan Raine
Committee Secretary
Senate Economics Legislation Committee

Submission to the Inquiry into Treasury Law Amendment (Better targeted Superannuation Concessions and Other Measures) Bill 2023 and a related bill [Provisions]

Thank you for the opportunity to provide feedback to the Senate Economics Legislation Committee as part of its inquiry into the Treasury Law Amendment (Better targeted Superannuation Concessions and Other Measures) Bill 2023.

Block is a global technology company and an overarching ecosystem of many businesses, including Square, Afterpay, Cash App, TIDAL and TBD, united by their purpose of economic empowerment. In Australia, our core business units include Afterpay – the Australian-founded Buy Now Pay Later (BNPL) provider – and Square, which helps merchants more easily run and grow their businesses with its integrated ecosystem of commerce solutions.

In this submission, we address the proposed changes to the payments system regulatory framework, with a particular focus on the Reserve Bank of Australia's (RBA) intention to extend regulation of surcharging to BNPL products under its expanded powers. We believe this would increase the cost of living for millions of consumers, reduce competition in financial services, and harm the Australian FinTech sector, which already faces many barriers to competing in a highly concentrated market. Without a robust and careful review of the impact of a larger payments regulatory perimeter – there is a real and highly concerning risk of deleterious impacts on consumers, competition and the broader economy.

In our submission we provide an overview of the following:

- The historic policy rationale for enabling the imposition of payment surcharges on consumers via regulation;
- The critical differences between BNPL and the card scheme networks;
- The benefits that BNPL has generated for consumers, merchants and competition; and
- Our recommendation for the RBA to be required to demonstrate a clear market failure before creating new regulations.

Overview of surcharging regulation

Proposed amendments to the Payments System (Regulation) Act will greatly expand the regulatory perimeter for payment related functions in the Australian economy, capturing emerging payments systems and participants. Many aspects of these reforms will update the regulatory framework with the rapidly changing technology that permeates modern payments. Block welcomes many of these reforms and efforts to make Australia's payment system more competitive and innovative.

However, expanding the ability of the RBA to designate and regulate a wide range of payment systems, should be done with appropriate guardrails. In particular, a threshold matter for any new regulation should be clear evidence of market failure. Once market failure is established, a holistic and evidence-based assessment of the appropriate regulatory intervention must be conducted, including the risk of unintended consequences.

Concerns regarding an expanded payments regulatory framework are particularly relevant where a regulator's limited mandate may prevent a holistic analysis of a policy issue. For example, the RBA has previously concluded that regulations should be made to invalidate no-surcharging clauses used by BNPL providers, to align with the approach taken in relation to the international card schemes. This policy position came about due to the role played by the international card schemes in the Australian payments market. The card schemes have been deemed by the RBA to have sufficient power and market share to be 'must take' payment methods for merchants.

The proposed expansion of the RBA's powers to incorporate BNPL products – and in time, the enablement of surcharging – risks burdening millions of Australian consumers without evidence of market failure, or a comprehensive government assessment of its implications. The pronounced differences in market dynamics between the BNPL sector and traditional consumer credit, coupled with their distinct impacts on merchants and consumers, mean that previous regulatory approaches lack applicability.

Differences in market dynamics refute the rationale for extending surcharging policy to BNPL

The RBA's stated rationale for enabling, via regulation, the ability of merchants to impose surcharges when accepting payments that are processed via the card schemes is that the market is characterised by two dominant international providers, where merchants are compelled to accept both. In essence, surcharging is a policy lever designed to address specific market characteristics and effects of those characteristics on merchants and other stakeholders (limited competition and product and pricing differentiation).

While traditional credit card networks operate within a landscape dominated by a limited number of players and minimal differentiation, the BNPL sector thrives on innovation and competition, offering a plethora of options for merchants.

The BNPL sector is highly competitive and diverse, with at least 15 operators in Australia and growing. These providers offer a wide spectrum of product and price structures, ranging from no-cost options to extended fee-free periods, allowing merchants to tailor their offerings to their target market and business model. Some providers offer no additional costs to merchants over normal card transactions, or extended fee free periods. Importantly, some allow merchants to surcharge customers for using their product, and others ensure customers are not charged at checkout for using their product. Other providers, like Afterpay, adopt a merchant-centric approach, offering a platform for risk assumption and customer acquisition in exchange for negotiated merchant transaction fees. This model has not only driven competition and innovation but also delivered tangible benefits to merchants and consumers alike.

The diverse and competitive BNPL market allows merchants to choose the provider(s) that are right for them. Almost half of Afterpay small to medium sized merchants offer one other BNPL provider and the majority say they would remove a BNPL provider if it was not providing sufficient value.[1] Unlike the card schemes, merchants only choose to use BNPL products when and if they provide net value to their business and almost never offer all or the majority of BNPL products available to them.

BNPL also remains a tiny fraction of the payments ecosystem and unlike the card schemes, is not 'must take' for merchants. Recent RBA data demonstrates that BNPL transactions represent only 0.7% of payments. In contrast, purchases by cards make up 76% of consumer payments. The dominant international credit cards were launched in Australia in 1984 and were not subject to RBA regulation until 2004, by which time they represented around 36% of spending. While BNPL products are more prevalent in some industry segments, they still represent a tiny fraction of transactions compared to total card processing volumes.[2]

It is therefore clear that the market dynamics of the international card schemes and BNPL products are not alike. And the same policy rationale for imposing surcharging rules on the BNPL sector does not exist.

BNPL merchant fees are trending downwards and merchants receive a diverse range of benefits

The competitive dynamics within the BNPL sector have led to a consistent downward trend in merchant fees. In addition, the introduction of BNPL products has also aligned with an overall reduction in merchant service fees - across the payments sector more broadly. This makes it clear that competitive market dynamics are working effectively without regulatory intervention. It also contrasts starkly with the circumstances that led the RBA to impose no surcharging rules on the card schemes, where credit card fees were continuing to increase and market share remained concentrated and stagnant.

In FY22, the BNPL sector delivered $2.7 billion in new revenue for Australian retailers, including through customer acquisition, increased basket size of existing customers, rewards, marketing and business insights. Afterpay, for example, intentionally provides a free service to consumers, and a powerful sales and marketing platform for merchants in exchange for a negotiated merchant transaction fee. Our merchant fee includes all transaction processing costs, and because Afterpay is the merchant of record on purchases made by customers, our size and scale enables us to leverage reduced processing costs. Merchants pay Afterpay not for facilitating a transaction but for assuming risk on their behalf and providing a marketing channel for new and returning customers.

A merchant that surcharges the full Afterpay merchant fee for an Afterpay transaction would recover significantly more than their payment processing costs because this fee also reflects the costs of other benefits that the Afterpay platform provides. Beyond facilitating transactions, BNPL platforms serve as effective marketing channels, driving customer engagement, and enhancing brand loyalty. Any regulatory intervention that undermines these benefits risks stifling innovation and competition within the payments ecosystem, ultimately harming consumers and merchants.

[1] Mandala analysis, 2023.
[2] Australian Merchant Acceptance Program, RFI Global, 2023.

Imposing BNPL surcharges would punish consumers for using a lower cost alternative to credit cards

BNPL stands out as a prominent example of homegrown innovation and competition. Consumers have embraced free and low risk BNPL products that rely primarily on revenue from merchants. Merchants choose to offer BNPL because they connect them with those customers – much like any other lead acquisition service.

Afterpay is interest free, customers can no longer make purchases when a payment is late and late fees are low and capped. Australians accrued $337 million in benefits by using BNPL products in 2022 compared to other credit products. For Afterpay alone, our customers saved $110 million in fees compared to using credit cards.

Despite these benefits, the RBA argues that merchants should have the right to pass on costs associated with BNPL to consumers. It is important to note that merchants already have this right. There are a wide variety of consumer credit products, as well as BNPL products, that offer the ability to surcharge customers. Conversely, if surcharging rules were imposed on the BNPL sector, then all customers would lose their ability to use certain BNPL products, like Afterpay, for free as long as payments are made on time.

The innovation of BNPL has increased competition in consumer credit and improved consumer outcomes

Australia's credit card market has historically lacked meaningful competition. By some estimates, the big four banks currently hold 93% of the credit card issuing market[3] — a level of concentration more than double that of the UK and US markets, and has remained stubbornly high for many years. Limited competitive pressure has resulted in poor consumer outcomes for Australian credit card users. Interest rates have historically gone "up like a rocket, down like a feather". Since late 2011, the average interest rate on 'standard' credit cards monitored by the RBA remained around 20%, despite significant reductions to the official cash rate.[4]

In addition to maintaining consistently high interest rates, credit cards also operate regressively, with poorer consumers cross-subsidising wealthier consumers. Wealthier households use credit cards in a savvy way to earn reward points, while avoiding interest by repaying balances in full each month (these consumers are known as 'transactors'). These transactors are not profitable for the banks issuing credit cards. Banks instead rely on lower-income consumers who do not repay their balances in full each month and incur interest rates of 20% or more.

This means that credit card customers who pay their balances in full each month are heavily subsidised by those who revolve in interest. Conversely, no cohort of Afterpay customers cross-subsidies any other. While Afterpay does earn revenue from customers directly via late fees, this is a small percentage of our total revenue. That is why vulnerable consumers save the most by shifting to Afterpay from credit, being up to seven times better off.

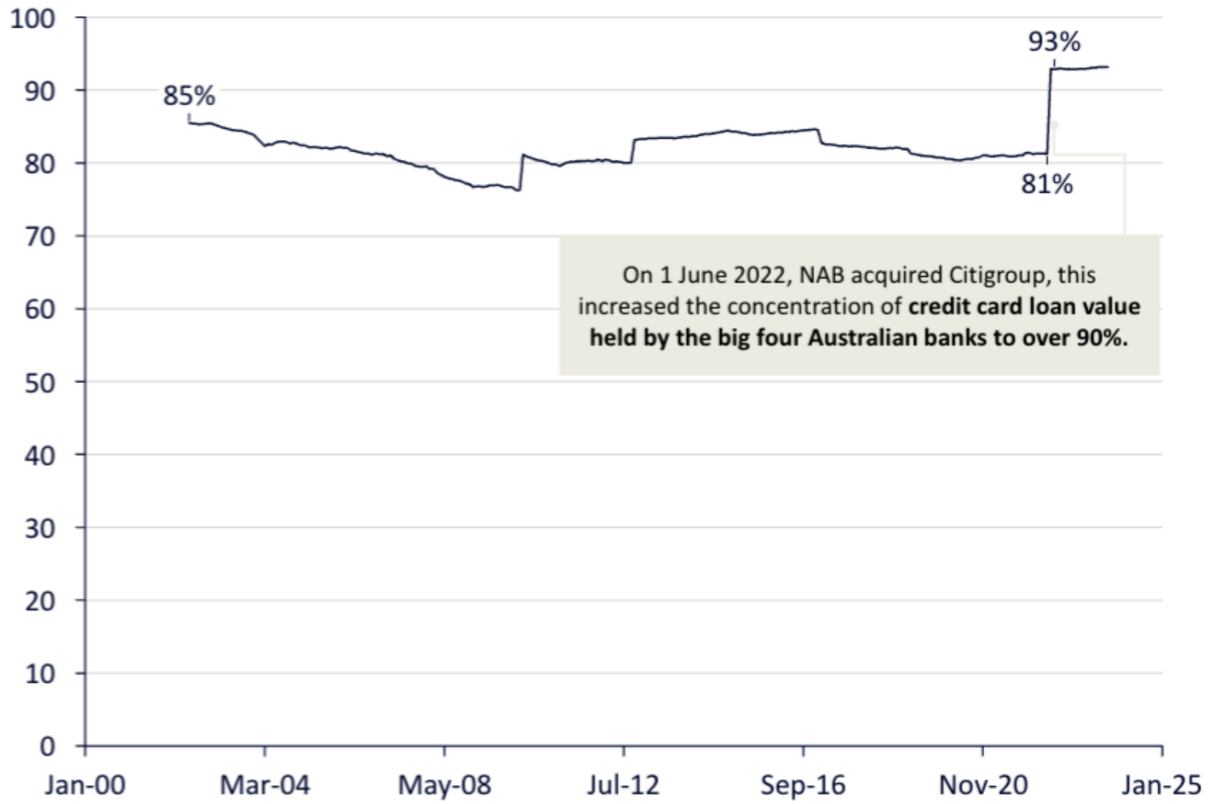
---

[3] PRA 2002 –June 2019, Authorised deposit-taking institution statistics back-series, Mandala analysis.
[4] Source: APRA, RBA 2017, RBA 2023, IBIS 2023, IBIS 2023, Senator HON Katy Gallagher 2014, RBA 2021, Productivity Commission, Inquiry into the Financial System 2018.

Additional attempts were made in 2014 to promote competition within the highly concentrated credit card issuance market. The Government noted "increased competition will also benefit consumers and retailers by putting downward pressure on credit card fees and charges". A decade later, however, market concentration in credit card issuing has only increased.

Credit card issuing: concentration of household credit card loans value ($m) held by major banks

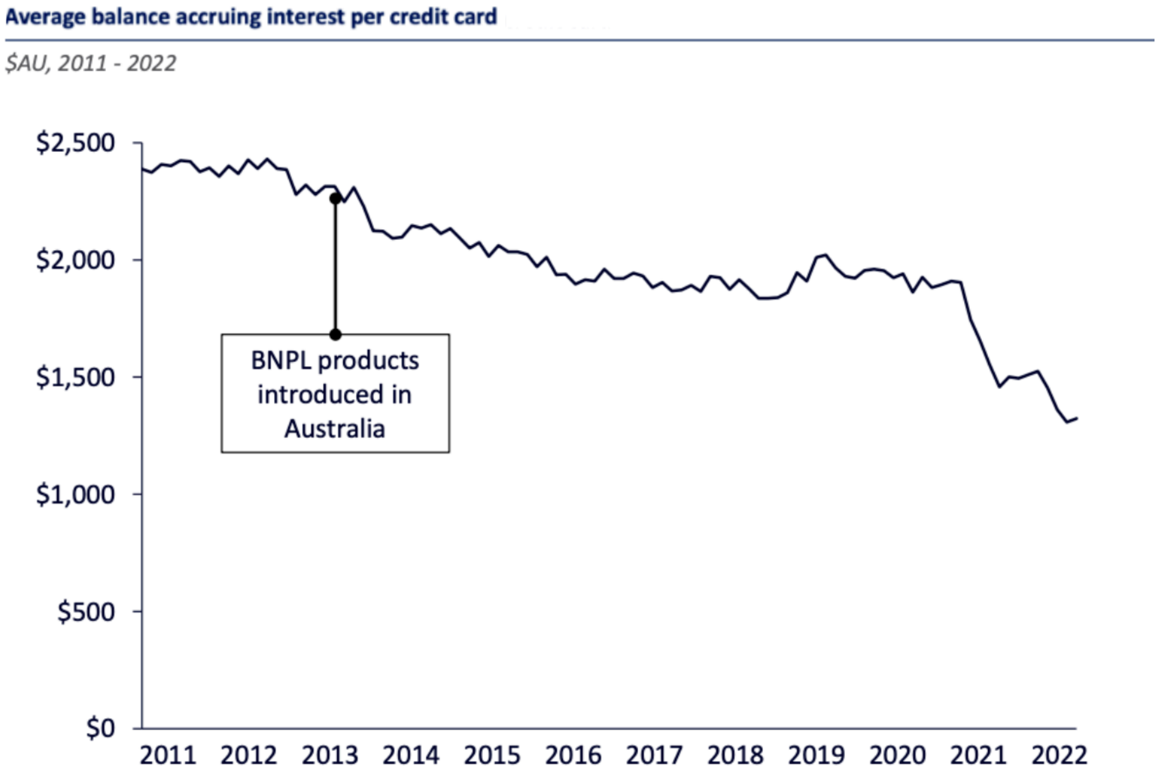
Share held by major banks, annual average %, 2002-2023

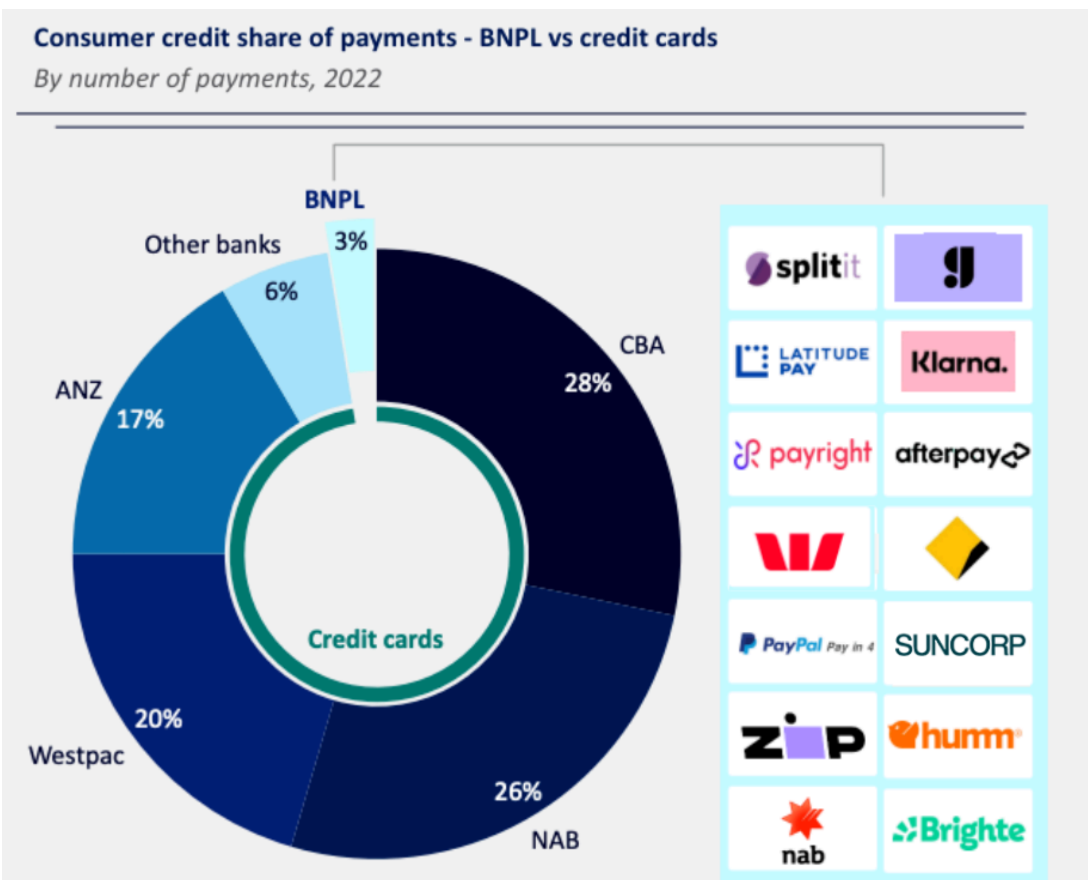


Source: APRA 2002 – June 2019, *Authorised deposit-taking institution statistics back-series*, Mandala analysis.

It is only through the competitive pressure of the BNPL industry that credit card outcomes have improved for customers. Since the introduction of BNPL, credit card accounts and average balances incurring interest have declined. As noted by Treasury, "BNPL has also driven some consumers to shift away from expensive, higher risk credit such as payday loans and towards cheaper and lower risk BNPL credit. For example, the National Credit Providers Association (NCPA) found that applications for Small Amount Credit Contract (SACC) loans have declined by over 11 per cent in the past financial year. The NCPA partially attributes this decline to BNPL products taking away market share."

In addition, the major banks and other credit card issuers have introduced their own BNPL products in response to consumer demand. Many of these provide offers that include monthly fees based products, and some lenders have even partnered with BNPL providers to allow users to link their rewards cards to services like Afterpay.





Source: Reserve Bank of Australia payments statistics and analysis by Mandala Partners

Imposing surcharging regulation on BNPL would erode the newly established competitive tension in the consumer credit market. It would push customers back to a traditional credit card model that has underserved consumers for decades. It would also represent a substantial economic transfer away from consumers to the major banks, which continue to dominate the credit card market.

Regulators should be required to demonstrate a clear market failure before enforcing regulations designed to address instances of market failure

The regulatory landscape surrounding payments is notably interventionist, often entailing pricing controls and constraints on business-to-business contracts, including the prohibition of no-surcharging clauses. While such measures might find justification in instances of market failure or insufficient competition, it is imperative to assess their suitability and efficacy within the context of the BNPL sector.

The justification for such an interventionist approach has been the nature and limited competition that has historically existed in some aspects of the payments sector. Notably, the natural oligopoly of the card schemes, as well as the historically highly concentrated credit card issuing and merchant acquiring sectors. Policy levers such as price caps and surcharging signals are specifically designed for when market failure or a distinct lack of competition exists.

Using policy levers designed for non-competitive or market failure environments to highly competitive sub-sectors will yield unintended consequences. This approach risks entrenching incumbents, hindering innovation and new entrants, and ultimately leads to poorer outcomes for merchants and consumers.

To safeguard against unintended consequences and ensure regulatory measures are proportionate and effective, regulators should be required to demonstrate that a market failure exists or has occurred before imposing regulations designed to address such instances. For example, prior to any intervention in the BNPL market, the RBA must consider factors such as:

- The proportion of BNPL transactions in the overall payments landscape
- Whether BNPL merchant fees are increasing, remain flat, or are declining
- The role of BNPL platforms in acting as a lead generation tool and marketing platform for merchants
- Whether there is clear evidence of cross-subsidisation (rather than a theoretical possibility), and whether cross-subsidies are regressive or otherwise
- The role of BNPL platforms in generating competition in the market for consumer credit products
- The consumer benefits that consumers receive from using BNPL products, and that credit card customers receive from increased competition.

Rationale for no surcharging rules and application to different payment functions

Policy rationale for imposing surcharging rules	Card schemes	BNPL
'Must take' payment method Merchants are effectively required to offer all/most brands regardless of cost. Normal market forces do not apply.	Yes	No
Dominant form of payment Represent a sufficiently large portion of total payments to be systemic and hold significant market power.	Yes	No
High market concentration High degree of concentration within the market, resulting in limited competitive pressure on price or product differentiation.	Yes	No
Regressive cross-subsidies Product generally benefits high income consumers at the cost of lower income consumers.	Schemes are neutral, credit cards are regressive.	No
Merchant fees increasing over time prior to regulation Market dynamics are working to drive merchant fees higher rather than lower.	Yes	No

The current regulatory approach, while aiming to address market inefficiencies, risks exacerbating distortions and stifling competition in the payments sector. By providing clear evidence of market failure before implementing regulations, regulators can ensure that interventions are targeted, effective, and conducive to a competitive and innovative payments landscape. Furthermore, a comprehensive review of competition in retail payments by the ACCC would provide invaluable insights to inform regulatory priorities and strategies, ensuring that the evolving payments ecosystem remains vibrant and consumer-centric.

Given the breadth of issues that require consideration, we support a review of competition in retail payments to inform the regulator's priorities and direction under new wide-ranging powers. In particular this should consider how the new licensing regime can encourage greater innovation and competition in card issuing, consumer credit, merchant acquiring, payment gateways and e-commerce platforms, as well as digital wallets.

Conclusion

Thank you for the opportunity to make this submission. We look forward to ongoing engagement with the Committee. Please do not hesitate to contact us if you require further input or clarification.

Yours sincerely

Michael Saadat
International Head of Public Policy