Chapter 5

Buy now pay later

Market participants and products

5.1 Buy now pay later products are relatively new to the market. They allow a consumer to buy and receive goods and services immediately, but pay for them over a specified period. The industry has expanded rapidly recently. The number of consumers using these products increased from 400,000 to approximately two million between 2015 and 2018.[1] Good Shepherd Microfinance estimates that 30 per cent of applicants for their microfinance loans are repaying such a debt.[2]

5.2 The newness of the industry is shown by ASIC's finding that 70 per cent of users said they used a buy now pay later arrangement for the first time in the last 12 months. Users tend to be young: 60 per cent are 18–34 years old. There were more female than male users.[3]

5.3 Buy now pay later companies employ a variety of business models.

5.4 One of the fastest growing companies, Afterpay, refers to its product as a 'budgeting tool', and specifically states that it is not a line of credit. It does not charge interest or account keeping fees. It charges merchants for the use of the service, and it levies late fees. It says that the late fees are capped, and are, in fact, less than the cost to the company of late payments. Most of its revenue is from merchant fees.[4]

5.5 Zip Pay similarly does not charge interest. It does charge an account keeping fee. It notes that its business model and market are very different from those of small amount credit contract (SACC) providers, and that it '…absolutely [does] not target consumers at risk of financial hardship'.[5] ZipMoney is quoted as having 800,000 clients and conducting two million transactions last year.[6]

5.6 Flexigroup, the parent company of buy now pay later product Certegy Ezi-Pay, said that for Certegy, 63 per cent of revenue comes from merchant fee income, while less than two per cent was from late or default fees. Certegy deals with bigger transactions than the other buy now pay later operators: almost half of its revenue is from sales of solar panels or other home improvements.[7]

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1 ASIC *Review of buy now pay later arrangements*, *Report 600*, December 2018, p. 17.

2 Good Shepherd Microfinance, *Submission 50*, [p. 4].

3 ASIC *Review of buy now pay later arrangements*, *Report 600*, December 2018, p. 25.

4 Afterpay, *Submission 26*, pp. 4–5.

5 Zip Co Ltd, *Submission 18*, [p. 2].

6 Mr Richard Wood, Credit Manager, Good Shepherd Microfinance, *Committee Hansard*, 12 December 2018, p. 41.

7 Ms Rebecca James, Chief Executive Officer, Flexigroup Limited, *Committee Hansard*, 22 January 2019, pp. 34–5.

5.7 Buy now pay later schemes are seen as an alternative to credit cards by young consumers:

> …there has been a huge amount of coverage of credit, and the dangers of credit, over the last 10 years as well, so there's a kind of slowing down of the normalising of credit. Ultimately, people still want to consume and so they're looking for alternative ways to consume.
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> …It's just that, for younger people, it's part of their experience; they're more familiar with it; it makes more sense to them than, say, a line of credit or a credit card.[8]

5.8 The National Online Retailers Association (NORA) sees these schemes as an improvement on the traditional 'layby' model. They offer huge benefits to the industry, particularly through the reduction or absorption of Card Not Present fraud—which is possible when buyers give credit card details, for example online or by phone or email, and do not present their card.[9] The industry sees such innovation as crucial in delivering greater financial control and easing cost-of-living pressures for consumers over the long term.[10]

5.9 The companies use modern technology to provide a service that is easy to use and fast. Zip.co and Afterpay both spoke about their algorithms, which enable them to investigate consumers' financial circumstances and test their eligibility for funds:

> We're able to provide an automatic result based on our analysis of all of those data points that I touched on. Our algorithm is assessing that information in real-time and, in fact, we're actually consuming more data than a traditional credit provider would for an application of a credit card or home loan.[11]

5.10 ASIC agreed that this could work:

> …because the responsible lending obligations are about the particular consumer who's applying for credit, it is possible, through technology, for a credit provider to use technology to obtain information about that consumer, whether that's bank account transaction information or other information that's available electronically, and feed that information into an algorithm in order to make a lending decision, so long as the information is about that consumer and is relevant to the lending decision and the credit provider's taken reasonable steps to obtain the relevant information. So, yes,

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8 Dr Paul Harrison, Director, Centre for Employee and Consumer Wellbeing, Deakin University, *Committee Hansard*, 22 January 2019, p. 5, p. 6.

9 National Online Retailers Association (NORA), *Submission 19*, p. 1.

10 Mr Larry Diamond, Co-Founder and Chief Executive Officer, Zip.co, *Committee Hansard*, 22 January 2019, p. 9.

11 Mr Peter Gray, Co-Founder and Chief Operations Officer, Zip.co, *Committee Hansard*, 22 January 2019, p. 12; also Mr Nick Molnar, Chief Executive Officer and Co-Founder, Afterpay, *Committee Hansard*, 22 January 2019, p. 11.

> it is possible for algorithms to form part of decision processes that lenders use…[12]

5.11 But Mr Paul Holmes of Legal Aid Queensland was sceptical of such automation of judgements:

> I can't speak for the buy-now pay-later algorithm yet, but my experience of the payday lending industry is they've been using algorithms to interrogate data and assess debt for a number of years now, and it hasn't improved their ability to lend responsibly or lend appropriately. So I'm personally going to take a bit of convincing that just having a fancy algorithm is enough to assess the individual circumstances of an individual person…[13]

Credit or not credit?

5.12 There was some debate about whether buy now pay later schemes are a form of credit. They do not charge interest to the customer, which is an element of the definition of credit under the National Credit Act. They are different from credit cards, which provide a source of funds for unspecified purposes. Each debt is applied to a specific product, which is provided directly to the customer at the time of purchase. Buy now pay later companies pay the merchant the advertised cost of the product and the customer pays the product off in a series of instalments with no interest incurred.

5.13 ASIC was equivocal about whether they are a form of credit. They do not meet the definition under the National Credit Act, but they are credit as defined in the ASIC Act:

> If you're thinking of credit in the ordinary everyday understanding of what credit is, then we would say it is a form of credit because it enables consumers to pay for goods over time and, by postponing the payment of goods, you're effectively being given a form of credit in the ordinary sense of the word.[14]

5.14 Buy now pay later companies were also divided. Zip.co said:

> We wholeheartedly support ASIC's position that buy now pay later is a form of credit…[15]

5.15 However, Afterpay said:

> We've never been defined as credit when it comes to the national credit code nor do we rely on an exemption as confirmed by ASIC. We never charge interest.[16]

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12 Mr Michael Saadat, Senior Executive Leader, Deposit Takers, Credit and Insurers, ASIC, *Committee Hansard*, 24 January 2019, p. 15.

13 Mr Paul Holmes, Senior Lawyer, Civil Justice Services (Consumer Protection), Legal Aid Queensland, *Committee Hansard*, 22 January 2019, p. 27.

14 Mr Michael Saadat, Senior Executive Leader, Deposit Takers, Credit and Insurers, ASIC, *Committee Hansard*, 24 January 2019, p. 14.

15 Mr Larry Diamond, Co-Founder and Chief Executive Officer, Zip.co, *Committee Hansard*, 22 January 2019, p. 10.

5.16 Good Shepherd Microfinance was impatient of the fine points of debate, and believed that buy now pay later is a form of credit:

> …a business lets you buy something without paying for it immediately, it sends you a payment schedule listing payment amounts and due dates. It then advises you that it'll charge you a late fee if a payment's missed and ultimately, if required, passes it on to their collection agency. To the average Australian that is a credit product and, as such, should be treated as one.[17]

Impact on consumers

5.17 The ASIC study of buy now pay later products reported that users found that the products allowed them to spend more than they otherwise would and to buy things they otherwise might not have. It expressed concern that these products may pose a risk of overcommitment to some consumers and sometimes cause inflated prices for consumer goods. It noted that one in six consumers reported difficulty in meeting payments. It pointed out that there was a particular danger in the 23 per cent of cases where consumers used credit cards to pay these debts, thus incurring substantial interest charges. It noted that over 40 per cent of users had incomes of under $40,000, and of this group, almost 40 per cent were either students or in part-time work.[18]

5.18 Many submissions refer to cases of consumers who have got into trouble with multiple buy now pay later contracts, often having multiple contracts or using these contracts alongside other SACCs.[19] Good Shepherd Microfinance reported that the majority of applicants for microfinance have multiple buy now pay later accounts with various providers (along with SACCs).[20] An extreme example was:

> One loan applicant recently provided us with a 90 day bank statement containing 288 buy-now pay-later transactions totalling $5,600. This case study demonstrates the large amount of credit that can be accessed with no verification of income, credit check or assessment of capacity to repay.[21]

5.19 Care Inc reported that it was seeing an increase in the number of clients with more than one buy now pay later debt who were struggling to make repayments:

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16 Mr Nick Molnar, Chief Executive Officer and Co-Founder, Afterpay, *Committee Hansard*, 22 January 2019, p. 10.

17 Mr Richard Wood, Credit Manager, Good Shepherd Microfinance, *Committee Hansard*, 12 December 2018, p. 38.

18 ASIC, *Review of buy now pay later arrangements: Report 600*, November 2018, pp. 10–12.

19 See, for example, Consumer Credit Law Centre SA, *Submission 33*, pp. 6–7; [name withheld] *Submission 45*, p. 1; [name withheld] *Submission 48*, p.1; National Credit Providers Association, *Submission 51*, p. 20.

20 Mr Richard Wood, Credit Manager, Good Shepherd Microfinance, *Committee Hansard*, 12 December 2018, p. 41.

21 Good Shepherd Microfinance, *Submission 50*, [p. 5].

The scheme encourages people with limited financial capacity to purchase goods that they cannot afford upfront, increasing the likelihood of future financial stress.[22]

5.20 Buy now pay later products are also emerging as a cause of insolvency:

And obviously buy now, pay later schemes are an emerging issue with some kind of buy now, pay later funding present in more than 20 per cent of insolvencies.[23]

5.21 The provider companies insist that they take a lot of care to ensure that consumers do not overcommit themselves:

In fact, we refuse 30 per cent of purchasers and 50 per cent of first-time purchasers based on our algorithms and consumers' history. Be late one payment, we suspend your account and you can't buy anything else through Afterpay until you've come good.[24]

5.22 They point out that the rate of customers having negative effects from buy now pay later commitments (one in six) is similar to the rate in the credit card sector.[25]

5.23 Mr Paul Holmes from Queensland Legal Aid pointed out that there may be an artificial lowering of the reported defaults under buy now pay later schemes. Because it is not regulated as credit it does not have hardship provisions. A customer who has multiple credit products is likely to seek the hardship provisions of other products, and pay the buy now pay later account first:

So what you end up having is a cost shifting of the hardship…part of the reason the default rates are very low is people are paying that first and often…[because] they've got hardship over here from these other regulated products.[26]

5.24 Dr Paul Harrison pointed out that the newness of the product and the ease of access was attracting young people:

This new form…of offering money to people is very new to everybody…There are public social norms now around: 'Avoid credit,' whereas there is not a lot going on about: 'Avoid getting into difficulty with a buy-now-pay-later type of approach.'… It's also more difficult to get credit…So, for a young person who has not got a strong credit rating or who hasn't had a lot of experience with credit, this is much easier to transact.[27]

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22 Care Inc, *Submission 11*, p. 4.

23 Mr Benjamin Paris, Non-Executive Director, Personal Insolvency Professionals Association, *Committee Hansard*, 12 December 2018, p. 47.

24 Mr Nick Molnar, Chief Executive Officer and Co-Founder, Afterpay, *Committee Hansard*, 22 January 2019, p. 11.

25 Mr Larry Diamond, Co-Founder and Chief Executive Officer, Zip.co, *Committee Hansard*, 22 January 2019, p. 9.

26 Mr Paul Holmes, Senior Lawyer, Civil Justice Services (Consumer Protection), Legal Aid Queensland, *Committee Hansard*, 22 January 2019, p. 27.

27 Dr Paul Harrison, Director, Centre for Employee and Consumer Wellbeing, Deakin University, *Committee Hansard*, 22 January 2019, pp. 6–7.

Conduct of providers

5.25 There were questions raised about the companies' insistence that their algorithms prevented overcommitment by consumers and the evidence from a number of other sources of very many consumers with multiple buy now pay later debts which they could not service, often in conjunction with other credit products. Clearly, more needs to be done to ensure consumers are protected, and company algorithms alone are not sufficient.

5.26 Criticisms of the behaviour of individual providers of buy now pay later were relatively rare. There was more concern about the nature of the product: in particular, that it allowed people to consume on impulse.

5.27 Dr Paul Harrison's analysis of consumer decision making is discussed in Chapter 3. He emphasised that 'the goal is to get consumers to make the decision as quickly as possible'. In recent years shopping has gone on line, and the technology has been speeded up.[28]

5.28 Further, with buy now pay later, the purchase and the paying for it have been bundled into one product to ensure the impulse is acted on immediately:

> …there's a halo effect that occurs when…consumers see a product that they want to buy and see the ease with which [they're] able to get credit or some kind of financial assistance in that moment.

5.29 Consumers in such situations do not stop and think that there are two different products and one might be better purchased elsewhere.[29]

5.30 While consumers are responsible for their own behaviour, when problems are widespread it is necessary to look for systemic causes. In particular, the targeting of buy now pay later products to young people does raise some questions:

> I think we are seeing too much evidence in our applications to suggest that many consumers are actually already vulnerable by the time we're seeing them. I agree. The borrower does have some responsibility but when the borrower is 18 and trying to pay rent, are they capable of making those decisions which have potentially a decade's worth of impact?[30]

Nature and adequacy of the current regulatory arrangements

Current regulation

5.31 Representatives of ASIC explained current regulation:

> Buy now pay later products are generally not credit under the National Consumer Credit Protection Act because that Act defines consumer credit in a particular way and has exemptions for arrangements that meet certain

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28 Dr Paul Harrison, Director, Centre for Employee and Consumer Wellbeing, Deakin University, *Committee Hansard*, 22 January 2019, pp. 2–3.

29 Dr Paul Harrison, Director, Centre for Employee and Consumer Wellbeing, Deakin University, *Committee Hansard*, 22 January 2019, p. 3.

30 Ms Corinne Proske, General Manager, Retail and Online, Good Shepherd Microfinance, *Committee Hansard*, 12 December 2018, p. 42.

> criteria. Buy-now pay later-products generally fall within the exemptions that exist in that piece of legislation. However, buy now pay later products are credit as defined in the ASIC Act, and the ASIC Act contains the general consumer protection provisions that exist, including prohibitions against misleading or deceptive conduct and unconscionable conduct.[31]

5.32 ASIC noted that because they are not subject to the responsible lending obligations, buy now pay later operators are not required to consider the income or existing debts of customers. This means that they can offer finance to consumers who cannot afford to repay; and that a consumer who is in default can still get credit from another provider.[32]

5.33 AFCA pointed out the same anomaly:

> Responsible lending laws do not apply to these arrangements, and this, we believe, does cause real difficulty. We believe that some form of affordability assessment should be undertaken and consumers of these services should have the ability, as many other consumers do, to bring matters to us as the ombudsman if they feel that they've been treated unfairly.[33]

5.34 Choice also noted that a quarter of Afterpay's income in the last financial year was from late fees, and suggested that such lenders should be subject to responsible lending obligations.[34]

Changes under way

5.35 The legislation providing for Treasury Laws Amendment (Design and Distribution Obligations and Product Intervention Powers) Bill 2018 is currently before the Parliament. ASIC argues for the extension of the product intervention power to the buy now pay later sector, rather than bringing the sector into the National Credit Act. Representative of ASIC commented:

> We think that the extension of product intervention powers to this sector will enable us to intervene and require things to be done in a much more targeted and more effective way because it will allow us to address the potential consumer harm more directly…[35]

5.36 It would also be flexible:

> The product intervention power, as currently drafted, would allow…an entity-specific intervention, where it was just that entity with their product that was the issue. But, if the problem was sector wide or even a broader

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31 Mr Michael Saadat, Senior Executive Leader, Deposit Takers, Credit and Insurers, ASIC, *Committee Hansard*, 24 January 2019, p. 13.

32 ASIC, *Submission 21*, p. 19.

33 Mr David Locke, Chief Ombudsman and Chief Executive Officer, Australian Financial Complaints Authority, *Committee Hansard*, 24 January 2019, p. 2.

34 Choice, *Submission 22,* p. 2.

35 Mr Michael Saadat, Senior Executive Leader, Deposit Takers, Credit and Insurers, ASIC, *Committee Hansard*, 24 January 2019, p. 15.

> group that's still not sector wide but a broader group, the intervention can be on that broader basis.[36]

5.37 Treasury noted that the bill was structured to allow further products to be brought in easily.[37]

5.38 The government has also introduced amendments to the *Competition and Consumer Act 2010* which would create a consumer data right and will enable sellers of credit products to check the indebtedness of applicants for credit. This was welcomed by the industry.[38]

Other proposed changes

5.39 The Consumer Action Law Centre and Choice called for buy now, pay later providers to be brought into the scope of the National Credit Act.[39] Mr Paul Holmes of Legal Aid Queensland agreed:

> …all of these products should be treated in the same way, because they have the ability to have the same adverse impact.[40]

5.40 Zip.co called for:

> …a sector-specific regulatory regime centred on three key pillars around responsibility, transparency and customer support: one, where we see minimum standards for up-front due diligence to ensure customers can afford the repayments; two, that customers understand what they are signing up for; and, three, that hardship safeguards are in place to help customers should their financial circumstances change.[41]

5.41 This would be close to, but not identical with, coverage under the National Credit Act:

> It's very close to full, responsible lending compliance. I think our view of regulation for the sector should be fit for purpose for the products it's regulating, so we would advocate for a scaled-down version of responsible lending. In fact, we would advocate income verification and caps on the amount of repayment that it could take up of a consumer's income.[42]

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36 Mr Greg Kirk, Senior Executive Leader, Strategy Group, ASIC, *Committee Hansard*, 24 January 2019, p. 15.

37 Ms Kate O'Rourke, Principal Adviser, Consumer and Corporations Policy Division, Markets Group, Department of the Treasury, *Committee Hansard*, 24 January 2019, p. 32.

38 Mr Peter Gray, Co-Founder and Chief Operations Officer, Zip.co, *Committee Hansard*, 22 January 2019, p. 16; Mr Anthony Eisen, Executive Chairman and Co-Founder, Afterpay, *Committee Hansard*, 22 January 2019, p. 15.

39 Consumer Action Law Centre, *Submission 37*, p. 5; Choice, *Submission 22*, p.2.

40 Mr Paul Holmes, Senior Lawyer, Civil Justice Services (Consumer Protection), Legal Aid Queensland, *Committee Hansard*, 22 January 2019, p. 27.

41 Mr Larry Diamond, Co-Founder and Chief Executive Officer, Zip.co, *Committee Hansard*, 22 January 2019, p. 10.

42 Mr Peter Gray, Co-Founder and Chief Operations Officer, Zip.co, *Committee Hansard*, 22 January 2019, p. 12.

5.42 Afterpay also did not want the industry to come under the National Credit Act, and instead supports the extension of the product intervention power:

> …it is easier to regulate Afterpay like traditional credit products, but that is a blunt and simple solution to a more complex issue—and one that risks stifling innovation...traditional protections and traditional regulation does not deliver positive customer outcomes…Afterpay has publicly supported reforms that would see ASIC's intervention powers extend to cover the buy-now pay-later sector and create a regulatory framework for different business models within the same industry...
>
> In addition to this…we would seek [regulation] so we can better share information around positive and negative behaviours of our users and understand when people are using multiple products and appropriately.[43]

5.43 However, Zip.co asserted that compliance with the National Credit Act:

> …would have a very minimal impact on our day-to-day operation. We're already undertaking the majority of the things we would need to do to comply with the National Credit Code.[44]

5.44 Certegy would be affected if the SACC cap were to be imposed on buy now pay later products, because it tended to fund more expensive products:

> Yes. I don't necessarily think that limiting a cap on the amount that can be borrowed will address the concerns that are raised throughout the committee. In particular, again, the fit-for-purpose nature of this product is for consumers who would like to buy items for their home or essential items and choose a product that assists with their budgeting arrangements, instead of putting that particular purchase on a credit card.[45]

5.45 Dr Paul Harrison argued that slowing down the process of online purchasing and paying was important. He did not believe a cooling down requirement would work, because that took effect only after the decision had been made and acted on. Rather, he advocated regulation requiring a 'double opt-in', where the consumer had to make two decisions, separated in time.[46]

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43 Mr Nick Molnar, Chief Executive Officer and Co-Founder, Afterpay, *Committee Hansard*, 22 January 2019, p. 11.

44 Mr Peter Gray, Co-Founder and Chief Operations Officer, Zip.co, *Committee Hansard*, 22 January 2019, p. 15.

45 Ms Rebecca James, Chief Executive Officer, Flexigroup Limited, *Committee Hansard*, 22 January 2019, p. 34.

46 Dr Paul Harrison, Director, Centre for Employee and Consumer Wellbeing, Deakin University, *Committee Hansard*, 22 January 2019, p. 2.