



**To:** US Consumer Financial Protection Bureau

**Response to:** "Inquiry Into Buy-Now-Pay-Later (BNPL) Providers"

**March 2022**

While there have always been various forms of instalment credit products in the marketplace, Buy Now, Pay Later (BNPL) is a uniquely Australian invention, that has now been exported around the world.

As Australian based consumer groups, we are therefore well placed to comment on the product and its impact on Australian consumers. Our casework experience, as well as research from our regulator, shows that the product can be harmful for a proportion of people that use it. We have no doubt that US consumers will experience the same problems.

In Australia, as is the case in most parts of the United States, BNPL sits outside the laws applying to other credit products. We urge regulators to put in place adequate safeguards for BNPL products.

*Questions about this submission*

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## **ABOUT US**

Consumer Action and Financial Counselling Australia are consumer groups based in Australia.

### **About Consumer Action Law Centre**

Consumer Action is an Australian independent, not-for profit consumer organisation with deep expertise in consumer and consumer credit laws, policy and direct knowledge of people's experience of modern markets. We work for a just marketplace, where people have power and business plays fair. We make life easier for people experiencing vulnerability and disadvantage in Australia, through financial counselling, legal advice, legal representation, policy work and campaigns. Based in Melbourne, our direct services assist Victorians and our advocacy supports a just marketplace for all Australians.

Consumer Action operates a free legal advice service for individuals and community workers, and a financial counselling advice service<sup>1</sup> for individuals in the state of Victoria. Consumer credit debt is generally the predominant issue people seek our advice on via both these services, with the associated debts often the leading factor pushing people into, or towards, financial hardship.

### **About Financial Counselling Australia**

Financial Counselling Australia (FCA) is the peak body for financial counsellors.

Financial counsellors work in not-for-profit community organisations and provide free and confidential advice and support to people experiencing financial stress. In Australia, financial counsellors are subject to a range of professional requirements including that they hold a Diploma of Financial Counselling, undertake a minimum amount of continuing professional development each year and abide by a Code of Ethical Practice.

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<sup>1</sup> Our financial counsellors respond to calls to the National Debt Helpline. This is a free service available to any person in Australia who may be struggling with debt.

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## Glossary/Reference Guide

AFIA	Australian Finance Industry Association. A number of BNPL providers are members of AFIA and have put together a self-regulatory code for their industry.
Afterpay	The largest BNPL provider in Australia.
ASIC	Australian Securities and Investments Commission (in some ways equivalent of the Bureau of Consumer Financial Protection).
Australian Code	AFIA Buy Now Pay Later Code of Practice
NCCPA	<i>National Consumer Credit Protection Act 2009</i>  The NCCPA law applies to consumer credit, such as home loans and credit cards. Amongst other things, the Act imposes a licensing regime and requirements on licensees to lend responsibly. BNPL sits outside the Act (based on a current exemption in the law).

# 1. Context for our Response

## 1.1 About this Submission

This consultation comes at a critical time, as the use of BNPL has continued to grow significantly over the last few years both in Australia<sup>2</sup> and in the United States.<sup>3</sup> In Australia, this growth has flowed through to financial counselling casework.

As we understand the legal status of BNPL products in the US, it appears to be extremely similar to that in Australia – that is, it is essentially unregulated credit.

The purpose of our submission is to share our experience in a regulatory environment that lacks legislated consumer safeguards for BNPL products, and where debts accrued from BNPL products are becoming an increasingly common, contributing to financial hardship for many people.

A key difference in the Australia compared to most US jurisdictions is the emergence of industry self-regulation in the form of a code of practice (Australian Code). This was developed by the industry, partly in response to a federal parliamentary inquiry in 2019 that recommended this occur.<sup>4</sup>

Our submission primarily responds to the Consumer Financial Protection Bureau’s question of whether there are ways in which the BNPL market can be improved. Based on our experience in Australia, there is a clear need for proportionate and substantial regulation of credit issued in the form of BNPL. To date, the Australian government has taken a hands-off approach to the industry, and has left the industry to regulate itself. The key consumer protections that apply to other forms of credit in Australia do not apply to BNPL (discussed further below).

As a result, BNPL products are currently contributing to the extent and severity of financial hardship in Australia. This poses substantial risk to both individuals and the community. Many of the Australian BNPL providers are the same key market players as in the US. We encourage the Consumer Financial Protection Bureau to work with legislatures to introduce substantive consumer protections to ensure that the BNPL industry can benefit consumers safely. The BNPL industry has shown that profit will come before consumer protection if left to its own devices.

This submission:

- explores the experience of industry-self regulation in Australia setting out why this is not adequate in addressing the harm being caused by BNPL;
- includes some observations about other aspects of the operation of BNPL in Australia;
- makes suggestions about what stronger safeguards are needed.

## 1.2 Legal status of BNPL in Australia is similar to the US

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<sup>2</sup> ‘20-280MR ASIC releases latest data on buy now pay later industry’ <https://asic.gov.au/about-asic/news-centre/find-a-media-release/2020-releases/20-280mr-asic-releases-latest-data-on-buy-now-pay-later-industry/>

<sup>3</sup> <https://www.paymentsdive.com/news/buy-now-pay-later-demand-hit-us-high-during-holiday-season/617146/>

<sup>4</sup> <https://www.abc.net.au/news/2020-09-03/buy-now-pay-later-regulation-fintech-senate-inquiry/12614068>

Similar to the US, where BNPL products sit outside consumer protection laws for credit such as the federal Truth in Lending Act (TILA), BNPL sits outside Australia's consumer protection framework and the *National Consumer Credit Protection Act 2009* (NCCPA).

As in the US, some BNPL providers in Australia charge fees, such as account keeping and late payment fees. They are able to do this without falling within the definition of credit as the NCCPA contains some limited exemptions to the definition of 'credit', which permit fees to be charged if they fall within certain limits.<sup>5</sup> In many cases, the fees charged by BNPL providers in Australia appear to be specifically structured to charge the maximum possible while staying within the boundaries of these exemptions.

Australian BNPL providers make significant revenue through the fees they charge merchants, which average around 4% of the cost of the goods, significantly more than most other payment platforms.<sup>6</sup>

Australia's corporate regulator, the Australian Securities and Investments Commission (ASIC), has some limited oversight of BNPL because it falls under a definition of 'financial product' contained in ASIC's enabling legislation.<sup>7</sup> However, the powers ASIC holds by virtue of BNPL falling within this definition are limited to more general laws, rather than those specifically designed for credit.<sup>8</sup>

In short, this means that BNPL occupies a very similar position in relation to Australian law as it does within US law – that is, the way BNPL is structured allows it to be treated differently to traditional forms of credit.<sup>9</sup> We note this is different in the State of California, where the State has classified some pay-later products as loans.<sup>10</sup>

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<sup>5</sup> See s 6(1) of Schedule 1 to the NCCPA.

<sup>6</sup> In Australia, BNPL providers commonly prohibit merchants from passing on the fees charged by the BNPL provider on transactions, by the use of 'no surcharge rules'. While these arrangements appear to benefit consumers, there are signs that retailers aim to make back the costs incurred to consumers by other means, such as by inflating the retail prices of goods across the board, or where the agreed price for a product or service is negotiable. See example 3 in ASIC's Report 600 on BNPL:

<https://download.asic.gov.au/media/4957540/rep600-published-07-dec-2018.pdf>.

<sup>7</sup> *Australian Securities and Investments Commission Act 2001* (Cth), s 12BAA.

<sup>8</sup> ASIC also has a product intervention power that it can use to intervene regarding a financial product if there is a real risk that product is causing 'significant consumer detriment', however this power is intended to be a timely response to market wide conduct, and has only been used in exceptional circumstances to date.

<sup>9</sup> The Australian Government has recently announced a consultation on the future of Australia's payment system and this will include BNPL. At present, BNPL falls outside of this framework, unlike other credit products. For more information, see <https://joshfrydenberg.com.au/latest-news/transforming-australias-payments-system/>.

<sup>10</sup> <https://www.responsiblelending.org/research-publication/testimony-buy-now-pay-more-later-investigating-risks-and-benefits-bnpl-and>

## 2. Evidence of Detriment in Australia

The empirical evidence of consumer detriment from BNPL in Australia is clear. Given that BNPL sits outside of the regulatory framework in both of our countries and the similar growth in usage, it is likely that the experience of US consumers will be much the same as that of Australian consumers.

### 2.1 ASIC Reports in 2018 and 2020

The strongest evidence of detriment in Australia comes from reports by ASIC in both 2018<sup>11</sup> and 2020.<sup>12</sup> These reports analysed data from the BNPL providers and also surveyed consumers about their experiences. Relevant findings from the most recent report in November 2020 show that a large number of people experience negative outcomes from using the product.

- 21% of buy now pay later users surveyed had missed a payment in the last 12 months;<sup>13</sup>
- 39% also had a small and/or medium amount credit contract (a small amount credit contract is colloquially known in Australia as a payday loan, a medium amount credit contract is a loan between \$2,000 - \$5,000 that is also a costly form of credit);<sup>14</sup>
- 20% of BNPL users reported that they had cut back or went without essentials (such as meals) in the last 12 months, in order to make their BNPL payments on time;<sup>15</sup>
- 15% of consumers had taken out an additional loan in order to make a payment on time.<sup>16</sup>

This detriment was magnified for younger people using BNPL who proportionately were more likely to have cut back on essentials in order to make a payment or to have taken out an additional loan, compared to other age groups.<sup>17</sup>

The analysis of BNPL data confirms the reliance of the business model on late fees:

- between 9% - 15% of BNPL transactions incurred late fees each month;<sup>18</sup>
- over the three year period to June 2019, BNPL revenue from late payment fees represented up to 15% of total revenue.<sup>19</sup>

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<sup>11</sup> Australian Securities and Investments Commission, Report 600, Review of buy now pay later, November 2018, <https://asic.gov.au/regulatory-resources/find-a-document/reports/rep-600-review-of-buy-now-pay-later-arrangements/>

<sup>12</sup> Australian Securities and Investments Commission, Report 672, Buy now pay later: An industry update, <https://asic.gov.au/media/5852803/rep672-published-16-november-2020-2.pdf>

<sup>13</sup> *ibid*, p 12.

<sup>14</sup> *ibid*, p 12.

<sup>15</sup> *ibid*, p 15.

<sup>16</sup> *ibid*, p 15.

<sup>17</sup> *ibid*, p 15.

<sup>18</sup> *ibid* p 12.

<sup>19</sup> *ibid* p 13.

A business model that relies so heavily on consumers paying a penalty in the form of a late fee is a cause for concern.

## **2.2 Financial Counselling Australia December 2021 Report**

More recent data from the financial counselling sector reinforces the research from ASIC, demonstrating that harm from BNPL is becoming more widespread in Australia. In December 2021, FCA released a report on a survey of financial counsellors across Australia.<sup>20</sup>

The findings indicate that BNPL debt is growing rapidly in the case work of financial counsellors, often as an additional debt on top of other forms of credit such as credit cards and personal loans.

The infographic on the next page summarises the report.

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<sup>20</sup> It's Credit, It's Causing Harm and It Needs Better Safeguards: What Financial Counsellors Say About Buy Now Pay Later, Financial Counselling Australia, December 2021.

<https://www.financialcounsellingaustralia.org.au/docs/its-credit-its-causing-harm-and-it-needs-better-safeguards-what-financial-counsellors-say-about-buy-now-pay-later/>.

# What Financial Counsellors Say about **Buy Now, Pay Later**

In October 2021, 248 financial counsellors completed a survey about their casework experiences of **Buy Now, Pay Later** providers. This is a 25% response rate.



**Buy now, pay later debt is rapidly growing** – 84% of financial counsellors said that about half, most or all of their clients had BNPL debt at the time of the survey. **A year ago, this figure was just 31%.**



**Buy now, pay later debt is contributing to financial stress** – 61% of respondents said most or all clients with BNPL debt are experiencing financial stress because they have become overcommitted with BNPL debt.



**Industry hardship practices are falling short** – clients and financial counsellors are facing significant challenges when addressing hardship with companies.



**Buy now, pay later is being used to cover essential day-to-day costs** – examples include groceries, medication, and utility bills.



**Buy now, pay later needs to be regulated to safeguard people** – 95% of financial counsellors said BNPL should be covered by the National Credit Code. This would reduce unsafe lending and overcommitment.



### **3. The Australian Self-Regulatory Code is Inadequate**

#### **3.1 How the Australian Code fits into the regulatory landscape**

As noted above, the BNPL industry in Australia has developed a Code of Practice (Australian Code) through their peak body, the Australian Finance Industry Association (AFIA). The Code came into effect on 1 March 2021.

The Australian Code falls well short of what consumers should expect in terms of safeguards and rights when dealing with BNPL. While it is technically correct that the Australian Code goes above the law that applies to BNPL, this is an exceptionally low bar given that consumer credit laws do not apply to BNPL.

Consumer Action, Financial Counselling Australia and other consumer advocacy groups in Australia engaged with AFIA in the development of the Australian Code and provided feedback on draft versions,<sup>21</sup> as we do with numerous industry codes. Unfortunately, most of our feedback was not taken on board.

There were no formal requirements imposed on AFIA and the BNPL sector by any government source in developing the Australian Code. The BNPL sector may have been encouraged to develop a code by the Australian Government, but industry has complete discretion on what the Australian Code actually says and does. Additionally, it has not gone through any formal government approval process, unlike other Australian financial services industry codes.<sup>22</sup>

We point out the substantial holes in the Australian Code below as a warning of the likely outcome of industry self-regulation and to support the case for legislated proportionate regulation that can effectively mitigate consumer detriment. The Australian Code appears to be doing little to reduce the rate and severity at which BNPL debts contribute to financial hardship.

#### **3.2 Not compulsory**

Perhaps the most glaringly obvious hole in the Australian Code is that it is entirely optional. There are currently eight BNPL providers that are AFIA members and have signed up to the Code and publicly committed to be held to it. While they may represent a majority of sales in the market, this is only around half of the existing BNPL providers.<sup>23</sup> The Code has no application whatsoever to BNPL providers that are not signatories.

#### **3.3 Providers can offer credit without affordability assessments**

The Australian Code's biggest shortcoming in terms of preventing financial hardship is the absence of any obligation on signatories, for the vast majority of BNPL products, to make any assessment as to whether the borrower can afford to repay the amount borrowed.

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<sup>21</sup> See, for example: <http://consumersfederation.org.au/wp-content/uploads/2020/05/20200506-FINAL-Submission.pdf>.

<sup>22</sup> For example, the Australian Banking Association submitted its Banking Code of Practice to ASIC for approval when it was last reviewed.

<sup>23</sup> <https://www.ibisworld.com/au/industry/buy-now-pay-later/14769/> This report found that 17 BNPL providers were operational in Australia in April 2021.

Clause 11 of the Australian Code's title refers to a commitment to make sure BNPL products are suitable for customers. Unfortunately, in substance, clause 11 is nothing more than an impressive exercise, taking over two pages, to say that BNPL providers need not do anything substantial except verify the identity of a customer before approving them for a line of credit up to \$2,000. If this relates to an existing customer of the BNPL provider, this limit is extended to \$3,000. This covers the lion's share of BNPL product structures and users.

Clause 11.3 contemplates BNPL providers undertaking an upfront assessment process and speaks about ensuring customers are not vulnerable and being satisfied with the information obtained about the customer. However, a close reading indicates these requirements do not actually require any specific action of the BNPL provider. In terms of affordability, customers need only be capable of making an initial payment upfront, and they are deemed appropriate borrowers.

Many BNPL providers promote the absence of any affordability assessment or credit check whatsoever in their marketing campaigns, and it is part of what makes BNPL so easy to access. This only changes if the BNPL provider is lending over \$2,000 (or \$3,000 to an existing customer) – at which point the Australian Code can be satisfied simply by an external credit check – to approve any amount up to \$15,000.<sup>24</sup> Only when approving BNPL transactions over \$15,000 are Code subscribers required to undertake any actual assessment of the finances of the customer.

This is in direct contrast to forms of equivalent regulated credit captured under the NCCPA, the key consumer protection regulation in Australia for credit. Under the NCCPA, credit providers must assess and verify the income and expenses of any prospective borrower and ensure the credit product is 'not unsuitable' before advancing them the credit (known in Australia as 'responsible lending'). The Australian Code goes to lengths to avoid establishing any obligation to lend responsibly.

This is a gaping hole in the Australian Code, and it is the main reason that it does little to nothing to reduce or prevent BNPL products sold under the Code contributing to financial hardship.

### **3.4 Lack of Meaningful Enforcement Powers**

A further shortcoming of the Australian Code is that the incentives for BNPL providers to comply with the meagre consumer protections it contains, are lower than under the consumer credit laws BNPL is designed to avoid. If a BNPL provider is found to have breached the Australian Code, they are only required to take the necessary action to fairly reinstate the consumer. The committee overseeing the Australian Code has sanction powers, but they are weak.<sup>25</sup>

In terms of financial penalty, the committee's powers are limited to requiring the BNPL provider to undertake a commercially reasonable rectification process. There may also be costs involved if directed to undertake a compliance review, but nothing beyond that is necessary to identify the extent of the provider's non-compliance. All other sanctions only pose reputational risk for the BNPL provider, such as a notice of non-compliance being published. To date, we are not aware of any outcomes of inquiries, investigations or compliance activities of the committee overseeing the Australian Code.

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<sup>24</sup> The Aus BNPL Code also allows BNPL providers to determine suitability with an assessment of the income and expenses of the borrower for amounts between \$2001-\$15,000, but the credit check appears to be the more commonly used option in these circumstances : see clause 11.5 and 11.12.

<sup>25</sup> Australian Code, clause 10.9.

In contrast, consumer credit laws have teeth, because they carry significant financial penalties if breached, and provide stronger protections that can be relied upon by consumers in external dispute resolution. BNPL services are capable of causing equivalent harm to individuals, and there is no reason their providers should not face the same penalties as other credit providers when they breach community expectations.

## **4 Identified Risks with Unregulated BNPL**

### **4.1 BNPL providers are blind to financial hardship**

Financial hardship is unlikely to be visible to BNPL providers. While BNPL providers generally consider people making their BNPL repayments to be appropriate users of their product, these people may still be experiencing significant financial hardship.

The inadequacy of the BNPL's approach to identifying financial hardship is evidenced by the vast discrepancies in the rates of hardship the industry has reported in Australia compared with those identified from other sources. For example, in 2020 AFIA told an Australian parliamentary committee that the incidence of hardship requests across the industry was less than one per cent.<sup>26</sup> This runs counter to the ASIC research from 2020, noted above, which found one in five users were experiencing harm.

As well, in the experience of financial counsellors, BNPL providers can be difficult to contact and do not respond appropriately to requests for financial hardship assistance. In the Financial Counselling Australia Report, financial counsellors were asked to rate the BNPL providers that they dealt with frequently, using a scale of 1 – 10, where 1 is the worst rating and 10 the best. Of the four providers rated, the ratings were: Afterpay 5.9, Zip 5.5, LatitudePay 5.2 and Humm 4.7. These ratings indicate the industry has a long way to go to improve hardship responses.

### **4.2 The model incentivises prioritising BNPL repayments**

While the approach of BNPL providers to freeze the accounts of customers who have missed payments and increase the spending limits of customers only in response to good payment history is described by industry as a mechanism for reducing financial hardship, there is data that suggests it can also encourage consumer behaviour that leaves them worse off. This is consistent with the observation in ASIC's 2020 report that customers use credit cards to pay their BNPL instalments.<sup>27</sup>

In November 2021, the Commonwealth Bank of Australia provided data to a Federal parliamentary committee that indicated their customers who use BNPL products were 50-100% more likely to overdraw their transaction account, or fall behind on repayments.<sup>28</sup> Where 7.2% of customers with BNPL accounts had overdrawn their account, only 3.9% of similar customers without BNPL accounts, had done the same.

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<sup>26</sup> Senate Select Committee on Financial Technology and Regulatory Technology, *First Interim Report*, September 2020, at 8.63. Available at: [https://parlinfo.aph.gov.au/parlInfo/download/committees/reportsen/024366/toc\\_pdf/SelectCommitteeonFinancialTechnologyandRegulatoryTechnology.pdf;fileType=application%2Fpdf](https://parlinfo.aph.gov.au/parlInfo/download/committees/reportsen/024366/toc_pdf/SelectCommitteeonFinancialTechnologyandRegulatoryTechnology.pdf;fileType=application%2Fpdf).

<sup>27</sup> Buy now pay later: An industry update, ASIC, *Report 672*, p 17. <https://asic.gov.au/media/5852803/rep672-published-16-november-2020-2.pdf>

<sup>28</sup> <https://www.businessinsider.com.au/commonwealth-bank-bnpl-regulation>.

A similarly concerning trend was highlighted in the Financial Counselling Australia report, with many financial counsellors indicating that they had clients who prioritised their BNPL repayments over other essential expenses. The BNPL model can create an additional incentive for consumers to make their BNPL repayments – it keeps their account open, and can lead to purchase limit increases. This is reminiscent of practices in the credit card industry, since banned in Australia, where banks provided unsolicited credit card limit increases. In contrast, some BNPL providers automatically increase a consumer’s BNPL limit.

#### **Case Study – Donna’s story**

Donna (name changed) is a single mother of three living in regional Victoria who works part time and receives a variable income. Donna contacted the National Debt Helpline in March this year because she was struggling to manage debts accrued from utility bills, a car loan, a credit card, insurance and multiple BNPL debts. The BNPL debts were all with companies subject to the BNPL Code.

Donna told us that she had recently obtained a loan from a third tier lender to pay off the credit card and some of her BNPL debts, because she was struggling to meet the repayments. Initially, Donna indicated that she was comfortable with her remaining BNPL debts. In the following months while we were assisting Donna negotiate some of her debts, she informed us that she was struggling for money and had been using BNPL to pay for food, and had to take out other short-term credit to pay for her daughter’s living expenses (which was likely provided in breach of credit laws).

Donna had high credit limits for BNPL products. At one point she owed \$2,000 to one major BNPL provider, nearly another \$2,000 to another BNPL provider, with a similar amount owing to the same provider via regulated credit as well. She likely had high BNPL credit limits because she had consistently made her repayments, which disguised her financial hardship. The reality was that she couldn’t afford the repayments with her other debts and was using these services to pay for essentials.

Donna is still paying off her BNPL debts, but has told us she cancelled one of her BNPL accounts. We have sought to assist her to negotiate the debt with the other BNPL provider, but this is difficult because so few laws apply to BNPL. Initially, the BNPL provider refused to provide Consumer Action with any documents regarding the BNPL debt (a likely breach of the BNPL Code). The BNPL provider described the BNPL facility as ‘not regulated’.

### **4.3 Late fees more likely**

One other obvious way BNPL contributes to financial hardship is through the fees charged for missed payments. The risk of this occurring is greatly exacerbated where BNPL providers do little to assess whether the customer has the capacity to repay the debt in the first place. If a person cannot afford the repayments, they are set up to fail, and inevitably will incur late fees that mean they pay more for their purchases. These fees are more likely to be incurred by precisely the people who should not have been signed up to additional credit in the first place.

#### 4.4 No detailed approval process increases risk of vulnerabilities being missed

##### Case Study – Sophia’s story

Sophia called the financial counsellors at Consumer Action in June 2021. Sophia told us that she is very overwhelmed and is a survivor of family violence. She has approximately \$30,000 in debts, including a car loan, BNPL debt and 3 credit cards all in her name but incurred by her ex-partner. The BNPL debt is approximately \$4,000 and she originally took it out for dental bills. However, Sophia’s ex-partner has repeatedly used the account to buy things and does not make repayments. Sophia has now received a default notice from the BNPL provider.

Under the NCCPA, regulated credit providers must ensure any credit product sold is appropriate to the requirements and objectives that have caused the consumer to seek credit. This process provides a valuable point at which credit providers can identify vulnerabilities of a consumer. When done correctly, making the necessary inquiries as to the purpose of the credit can help identify red flags that may indicate financial abuse. Coerced debt is a common factor in the inability for victim/survivors of family violence to leave a violent or abusive relationship to re-establish their lives.

As noted above however, the Australian Code effectively allows BNPL providers to lend up to \$15,000 while being oblivious to the reason for which their customer is using the funds. This makes it the easiest form of commonly available credit that can be used to perpetrate financial abuse.

Obviously, a product that almost exclusively involves remote transactions may have limits on the extent to which it can be used to proactively identify financial abuse. However, this distinction with BNPL from regulated credit is one clear situation where BNPL makes accessing credit, and loading someone else up with the debt, even easier.

#### 4.5 Returning products

BNPL providers do not have obligations to assist their customers if there are problems with an item or service purchased using a BNPL product, despite being the intermediary between purchaser and retailer. It also means that by using BNPL, people have fewer rights or options available to them than if they used an alternative payment method, such as a credit card that has a chargeback option.

There is already one example of the impact this can have in a published decision by the Australian Financial Complaints Authority (AFCA), Australia’s external dispute resolution service for financial services.<sup>29</sup> In that case, a customer used an Australian Code signatory’s service to make a purchase, but within a week sought a refund as he found the product was faulty. The retailer apparently initially agreed to refund him, then reneged. Despite the BNPL provider having a relationship with the retailer, they indicated they could not help and continued to seek payment. The customer disputed the payment at AFCA and was unsuccessful, eventually being charged an additional 23% of the purchase price in late fees, as well.<sup>30</sup>

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<sup>29</sup> One of the few substantial benefits to the Aus BNPL Code is that it requires members to become members of AFCA – which is otherwise not compulsory for BNPL providers. However, as the Discussion Document already indicates that BNPL providers are required to make external dispute resolution available to customers, we assume it would provide little value in New Zealand.

<sup>30</sup> <https://service02.afca.org.au/CaseFiles/FOSSIC/711283.pdf>

## 4.6 Questionable Marketing and Advertising

While the Australian Code contains a commitment that advertising and promotional material will be clear and not misleading and deceptive, BNPL providers in Australia continue to try and differentiate themselves from the provision of credit, and in a way that appeals to young people in particular.

A recent report from Newcastle University (in New South Wales, Australia) found that young people in particular did not initially recognise that using BNPL was using credit – with this realisation only coming after they struggled to make repayments.<sup>31</sup>

BNPL websites and apps clearly include marketing materials aimed at associating their products with aspirational lifestyles that would not otherwise be available, and use technology to personalise the experiences for consumers. BNPL product app interfaces and tools also replicate the experiences of a digital game, giving people a sense of control and using rewards or positive reinforcement.

## 4.7 BNPL can be a high cost option

One of the myths surrounding BNPL is that it is an inexpensive form of credit. This is not true and depends on how the product is used. For the portion of people that pay fees, the cost of BNPL can be equivalent to that of high cost credit cards. For smaller amounts, the cost can be even more.

The example below, based on the Afterpay business model shows this.<sup>32</sup> The example assumes that the consumer pays a late fee on all of the payments.

Transaction amount	\$100
Late fees	\$10 for the initial late fee, with \$7 charged every 7 days if the debt remains due. Late fees are capped at 25% of the original purchase amount.
Timeframe	“Shop now and pay over 6 weeks”.

The quasi-annual interest rate for the example above is 25%.<sup>33</sup>

If a BNPL provider charges both late fees and monthly account keeping fees, the quasi-annual interest rates are much higher.

## 4.7 Fees are not transparent

The calculations above are based on what we understand are the late fees charged by Afterpay in the US. These fees are not clear on the actual Afterpay website in the US<sup>34</sup> nor in Australia. On the

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<sup>31</sup> Farrugia, D., Cook., J Senior, et al., *Young people, debt and consumer credit pilot study report*, 2021, University of Newcastle, <https://nova.newcastle.edu.au/vital/access/manager/Repository/uon:38627>

<sup>32</sup> <https://www.investopedia.com/afterpay-review-5189707>

<sup>33</sup> Effective annual interest rate =  $(1 + i/n)^n - 1$ , where  $i$  = nominal interest rate,  $n$  = number of compounding periods.

<sup>34</sup> <https://www.afterpay.com/en-US>

Australian website, the only place we could find information about fees was in the FAQ section.<sup>35</sup> In Australia, about 10% of the company's revenue is from late fees.

We have not conducted a similar analysis of the websites for other BNPL providers, but it is a concerning practice if the fees they charge are not transparent.

#### **4.9 Other concerning practices**

There are a range of different BNPL business models and concerning practices in BNPL in Australia and we expect there are similar problems in the US.

- A number of BNPL providers market BNPL for purchases of between \$15,000 - \$30,000. The first business models with these larger limits were for roof top solar panels, batteries and home renovations.<sup>36</sup> You can now however also use BNPL for health care, including cosmetic surgery;
- BNPL can be used to purchase fractional property investments.<sup>37</sup> This is a complex investment product at the best of times;
- BNPL can be used to purchase alcohol while a person is out drinking.<sup>38</sup> Alcohol is an addictive product for some people;
- BNPL providers encourage people to use it for household bills, such as electricity, and everyday living expenses, such as groceries. Using credit for day to day expenses can be a recipe for disaster. As well, people struggling to pay these expenses generally have other options such as accessing energy retailer hardship programs;
- BNPL debts being paid from credit cards;
- Financial counsellors report more and more people with multiple BNPL accounts and payments. This actually makes it harder to manage money.

## **5 Ways to improve the BNPL market – appropriate regulation**

The most effective way to improve the BNPL market is for it to be appropriately regulated with requirements that:

- require BNPL providers to assess whether a person can afford to repay any initial credit limit, as well as any increases in the initial limit. This assessment must be based on their financial position;
- prohibit unsolicited credit limit increases;

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<sup>35</sup> <https://help.afterpay.com/hc/en-au/articles/218320423-Is-Afterpay-really-interest-free-Is-there-a-catch->

<sup>36</sup> See for example: Brighte ([www.brighte.com.au](http://www.brighte.com.au)), Openpay ([www.opy.com.au](http://www.opy.com.au)), Payright ([www.payright.com.au](http://www.payright.com.au))

<sup>37</sup> See Bricklet ([www.bricklet.com.au](http://www.bricklet.com.au))

<sup>38</sup> <https://thenewdaily.com.au/finance/finance-news/2021/11/09/afterpay-pubs-alcohol/>

- require BNPL providers to make reasonable inquiries about the purpose for which their customers are seeking a line of credit through their product;
- require BNPL providers to record BNPL limits in the credit reporting system;
- limit the cost of late fees that can be charged to a customer (the level will need further analysis, but should relate to reasonable quasi interest rates);
- require BNPL providers to respond to financial hardship appropriately;
- have processes to allow consumers to charge back transactions where there are disputes about the goods purchased;
- are members of an external dispute resolution scheme;
- ensure that financial penalties that are already part of consumer credit laws apply equally to the sale of BNPL products, where relevant.