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11 August 2020

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Senior Manager, Financial Services Group
Australian Securities and Investments Commission
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By email: product.regulation@asic.gov.au

Dear [redacted]

ASIC's Consultation Paper 330: Using the Product Intervention Power: Continuing Credit Contracts

The Australian Finance Industry Association (AFIA) welcomes the opportunity to provide a submission in response to ASIC's Consultation Paper 330 (CP 330), where it proposes the use of ASIC's product intervention powers to address significant consumer detriment arising from continuing credit contracts issued to retail clients.

AFIA represents over 100 providers of consumer, commercial and wholesale finance in Australia including retail banks, finance companies and fintechs, including Buy Now Pay Later (BNPL) providers. Our members provide innovative consumer products and specialised finance to meet small to medium enterprises (SMEs) working capital, cashflow and investment needs. For more information about AFIA, please see **Attachment A**.

AFIA BNPL members represent over 95% of the BNPL market, include, Afterpay, Brighte, flexigroup, Klarna, Latitude, OpenPay, Payright and Zip Co.

AFIA's role as an industry body is to drive industry leadership and represent members' views, facilitate self-regulation through industry codes, and to work with the Federal Government, financial regulators, and other stakeholders to promote a supportive environment for the financial services industry.

OUR SUBMISSION

Our submission focuses on the importance of the appropriate application of ASIC's proposed use of its product intervention power to continuing credit contracts, ensuring it is applied to address the "concerning conduct" identified[1] that limits the total fees that can be charged, and not in a manner that

[1] https://download.asic.gov.au/media/5670099/cp330-published-9-july-2020.pdf , paragraph 16.

would potentially limit continuing credit contract models that are beneficial to consumers, and have not been identified by ASIC as resulting in, or likely to result in significant detriment.

We note that ASIC is concerned that the continuing credit products issued by Cigno and BHF Solutions Pty Ltd (BHFS)) are likely to result in significant detriment due to borrowers incurring a very high cost, relative to the loan amount. ASIC is also concerned that continuing credit products are being issued to vulnerable clients, including many whom are already in financial difficulty.

We note that the proposed product intervention order intends to prevent continuing credit providers and associated services providers from relying on subsection 6(5) of the National Credit Code (NCC) when the combined costs associated with the credit facility (provided by the credit provider) and the associated collateral service delivery (provided by the associate), significantly exceed NCC exemption limits.

We understand from our conversations with ASIC that the focus of this product intervention order is to specifically address conduct from the identified entities (Cigno and BHF Solutions Pty Ltd (BHFS)), and effectively deal with similar conduct identified in ASIC's product intervention order regarding short term credit made on 12 September 2019[2]. Further, we understand that ASIC is seeking a broader application of this product intervention order to avoid a manifestation of the same type of conduct, and to avoid 'phoenix' type activity occurring under different structures.

In principle, we support ASIC's proposal to impose a cost cap on the total fees that can be charged under continuing credit contracts targeted at low income/unemployed retail clients. It will be important that when determining the design of the product intervention order, ASIC ensures it will only apply to restrict "concerning conduct" of the nature identified, and would not capture other types of business models (like Buy Now Pay Later) where there has been no resulting significant detriment, or likelihood of significant detriment found.

We believe that it is important for competition and innovation to be driven through market forces and customer demand, supported by evidence-based policy. Regulation should be used to foster an appropriate environment in the advent of a market failure or when interventions are required to achieve optimal outcomes for customers, businesses, the financial system, and the broader economy, and where those interventions are deemed economically necessary and beneficial.

KEY RECOMMENDATION 1 – THE PRODUCT INTERVENTION ORDER SHOULD BE LIMITED TO CONTINUING CREDIT CONTRACT MODELS IDENTIFIED IN CP 330, AND SHOULD NOT INADVERTENTLY INCLUDE OTHER CONTINUING CREDIT CONTRACT MODELS LIKE BNPL

We note that ASIC will look to make a market-wide order when seeking to address a practice that is relatively widespread or, even if the practice is not currently relatively widespread, there is a risk the practice will be 'phoenixed' or it is one that could be adopted by others[3].

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[2] https://download.asic.gov.au/media/5268222/product-intervention-order-notice-12-september-2019.pdf

[3] https://download.asic.gov.au/media/5633261/rg272-published-17-june-2020.pdf , at page 9.

We understand that ASIC's concern is with the risk that the practice will be 'phoenixed' due to the continuing credit contract model as identified in CP 330 raising similar concerns to the conduct ASIC identified when making its product intervention order on short-term credit in September 2019.

We note that CP 330 raises concerns that the identified continuing credit contracts are issued in a way that:

a) Does not give retail clients access to external dispute resolution schemes such as AFCA;
b) Is without a credit licence, which means retail clients do not have the consumer protections under the National Credit Act;
c) Is without properly testing whether retail clients can afford the repayments, as the providing entities do not appropriately consider the expenses of each retail client;
d) Has high fees payable on default, which creates a financial incentive to potentially offer credit to retail clients who are unable to meet repayments; and
e) Results in further financial hardship due to the high cost compared to the amount of credit provided[4]

It is important that ASIC distinguishes this type of conduct under the continuing credit contract model, as different from other continuing contract models, such as BNPL.

Many of AFIA's BNPL members rely on the continuing credit contract exemption to provide a simple, convenient, innovative and affordable way to pay for products and services.

The importance of product design in ensuring good outcomes for consumers is highlighted by the business models of BNPL providers. All BNPL providers currently cap their late fees at low levels, do not charge interest, and prevent customers from further spending if they miss a payment. This means a customer cannot lose control of their spending using BNPL products or enter a BNPL debt spiral.

As a result, BNPL products are unlikely to result in the significant consumer detriment that has been identified by ASIC in CP 330. illion and AlphaBeta have provided market data[5] indicating that BNPL products have held up well during the COVID-19 crisis due to the consumer friendly and simple nature of the product. Furthermore, the product is used as a budgeting tool with customers using their cash in smart ways. This has resulted in a significant uptake across all income and age brackets[6] and has coincided with an acceleration away from credit cards and towards debit cards and payments methods based around customers' own funds.

The recognition of BNPL products being used as a financial management or budgeting tool was also recognised in ASIC Report 600, where it noted that BNPL providers take steps to help consumers stay

[4] https://download.asic.gov.au/media/5670099/cp330-published-9-july-2020.pdf, at paragraph 20
[5] http://www.alphabeta.com/illiontracking?utm_source=illion&utm_medium=email&utm_campaign=real-time-economic-tracker
[6] http://www.smh.com.au/business/the-economy/strapped-for-cash-coronavirus-is-changing-the-way-we-pay-20200505-p54q3y.html

in control and make informed decisions about their purchases and repayments through notifications, online accounts, and mobile apps.[7]

The introduction of AFIA's BNPL Code of Practice, a world-first, will impose requirements that go above and beyond the existing legislation to introduce additional consumer protections, while ensuring competition and innovation across the BNPL sector[8].

Under the AFIA BNPL Code (currently in draft and being finalised), all code compliant members will be required to join the Australian Financial Complaints Authority (AFCA) - we note that all AFIA BNPL members are already voluntary members of AFCA. While the Code has not yet formally taken effect, BNPL providers have already incorporated many of the Code's commitments in their business models. As noted below, this is ensuring that consumer outcomes remain positive, particularly during COVID-19.

We note that ASIC is also concerned that the significant detriment ordinarily resulting from the issue of continuing credit contracts may be further exacerbated by the current economic situation, as a result of the COVID-19 pandemic. Consistent with other parts of the financial services industry, AFIA BNPL providers initially experienced a spike in hardship requests in March and April 2020, including from consumers who proactively contacted them concerned about possible changes to their financial situation. Since then, requests for hardship assistance have fallen to around pre-COVID levels across the BNPL sector, despite a significant increase in transaction activity in the BNPL sector during the COVID-19 crisis. By continuing to provide easily accessible and flexible solutions for their customers, there has been no increase in long-term customer assistance or in the volume of AFCA complaints received.

The growth of BNPL during COVID-19 and the positive trend in terms of low complaints and request for hardship assistance relative to total volume of transactions continues to demonstrate the value that these products provide to customers. Furthermore, the BNPL sector has been underpinning retail businesses in Australia and helping these businesses through the COVID-19 crisis.

As a new fintech, the BNPL sector recognises the importance of establishing best practices and setting high standards, to ensure the appropriate balance between consumer outcomes and preserving customer choice to make purchases and payments in a way that suits their needs.

As a result, of the above, we recommend that ASIC provides certainty that BNPL continuing credit contract models are not inadvertently captured by this product intervention order, in order to not negatively impact on the broader economy or limit access to credit.

It is important that ASIC provides further clarity in the proposed product intervention order, that the purpose of the order is to stop practices that were subject to a previous product intervention order from

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[7] ASIC, *Report 600: Review of buy now pay later arrangements,* December 2018, available at http://download.asic.gov.au/media/4957540/rep600-published-07-dec-2018.pdf paragraph 138

[8] https://static1.squarespace.com/static/598589963e00bec843be0ea1/t/5ec227afac35107c14f4708d/1589782450600/Media+Release+-+BNPL+Code+180520+-+Final.pdf

being "phoenixed" or adopted by others, and are not seeking to address a practice in continuing credit models that is relatively widespread.

AFIA believes it is critical that, as part of the ongoing response and economic recovery phase to the COVID-19 crisis, the Government continues to support the growth of the BNPL sector and does not stifle competition and innovation in the financial services industry. This includes promoting competition within the payments and credit industry, for example, by not restricting the use of BNPL products.

KEY RECOMMENDATION 2 – CONTINUING CREDIT CONTRACTS REGULATED UNDER THE NCC AND THE AFIA BNPL CODE SHOULD BE SPECIFICALLY EXCLUDED

We note that the proposed product intervention order is intended to apply to continuing credit providers and associated service providers that purport to satisfy the exemption requirement under subsection 6(5) of the NCC.

However, the limitation on the fees and charges that can be charged is not limited to continuing credit contracts relying upon the section 6(5) exemption but applies to *any* (emphasis added) continuing credit contract. In effect, the limit on the fees and charges in this proposed draft intervention order would apply to any continuing credit contract, irrespective of whether the continuing credit contract was relying upon on the Section 6(5) exemption or was regulated under the NCC.

We recommend that Section 5(1) is amended so that the product intervention order will only apply in circumstances where the continuing credit contract is purporting to rely on Section 6(5). This will avoid the unintended consequence of continuing credit providers offering both a NCC regulated continuing credit product and an unregulated continuing credit product from having the product intervention order inappropriately applied to its NCC regulated continuing credit product.

Further, we recommend that ASIC specifically excludes code subscribers to the AFIA BNPL Code from the product intervention order. With the AFIA BNPL Code being contractually enforceable through AFCA by consumers, as well as enforced through the independent Code Compliance Committee, the Code will achieve the same effect as NCC regulation in terms of preventing consumer detriment.

KEY RECOMMENDATION 3 – ASIC TO CLEARLY DEFINE THE TERM 'ASSOCIATES' AND THE TYPE OF 'COLLATERAL CONTRACTS' THE PRODUCT INTERVENTION ORDER INTENDS TO CAPTURE AND NOT INADVERTENTLY CAPTURE RETAIL MERCHANTS

As currently drafted, there is concern that the proposed product intervention order may unintendedly capture retail merchants as 'associates' – in particular if the term 'associates' take on the definition as prescribed under Section 15 of the *Corporations Act 2001* – see below.

Under Section 15 of the *Corporations Act 2001*, the definition of associate includes a reference to:
(1) The associate reference includes a reference to:
(a) a person in concert with whom the primary person is acting, or proposes to act; and

(b) *a person who, under the regulations, is, for the purposes of the provision in which the associate reference occurs, an associate of the primary person; and*

(c) *a person with whom the primary person is, or proposes to become, associated, whether formally or informally, in any other way;*

in respect of the matter to which the associate reference relates.

(2) If the primary person has entered, or proposes to enter, into a transaction, or has done, or proposes to do, any act or thing, in order to become associated with another person as mentioned in an applicable provision of this Division, the associate reference includes a reference to that other person.

We note that most BNPL providers give customers the ability to apply for their BNPL product through a merchant (in most cases, through the merchant's website). Therefore, in the event retail merchants were considered to be 'associates' under the product intervention order and the finance was under a BNPL continuing credit contract, the sale contract between the consumer and the merchant could be seen as a "collateral contract". We believe that this would have unintended consequences, mainly with the merchant's fees and charges potentially going towards the calculation of the maximum charge under Section 6(5) (i.e. $200 for the first 12 months and $125 for any subsequent period of 12 months thereafter).

We recommend that ASIC clearly defines "associate" so that it will not inadvertently capture retail merchants. Further, we recommend that ASIC provider further guidance as to what a "collateral contract" is, and that it specifically excludes sale contracts between a consumer and retail merchant when financed by a BNPL provider.

KEY RECOMMENDATION 4 – LATE PAYMENT FEES SHOULD BE SPECIFICALLY EXCLUDED FROM THE CAP ON FEES AND CHARGES IMPOSED FOR THE PROVISION OF CREDIT

We believe that the drafting of the condition in Section 5(5)(a) should be amended to better align with Section 6 of the NCC. The way it is currently drafted, could mean that the cap would *include* (emphasis added) fees and charges such as late payment fees.

We recommend that the wording of Section 5(5)(a) is amended to be consistent with the exemption in section 6(5) of the NCC, and is therefore limited to *only* apply to the fees and charges that may be imposed or provided *for providing the credit*, and should specifically exclude fees which are not imposed or provided for providing the credit, such as late fees.

CONCLUDING COMMENTS

By adopting our recommendations, we believe that policy settings would be more appropriately balanced and may not unnecessarily impose practices that are unduly burdensome on business, so we continue to:

- Promote simple, convenient, innovative, and affordable credit to finance Australia's future, including maximising access to credit for customers able and willing to service their commitments and minimising the likelihood or incidence of customers entering unsuitable credit contracts

- Foster competition and innovation in Australia's financial services industry, which enables our members to grow, expand and thrive as key participants in the lending market and other markets, and
- Generate greater financial and economic participation by consumers and small businesses in Australia's financial system and economy, and social participation to create financial wellbeing

This is even more important in a post COVID-19 environment where the focus needs to be on accelerating job creation and growth opportunities so as to fast track the broader economy.

We would appreciate the opportunity to discuss our recommendations and provide further feedback in a meeting with ASIC. Should you wish to discuss our submission or require additional information, please contact me or [redacted], Associate Director, Policy at [redacted] or [redacted]

Yours sincerely,

[redacted]

[redacted]
Chief Operating Officer
Executive Director, Policy and Risk Management