



10 February 2020

Head of Payments Policy Department
Reserve Bank of Australia
GPO Box 3947
Sydney NSW 2001

By email transmission: PYSubmissions@rba.gov.au

Review of Retail Payments Regulation: Issues Paper November 2019

Zip Co Limited ('Zip') welcomes the opportunity to provide a submission to the Reserve Bank of Australia ('RBA') on Review of Retail Payments Regulation ('Issues Paper').

Zip is an ASX-listed company and a leading player in the digital retail finance and payments industry. Zip offers point-of-sale credit and digital payment services predominantly to the retail, education, health and travel industries. It operates under the Zip Pay, Zip Money and Pocketbook brands in Australia. Zip has a presence in Australia, New Zealand, and the United Kingdom.

Zip is focused on offering transparent, responsible and fairly priced consumer credit and payment solutions. From day one, Zip has conducted credit and identification checks on all of its customers. Its platform is entirely digital and leverages big data in its proprietary fraud and credit decisioning technology to deliver real-time consumer responses. As a result of Zip's focus on its proprietary platform, Zip's customer performance, delinquency and bad debt rates are considerably better than market comparables.

This submission provides Zip's position on why any form of regulatory intervention into the commercial arrangements that 'Buy Now Pay Later' ('BNPL') providers have with their merchants is not needed or appropriate. The submission is limited to information Zip considers pertinent for the RBA to review as part of its consultation process with specific regard to surcharging. For this reason, the submission is not structured to respond to each individual question posed in the Issues Paper.

ZIP'S SUBMISSION

Since the early 2000s, as part of its responsibilities to promote efficiency and competition among payment systems, the RBA has developed and refined a regulatory framework for card payment systems through engagement, implementation and review. Initially reforms required card schemes to remove the prohibition on surcharging from scheme rules, effectively allowing merchants to provide price signals to consumers for more expensive card payment methods. The RBA reviewed and fine-tuned this framework in 2013 and again in 2015–2016, preventing the ability of excessive surcharging by merchants.



There are strong reasons against applying an analogous regulatory approach to BNPL providers who are emerging as competitors to the legacy card payment systems. For Zip specifically, these reasons are:

- a) The business model of Zip is fundamentally different to that of card payment providers. Zip provides a plethora of services to its merchants, and most importantly acts as a marketing and customer acquisition partner. It also provides significant commercial benefit by removing all fraud and chargeback risk for the merchant.
- b) There is no evidence to date that Zip, or more broadly BNPL products, are causing inflation to the cost of goods and services for consumers. The approach to surcharging and price signalling that now applies to the legacy card payment systems was necessitated by unique economic and marketplace circumstances which are not present in the BNPL sector.
- c) The BNPL sector is characterised by increased competition, low barriers to entry and innovation. These characteristics have not led to an increase in merchant service fee (as they historically did for the card payment systems).

In submitting its position, Zip welcomes this open dialogue and the opportunity to work with regulators and industry groups to ensure its products and services remain appropriate, valuable, and innovative for merchants and consumers alike.

Zip's Business Model

Zip is the conduit between merchants and customers, bringing both sides together for a fair and valued payments experience. Compared with established card payment providers, as a BNPL operator, Zip has a completely different business model and direct relationship with its merchants and customers.

In order for the business model to operate, Zip invests heavily in its product which delivers merchants significant volumes of new customer leads, increased conversions and average order values, and also significant bottom line value in providing protection against fraud and chargebacks. There is a strong business proposition behind Zip's merchant service fee ('MSF') which is not directly associated with the cost of processing a payment transaction. The value-add that Zip brings to its merchants' businesses is the heart of Zip's business model and the take up by both merchants and customers is evidence of the success of this.

Lead Generator

Approximately 70% of Zip's transaction volume is generated through ecommerce (online or through the app). Merchants with an ecommerce presence adopt a multi-pronged strategy in how they acquire customers. Service providers who offer similar or competing consumer acquisition services include Google, Facebook, Amazon, eBay and affiliate programs. These vendors provide the service at a cost to the merchant.

Zip provides a similar lead generation offering to its ecommerce merchants. Zip is a trusted partner for merchants as Zip drives new customer traffic, increased order value and higher conversion rates to its merchants. Similar to other lead generators like Facebook and Google, Zip charges a fee for this service. This MSF is an exchange for an important business value-add. Yet there is no discussion about how lead generation vendors are inflating prices for consumers or whether the fees they charge should be subject to a surcharge for customers coming to merchants via these channels.

Zip's Guarantee – No Fraud or Chargeback Costs

Fraud is highly prevalent with online and card-not-present transactions, resulting in high levels of fraud and chargeback risk, which result in significant costs or losses to merchants. Zip is a closed loop solution with high levels of inbuilt protection for fraud and security which provides a meaningful bottom line benefit to merchants. As a result of its investment in its platform, Zip is able to cover its merchants for ALL the fraud and chargeback liability. Card transactions offer no such protection to merchants for fraud or chargeback risks. This is a highly valuable service and benefit for ecommerce merchants. The cost of development and maintenance of this platform is not insignificant.

Further service offerings that Zip provides to merchants include;

- Zip's customer insight data, providing Zip merchants with access to Zip's customers and data capability, presenting valuable insights on customer behaviour and preference. This valuable information can be used by merchants to assist with understanding consumer behaviours, allowing them to drive customer volumes, increase the dollar amount of each transaction (increasing basket size), and gain insight on how their customers transact online and instore.
- Through Zip's product offering and investment in technology, Zip has acquired a broad customer base of 1.6M, inclusive of GenY (who statistically have not been adopters of the more traditional credit products). As Zip is a brand in its own right, merchants benefit from the synergies Zip provides from marketing campaigns which it executes to its customer base. Becoming part of Zip's closed loop, merchants gain access to an engaged customer base. This delivers and assists merchants with loyalty and repeat purchases.

Zip caters to the different commercial needs of each merchant. The MSF charged by Zip is a direct contractual fee that the merchant agrees to pay for all these services. To compare Zip's MSF to the fee that merchants are charged by the banks for processing card transactions is to grossly mischaracterise and undervalue the service offering that Zip provides its merchants and customers.

It is important to distinguish Zip's business model, and the BNPL business models more generally, to that of the legacy card payment systems. In the card payment systems, the merchant has a contractual relationship with the acquirer, not the card issuer. The acquirer is the middle person in the supply chain which only provides the payment processing services. In contrast, as outlined above, BNPL providers have a direct contractual relationship with merchants and provides acquiring services alongside marketing, customer acquisition, pipeline management software, and chargeback and fraud protection guarantee. A direct comparison between the scheme networks and BNPL sectors is not comparing a like for like, as it fails to consider the differences in the business models between the two sectors and what the MSFs represent in each distinct commercial relationship.

Card Payment Systems – Market Place Dominance

Unlike the legacy card payment systems, there is no data or marketplace conduct to date that warrants regulatory intervention in the form of prohibiting 'no surcharge' clauses in commercial contracts between BNPL providers and merchants.

In the early 2000s, the RBA identified what it classified as a marketplace distortion within the card payment systems which necessitated regulatory intervention.

Competition in the mature cards market led *'to the counterintuitive result of increasing the price of payment services to merchants (and thereby leading to higher retail prices for consumers)'*¹. Because cards were ubiquitous, merchants had no choice but to accept card payments, regardless of the fees charged by their acquiring bank. Card scheme rules prevented merchants from passing on these costs to the consumer. Merchants would wear the costs and incorporate them into their overall operational overhead, which ultimately resulted in the inflation in prices of goods and services to consumers.

The legacy card payment systems are very different to the emergent BNPL providers. A crucial pillar of the RBA's justification for regulatory intervention in the 2000s was that card payments were the dominant form of payment in the retail payments space. Even today, card payments remain by far the dominant form of payment method for retail payments. As the RBA noted, in 2018–2019, 10 billion debit and credit card payments were made with a total value of \$678 billion.² This dominant market position of card payments developed over decades.

The BNPL sector, in its current form, has only emerged over the last few years. While the BNPL sector has enjoyed rapid growth for consumers and merchants alike, a key point to note is that a significant proportion of BNPL transactions are online, with little penetration to date of instore payment volume. This demonstrates that BNPL, as a payment method, is still very immature.

It simply cannot be the case that in such a short space of time, with limited penetration of instore payments, that the BNPL sector is ubiquitous like card payment systems so that merchants are incorporating the cost of accepting Zip (or other BNPL providers) into the prices of goods and services they sell. Zip, and the BNPL sector more generally, have neither the market dominance nor the advantage of decades of entrenchment to have had such an impact on the pricing of goods and services.

However, *even if* this BNPL ubiquity had occurred, the RBA should consider whether merchants are justified in adjusting prices to account for the significant business enhancements Zip, and other BNPL providers, offer. Merchants make the considered choice to partner with Zip, not as a payment processing platform, but as a multifaceted partnership which provides customer leads, marketing tools, and guarantees for no fraud or chargeback losses. Like other business propositions, the choice to partner with Zip incurs operational costs in exchange for valuable services provided to the merchant.

Buy Now Pay Later - Competition, Innovation, & Diversity

The BNPL sector is characterised by competition, innovation and diversity. There is a variety of distinct BNPL arrangements (unlike the homogeneous legacy card payment systems) and the relationship between BNPL providers and their merchants is direct and tailored to each individual merchant.

Unlike the card payment systems where the lack of competition led to merchant detriment and market malfunction, current and new competition exerts downward pressure on the MSF and is a key driver to ensuring Zip provides real value-add to its merchants through innovation and diversity.

Zip operates in a closed loop arrangement where Zip has a direct commercial relationship with both the merchant and the customer. In this arrangement, there is no third party mandating or influencing what price Zip charges its merchants for the

¹ Reserve Bank of Australia, 'Review of Retail Payments Regulation: Issues Paper,' November 2019, pg 6.

² Ibid, page 1.

services it provides. Instead, the MSF is a matter of commercial negotiation between each merchant and Zip. The importance of the direct commercial relationship also means that when there is competition between BNPL providers, the merchant benefits as these providers must justify their value-add over their competitor and the merchant has negotiating power (unlike in the legacy card payment systems). Part of that process can result in a decrease in MSF in order to remain competitive. This position is supported by a decrease in Zip's average MSF from 2016 to 2019.

The multi-faceted relationship and value creation that BNPL providers offer to merchants is further demonstrated by merchants negotiating on other services (i.e. around brand exposure and marketing support rather than price) and having one or more BNPL provider offering. The latter shows that there are strong actual and perceived differences in BNPL offerings, which also results in different fees charged by each provider.

The increase in popularity of Zip's products and services for both consumers and merchants, as well as increased competition in the BNPL sector, have not incapacitated merchants from exerting downward pressure on Zip's MSF. This is very different to the legacy card payment systems, where merchants have no influence over the MSF. Thus, the BNPL sector encourages competition amongst market players to innovate, pivot and remain a profitable partner to merchants. This is clearly apparent in the significant difference in products and services that are offered by BNPL providers, demonstrating that a one size fits all approach is not at play in this sector. This is distinct from the card payment systems, where in the most part there is a homogenous product with similar offerings.

In the BNPL sector, low barriers to entry, competitive market forces, and innovative players have resulted in a great diversity of product offerings, services and business revenue models. While there are early players in the BNPL sector who have built substantial businesses, Zip included, there are low barriers to entry into this market. This is evidenced by the arrival of at least three new players into the Australian market in the last 12 months.

In the Australian Securities & Investments Commission ('ASIC') Report 600 - Review of buy now pay later arrangements ('Report 600'), two of ASIC's key findings were that the BNPL sector is rapidly growing, diverse and evolving industry. Zip has consistently supported appropriate regulatory oversight and engagement, however, the development of reforms should not be done in isolation of the marketplace the reforms are seeking to regulate. RBA intervention in the card payment systems, specifically the prohibition on 'no surcharge' rules, developed over time, after the card payment systems were well-established and with the benefit of years of data around card payment system dynamics (including pricing behaviour). In contrast, BNPL is an emerging competitive and diverse market. A one size fits all approach for surcharging that is appropriate for card payments is not an appropriate approach for the variety and developing range of BNPL offerings.

To regulate or intervene in the commercial relationship of the BNPL provider and merchant, without demonstrated cause, would be premature and detrimental. This is especially true when competition in the marketplace has seen decrease in fees for merchants. Mandating specific prohibitions in commercial contracts, at this early stage, would stifle innovation, undermine the ability of BNPL providers to provide choice to both merchants and consumers, and lead to less competition overall in the retail payments sector.

Going Forward - Continue To Monitor

At this time, Zip is of the view that allowing the BNPL sector to continue to grow and innovate for the short to medium term will see whether the market forces play out differently to that of the card payment systems, and whether banning 'no surcharge' terms is an appropriate measure for the RBA to consider.

By taking a monitoring approach, the RBA can engage fully with BNPL marketplace participants to better understand each providers' unique business model and how this differentiates the BNPL sector from the traditional card payment systems.

This approach of closely monitoring the BNPL sector and not inhibiting innovation has been embraced by other regulators. ASIC, in particular, is active in its monitoring of this sector. Report 600 was the result of ASIC's review of six BNPL providers during 2018. The culmination of ASIC's review and findings were that, in essence, it was too early for regulatory intervention, albeit close monitoring for both changes in the sector and any potential consumer harm was (and still is) considered warranted. ASIC is currently in the process of its second review and engaging closely with BNPL providers.

Zip recommends that the RBA adopt ASIC's approach in engaging with the sector to monitor and gauge the implications that BNPL products and services may have on the retail payments sector in terms of competition and efficiency.

Zip also supports RBA and ASIC engaging with one another to ensure regulatory oversight and monitoring is not duplicated, and that any consumer harm that is potentially identified may be addressed through established enforcement mechanisms.

Conclusion

Zip would be happy to engage further on this submission with the Reserve Bank of Australia. For more information contact Matthew Abbott on 0402 543 128 or matthew.abbott@zip.co

Yours faithfully,

Peter Gray
Co Founder, Executive Director and Chief Operating Officer,
Zip Co Ltd

ENDS