**Review of Retail Payments Regulation**

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This memorandum is to inform regulation and consumer advocacy legislation on retail payment systems conducted by the Reserve Bank of Australia. Specifically, we address Q1 and Q7 of the Retail payments regulation: Issues paper.

Typically, there are three ways that consumers can pay for their purchases of goods and services:

* Payment of cash;
* Payment through credit card;
* Use “buy-now-pay-later” (BNPL) services.

BNPL is recent innovation that has experienced phenomenal growth and popularity. These services allow consumers to make the purchase currently, and spread out their payments over a period of time, interest free. BNPL companies do not explicitly charge interest and they are thus not regulated under the National Credit Act.[[1]](#footnote-1) This legal loophole enables BNPL providers to operate without lending obligations such as performing a credit check or evaluating consumers’ ability to repay debt.[[2]](#footnote-2) However, these services do charge a late payment fine, should the consumer fail to make timely payments.

To understand the costs to consumers of using BNPL products from businesses such as Afterpay and Zip Pay, we need to understand their business model. Let’s look at the case of Afterpay, an industry leader in the BNPL sector. Its business model[[3]](#footnote-3) is to provide consumers with the ability to spread the cost of purchase to four subsequent payments of equal amounts, due every fortnight. Afterpay’s revenue comes from two sources: merchant fees (75% of total revenue in 2018) and late payment fees from delinquent customers (25% of total revenue in 2018). Afterpay charges the merchant a fee of 3 to 6% of the value of the transaction, plus 30 cents for every single purchase. Clearly, the merchant is willing to pay this fee to be able to make the sale, they otherwise would not or perhaps would make at a later date. Some studies have shown, instant and convenient access to credit prompts impulse purchases. From that perspective, Afterpay is getting a commission for facilitating sales (impulse purchases) that would otherwise not occur. However, from an alternative perspective, the merchant is paying Afterpay a charge towards factoring of accounts receivable.

Anecdotal evidence suggests that merchants dealing with BNPL operators feel the pinch from the 3 to 6 percent fee and have long been wanting to pass this cost to consumers but cannot due to BNPL agreements in place which prohibit this. There is support for a change in regulation to allow such merchants to pass the 3 to 6 percent cost to consumers (in the form of a ‘surcharge fee’) who will then appreciate the true cost of the BNPL transactions. This obviously alarms BNPL operators whose business model is premised on the notion that BNPL products have no costs associated with it if its consumers budget properly and make their payments on time. If such consumers realize that there is an actual cost to BNPL transactions, the business model of BNPL operators is undermined.

If however, the surcharge fee remains in effect and merchants have no choice but to absorb this fee, such merchants have already touted the idea of increasing prices to be compensated for this surcharge. After all, merchants can levy a surcharge on credit card payments, but not for more expensive BNPL transactions causing such merchants to complain about the inequities in this situation.[[4]](#footnote-4) More importantly, if this remains the case and merchants cannot pass on the surcharge to consumers, BNPL consumers will continue to be in the dark about the fact that there is an actual cost to entering into a BNPL transaction.

Additionally, it is not clear that consumers fully factor in the cost of late payment fees in their decision to avail of BNPL services. The late-payment fee charged by the BNPL providers are often a fixed fee and could lead to exorbitant interest charges for small purchases (say a few hundred dollars). Moreover as these fees are recurring, it is conceivable that some of the consumers who default on their payments, end up paying additional fines on the original fines. That is the fines are cumulative and could cause some consumers to inadvertently fall into a debt trap. It is not clear, that the fee arrangements and the consequences are evident to the consumers, especially those with limited financial knowledge and resources, who often are the society’s most vulnerable.

We believe the purpose of regulation is not just to protect the educated and the rich, but it is imperative the vulnerable—the uneducated and the poor. This latter segment could often be tempted by the allure of the BNPL service and be unwary of the risks and dangers they impose. Since the BNPL services do not perform credit checks and the usual determination of the ‘ability to pay’ prior to granting credit, they perhaps attract the vulnerable section of the society, who are unable to obtain traditional credit. Once attracted, the BNPL business models profit from the misfortune and hardship of these individuals which causes the inability to pay. It is not clear to us, based on public documents, whether internal company policies at the BNPL providers restrict granting future credits to those who previously defaulted, or do they in fact continue to trap these individuals into more and more debt.

There are many unanswered questions regarding the practices of BNPL which could be objectively determined through additional research and access to internal operational data. We will happy to conduct rigorous research of these concerns should such a study is deemed useful and is commissioned.

1. <https://theconversation.com/how-zip-pay-works-and-why-the-extra-cost-of-buy-now-pay-later-is-still-enticing-110429> [↑](#footnote-ref-1)
2. <https://theconversation.com/whats-the-difference-between-credit-and-debt-how-afterpay-and-other-bnpl-providers-skirt-consumer-laws-113464> [↑](#footnote-ref-2)
3. <https://theconversation.com/explainer-how-lending-startups-like-afterpay-make-their-money-86477> [↑](#footnote-ref-3)
4. <https://www.smartcompany.com.au/finance/afterpay-surcharge-bnpl/> [↑](#footnote-ref-4)