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A submission from Afterpay to the Reserve Bank of Australia (RBA) Review of Retail Payments Regulation: Issues Paper (RBA Review)

Dear Dr Richards

Thank you for the opportunity to provide this submission in response to the RBA's Issues Paper. Afterpay notes that this Issues Paper is broad ranging and that the main focus is on payment systems rather than buy now pay later (BNPL) services. However, as a key player in the BNPL sector, Afterpay Limited[1] (Afterpay) provides this submission in response to the specific issues raised by the RBA in relation to the BNPL sector.

Afterpay welcomes regulation that meaningfully improves consumer outcomes, while promoting innovation and competition in the interests of consumers and merchants.

Afterpay offers a simple and highly effective platform for consumers and merchants. Afterpay provides a customer-centric product that has resonated with consumers because it has turned the traditional model of credit on its head. Merchants benefit significantly by being part of the Afterpay ecosystem, as it delivers them value, reduced risk, and deeper engagement with customers. Our platform's success is underpinned by an innovative model which does not seek to charge the customer. While part of a growing BNPL sector, Afterpay differs significantly from other BNPL participants in this regard.

Afterpay's unique characteristics and value proposition to merchants and consumers means it should not be considered a payment system. Any contemplation of regulatory reform in this area should be part of a parliamentary process that has a broader lens than the regulation of payment systems. The BNPL industry, as a growing and innovative industry, should also be recognised for its efforts to self-regulate and raise standards.[2]

[1] Afterpay is a listed company on the Australian Securities Exchange (ASX) and is an ASX100 company that employs over 550 staff across Australia, New Zealand, the United States and the United Kingdom.
[2] https://www.afia.asn.au/bnpl

Extending the regulation of traditional payment systems to Afterpay and its style of BNPL would not be appropriate given:

1. The nascency and size of the BNPL sector, with less than 1% of total payments in the economy being made via a BNPL service. In contrast, the dominant international card payment systems - whose business models are reliant on charging both the consumer and the merchant - were launched in Australia in 1984 and were not subject to RBA regulation until 2004. By 2004, there were over 10 million cards on issue, with 36% of spending financed with credit cards at interest rates of over 15%.

2. The important and fundamental differences between a platform such as Afterpay and traditional payment systems. There is a wide difference in the actual services and benefits provided to merchants and customers by Afterpay compared with card payment systems.

3. The diversity of the BNPL industry, in both types of business models and number of competing firms. Even BNPL participants that appear to offer a similar product to Afterpay are different to Afterpay in important ways.

4. The disproportionate impact that regulation would have given the widely-varied fee charging approaches of BNPL participants.

5. The benefits to consumers from the Afterpay platform, including when compared to traditional credit card payments that perpetuate a cycle of expensive revolving debt.

6. Unlike credit cards, there are no cross-subsidies between different Afterpay customers, and between Afterpay customers and non-Afterpay customers. Also unlike credit cards, the fees paid by merchants to Afterpay do not subsidise reward points for select customers.

7. The benefits to merchants from the Afterpay platform that go well beyond the transaction itself. Merchants partner with Afterpay for much more than payment processing and pay for a range of benefits that they receive directly. As a customer acquisition channel for merchants, Afterpay competes with large players such as Google and Facebook, and provides leads to merchants at a much lower cost. Afterpay delivers benefits to merchants through:
    - Marketplace customer referrals,
    - Reduced customer acquisition costs,
    - Higher average order values,
    - Reduced return rates, and
    - Lower fraud costs.

8. The provision of merchant benefits which mean that, on a net basis, merchants gain more from Afterpay than what they pay to Afterpay. Reflecting this, merchants have not raised prices on goods most commonly purchased via Afterpay versus those goods less-commonly purchased via Afterpay.

9. When applying the public policy considerations stipulated under the relevant legislation (financial safety, efficiency, competition, and systemic risk), Afterpay's platform creates no impetus for regulatory reform. Surcharging reform would risk undermining important innovation and benefits for consumers, merchants and the wider economy, and would not achieve the public policy intent of the regulatory framework for payment systems.

10. The current regulatory framework applies to "payment systems", and Afterpay is not a payment system within the scope of the legislation. Afterpay relies on existing payment systems to process transactions, and is the merchant of record for customers. Other point-of-sale instalment payment arrangements have existed for decades and have never been mooted for surcharging reform. Potential reform in this area should be subject to a full parliamentary process.

Our submission is divided into four broad sections:

1) The BNPL industry

2) The Afterpay product and platform

3) Responding to the RBA's specific questions in the Issues Paper relevant to the BNPL sector

4) The current jurisdiction of the RBA in regulating payment systems

Our submission has been informed by expert analysis independently conducted by AlphaBeta Economics. We refer to some of this analysis directly in this submission, and provide detailed analysis in Attachment A. AlphaBeta is available to discuss any aspect of its analysis with the RBA.

1. **The BNPL industry**

What the BNPL sector shares in common is the provision of a service that connects consumers with merchants, with a service that allows consumers to make payments in interest-free instalments. Although interest-free point-of-sale arrangements have existed for many years, particularly through large department stores, we note that there has been no review of the surcharging (or lack thereof) of these deferred payment arrangements.

The BNPL industry is diverse

The diversity of operators within the BNPL sector was the second of ASIC's Key Findings in its 2018 review of the BNPL industry[3] (ASIC Review). ASIC found that "the market for these arrangements is diverse, evolving, and growing rapidly."[4]

[3] Report 600 Review of buy now pay later arrangements, ASIC, November 2018.
[4] ASIC Review, para 2.

The most important difference between companies in the BNPL industry relates to how each company earns its revenue. The ASIC Review concluded that BNPL providers differ significantly in terms of the revenue earned from merchants versus consumers.

In Afterpay's case, we make the vast majority of our revenue from the fees we charge merchants. This is a fundamental part of our business model. Afterpay's business model and profitability rely on consumers paying on time and therefore not incurring any charges. Consumers that do not pay on time are suspended from the Afterpay service. And although Afterpay charges late fees, these are capped both in dollar terms ($68) and as a percentage (25%) of the transaction amount - with the cap being the *lower of* the dollar amount or percentage. As a result, although we earn revenue from consumers in the form of late fees, these fees are less than the costs to Afterpay associated with late-paying consumers, and accordingly such customers are not a source of profit.

Currently, Afterpay earns about 19% of its revenue from consumer fees, compared with much higher percentages for our competitors (29%, 34% and 63%, according to the ASIC Review) and around 68% for credit cards. This again reflects the nature of our business model: our profitability relies on only providing our service to consumers who have the ability to pay us back on time across four instalments.

While other BNPL providers would also argue that they rely on customers paying them back on time, their business models are different in important ways. Other providers do not require customers to repay a BNPL purchase in a defined period. Customers may extend repayment periods indefinitely so long as minimum repayments are met and/or a fixed monthly fee is paid.

Some BNPL providers are different to Afterpay in other ways. Some BNPL companies provide interest-free loans to cover very significant purchases - from $2,000 all the way up to $30,000. These business models - while still classified as BNPL - are based on substantially different arrangements.

The diversity within the BNPL sector has further increased with the recent entrance of Klarna into the Australian market. Although Klarna's product may appear similar to Afterpay's, there are important differences. Firstly, under its initial operating model in Australia, Klarna does not appear to have bilateral relationships with merchants. Instead, it is our understanding that Klarna allows consumers to shop within its smartphone application, where consumers can click through to merchants to complete purchases. Klarna may be remunerated for some of these clicks through affiliate marketing networks which pay between 3-15% in commission (i.e. significantly more than Afterpay's merchant fee). Klarna provides its customers with a 'Ghost' Visa card to complete purchases.[5] To the merchant, this is processed as an ordinary Visa card transaction. However, the cost to the merchant includes both the card processing charge as well as the potential additional customer acquisition cost associated with the affiliate marketing network. In contrast, Afterpay's platform is built on a merchant partnership model which is underpinned by a free service for consumers.

[5] In other markets, we understand that Klarna charges consumers a fee for issuing Ghost Visa cards.

This diversity is a significant issue in the context of the RBA's current review. The different business models that come under the broad banner of 'BNPL' each have unique characteristics, and any consideration of regulatory reform must take into account these differences without compromising competition and consumer choice. The diverse offerings within the BNPL sector, including Afterpay's unique model, are not suited to a simple extension of the existing regulatory framework.

In contrast to the diversity within the emerging BNPL sector, traditional credit and debit card schemes are strikingly similar to each other in their structure and operation. Given the dominance of card payment systems over more than two decades, Australia's payment system regulations were designed in response to these relatively uniform business models and reflect their structure and operation.

The value that Afterpay brings to our merchant partners is significantly greater than the simple processing of a payment to a merchant. The depth and diversity of these benefits are what make Afterpay an attractive proposition for merchants. Together with the simplicity and convenience of our consumer offering, these merchant benefits constitute the core of our value proposition and business model.

This approach is made possible because, in contrast to card payments, the Afterpay platform involves bilateral relationships between Afterpay and consumers on the one hand, and Afterpay and merchants on the other. Through this approach we provide a free service to consumers, and a powerful sales and marketing platform for merchants in exchange for a negotiated merchant transaction fee.

Regulating this business model, on both the customer and merchant sides, via an extension of existing regulations is not in the public interest.

The BNPL industry is nascent and competitive

Australian consumers are increasingly using Afterpay and other BNPL products and services. However, overall retail transaction data confirms the BNPL sector remains in its early stages and constitutes a tiny proportion of the overall retail payment economy.

In the 12 months to 2019, purchases completed using BNPL products and services increased in value by almost 50 per cent. However at a total value of $6.2 billion, these purchases still constituted less than 1 percent of the total value of total payments last year.[6]

Afterpay and the BNPL sector therefore sit in contrast to the dominant providers in the payment system - the major credit and debit card schemes.

[6] See Attachment A, page 2.

Together, credit and debit purchases via the traditional card schemes constituted 82 percent of retail purchase transactions in 2019.[7] This reflects the long anticipated and planned-for transition in the retail economy from cash to electronic payments under Australia's payment system policy framework. And it also reflects the continued dominance of the small number of major providers, which prompted development of the current regulatory framework more than two decades ago.

When the *Payment Systems (Regulation) Act 1998* (PSRA) (enabling the current surcharging regulations) was enacted, electronic credit card payments were identified as a broadly positive and rapidly growing component of the payments system in Australia. At that time, however, concerns regarding transparency, price signalling and competitive market forces were raised as important motivations for regulatory intervention - specifically regarding interchange fees and surcharging.

These concerns reflected the market dominance within the electronic payments sector of the two major credit card schemes. Point of sale payment infrastructure and complex transfer and settlement arrangements meant the sector was viewed as lacking transparency, potentially impacting user choice, new market entry, overall competition and, therefore, price efficiency in the sector.

The nascent and competitive BNPL sector does not reflect any of those market characteristics.

2. The Afterpay product and platform

Background

Afterpay has grown into a leading international player in the BNPL sector, with over 3 million customers in Australia and New Zealand, over 3 million in the United States, and around 500,000 in the United Kingdom. Our Australian business continues to be largest from a volume perspective.

The Afterpay service is offered as an option by participating merchants online and/or instore. Customers who choose to purchase products using Afterpay receive the purchased products upfront and repay the purchase price (or order value) in four instalments (every two weeks) to Afterpay. Afterpay pays the merchant for the purchased product(s) upfront, minus our fee.

Afterpay's merchant fees are structured as a percentage of the order value or purchase price, and in most circumstances, a fixed fee per transaction is also applied. Responsible spending rules and consumer protections are built into the service – these rules help ensure customers never revolve in debt, with no exceptions. Where the customer does not pay their instalment payments on time, their access to our service is immediately suspended, and late payment fees can be applied. But any late fees are flagged to the consumer in advance, fixed, capped and do not accumulate or compound over time.

[7] See Attachment A, page 2.

Purchases using Afterpay are assessed using a proprietary fraud and real time repayment capability check, employed at the time of each and every order. This is a sophisticated algorithm-based technology which identifies likely risk spots both within customer groups and by product. As a result, up to 30 percent of order requests are not approved (this can be as high as up to 50 percent for first-time customers). The sophistication and accuracy of these checks has resulted in a default rate[8] of 1.1% in FY2019. This has reduced over time, notwithstanding Afterpay's growth rate, and compares favourably against the major banks and other traditional credit providers.

For consumers

Consumers have embraced the Afterpay platform and it is the most popular BNPL platform in Australia by a significant margin. This is also reflected in our net promoter score (NPS) (a widely used measure of customer satisfaction) which is over 80. The major banks' NPS scores are between 7.2 and negative 4.4.[9]

Consumers are required to provide Afterpay with debit or credit card payment information, and around 85% provide debit card details. Each and every transaction with Afterpay is processed as an individual debit or credit card payment, with Afterpay as the merchant of record.

For consumers, Afterpay delivers a convenient add-on to debit cards and traditional forms of credit, which allows for delayed settlement, spend tracking, budgeting support, and a substantial consumer marketplace. Consumers also benefit from not having to disclose their debit or credit card details to third parties.

As a delayed settlement and budgeting tool, the Afterpay platform is highly attractive for consumers with debit cards. We do not charge monthly or annual fees, and we do not allow consumers to extend their repayment time frame beyond four fortnightly instalments. Afterpay allows consumers to receive goods and services upfront without the need for a separate credit product.

This structure has meant that Afterpay's customers trust its service. This sits in stark contrast to traditional forms of credit - which are designed to draw customers deeper into ongoing and revolving debt in order to generate interest and returns for the lender. Credit card companies have built a business model which is only profitable when consumers do not achieve the promoted benefits of the product. It is generally the case that credit card companies do not make money from the 'transactors' that use their product - i.e. the customers that pay off their credit card balances in full each month and avoid interest charges. Instead, credit card companies make money from customers that do not benefit from 'interest-free periods' that are widely promoted - these 'revolvers' allow their credit card balances to remain unpaid in full from month-to-month and therefore attract 20% or more in interest charges.

[8] Default rate or gross loss refers to receivables impairment expense as a percentage of underlying sales.
[9] http://www.roymorgan.com/findings/8111-bank-satisfaction-and-nps-july-2019-201908260459

This "bait and switch" model is also reflected in widespread promotion of low-interest 'balance transfer' offers. These are only sustainable for credit card companies because a significant proportion of customers will not pay off their transferred balances within the promotional period. Remaining balances therefore attract standard interest rates of 20% or more - reinforcing the underlying revolving debt business model.

Recent regulatory reforms have been introduced to tackle the lack of customer-centricity and poor consumer outcomes associated with credit cards including:

- requiring credit card issuers to provide consumers with prominent minimum repayment warnings, to highlight the risk of only making minimum repayments,
- addressing the inherently unfair way in which interest charges are calculated and imposed,
- making it easier for consumers to cancel credit cards, and
- forcing credit card companies to ensure that consumers can actually afford to pay off their credit cards within three years.

Notwithstanding these reforms, over 60% of credit card balances remain interest-bearing, and consumers are using credit cards to pay for everyday purchases, resulting in them taking on long-term high-interest debt. The fact that average standard interest rates on credit card balances exceed 19% at a time when the RBA official cash rate is 0.75%[10] speaks volumes about the competitive dynamic and lack of customer-centricity in the credit card market.

As the RBA notes, the minority of consumers that avoid interest charges and earn rewards are being cross-subsidised by consumers for who credit cards are an expensive and unsuitable product. This inherently unfair outcome means that under the traditional credit card model, as it was intended to operate, financially vulnerable households are subsidising wealthier households.

This is not the case with Afterpay. Unlike credit cards, no cohort of Afterpay customers cross-subsidises any other. While Afterpay does draw revenue from customers directly via late fees, these fees are capped and do not reflect the costs that Afterpay incurs when consumers do not pay on time. In addition to capping our late fees, Afterpay has previously prevented consumers who repeatedly incurred late fees from using our platform, on the basis that our platform is not designed for consumers that do not meet their payment obligations on time.

Beyond the issue of internal cross-subsidisation, analysis from AlphaBeta has explored whether non-Afterpay customers have cross-subsidised Afterpay customers, in the absence of surcharges levied on customers electing to use Afterpay.

According to AlphaBeta's analysis there is no evidence of such cross-subsidisation (see page 8 of Attachment A). Based on merchant data, AlphaBeta compared price increases on the products that were most often purchased using Afterpay and those that are least often purchased using Afterpay. This reflected the hypothesis that, in the absence of any surcharge, the price of products purchased

[10] https://www.theaustralian.com.au/nation/fury-over-outrageous-credit-card-interest/news-story/4fad88c656e2343adcf5230ef3decc5a

most often using Afterpay would increase more than for products rarely purchased using Afterpay - in order to offset any additional merchant costs. This analysis showed no statistically significant relative increase in the price of products purchased most often with Afterpay. This reflects that, overall, an Afterpay transaction is not more expensive than a non-Afterpay transaction for a merchant, due to the reduction in other costs (such as marketing costs and fraud costs) associated with Afterpay transactions (see further below).

These results, and Afterpay's significant level of trust among customers, reflect the customer benefits built into our product offering and business model. AlphaBeta's further analysis of the wider impact of Afterpay confirms there is no adverse impact to non-Afterpay customers as a result of our innovative and unique business model.

For merchants

Afterpay also offers a powerful platform for merchants. Because of our customer centric model and platform, Afterpay is able to offer merchants highly valuable access to the significant and growing pool of Millennial and Generation Z customers who are keen to avoid traditional credit products. In addition to this access, the Afterpay model has been shown to drive improved sales performance for merchants across sectors and merchant types. Merchants particularly value Afterpay customers because our responsible spending safeguards ensure that these customers are more loyal and sustainable for merchants over the long term.

The Afterpay platform includes the following benefits for merchants:

- Higher order values,
- Increased number of orders,
- Increased customer base,
- Lower marketing costs,
- Lower customer service costs,
- Lower return rates, and
- Lower fraud rates.

Because Afterpay pays merchants upfront, it helps improve cash flow and eliminates consumer-caused fraud risk for merchants, including the risk of chargebacks.

Afterpay as a marketing platform

Perhaps the most significant benefit the Afterpay platform provides merchants is our powerful marketing ecosystem. Within this ecosystem the Afterpay platform supports merchants to optimise marketing and increase sales through a range of activities:

- The Afterpay Store Directory operates on the Afterpay website and smartphone app. In the financial year 2018/19, the Afterpay Store Directory drove over 48 million referrals of Afterpay customers to our retail partners. In October 2019 alone, the Store Directory produced over 10 million referrals globally.

- Afterpay Days are a bi-annual event where Afterpay merchants serve up offers and promotions to customers for a 36 hour period. Afterpay heavily promotes these days via electronic direct marketing, social media, other digital channels and public relations activities. Afterpay Day is now the sixth largest retail sale event in Australia, with overall daily merchant sales increasing by over 100%.

- Digital marketing campaigns are opportunities for Afterpay to drive mass audience awareness through premium positioning for merchants in banner placements within emails and on the Afterpay app. These are then available to the Afterpay's more than 3 million Australian customers.

- Sponsorship and partnership campaigns allow Afterpay to partner with selected merchants to develop customised and co-branded marketing campaigns funded by Afterpay. Merchants are also featured in various Afterpay consumer marketing campaigns on a regular basis.

- Global Mentorship Program: each quarter, Afterpay selects a total of 25 merchants leading across a diverse range of commercial, operational and marketing categories. The program's quarterly winners take part in a dedicated two-week Afterpay digital campaign showcasing their business to Afterpay customers. The annual grand prize offers one merchant the opportunity to engage in a bespoke mentorship program with some of the world's most successful retailers: Brian Sugar (Co-Founder/CEO, POPSUGAR); Hilton Seskin (Executive Chairman, Next Athleisure); and Global Retail Advisor, Paul Greenberg (Founder NORA Network). In addition, the winning merchant receives a ShopTalk Retail 2021 Conference Package, a six month digital strategy and marketing package, and investment pitch presentation coaching. The program is funded by Afterpay, and is available to small business merchants only.

- Data insights are made available by Afterpay through a number of tools for merchants, including:
  - On-demand reports prepared for enterprise merchants that provide knowledge of their own trading with Afterpay as well as industry benchmarks,
  - Customised reports that provide merchants with deep analysis into particular customers segments or regions, and
  - Insights into the behaviour of Afterpay's customers (e.g. most popular shopping hours) to help merchants optimise their marketing and resource allocation.

AlphaBeta has independently analysed the impact of these benefits for merchants, and modelled the profitability of an Afterpay transaction versus a non-Afterpay transaction. AlphaBeta's analysis concludes that Afterpay provides significant net benefits to merchants annually as a result of lower variable costs, and that Afterpay sales are more profitable than non-Afterpay sales.[11]

In a retail environment that has been struggling for several years, the availability of Afterpay and other BNPL platforms has provided important support for retailers - both online and in-store. This is

[11] Afterpay and AlphaBeta are available to discuss the analysis directly with the RBA.

particularly important given demographic change and the sustained reduction in consumers using credit cards.[12]

In addition to the substantial customer benefits outlined above, these merchant benefits are fundamental to Afterpay's unique business model. These significant and valuable benefits for merchants are exchanged for a negotiated merchant fee. The competitive nature of the nascent BNPL sector, and the wider merchant services sector, mean Afterpay is committed to improving the quality and breadth of services that we offer merchants into the future.

3. **RBA's questions relevant to BNPL**

1. How do merchants and other stakeholders view the benefits and services that BNPL models provide?

Afterpay delivers benefits to merchants through a range of marketplace features, including:

- Marketplace customer referrals,
- Higher average order values,
- Reduced return rates,
- Lower fraud costs, and
- Reduced customer acquisition costs.

These benefits are discussed in detail above.

2. How do the costs of payments received through BNPL services compare with the cost of traditional card payments?

Comparing the cost of payments received through Afterpay with the cost of a traditional card payment is not a like-for-like comparison.

Afterpay does not charge a payment processing fee. As detailed earlier in this submission, Afterpay charges merchants for a range of services. It is Afterpay that incurs the cost of processing payments via debit cards and credit cards. As with other merchants, the costs incurred by Afterpay vary according to the type of card used by the customer.

When a consumer completes a purchase with Afterpay, it is Afterpay that appears as the merchant of record on the consumer's debit card or credit card statement. An example of this is shown in Attachment B. This aligns with other customer platforms connecting merchants and customers across a wide range of sectors and sits in contrast to traditional card payment processing systems. As the RBA Review notes (s 2.1), existing payment networks are the 'rails' on which BNPL services run.

[12] https://www.afr.com/companies/financial-services/credit-cards-at-record-low-as-buyers-flock-to-afterpay-20190114-h1a1m6

As a marketing platform, Afterpay competes with other customer acquisition channels including Google, Facebook, Amazon and smaller players such as Unidays.[13] The fees charged by these companies for customer referrals range from 10 to 15 per cent, which is significantly higher than the typical Afterpay merchant fee (which explains why prices for items frequently purchased using Afterpay have not increased relative to items less-frequently purchased using Afterpay).

3. *Has the recent entry of additional BNPL providers influenced merchant fees for BNPL services?*

The BNPL industry is experiencing growth in both customer numbers and providers.

Although Afterpay, ZipPay and OpenPay were the key providers in the BNPL market until 2016, an additional six providers have entered the market in the last three years: Klarna, Humm, Brighte, Laybuy, Splitit and LatitudePay. Additional providers are expected to launch in Australia in 2020. This represents a compound annual growth rate of 34% (see page 3 of Attachment A).

With a growing number of players in the BNPL sector, merchants have clear choice over which BNPL service to accept, if any, and can offer more than one BNPL service. Based on AlphaBeta analysis of publicly available data, the number of merchants offering more than one BNPL service has increased by 10% since 2018 (see page 4 of Attachment A).

Unlike the traditional payment systems, Afterpay's business model is not structured to drive up merchant fees. Afterpay has a single product that operates in the same way for all customers. Afterpay does not offer incentives for some customers (such as reward points, balance transfer offers, lifestyle rewards, etc) which need to be funded by higher fees on merchants and high interest rates for revolving customers. Merchants also do not face unpredictable costs when accepting Afterpay as a payment method, unlike with credit cards where different credit cards can have significantly higher merchant fees (such as premium credit cards and internationally-issued credit cards). Afterpay's merchant fees have remained stable over time.

4. *Do all BNPL providers have binding no-surcharge rules or are merchants able to negotiate on these?*

Reflecting Afterpay's role as a platform (comparable to other platforms such Uber Eats), when a consumer completes a transaction with Afterpay, it is Afterpay that appears as the merchant of record on the consumer's debit card or credit card statement.

Afterpay's standard contract prevents our retail partners from imposing a surcharge on customers. The only merchant offering Afterpay that is contractually permitted to surcharge is Jetstar Airways (Jestar), and this arrangement reflects the particular characteristics of the airline industry. Although Jetstar does offer a surcharge-free method of payment (POLi), the overwhelming proportion of payments made to Jetstar are with surcharge-incurring payment methods. For historical reasons,

[13] Unidays is a marketplace for merchants to sell platforms and services to a network of university students, enabling new customer acquisition and providing a referral network.

consumers generally expect airlines (and other highly specific merchant categories) to impose surcharges for payments.

Notwithstanding the Jetstar arrangement, Afterpay's fundamental business model is about making our service freely available to consumers. Other players in the BNPL sector choose to operate a different business model, where charging the customer is a key driver of revenue. This is not Afterpay's current or future business model.

A merchant that surcharges the full Afterpay merchant fee for an Afterpay transaction would recover significantly more than their payment processing costs because this fee also reflects the costs of other benefits that the Afterpay platform provides. Such an outcome has no policy basis in the regulation of payment systems, and would be akin to having the RBA regulate other platforms which include the processing of a payment as one aspect of their service.

The table on page 5 of Attachment A illustrates how the product attributes of traditional payment systems compare with platforms that provide payment functionality.

Uber Eats also offers a platform, in the food delivery market, that shares some characteristics with the Afterpay platform. Like Afterpay, Uber Eats also facilitates payments from consumers to merchants. But although Uber Eats operates in the food delivery market, like Afterpay it offers spend tracking support for consumers, a consumer marketplace that connects users with merchants, and merchant benefits such as increased revenue and reduced costs. Although Uber Eats charges its restaurant partners a significant fee (around 30%), restaurants are not permitted to impose a surcharge on customers.[14]

As a marketing platform, Afterpay competes with other customer acquisition channels (see page 6 of Attachment A for a comparison). As noted below, there is no suggestion that marketing referral platforms be compelled to allow merchants to surcharge the fees they pay for customer leads.

5. Are some BNPL services viewed as 'must take' payment methods for particular market segments or transaction types; that is, do merchants feel that they cannot refuse to accept BNPL for fear of losing business?

BNPL services have achieved a high degree of popularity with consumers, however, they remain a very small share of total payments, and are a discretionary choice for merchants in all market segments. Merchants can choose from a variety of BNPL providers and BNPL business models.

Although BNPL services represent a greater proportion of transactions in particular retail segments, this popularity is driven by the value that Afterpay's platform delivers to merchants, over and above the sales performance experienced prior to Afterpay's introduction by the merchant.

[14] While customers may be charged a delivery fee, the cost of delivery is usually spread across the delivery fee and merchant fee.

The popularity of Afterpay in particular retail segments is not associated with Afterpay's payment processing functionality. The consumers that use Afterpay already have a debit or credit card and can use their cards at all of the merchants that Afterpay has a partnership with. Instead, the Afterpay platform - including the highly effective marketing components of the platform - is what makes Afterpay attractive to retailers.

This is akin to the importance of Google and Facebook as an essential marketing platform for retailers, and Uber Eats as a platform for restaurants and other take-away food stores. These platforms have become highly valuable (and even essential) for merchants, however, there is no suggestion that regulation be introduced to compel these platforms to allow merchants to surcharge the fees that they are charged.

Q16: Is there a case for policymakers to require that BNPL providers remove any no-surcharge rules, consistent with earlier actions in regard to card systems that applied such rules?

There is no basis for policymakers to require that BNPL providers remove no-surcharge rules. A regulatory intervention of this type would not recognise:

- The diversity of the BNPL industry, in both types of business models and number of competing firms.
- The nascency of the BNPL industry: the dominant international card payment systems were launched in Australia in 1984 and were not subject to RBA regulation until 2004. By 2004, there were over 10 million cards on issue, with 36% of spending financed with credit cards.[15]
- The important and fundamental differences between a platform such as Afterpay and traditional payment systems.
- The benefits to merchants and consumers of a platform such as Afterpay.
- The competitive dynamic within the BNPL industry.
- That Afterpay is in fact the merchant in the relationship with Visa and Mastercard: i.e. Mastercard is charging Afterpay to process payments. Afterpay's cost of using Mastercard is only one component in our costs charged to our retailer partners.

The PSRA generally allows the Bank to regulate where it considers it to be in the public interest to do so. Section 8 of the PSRA provides that:

> *In determining the public interest, the Bank must have regard to the desirability of payment systems:*
>
> - *being (in its opinion):*
>   - *financially safe for use by participants; and*
>   - *efficient; and*
>   - *competitive; and*
> - *not (in its opinion) materially causing or contributing to increased risk to the financial system.*

Taking these relevant factors in turn:

[15] *Visa International Service Association and Another v Reserve Bank of Australia [2003] FCA 977*, at 79.

- Financially safe for use by participants: as detailed in the submission, the Afterpay product is strongly customer-centric and has important safeguards for consumers.

- Efficient: efficiency has three dimensions (technical, allocative and dynamic) and the BNPL sector demonstrates efficiency across all three:
    - Technical and dynamic efficiency: the BNPL industry is growing and diverse, with a high degree of product innovation that is improving outcomes for both merchants and consumers.
    - Allocative efficiency: whereas in the traditional payments industry, competition among card schemes can lead to higher costs (i.e. higher interchange fees in order to attract issuing banks), the BNPL industry is characterised by competition for both merchants and consumers, and the ability for consumers to switch from one BNPL provider to another. Merchants choose whether to offer a particular BNPL service, and can decide not to offer any BNPL service while continuing to accept debit and credit card payment options (since all Afterpay customers must have at least a debit or credit card linked to their Afterpay account, and 85% of our customers link a debit card to their account).

- Competitive: the competitive dynamic in the BNPL industry is unlike that in the traditional payments industry. The BNPL industry is growing, diverse and actively competing for both merchants and consumers. The value proposition of a BNPL service is different to a payment service.

- Risk to the financial system: the Afterpay platform does not involve bank participants, does not engage in clearing and settling activities, does not engage with the RBA's exchange settlement accounts, and does not give rise to any systemic risk for the payments system. The proportion of total payments made by BNPL services remains very low. While the failure of a BNPL provider would have some impacts on merchants and consumers, there is a very low risk that such a failure would have broader impacts on the financial system.

4. **The RBA's current jurisdiction**

For the reasons discussed below, Afterpay does not consider itself to be a payment system as defined in the legislation.

Under the PSRA, the Payments System Board (PSB) has power to determine standards governing individual payment systems in Australia. In setting these standards, the PSB is charged with maintaining the stability, competitiveness and efficiency of the overall Australian payments system.

Under the PSRA, "payment system" is defined to mean a "funds transfer system that facilitates the circulation of money, and includes any instruments and procedures that relate to that system".

In the Explanatory Memorandum to the PSRA,[16] regulation of payment systems is grounded in the need to ensure the process of "clearing and settling" does not result in systemic risk to the economy. The PSRA's regulatory purpose is described as giving the RBA "additional legislative powers to regulate clearing and settlement systems, to control risk in the financial system and to promote efficiency and competition in the public interest". [17]

The meaning of "payment system" was considered by the Federal Court in the 2003 *Visa* case[18]. According to that judgement, the combined clearing, settlement and transfer of funds through the RBA's exchange settlement accounts comprise a "payment system". Other aspects of these four party card schemes, including particular payment flows that necessarily occur within such a system, were considered "instruments and procedures that relate to that system".

In contrast, the Afterpay platform is constituted by a series of bilateral relationships, rather than the operation of a broader system that involves the clearing, settlement and transfer of net payments between multiple parties.

The Afterpay platform is made up of two distinct features involving separate bilateral arrangements:

- A bilateral arrangement whereby Afterpay provides a form of credit to individual consumers, and
- A separate bilateral arrangement between Afterpay and a merchant, where Afterpay agrees to provide a range of services, including making a payment to a merchant for the transaction amount of the consumer's purchase (less applicable fees).

This means that the Afterpay platform is not a "funds transfer system" because it does not facilitate the transfer of funds from one party to another.

Likewise, the simple disbursement of loan funds, which is a common procedure across many finance products in the Australian market (including home loans and personal loans), is not of itself the type of funds transfer that facilitates the "circulation of money". It is simply a bilateral payment by a lender at the direction of its borrower.

This is consistent with the position in the United Kingdom (UK) and Europe. Within the context of the revised Payment Services Directive, the concept of "payment service" closely aligns with aspects of a payment system under the PSRA. The UK regulator, the Financial Conduct Authority (FCA) has provided guidance in relation to what it considers comprises a payment service. It states that in its view:

> *"mortgage or loan accounts do not fall within the scope of the regulations. This is on the basis that the simple act of lending funds or receiving funds by way of repayment of that loan does not amount to provision of a payment service."*[19]

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[16] Explanatory Memorandum, https://www.legislation.gov.au/Details/C2004B00343/6374c997-7afb-4cd9-b37c-87e2af1211a5, page 4.
[17] Explanatory Memorandum, page 7.
[18] *Visa International Service Association and Another v Reserve Bank of Australia [2003] FCA 977*.
[19] https://www.handbook.fca.org.uk/handbook/PERG/15/3.html

The alternative position would mean that a significant number of arrangements would fall within the definition of a "payment system" under the PSRA, an outcome that is inconsistent with the intended mandate of the PSB.

In these circumstances, any regulatory response to the emergence of the BNPL sector should be subject to a parliamentary process that clearly establishes the need for reform.

Conclusion

We urge the RBA to carefully consider the differences of a platform such as Afterpay compared with traditional card payments, and avoid applying a regulatory framework that would stifle innovation, compromise consumer choice and reduce competition. Through its unique business model, Afterpay actively competes for both merchants and consumers, and competes with marketing platforms such as Google and Facebook.

Because of the package of benefits associated with the Afterpay platform, merchants are not raising prices on products that are more frequently purchased using Afterpay. And unlike card payments, Afterpay's customers do not cross-subsidise one another.

While consumers and merchants are embracing BNPL platforms and realising significant benefits, the BNPL sector is still in its very early stages and accounts for less than 1% of transactions in the economy. Given the RBA's mandate, regulatory intervention is not in the public interest.

Afterpay appreciates the opportunity to provide this submission.

Yours sincerely

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