Senate Select Committee on Financial Technology
and Regulatory Technology
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A submission from Afterpay to the Senate Select Committee inquiry on Financial Technology (FinTech) and Regulatory Technology (RegTech)

Dear Committee Members

We welcome the opportunity to provide a submission to the Senate Select Committee on FinTech and RegTech. FinTech and RegTech developments are playing an increasingly important role in the financial services industry and broader economy, and it is timely for the Parliament to consider how to best position Australia in an internationally competitive marketplace.

Afterpay Limited (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. Afterpay has revolutionised the way that consumers pay for goods and services by turning the traditional model of high-cost consumer credit on its head. Afterpay has grown into a leading international player in the buy now pay later (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.

Afterpay welcomes a discussion on how Australia can better foster innovation and a start-up culture. There is an opportunity for Australia to be more competitive globally if we take the right approach in supporting people to take a chance and do something different. When we look at the United States, their top 10 companies are now dominated by consumer technology organisations – companies like Amazon and Google that didn't exist 25 years ago. In contrast, the face of the Australian stock market has not shifted from mining and banking in the past 30 years.

We need to create a culture where entrepreneurs want to try out new ideas and grow their businesses in Australia, with the right support and the ability to grow globally and compete with the incumbents. Enabling such a culture requires a regulatory environment that encourages early dialogue between regulators and companies that are seeking to do the right thing by consumers and stakeholders. This dialogue needs to recognise the importance of entrepreneurship in the marketplace.

Afterpay welcomes regulation that is fit-for-purpose and meaningfully improves consumer outcomes. Afterpay has taken a leadership role in helping develop a world-first code of practice for the buy now pay later industry. The code will enshrine the consumer safeguards that are built into our product, and distinguish our product from the traditional credit model which is based on encouraging consumers to make ‘minimum payments’ and kick the high-interest debt can down the road.

Investing for long-term growth means more innovation, more jobs, as well as finding new ways to inject competition into the economy for the benefit of consumers. We are committed to doing our part and investing in the full potential of Australian business at home and abroad.

In this submission, we cover the challenges faced by Afterpay in scaling from an Australian startup to operating across several significant jurisdictions, including:

- Australia’s technology ecosystem and accessing the right talent
- The regulatory environment
- Competition in financial services.

We also are pleased to raise a range of matters that will be beneficial for new start-ups and innovators in the FinTech and RegTech space.

Afterpay is also a proud member of FinTech Australia, the RegTech Association and the Australian Finance Industry Association. We are aware of their submissions and support them.

About Afterpay

Afterpay is a modern-day instalment payment service that enables consumers to buy products on a ’buy now, receive now, pay later’ basis. Afterpay was founded in Australia in 2014 and has since launched its Afterpay service in New Zealand, the United States and the United Kingdom.

The Afterpay service is offered as a payment option by participating merchants either online 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 instalment payments (every two weeks) to Afterpay. Afterpay pays the merchant for the purchased products upfront.

Participating merchants pay a fee to Afterpay for using the Afterpay service. 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. The vast majority of Afterpay’s income is derived from merchants rather than customers.

Afterpay is an alternative to traditional credit products. Afterpay is a no cost service to the customer if instalment payments are made on time. Responsible spending rules and consumer protections are built into the service – these rules help ensure customers never revolve in debt, no exceptions. In circumstances where the customer does not pay their instalment payments on time, their service is immediately suspended, and late payment fees can be applied. Late payment fees are fixed, capped and do not accumulate or compound over time.

The Afterpay service has gained significant popularity in the Australian and New Zealand markets with both customers and Afterpay's merchant partners. Afterpay launched in the US in May 2018 and has achieved rapid growth. Afterpay also recently launched in the United Kingdom under the Clearpay brand.

Supporting the retail sector

Today, it is estimated that Afterpay processes more than 10 percent of all online retail purchases for physical goods (e.g. fashion and footwear) in Australia and over 17 percent of the purchasing Australian population has transacted with Afterpay since its inception.

We have become an important part of the retail offering for a growing number of Australian businesses and their customers who now expect to be able to access more flexible ways of paying that don't require taking out an expensive traditional credit product and in which they can feel confident there are safeguards in place to help them to spend responsibly.

We have more than 30,000 partnerships (large and small) with Australian retailers who integrate with our platform. We have many significant partnerships with major Australian companies and, importantly, around 90% of our partnerships are with small and medium sized businesses (SMBs), categorised as businesses transacting less than $2,000 per day and between $2,000 and $5,000 per day respectively.

Afterpay is an important source of new customers for retailers. Millions of customers come to Afterpay to determine where to shop and Afterpay provides leads to its retail partners. Many retailers would not have access to such a large pool of core millennial customers otherwise. We estimate Afterpay is the largest retail lead referral source in Australia after Google.

The Afterpay platform is boosting the revenue of merchants, and that merchant sales growth is contributing significantly to the retail economy. In October 2019, we delivered 10 million referrals globally to our merchant partners.

Afterpay has also been operating in the dental and optical space since August 2018, and in this time, over 2,500 practices nationally are now offering Afterpay to their customers as an alternate way to pay for their treatment. The feedback from customers has been positive, with a large percentage of Afterpay customers saying that the availability of Afterpay prompted them to purchase the healthcare product or service, as they had been previously putting it off, and that they are better able to manage these expenses as part of their overall weekly budget.

Technology driven innovation

The Afterpay business model is underpinned by technology from end to end. Technology ensures that we deliver a product with strong consumer safeguards. 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[1] of 1.1% in FY2019. This has reduced over time, notwithstanding Afterpay's rapid growth rate.

Australia's technology ecosystem

Afterpay's growth has created hundreds of highly skilled jobs in Australia. In 2019, Afterpay hired 284 employees globally, with 194 of these positions based in Australia. We recruited 45 staff in technology roles. We currently have 49 roles open, including 24 in Australia. Of the 49 roles that are open, 14 are technology-related.

The key technology roles that we recruit for include: software engineering, information security, product management and analytics. Our focus is in attracting key skills sets, including

- software development: to maintain and build scalable platforms for ease of use for our merchants and consumer clients; and
- information security: cybersecurity expertise, automation, risk and compliance management.

The technology talent market for software developers/engineers in Australia is small and there is a significant shortage of qualified developers. To address this, Afterpay is looking at immersive software engineering training organisations such as General Assembly to increase the talent pool and open up training to non-technical individuals to be able to take their careers in a new direction.

To help create an early careers pathway in technology-related roles, Afterpay has launched a *Tech Graduate* program with a focus on supporting diversity in our technology teams. The first cohort of graduates to start in February 2020 includes three female developers and three male developers.

Exporting to the world

Afterpay has already achieved significant growth and success in the United States and the United Kingdom. As of the end of November 2019, we now have more customers in the United States than in Australia, with the enormous potential of the United States' market still to be realised. We have

[1]Default rate or gross loss refers to receivables impairment expense as a percentage of underlying sales.

built a technology platform and business model that is scalable and we continue to invest for growth.

Unlike other Australian financial services institutions which have attempted to expand offshore, Afterpay has managed to leverage its genuinely innovative and customer-centric product and succeed in key overseas markets. And while our offices in San Francisco, New York and the United Kingdom are growing rapidly, we remain an Australian company that is committed to supporting Australian jobs, Australian retailers and Australian fashion.

As part of our offshore expansion, we have greatly appreciated the support of Austrade's staff - particularly in San Francisco and New York. We continue to engage with Austrade as we consider our global footprint.

Australia's regulatory environment

Highly respected regulatory architecture

It is widely acknowledged that Australia's regulators and regulatory frameworks are world-leading in many respects, and the implementation of the recommendations of the Financial Services Royal Commission will further enhance Australia's reputation in this regard.

Australia's strong reputation is an asset to FinTech and RegTech companies, especially for companies such as Afterpay that have expanded offshore. A corollary of this, however, is that action by Australian regulators against FinTech companies can have a disproportionate impact on the reputation and status of a FinTech company, even in circumstances where a regulatory action is at the lower end of the regulatory pyramid.

Unlike in the case of established financial institutions (which attract various forms of regulatory action on a regular basis), even low-level regulatory action in relation to FinTech companies can have a significant impact on investor confidence and the ability of FinTech companies to grow their businesses.

We believe there is an opportunity for regulators to play a greater role in collaborating with new and growing FinTech and RegTech businesses to ensure that any regulatory concerns are addressed in a proportionate manner, and with a focus on good consumer outcomes and healthy competition rather than mere technical compliance with the law.

While recent legislative and funding changes have enhanced the ability and capacity of regulators, there is more than can be done to enhance the capacity and resources of regulators to enable them to act in a collaborative manner with FinTech and RegTech businesses.

Promoting and supporting innovation

Australian regulators have adopted some world-leading practices in their engagement with startup FinTech businesses. The introduction of regulatory sandboxes, innovation hubs and international cooperation agreements are very positive developments.

There remains, however, significant opportunity for greater collaboration between regulators and both early-stage and growing FinTech businesses. While Afterpay has now grown from an early-stage startup to a significant business in multiple jurisdictions, the continued fast growth of Afterpay and the fact it is a disruptor means that it can require a different type of engagement with its regulators than established institutions.

It is important to acknowledge that not all of the regulatory requirements that apply to the financial services industry are complex or difficult to understand: in particular, consumer protections such as prohibitions on misleading or deceptive conduct and unconscionable conduct. Any business that places customers at its centre, promotes and sells products of value in a responsible manner, and treats customers fairly is unlikely to find itself inadvertently engaging in misleading or unconscionable conduct.

However, beyond these cornerstone consumer protections, there can be no doubt that the financial services industry is subject to myriad laws which are highly complex in their application. Moreover, it is quite possible for a business to fail to technically comply with specific provisions in financial services laws without harming any consumers or its competitors.

On one hand, established institutions have dedicated legal, risk, compliance, regulatory affairs, public policy, and government relations functions - commensurate with the size and scale of their businesses. In contrast, a company still in its fast-growth phase such as Afterpay will be developing these functions as it grows.

Established institutions will also be applying their considerable resources to the operation of established regulatory frameworks. In contrast, growing FinTech businesses will frequently be engaged in business models that were not contemplated by pre-existing regulatory frameworks. Both regulators and businesses are therefore faced with the challenge of interpreting both *how* a regulatory framework applies to particular business practices, as well as the question of *how should* the regulatory framework apply.

Example: distributed ledger technology (DLT)
The emergence of DLT (or blockchain technology) has created uncertainty about the application of existing financial services laws. The application of DLT may engage legal obligations associated with non-cash payment facilities, securities settlement, financial markets, derivatives, and

managed investment schemes. In response, the Australian Securities and Investments Commission (ASIC) has issued an information sheet which acknowledges that there may be uncertainties:

> *At this stage, we believe the existing regulatory framework is able to accommodate the DLT use cases we have seen. However, as DLT matures, we anticipate that additional regulatory considerations may arise. These are most likely to be resolved with early and collaborative dialogue between ASIC and the industry. This information sheet is intended to form part of that dialogue.*[2]

The question of 'how should' is critically important, particularly when regulators are increasingly focused on consumer outcomes rather than technical compliance with the law, and are equipped with product intervention powers that allow them to address consumer detriment in a very flexible manner. A regulatory focus on consumer outcomes is unquestionably the right approach, but it means that important public policy questions must be considered when an innovative business finds itself grappling with the application of an existing regulatory framework.

Regulators already have significant experience in responding to unintended consequences of the application of the law. They have well-established processes to provide relief from the application of various laws, including in matters raising new and novel issues. The provision of exemptions and relief is powerful in two important ways: it ensures that the law does not apply in an unintended manner, but it also provides regulatory certainty to businesses.

Regulatory certainty has always been important, but due to a range of factors, it is more important than ever, and it is especially important to FinTech businesses. Firstly, the potential penalties that now apply to breaches of financial services legislation are now (quite appropriately) enormous. And although courts do not typically order penalties that will result in the bankruptcy of a business, the mere possibility of massive fines can spook investors and seriously harm the continued growth of a company.

Secondly, businesses now face a climate where regulators will be more likely to pursue court-based enforcement action in the event of non-compliance. While established institutions with large legal teams can absorb the cost of this type of regulatory posture, and even use the court system to have questions of law tested,[3] it is rarely an option for a growing FinTech business to be engaged in litigation with a regulator.

Given the complexity of regulation that applies to the financial services industry, growing FinTech businesses are at a significant disadvantage compared with established institutions. Regulators can, therefore, play a greater role in providing growing FinTech businesses with regulatory certainty -

[2] https://asic.gov.au/regulatory-resources/digital-transformation/evaluating-distributed-ledger-technology/
[3] https://www.theaustralian.com.au/finance/money/westpac-defeats-asic-over-debit-card/news-story/20971b37402c395c721b313fbb3bf554

beyond the existing role they play in providing relief from the law. Regulators can also provide regulatory certainty by expressing their view about how the law *should* apply and that they are content for a business to rely on that view.

Regulators already do some of this when they publish formal regulatory guidance, which plays an important role. However, there is a need for regulators to be able to be more agile in their engagement with emerging business models and to more nuanced questions about how the regulatory framework applies. The process of publishing formal regulatory guides does not always lend itself to speed or nuance.

It is important to note that having regulators be more agile in responding to emerging business models will, in many cases, require a range of regulatory approaches.

Traditionally, regulators have been reluctant to 'approve' or 'sign-off' on whether particular conduct will comply with the law. This is understandable - regulators should not be the outsourced legal functions for regulated entities. In the case of growing FinTech businesses, however, there are compelling public policy reasons for having regulators play a more hands-on role in working with businesses - including beyond the initial startup phase.

To achieve this, regulators need more resources: the existing resources dedicated to FinTech and innovation-related initiatives are very small. In Australia, ASIC, the Australian Prudential Regulation Authority (APRA) and AUSTRAC have a fraction of the resources that the United Kingdom regulators have, even after allowing for the difference in market-size. Regulators also need a shift in mindset: regulators already have experience in responding to unintended consequences by providing relief from the law: this needs to develop and evolve so that regulators are also confident in 'making calls' about how the law should apply, underpinned by the spirit of the law, achieving good consumer outcomes and promoting competition.

Giving regulators such an enhanced role would significantly boost collaboration between FinTechs and regulators. This has the potential to achieve significant benefits:

1) FinTechs can grow their businesses and promote competition with regulatory certainty.
2) FinTechs can avoid having to comply with technical regulatory requirements that are not fit for purpose - i.e. requirements that impose substantial costs on a business without any meaningful improvement in consumer outcomes.
3) FinTechs can attract additional capital by avoiding regulatory incidents due to inadvertent or technical non-compliance.
4) Regulators will gain more experience in understanding how their regulatory framework applies in practice, as well as being more proactive in promoting good consumer outcomes (rather than responding when things have already become a problem).

Multiple regulators

There is also an opportunity for clarifying and streamlining the responsibilities of regulators, to ensure that regulatory outcomes are driven towards optimising consumer outcomes rather than creating unnecessary and duplicative regulatory burden.

For example, although ASIC has recently been provided with a competition mandate, it does not have competition powers - unlike its regulatory counterpart in the United Kingdom (the Financial Conduct Authority (FCA)). Although we do not propose that ASIC is given full competition powers, we consider there is an opportunity to allow ASIC to authorise/approve industry initiatives which promote good consumer outcomes but which may technically trigger competition laws.

This issue is particularly relevant in the context of self-regulatory codes of conduct. Many industry codes of conduct will include provisions that are designed to reduce harm to consumers - such as capping or removing commissions, or capping or removing fees. Such provisions can, however, trigger the application of competition laws, and therefore require separate and further approval by the Australian Competition and Consumer Commission (ACCC).

The experience of the recently updated Banking Code of Conduct (Banking Code) demonstrates the inefficiencies associated with the current process. Despite having the Banking Code approved by ASIC, the Australian Banking Association (ABA) was required to obtain separate competition approval from the ACCC.[4]

At best, the current system acts to delay the introduction of better standards by industry participants, and at worst, disincentivises industry sectors from proposing positive and concrete measures for fear of tripping over competition laws.

"Regulated" versus "unregulated"

As noted earlier in this submission, innovative business models will often not fit neatly inside existing regulatory frameworks. In Australia, this has frequently led to commentary that a particular business model or product is "unregulated" - with its associated pejorative implication.

Before ASIC was provided with its broad product intervention power, the notion that a particular financial product might be unregulated (due to exemptions in the law) might have been true. However, ASIC now has the capacity to intervene in relation to all financial products - whether or not they are otherwise regulated under the Corporations Act or National Consumer Credit Protection Act (NCCP Act) - because the product intervention power is applicable to all products and services subject to the ASIC Act. The ASIC Act has the broadest possible coverage over financial services, as it

[4] https://www.accc.gov.au/media-release/banking-code-changes-to-assist-low-income-customers-and-farmers-in-drought

is designed to ensure that the the catch-all consumer protection provisions (such as prohibitions on misleading or deceptive conduct and unconscionable conduct) apply to all financial services without exception.

ASIC's broad product intervention power ensures that all financial services can be subject to fit-for-purpose regulation: it allows ASIC to intervene in a targeted manner, to directly address the potential consumer harms that may be arising in a particular market. This *outcomes-based* regulatory approach is exactly the type of approach that is required for new and growing FinTech businesses.

The design and distribution obligations will also add an important additional layer of outcomes-based regulation. As with ASIC's product intervention power, the design and distribution obligations have broad applicability and provide a comprehensive framework of protection for most consumer financial products (including buy now pay later products). As noted by ASIC, the design and distribution obligations will bring accountability for issuers and distributors to design, market and distribute financial and credit products that meet consumer needs. This will require issuers to identify in advance the consumers for whom their products are appropriate, and direct distribution to that target market.[5]

Taken together, the product intervention power and design and distribution obligations have the capacity to promote good consumer outcomes far more effectively than the traditional regulatory frameworks that have been in place since 2001. As was demonstrated by the Financial Services Royal Commission, the traditional regulatory frameworks have, in many respects, failed to protect consumers from poorly designed products and sharp sales practices. ASIC has described this as the 'anything goes as long as you disclose' mentality by traditional financial services firms.[6]

In this context, we would urge a move away from describing FinTechs that are offering innovative business models as "unregulated". Not only is it not correct to use this term as a general descriptor, it also acts to inhibit the potential of FinTech firms to grow and promote competition. This is because negative public commentary reduces the confidence of consumers, business partners, investors and other stakeholders.

The important role of self-regulation

The Financial Services Royal Commission revealed the need for smarter and more fit-for-purpose regulation and self-regulation as a way to better ensure strong consumer outcomes. Effective self-

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[5] https://asic.gov.au/about-asic/news-centre/find-a-media-release/2019-releases/19-079mr-asic-welcomes-approval-of-new-laws-to-protect-financial-service-consumers/

[6] https://asic.gov.au/about-asic/news-centre/speeches/consumer-outcomes-a-truth-universally-acknowledged/

regulation can and should play an important role in raising industry standards in the interests of consumers.

Effective self-regulation has many benefits, including:

- It is more flexible and adaptable than formal regulation, and allows industry participants to quickly respond to emerging risks in a market sector. The process of implementing legislative change is always time consuming, but particularly so in the financial services area post-Royal Commission.
- It can address potential consumer harms in a tailored and more effective way than regulation: because self-regulatory codes are created within sub-sectors of the financial services industry (such as retail banking, mutual banking, insurance, insurance broking, life insurance, insurance in superannuation, etc) the provisions within such codes can directly address the conduct of businesses and impact on consumers within the relevant sub-sector.
- It can promote confidence by consumers and other stakeholders in the conduct and reputation of an industry sector, particularly where self-regulatory initiatives go above and beyond what is required under the law.
- It can complement and enhance the existing regulatory framework, including by giving concrete and practical meaning to principles-based legal provisions. For example, codes of conduct can elaborate on what it means to treat consumers fairly, or identify the practical steps that businesses can take to ensure they are distributing their products to an appropriate target market.

As recently noted by the Chair of APRA, Wayne Byres:

> *...if self-regulation is not in good shape, we need to restore it. More formal regulation and enforcement cannot be the only answer to the issues of community concern. It must be accompanied by a healthy degree of self-regulation: industry codes of practice with genuine force, stronger frameworks of governance and accountability within companies, and a commitment by individuals to seek to operate with ethical restraint. Everyone needs to step up to the challenge. Governments and regulators can help to restore the foundations for self regulation, but only the industry and its participants can return it to full health.*[7]

The Senate Standing Committee on Economics recommended that the buy now pay later sector create a code of conduct (recommendation 10). The sector is currently working on a code to directly address the issues identified by the Senate Committee, as well as ASIC's Report 600 into the sector.

[7] https://www.apra.gov.au/self-regulation-dead

Competition in financial services

The “regulated” versus “unregulated” commentary is also a feature of how large financial institutions use regulation as a vehicle to try and thwart competition from new industry entrants. In Afterpay’s case, banks have sought to undermine Afterpay’s popularity with Millennial and Generation Z consumers by suggesting (including through mortgage brokers[8]) that obtaining a home loan will be more difficult for Afterpay’s customers due to the operation of the responsible lending obligations.[9] This is despite there being no such regulatory requirement or expectation.

ASIC’s recently updated guidance in RG 209 says that credit providers should consider the full range of existing commitments owed by a consumer, with both traditional and non-traditional forms of credit listed as examples of such commitments. It has long been the case that consumers with multiple credit cards may be required to consolidate their credit card accounts in order to reduce their total credit liabilities (although banks have also typically provided their home loan customers with a ‘bundled’ credit card when approving home loan applications). The notion that a credit card with a limit of $5,000, $10,000 or $20,000 is ‘safer’ than an Afterpay account that allows consumers to borrow up to $2,000 (and typically much less - the average outstanding balance is $208) repaid over four instalments is simply not credible.

Banks have also self-interestedly argued that responsible lending laws should apply to Afterpay,[10] even though the Financial Services Royal Commission revealed poor or non-existent compliance with such laws by the same banks that are subject to them.[11] The Royal Commission also revealed that mere compliance with responsible lending laws is no guarantee of good consumer outcomes, and that good product design plays a more critical role in preventing consumer harm.

In Afterpay’s case, our product is purposefully designed with important consumer safeguards in place and turns the traditional model of credit on its head. Unlike a traditional credit product, Afterpay does not charge interest - ever. This means we do not charge interest (or worse, default interest) if consumers are late. Instead, we apply late payment fees, but these fees are capped at a fair level and can never exceed 25% of the original value of the customer’s order or $68, whichever is less. In addition, we freeze a customer’s account as soon as a payment is missed, to prevent the customer from taking on more than they can afford. This is in stark contrast with credit cards, where very low minimum payment requirements mean that consumers can extend their credit card debt over many years (or decades) at interest rates of 20% or more.

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8 https://www.smh.com.au/business/banking-and-finance/avoid-using-afterpay-if-you-want-a-home-loan-mortgage-brokers-warn-20191018-p53234.html

9 https://www.news.com.au/finance/business/banking/dont-use-buy-now-pay-later-services-if-you-want-a-home-loan-mortgage-brokers-warn/news-story/e10021145efea4ae9fcd82e2e4c26ec1

10 https://www.smh.com.au/politics/federal/big-banks-launch-assault-on-predatory-buy-now-pay-later-rivals-20190108-p50q6h.html

11 https://www.smh.com.au/business/banking-and-finance/breaches-of-responsible-lending-laws-widespread-20180927-p506g5.html

Our approval process is designed to ensure that our customers can afford their purchases. Using a sophisticated decisioning algorithm, we make intelligent, real-time decisions about every transaction, underpinned by proprietary technology. All purchases using Afterpay are assessed using advanced fraud and real time repayment capability checks at the time of each and every order. Unlike for credit cards, we do not make one-off decisions to approve customers with large spending limits. New customers are provided with low spending limits (usually around $500), are required to make their first instalment payment upfront, and we will only increase limits once customers have demonstrated a positive repayment behaviour over time.

This approach has strong foundations. Repayment behaviour is widely considered one of the strongest predictors of future repayment capacity, and Afterpay's experience is consistent with this. Our credit losses for more established customers (who generally have higher spending limits) are smaller than for new customers with low spending limits.

Although Afterpay is not subject to the NCCP Act, we have been a voluntary member of the Australian Financial Complaints Authority (AFCA) (and its predecessor scheme) since 2016. Providing consumers with access to AFCA is a critical consumer protection and we are proud of the low number of complaints that are taken to AFCA by our customers. The vast majority of the low number of complaints relate to cases where we have frozen or cancelled a customer's account due to non-payment. We also operate a generous financial hardship policy that provides the same, if not greater, assistance for consumers than the requirements of the NCCP Act.

Afterpay makes money when our customers pay us back in full, and we have designed our system in a way that enables customers to do so. We issue reminders four days before a payment is due, and if a payment is missed, we send an immediate reminder on the same day to enable the customer to make a payment before a late fee is applied.

The idea that an Afterpay customer is a higher-risk for a bank when applying for a home loan is clearly disingenuous. A significant proportion of younger generations are avoiding credit cards and using Afterpay as a budgeting tool. These customers are forming strong savings habits, and 85% of them are using debit cards to manage their finances with Afterpay. Banks should be rewarding consumers that can meet their repayments with Afterpay and avoid long-term high-interest revolving debt. An Afterpay transaction can never last more than four fortnightly payments: we do not allow customers to pay extra fees or interest and 'kick the can down the road' by extending the payment time frame. Afterpay's customers do not take on long-term financial commitments.

Consistent with ASIC's updated regulatory guidance in RG 209, Afterpay's customers are in an excellent position to adjust their spending behaviour - if required - in order to meet the repayments under a home loan. Banks already know this: they are not actually rejecting home loan applications simply because someone is an Afterpay customer. The idea that a significant proportion of

Millennials, and over 3 million Australians and growing, will be turned away by banks when applying for the banks' most profitable product clearly does not stack up.

By only increasing a customer's spending limit after they have demonstrated strong repayment behaviour, Afterpay ensures that lending responsibly is built into our business model. Banks that shun Millennials and their new ways of spending risk losing business to forward-thinking financial services businesses that are interested in attracting the economy's valuable customers.

Ultimately, it is our popularity with consumers and merchants, and our very low default rate, that demonstrate that our model and proprietary risk management system works. Our default rate[12] was 1.1% in FY2019, comparing favourably against the major banks and other traditional credit providers who are subject to responsible lending laws.

RegTech

Afterpay is a member of the RegTech Association and supports the submission it has made to this inquiry. Although Afterpay is not a RegTech business, it is a natural user of RegTech solutions to help meet its compliance obligations as it grows.

The key RegTech issues we would highlight in this submission reflect many of the matters already noted above, including the need for regulators to collaborate with industry, and the need for regulators to be adequately resourced to allow for effective collaboration.

As with any technological (and indeed human-based) solution, no RegTech solution is perfect and free from errors. It is important for all stakeholders to recognise this reality, and for proportionate and balanced responses when things do go wrong. Similarly, to enable greater adoption of RegTech solutions, and to allow for the significant benefits of such solutions to be realised, there must be an appreciation of the likelihood that legacy compliance breaches may be surfaced as RegTech is implemented.

The regulatory response to a technology-linked compliance breach requires consideration of the compliance culture of an organisation. This is particularly important because companies with strong compliance cultures are more likely to be identifying compliance breaches within their systems and processes. Regulators that take strong enforcement action in such situations may disincentivise companies from investing in RegTech because of the negative regulatory consequences of doing so.

[12] Default rate or gross loss refers to receivables impairment expense as a percentage of underlying sales.

Conclusion

Afterpay appreciates the opportunity to provide this submission. Please do not hesitate to contact our Director of Public Policy & Regulatory Affairs, Michael Saadat, at michael.saadat@afterpay.com.

Yours sincerely

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