19 June 2024

Consumer Policy
Building, Resources and Markets
Ministry of Business, Innovation & Employment

By email: consumer@mbie.govt.nz

Submission to Discussion Paper on fit for purpose consumer credit legislation

Afterpay welcomes the opportunity to provide this submission to the Ministry of Business, Innovation and Employment (MBIE) in response to the Discussion Paper on fit for purpose consumer credit legislation (Discussion Paper).

Afterpay is an Australian-founded financial technology company and the leading Buy Now Pay Later (BNPL) provider in New Zealand and internationally. Since 2017, we have helped more than half a million Kiwi consumers and supported tens of thousands of businesses of all sizes across the country. We are a member of the Financial Services Federation (FSF) – the industry body representing responsible and ethical non-bank finance providers operating in New Zealand – as well as FinTech NZ, which promotes technology and innovation in financial services.

Overarching comments

Afterpay welcomes the release of MBIE's Discussion Papers on the Government's consumer credit reforms, which seek to simplify and streamline regulation, remove undue compliance costs for financial markets participants, and improve outcomes for consumers. We provide in-principle support for the FSF's submission, in addition to providing our own perspective on these issues. At a high level, these recommendations include:

- **The removal of the due diligence duty for directors and senior managers of consumer credit providers**. As the FSF explains, these requirements may be disproportionate and have unintended consequences for lenders and consumers. Alternatively, of the options presented in the Discussion Paper, our preference would be the retention of the due diligence duty but the removal of restrictions on indemnities and insurance (option A1). This, however, poses a number of issues, including imposing costs on lenders, which may overwhelm the stated benefits of the obligation.
- **Further clarification is required on the proposed transition of consumer credit supervision from the Commerce Commission to the Financial Markets Authority** (FMA). More information is needed as to how lenders – particularly non-bank lenders and FinTech providers – will be supervised by the FMA and the obligations that would apply. If the Government proceeds with the transfer of regulatory responsibility to the FMA, our preference would be to transition to a market services licence model under option B1, which broadly aligns with the Australian model and other international approaches to regulating consumer credit. A transitional period of at least twelve months would be appropriate.

- **Existing disclosure obligations in s.35 of the Credit Contracts and Consumer Finance Act 2003 (CCCFA) may require some clarification.** This section provides that disclosure is generally considered to be 'made' when sent and this applies to initial disclosure (s.17), request disclosure (s.24), variation disclosure (s.22 and s.23), transfer disclosure (s.26A), and debt collection disclosure (s.132A). Section 23(7) however provides that disclosure does not have to be given if the debtor cannot reasonably be located. This could infer that the disclosure would not be considered effective under s.23 if the lender is aware that the customer has not received the disclosure, unless 'reasonable' location attempts were undertaken. To minimise this uncertainty, we recommend that s.23 be amended to make clear that disclosure under s.23 can be considered 'made' when sent.
- **Afterpay supports option D2, which would provide greater flexibility by lifting the conditions related to electronic methods of disclosure** while ensuring the disclosure is readily accessible in a permanent and legible form at all times over the life of the contract. Borrowers – particularly younger generations – now expect digital communications and electronic disclosures, rather than that being the exception. This is true of Afterpay's customer base who purposefully engage with a digital product. The CCCFA should be technology-agnostic on this issue and allow the lender and borrower to decide what is the most effective means of disclosure or communication.
- **Afterpay supports the review of the high-cost credit provisions, introduced in 2020 to address the excessive cost of these credit products**, **the debt spirals they create, and their impact on vulnerable consumers**. We support these provisions, which as MBIE notes, has led to the contraction of the high-cost lending market, leading to fewer individuals encountering financial difficulties as a result of this product design.

In addition to these recommendations, we wish to provide some broader context on the BNPL sector in light of the Discussion Paper's commentary, which includes some incorrect information about how products like Afterpay work. To that end, the final part of this submission outlines our product design and in-built consumer protections, how our customers use our product, and why New Zealanders are choosing Afterpay as a low-cost and better alternative to high-interest credit cards.

This context is very important for policymakers examining the policy settings around consumer credit – particularly as innovative new models disrupt highly concentrated financial services markets and enhance competition to the benefit of consumers.

How Afterpay works

Afterpay offers 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. In circumstances where the customer does not pay their instalment payments on time, their service is suspended until any overdue payments are met, and late payment fees can be applied. These fees are capped at a fair level and do not accumulate or compound over time. They can also never exceed 25% of the original value of the customer's order or $68, whichever is less.

This is in stark contrast with other traditional credit products, like credit cards, where very low minimum payment requirements mean that consumers can extend their credit card debt over many years at interest rates of 20% or more. It also means that Afterpay's business model and profitability rely on consumers paying on time and therefore not incurring any charges – non-paying consumers cannot generate new sales for Afterpay.

MBIE states in the Discussion Paper that "most of the profits from BNPL users rely on them defaulting." This is not true. Afterpay has purposefully designed a product that derives the vast majority of its revenue from merchants by offering a platform for risk assumption and customer acquisition in exchange for negotiated merchant transaction fees. Merchants invest in providing the Afterpay service to their customers because Afterpay provides a powerful marketing platform for reaching consumers, as well as reducing their operational costs. As a result, the cost of Afterpay is not borne by the consumer which in turn drives positive merchant outcomes.

Our customers

Afterpay is used by consumers across the country – from young women just starting their professional lives to retirees settling down. While our customer base skews towards younger generations – Millennials and Gen Z – the average age of an Afterpay customer is about 37. Our strong representation among these emerging generations reflects a growing trend among young people to avoid high-interest credit products.

Our research shows that the majority of our customers are mindful of their purchasing habits. Customers use Afterpay as a tool to help them spread the costs of items and better manage their finances.[1] It is clear that when customers are unable to access other forms of credit, due to our product design, Afterpay offers significant benefits in allowing them to access short-term, interest-free credit to meet their everyday needs.

In 2020 alone, Accenture analysis in Australia found that Afterpay customers saved over $110 million when compared to traditional credit cards.[2] That research also found that vulnerable consumers gain the most from switching from credit cards to Afterpay. The most vulnerable credit card users pay up to seven times more in fees compared to Afterpay customers.[3] Further, the overwhelming majority of Afterpay transactions are from repeat customers who have shown positive repayment behaviour.

Recent economic analysis by BIS Oxford Economics, commissioned by Afterpay, also found that Afterpay customers in New Zealand received between $22 million and $45 million in gross benefits in 2022 with the key benefits being savings from avoided interest and better budgeting, smoothed cash flows and greater control over finance.[4] That research found that 66% of Afterpay customers indicated that avoiding interest payments was an important benefit of Afterpay. BNPL customers also described a range of benefits such as ease of repayment of large purchases (50%), better tracking and management of repayments (48%), and easier completion of online payments (36%). Respondents viewed Afterpay as superior to credit card usage on a number of criteria, particularly due to the fact that no interest was charged (66%), it was easier to pay as amounts were broken down into smaller instalments (50%) and it was easier to track and manage payments (48%).

---

[1] Accenture, The Economic Impact of Afterpay, 2020.
[2] Accenture, The Economic Impact of Afterpay, 2020.
[3] Accenture, The Economic Impact of Afterpay, 2020.
[4] BIS Oxford Economics, Economic Impact of Afterpay in New Zealand, March 2023.

The Discussion Paper correctly notes that more and more consumers are adopting BNPL. Yet the BNPL market is still in its nascency having only been in operation for roughly a decade. Afterpay, for example, was founded in 2014. Since then, the BNPL industry has grown rapidly yet represents less than 1% of payments and less than 5% of retail spend in most jurisdictions. Its growth in New Zealand, driven by home-grown companies and emerging fintechs, has significantly disrupted the traditional credit industry. This disruption is leading to more choice, and ultimately better outcomes, for consumers. BNPL is also providing much needed competition in the consumer credit market as younger generations of consumers vote with their feet and adopt more consumer-friendly products like Afterpay, rather than opting for the incumbent credit card market.

Importantly, the potential sources of consumer detriment from BNPL products remain limited. Centrix data demonstrates that hardship levels as a result of BNPL use have remained consistently low (0.4%, or 4 in every 1,000 BNPL customers). The level of consumer hardship relative to Afterpay's customer base remains low – in FY22, we received 4,079 hardship applications (which represents less than 1% of our total customer base) and 100% of these were approved. Further, Centrix data shows that when comparing consumer outcomes by age cohorts, BNPL arrears (for a given age cohort) are no higher, and in some cases lower, than credit cards and personal loans. Average credit scores for BNPL are also higher than personal loans.[5]

Regulatory guardrails

BNPL providers will soon be subject to the CCCFA, complementing our existing inbuilt protections.

The New Zealand Government determined in August 2023 that the CCCFA should be applied in a fit for purpose and proportionate manner to BNPL products. Afterpay welcomes this regulatory framework. As a result, BNPL products will be required to undertake credit checking on new customers, report positive and negative customer repayment performance to credit bureaus, and develop a credit policy that explains how credit report information is used when assessing whether or not to provide credit to a borrower.

Formal regulation under the CCCFA is bolstered by PayWatch – an industry-led BNPL indebtedness indicator launched in partnership with New Zealand credit bureau, Centrix.[6] This initiative represents a tailored and effective response to the risk of vulnerable consumers using multiple BNPL accounts when they are in financial difficulty.

Under PayWatch, each BNPL industry participant accessing the Centrix service is alerted if a new account applicant has an active overdue account with another BNPL participating provider. The service operates based on a daily feed from each participant denoting every active account that is overdue, in circumstances where a customer has consented to their information being disclosed for this purpose. Where one or more payments is more than seven days overdue, participants are alerted of that new potential customer's status, and the number of BNPL providers that have provided an overdue status on that potential customer.

[5] Centrix, Buy Now Pay Later Insights, August 2022.
[6] 'Centrix and 'Buy Now Pay Later' providers launch world-first PayWatch initiative to deepen customer protections', 10 May 2023.

This information will be used as part of the upfront affordability assessments being conducted by BNPL providers to ensure we continue to lend responsibly. Each BNPL provider is still responsible for making their own independent decision on whether to provide its services to any such customer.

PayWatch has a number of important advantages over the traditional credit reporting system. It is closer to real-time in providing an indication of someone's indebtedness status with a BNPL provider and has comprehensive coverage of consumers using BNPL products, whereas many younger adult consumers have thin or blank traditional credit files with the credit reporting bureaus.

Commentary on BNPL

Consideration of these internal and external guardrails is largely absent in the Discussion Paper.

BNPL represents some of the lowest cost credit products available to New Zealand consumers. In fact, the Australian Treasury categorised BNPL products as "low-cost credit contracts" (LCCCs) in its draft legislative package for the BNPL sector. This reflects the fact that products, like Afterpay, have been designed differently to traditional credit, including by:

- Preventing customers from spending if they are in arrears.
- Starting customers on a low initial spending limit that only increases gradually with proven on-time repayment behaviour.
- Providing dynamic spending limits, which may increase or decrease depending on the customer's repayment performance.
- Requiring new and many existing customers to make their first repayment upfront for each purchase.
- Not providing a guaranteed line of credit..
- Capping late fees at a fair and reasonable level.

These consumer protections have successfully contributed to 95% of all Afterpay instalments being paid on time and 98% of all purchases not incurring late fees in Q1 2024.

While the Discussion Paper comments on BNPL, it largely ignores consumers using existing credit products with interest rates of 20% or more, like credit cards, which offer consumers high revolving credit limits of upwards of $10,000. This is despite the Discussion Paper observing that while:

> *"...there are no longer debt spirals resulting from high-cost loans since the high-cost consumer credit sector was eliminated... debt spirals may still occur for other types of consumer credit."*

The primary source of debt spirals is credit cards and other high-interest products, as a direct result of their product design which supports their business models. The Discussion Paper states that "the lenders we have talked to have not reported an increase in the take-up of longer-term loans". However, Centrix data shows credit card demand increasing year over year[7] and Reserve Bank of New Zealand data shows credit card spending increasing over the four year period from 2020.[8]

[7] Centrix Credit Indicator Report April 2024.
[8] Reserve Bank of New Zealand.

The Discussion Paper also notes that the withdrawal of high-cost loans should have theoretically resulted in lower costs of borrowing. Instead, the cost of borrowing across consumer credit products has remained stable. Over the past decade, the average interest rate on credit cards monitored by the Reserve Bank of New Zealand has remained around 20%, despite significant reductions to the official cash rate.[9]

It is important to note that credit cards also operate regressively, with poorer consumers cross-subsidising wealthier consumers. Wealthier households use credit cards in a savvy way to earn reward points, while avoiding interest by repaying balances in full each month (these consumers are known as 'transactors'). These transactors are not profitable for the banks issuing credit cards. Banks instead rely on lower-income consumers who do not repay their balances in full each month and incur interest rates of 20% or more.

This means that credit card customers who pay their balances in full each month are heavily subsidised by those who revolve in interest. Conversely, no cohort of Afterpay customers cross-subsidies any other. While Afterpay does earn revenue from customers directly via late fees, this is a small percentage of our total revenue. That is why vulnerable consumers save the most by shifting to Afterpay from credit cards, being up to seven times better off.

Supporting financial access

Access to low-cost and transparent BNPL products, like Afterpay, has supported a vast number of New Zealanders, many of whom have been underserved by the consumer credit market.

Many BNPL customers are eschewing traditional high-interest credit products entirely and choosing a better alternative at the outset. As noted above, Afterpay generated net benefits of over $153 million for consumers and merchants in New Zealand in FY22. Benefits included interest and fee savings, budgeting benefits to consumers, growth in sales and associated profits for merchants, and cost efficiencies for merchants. These benefits are significant, particularly for consumers who would otherwise have used high-cost credit cards, which risk consumers falling into a debt spiral.

Afterpay's spending limits in response to payment behaviour can proactively support customers who may be more vulnerable at the first sign of financial difficulty. We provide customers with the space and time to address any financial challenges before they are able to access any further spending. If consumers are in financial difficulty, we have an extensive and sensitive hardship policy in place to support them, and we refer customers to the relevant financial mentors and budgeting services that can provide guidance to customers with debt problems.

Conclusion

Thank you for the opportunity to make this submission. We look forward to ongoing engagement with MBIE. Please do not hesitate to contact us if you require further input or clarification.

[9] Reserve Bank of New Zealand.