Submission.

Treasury Payment System Review

Klarna Australia Pty Ltd

Level 16, 175 Pitt Street

Sydney NSW 2000 Australia

ABN 82 635 912 579

Introduction

Klarna welcomes the opportunity to comment on Treasury's Payment System Review.

Given Klarna's relatively recent commencement of operations in Australia and the review's comments on developments in the payments system (and buy now pay later specifically), this submission:

- Introduces our business, provides information on our approach to responsible onboarding and ongoing management of customers.

- Provides some high-level comments on the regulatory architecture of the Australian payments system.

We believe one valuable outcome from Treasury's review would be a recommendation for government, regulators and industry to work together to create a shared vision for the Australian payments system. This would be focused on delivering clear benefits for consumers, small business and the broader economy, would provide a focal point for the sector's efficient development and reduce the potential for complexity to creep in over time due to competing reviews and legislative change.

About Klarna

Klarna is a global payment provider founded in 2005 in Stockholm, Sweden. We are a fully licenced bank in Europe and process 1 million transactions per day across 17 international markets. Klarna is now one of the world's largest private fintechs, with a valuation of over $US10.65bn. In January 2020, Klarna entered the Australian market in partnership with the Commonwealth Bank of Australia and operates independently as Klarna Australia Pty Ltd.

Globally, Klarna serves more than 90 million consumers and is partnered with over 200,000 merchants, including H&M, IKEA, Expedia Group, Samsung, ASOS, Peloton, Abercrombie & Fitch and Nike globally; and Country Road, Cotton On, Kogan.com, Appliances Online, JD Sports, Roses Only and Dick Smith in Australia.

Klarna is driven by making the shopping experience easy and pleasurable for our customers. We aim to give shoppers greater control and flexibility over their spending and cash flow. In so doing, our products also unlock value for retailers and enable them to compete more effectively.

In Australia, Klarna currently offers a direct to consumer shopping app, which enables consumers to shop online and in-store with the Klarna app and pay for purchases in four fixed bi-weekly instalments with no upfront fees or interest. There are two ways to use Klarna:

1. Through our App (which enables consumers to shop at any retailer, online or in-store, regardless of whether they are integrated with Klarna); and

2. Via a direct integration, which allows consumers to select Klarna as a payment option at checkout on an integrated retailer's website.

Klarna introduced the innovative "shop anywhere" feature outlined in point 1 above to the Australian market. Klarna will continue to innovate and expand its product offering in the Australian market to deliver additional solutions for consumers and merchants.

We employ a growing team of approximately 50 people in Australia and have over 3,500 employees globally.

Klarna's approach to responsible onboarding and sustainable finance

Klarna is fully committed to the Australian market and building a long term and enduring business which provides innovative products and services to Australian consumers. As part of this commitment we recognise that customer preference and loyalty underpins business success and, as such, we believe that good consumer outcomes are essential.

As an intermediary, Klarna takes on risk on both sides of a transaction. We therefore have a strong interest and motivation to ensure we are only offering our products to those consumers and merchants for whom they are suitable.

We want to ensure that all our products are appropriate for all our customers, that our customers can increase their access as we build a better picture of their purchase and repayment behaviour and that access is restricted if a customer is in a vulnerable state.

Klarna is a fully licenced bank in Europe and is regulated across all European markets. As part of this, Klarna, and its operations, are subject to ongoing monitoring and supervision by European financial regulators and we apply the same strict standards across our business and products globally. In Australia, Klarna offers a mature and tested process to protect vulnerable customers and deal responsibly with financial hardship.

To this end, we take the following approach:

- Each transaction with Klarna is assessed and approved individually - our product is not an open line of revolving credit .

- We are transparent about the fact we credit check our customers before their first purchase with us, as part of their onboarding process.

- Credit checks are conducted by the independent credit agency Illion.

- The credit check does not change the customer's credit score (however the fact that we have checked is visible to future parties who may view the report) .

- In addition, Klarna conducts an affordability assessment which considers a range of relevant factors to accurately assess a customer's financial situation.

- We do not allow access to any customer who our checks indicate is in a vulnerable state.

- We may conduct additional credit checks in certain circumstances, usually if there has been no activity on a customer's account for an extended period. This is because we may need to make sure that an individual's circumstances have not changed during the period of inactivity with us.

- First-time customers are given a lower initial spend limit with Klarna. Their spend limit for future purchases is increased as they display strong positive behaviour such as making repayments on time and as we build a better understanding of them.

- Each transaction has a set repayment schedule (spread across four equal instalments, one every fortnight), however customers are also given flexibility in how they make their repayments to suit their individual budgeting and cash flow requirements, (they are able to make one or all payments early at no charge, or they can request to "snooze" a payment. The snooze option incurs a small charge, however it allows the customer to avoid a full late fee, it can be used once per purchased item and delays the payment plan by 14 days).

- Should a customer fall behind in their repayments, they are prevented from using Klarna to make additional purchases until such time as their payment plan is back on track. This safeguard is an important part of preventing them from getting into further arrears or significant difficulty - and is a major point of difference from many other credit products.

- Klarna's rewards club (our category-leading rewards program launched in October) is designed to encourage responsible spending and repayment: customers only receive vibes (points) and rewards when they have made their repayments.

- If a customer indicates to us that they are experiencing financial hardship, our highly trained customer service team works directly with them to develop a plan to fulfill their outstanding payment.

- Late fees are applied to late payments; this is part of encouraging sustainable spending and repayment practices. However, late fees are strictly capped and Klarna actively seeks to help customers avoid them through advance push notifications, SMS and/or email ahead of scheduled payment dates.

- If a customer indicates an issue with their order or informs us they have returned their purchase, we will immediately pause their repayments and arrange refund once receipt is confirmed.

- Klarna views late fees as “negative” revenue as they indicate a poor customer experience. They have been applied to an extremely small proportion (<1%) of volume that has been written since they were introduced in August 2020.

Klarna has also initiated and continues to develop an ongoing *Mindful Money* campaign, which promotes considered, responsible spending and financial wellbeing, in line with our product offering. It also provides useful information, insights and tips via a dedicated section on our blog, as well as partnering with leading financial wellness commentators to provide their insights to our customer base.

Regulatory architecture

General comments

Klarna operates in 17 markets around the world and is accustomed to working within different regulatory frameworks.

We believe that appropriate, fit-for-purpose regulation can play an important function in building consumer and business confidence in well functioning markets. While our generally preferred starting point is self-regulation, we also recognise that regulation can be required if it is found to drive demonstrably better outcomes and more consistent treatment of players across a sector. When it is applied, Klarna believes that it is critical that regulation balance the following priorities:

- Delivering positive consumer outcomes with meaningful benefits

- Encouraging innovation and investment by businesses and individuals, to deliver further consumer benefits

- Fostering healthy competition between businesses of all sizes.

The rapid development of technology and innovation within global payments means it is an appropriate time for Treasury to review payment regulation. There is significantly more intermediation layering and complexity within the system than when the architecture was first developed.

Coordination

We believe there is value in Treasury reviewing coordination between the various regulators (Reserve Bank, ASIC, ACCC, AUSTRAC and APRA), other industry participants and the government to enhance cooperation, ensure the most effective distribution of responsibilities and eliminate any areas of overlap and the associated uncertainty that arises from duplication.

Some high-level observations:

- The RBA's dual role of policy development and regulation within payments, and the ACCC's role of surcharging enforcement, could be a source of potential ambiguity and uncertainty for the industry.

- Current payment systems regulation influences the payment systems designated by the RBA (Visa, MasterCard, American Express, Diners Club), which represent an important yet incomplete picture of the monetised online payments arena. Digital wallets, gateways, aggregators, POS software providers and shopping card providers all have a pecuniary interest (and therefore an effect on merchant and consumer outcomes) in the processing of payments through, or as a result of, their respective platforms.

- There appears to be substantial overlap in the regulation of consumer protections within payments, leading to potential inconsistency and uncertainty. For example, in a single consumer payment journey, the RBA, ASIC and ACCC may all carry vested regulatory interests in that journey, be it in licensing of the payment provider, overseeing their conduct, the content and placement of fee disclosures, or the application of surcharges. There may be scope to rationalise or combine responsibilities to improve clarity and outcomes.

- Regulation based on activity rather than whether a product fits in a finite and prescriptive class conferred by the Australian Wallis-based regime has a proven track record of success in Europe. A similar approach was also taken by the Monetary Authority of Singapore in that country's recent financial services reform. In this sense, one area of focus for this review could be the effectiveness of the non-cash payment facility licence class and whether that has been, and will likely continue to be, a sound approach to consumer protection against unscrupulous conduct in payments.

- In considering how to facilitate and unlock the benefits of new financial products developed by existing financial service providers and new financial technology ('fintech') and regulatory technology ('regtech') firms, Australia could draw on the experiences in other jurisdictions such as Singapore and the UK. In these countries, the regulatory frameworks are different but there has been a focus on developing an overarching strategy and establishing regulatory settings that, not only permit the operation of fintechs but, proactively foster an environment for innovation and competition to turn these jurisdictions into regional hubs for fintech/regtech to grow, and attract resources and talent to the finance and banking sector.

Self-regulation

As outlined above, Klarna believes there is a role for both self-regulation and direct regulation depending on the context and needs of a specific market. Klarna notes that a feature of Australia's approach to regulation has been a strong role for industry self-regulation. We also note that a report by the OECD Committee on Consumer Policy concluded that industry developed, principles-based, self-regulation that has the commitment of all participants can better address, and be more responsive to, issues of consumer protection and competition[1].

New sectors, such as Buy Now Pay Later (BNPL), are often characterised by multiple firms employing new technologies, operating different business models within a highly competitive market, and offering a range of different product constructs and use cases. In such scenarios, direct regulation developed by Government may not sufficiently address identified issues which can manifest differently across industry participants and the risk of a 'one-size-fits-all' approach is likely to impose unnecessary compliance burden and costs upon firms.

Self-regulation generally offers greater flexibility to respond to the rapidly changing nature and large number of independent intermediaries in the Australian payments system. We also recognise that the development of robust industry self-regulation includes the participation of Government, consumer organisations and other stakeholders. Appropriate self-regulation, as highlighted in the Treasury report on Industry Self-regulation[2], provides industry participants with a level of certainty and stability which fosters an environment for further competition and innovation, whilst giving customers a level of confidence that the design of regulation is fit for purpose.

As noted in Treasury's Issues Paper, the BNPL sector is currently developing a BNPL Code of Practice through the Australian Finance Industry Association (AFIA), expected to commence in 2021. Klarna is participating in the Code development process.

Surcharging & interchange fees

Klarna notes the current discussion around surcharging and the Reserve Bank's recent comments that there is not currently a public policy case to remove the no-surcharge requirements in BNPL.

Based on our experience in other markets, Klarna views surcharging as a poor consumer experience with no demonstrable public policy benefit. We support a review on whether

[1] OECD (2015). Industry self-regulation: Role and use in supporting consumer interests. https://www.oecd.org/officialdocuments/publicdisplaydocumentpdf/?cote=DSTI/CP(2014)4/FINAL&docLanguage=En

[2] The Treasury (August 2000). Report prepared by the Taskforce on Industry Self-Regulation. Industry Self-Regulation in Consumer Markets. https://treasury.gov.au/sites/default/files/2019-03/final_report.pdf

current cap on interchange fees are appropriate to keep transaction costs down for consumers and businesses, particularly small businesses.

Balance of risk and efficiency

It is important that regulation of payments strikes an effective balance between managing risk and delivering efficient outcomes. A case in point is the development of the Consumer Data Right (CDR).

Klarna strongly supports the underlying principle behind the government's introduction of CDR: giving consumers greater power over the use of their data. Open Banking has enormous potential benefits in democratising financial data access while delivering benefit to the market and consumers in enabling competition and choice of services.

We also understand and absolutely respect the need for security in the system. However, it is also important that these important checks and balances are delivered while remaining mindful of the consumer experience. Technology should allow greater security to be delivered without requiring unnecessary duplication of process. A smooth and positive consumer experience with CDR, particularly in its early days, is important for the system's credibility.

Similarly, when considering the differing requirements that exist for participation in other platforms/regimes such as the New Payments Platform, Comprehensive Credit Reporting, and the evolving Digital Identity framework, there is a significant risk of creating unnecessary compliance overhead for firms and creating poor experience outcomes for users who wish to access these products and services. To address these risks and eliminate duplicative costs, it would be desirable for the Government to take a lead on harmonising standards across these national platforms/regimes and establishing a central point of coordination for financial regulators and industry alike.

Contact

Angus Trigg

Head of Australia Communications & Public Policy
angus.trigg@klarna.com
+61 431 035 167