

ZIP'S SUBMISSION TO TREASURY ON BNPL REGULATION OPTIONS

Zip Co Limited ('Zip') welcomes the opportunity to provide a submission to Treasury's *Regulating Buy Now, Pay Later in Australia* ('**Options Paper**') and is appreciative of the engagement that has occurred with Treasury in the lead up to this paper.

Zip is an ASX-listed (ASX:ZIP) leading global financial services company, offering innovative, consumer centric products that bring customers and merchants together. Zip offers point-of-sale credit and digital payment services in numerous markets around the world, including through strategic investments. It operates the Zip Pay and Zip Money products in Australia, along with a presence in New Zealand, and the United States.

This submission provides Zip's position on why any form of regulatory intervention into the commercial arrangements of 'Buy Now Pay Later' ('BNPL') providers should be 'fit for purpose' and as such, **Zip strongly supports Option 2** set out in the Options Paper.

This submission is limited to information Zip considers pertinent for Treasury's review. For this reason, the submission is not structured to respond to each individual question posed in the Options Paper.

In line with the evidence-based approach expected of the Australian Government's *User Guide to Regulation Impact Assessments*¹, we have also assessed, where possible, the impacts of compliance associated with the Options. These impacts are qualitatively assessed given the uncertainty associated with the final regulatory position. We would welcome further consultation with Treasury and other stakeholders to ensure the regulatory burden measure is properly assessed against the principles outlined in the Options Paper.

While we support AFIA's submission on behalf of industry, we believe there are areas where there is scope to take a stronger regulatory position. Many of these views are consistent with the position that Zip has long advocated to Government, and also consistent with views presented in the public domain.

¹ *Australian Government Guide to Regulatory Impact Analysis*, Office of Impact Analysis, 2020

Zip's key points of submission

1. **Option 1** - suggests inclusion of bespoke provisions in the Credit Act to check that the BNPL product is not unaffordable for a person before offering it to them. Zip does not think this approach goes far enough to give protections to vulnerable customers and those who are already in hardship or cannot afford the repayments.
2. **Option 2** - Zip strongly advocates for Option 2. We believe that amending the Credit Act to require BNPL providers to hold an ACL will ensure the right obligations for internal and external dispute resolution, hardship provisions, compensation arrangements, fee caps and marketing rules. Zip already exceeds the obligations required under the AFIA BNPL Code of Conduct. Zip would, if requested, provide to ASIC our assessment process so that there is transparency on how we undertake due diligence for new applications.
3. **Option 3** - Zip does not support this option primarily because of the large impost to participants.
4. Zip believes that regardless of product construct or fees, products that provide larger credit limits over longer terms should be subject to a higher level of regulation. Setting a threshold level would not be inconsistent with the AFIA BNPL Code which applies a scalable approach to a consumer's ability to afford the BNPL credit.
5. Zip would like to restate its support for greater regulatory coordination and collaboration between agencies and bureaucrats. We believe value could be added via more collaboration between bureaucrats, legislators and regulators so as to avoid regulatory overlaps and inconsistency and unnecessary overhead around conduct and compliance.
6. Zip promotes a pro-consumer approach. For example, we have developed good working relationships with consumer representatives, including Financial Counselling Australia (FCA) who meet quarterly with Zip's executives and senior leaders to discuss customer issues. Zip also supports the Australian Government's programs such as the Moneysmart website, the Money Managed website, and the Commonwealth Financial Counselling resources. Zip also partners with Australian debt solutions charity *Way Forward* to support Australians in financial hardship.
7. Zip supports the principle around the enforceable role of ASIC being cost effective and efficient so that it minimises the risk of avoidance behaviour while considering the existing regulatory framework of the self-regulatory BNPL industry code. We accept that as part of formally regulating BNPL under the Credit Act, it may warrant a corresponding extension of ASIC Industry Funding Model (IFM) arrangements as part of its cost-recovery for regulating the BNPL sector. However, the IFM should be designed to ensure good corporate citizens do not disproportionately bear the burden of financing ASIC's efforts to enforce the law against those who may not be meeting the necessary standards.
8. Zip strongly supports the Options Paper's consideration to monitor and measure outcomes arising from BNPL use and the effectiveness of any reforms and initiatives.

General overview of Zip products

Zip is one of the leading providers of BNPL in Australia. Zip is focused on offering transparent, responsible and fairly priced consumer credit and payment solutions. Since inception, Zip has conducted credit, identification and affordability checks on its customers.

Zip has always taken the view that BNPL is a form of credit and a powerful tool for consumers to take control of their finances (see 2019 Senate Standing Committee Zip submission).² Our customer and credit assessment processes reflect this position — the Zip platform is entirely digital and leverages big data in its proprietary fraud and credit decisioning technology to deliver real-time consumer responses.

Zip is an established player in Australia’s consumer finance, BNPL and small business lending sector having more than 2.7 million customers in Australia who transact at over 41,000 integrated Australian merchants.

Merchants range from large household names such as Bunnings, Target, Kmart and Officeworks, to SMEs including retailers, hairdressers, vets and dentists.

In consumer finance, Zip has two key products:

- Zip Money – a product which provides an interest free digital line of credit to consumers of up to \$50,000. This product is regulated under the *National Consumer Credit Protection Act 2009* (the Credit Act).
- Zip Pay – a product which offers a ‘no-interest ever’ digital line of credit to consumers of up to \$2,000. It is a BNPL product and as such is not regulated under the Credit Act. However, Zip operates this product in accordance with the AFIA BNPL Code.

As the focus of the Options paper relates to the BNPL products not regulated under the Credit Act, our submission will focus on Zip Pay which may be impacted by the various options presented in Treasury’s paper.

Further information about Zip Pay is contained in the box below.

Zip Pay is a line of credit. A customer can redraw or transact up to their credit limit, should their account be up to date and they meet Zip’s drawdown criteria.

Zip Pay has a minimum credit limit of \$350, with the maximum credit limit of \$1,000 for new customers. Customers who have exhibited good repayment behaviour over time (using Zip’s internal criteria) can apply to increase their credit limit to \$2,000.

Customers can use the line of credit to purchase goods and services with Zip integrated merchants (closed loop), non-Zip merchants (open loop) via the Visa network, and to pay bills using BPAY.

² See Zip 2019 submission to Senate Standing Committees on Economics “Credit and financial services targeted at Australians at risk of financial hardship”, www.aph.gov.au.

Zip Pay is a digital product. Customers can perform transactions using:

- the Zip App or website;
- direct with merchants who offer Zip Pay as a payment method through the merchant's website or instore; and
- a single use Visa or digital Visa card anywhere that Visa is accepted.

Customers can structure their repayment amount and repayment frequency to suit their budget (subject to meeting minimum monthly repayments). Repayment frequency can be set to weekly, fortnightly or monthly. All customers are signed up to a direct debit at the point of sign up. Repayments can be linked to a nominated account and additional repayments can be made at any time.

Unlike some BNPL products offered by other providers, Zip Pay is not a “pay-in-four” solution but offers greater flexibility by allowing customers to make multiple purchases up to their agreed credit limit, with a flexible repayment plan.

No interest (including default interest) is charged in connection with purchases made or bills paid using Zip Pay.

We welcome the Options Paper recognising that not all BNPL products are the same and that different providers offer a range of diverse products.³ Our own observations of the market are that the nature, features, and customer use and experience differs from product to product, and from provider to provider.

The Options Paper notes that there are several ‘credit’ products that fall under exemptions included in the Credit Act.

As discussed in AFIA’s 2022 report *The Economic Impact of Buy Now Pay Later in Australia*, and for the avoidance of doubt, BNPL is not ‘payday lending’ or an online wage or salary advance product. BNPL is an improvement on traditional, point of sale retail finance and credit card offerings that is low cost and used widely by customers across all demographics.

Zip has long advocated that there are several credit products in the market that are exempt from the Credit Act although they offer large credit limits and represent a relative long-term credit commitment. Zip believes that regardless of product construct or fees, products that provide larger credit limits over longer terms should be subject to a higher level of regulation. Setting a threshold level would not be inconsistent with the AFIA BNPL Code which applies a scalable approach to a consumer’s ability to afford the BNPL credit.

³ (Options Paper, p. 11)

Options for Regulatory Intervention

Zip's response to specific questions raised in the Options Paper

Question: Are the guiding principles appropriate and fit for purpose to inform the development of a BNPL regulatory framework? What other factors should be considered?

While Zip is an ASX listed company, it is small compared with other well established financial services players in Australia. Despite its size and resource limitations, Zip engages with the following bodies and comply with various legislations and industry codes including:

- *Australian Securities & Investments Commission Act 2001 and Regulatory Guide 234 — Advertising financial products and services (including credit);*
- *Anti-Money Laundering & Counter Terrorist Financing Act 2006;*
- *Privacy Act 1988 and Spam Act 2001;*
- *Corporations Act 2001;*
- *Regulatory Guide 271 - Internal and External Dispute Resolution;*
- *ACCC Debt Collection Guidelines*
- *Modern Slavery Act 2018;*
- *Anti-Bribery legislation and the Criminal Code; and*
- *ASIC's Design and Distribution Obligations (DDOs) and Product Intervention Powers (PIP) under the Corporations Act 2001; and*
- *AFIA's BNPL Code of Practice.*

As such, Australia has a complex framework for regulating credit. These provisions are contained in various laws and legislative instruments administered by ASIC, OAIC, AUSTRAC, the ACCC and APRA, as well as other departments, regulators and agencies such as RBA, Home Affairs, and Treasury for the BNPL sector.

Zip supports strong regulatory foundations and procedures that *consider the existing regulatory arrangements for comparable regulated credit products* (Principle 4).

Building on the existing provisions will assist in maintaining confidence and trust in the credit system. It will also ensure that the regulations are better understood and complied with by industry (Principle 5); allow for rapid market development and innovation (Principle 2); and facilitate competitive neutrality and a level playing field (Principle 3).

Zip would like to restate its support for greater regulatory coordination and collaboration between agencies and bureaucrats. Zip believes value could be added via more collaboration between bureaucrats, legislators and regulators so as to avoid regulatory overlaps and inconsistency and unnecessary overhead around conduct and compliance.

We also emphasise the following matters in relation to the other principles.

Zip's highest priority principle is to *improve consumer protections while continuing to ensure BNPL products are accessible to consumers* for developing the proposed BNPL regulatory framework.

An example of Zip's pro-consumer approach has been the good working relationships we have developed with consumer representatives, including Financial Counselling Australia

(FCA) who meet quarterly with Zip’s executives and senior leaders to discuss customer issues, including:

- complaints received;
- customer hardship;
- customer satisfaction;
- engagement metrics; and
- industry and regulatory changes.

This is a forum that allows consumer groups to raise issues of concern directly with Zip executives and leaders, so that Zip can proactively manage any customer matters in an effective and efficient manner.

We also support the general principle that the regulations should be *flexible enough to allow new BNPL providers into the market and for new and existing BNPL providers to bring new financial products onto the market* (Principle 2). Zip has long advocated that it is essential that regulations should not stifle innovation or competition.

New regulations should be fit for purpose and tailored for the BNPL sector to ensure these products remain a viable alternative payment, as well as foster continued innovation and competition within the industry.

We also support the principle around the enforceable role of ASIC being cost effective and efficient so that it minimises the risk of avoidance behaviour while considering the existing regulatory framework of the self-regulatory BNPL industry code.

Question: Of the three options below, which option do you think is most appropriate? Would you change any aspects of that option?

Question: What do you think are the issues with the other two options?

Option 1

We do not support Option 1 for the following reasons.

Zip strongly advocates that all BNPL providers should hold an ASIC Australian Credit Licence. Zip believes there should be minimum standards and requirements that all market participants within the sector adhere to, which is outlined with an ACL where there are consequences for participants should they not meet these requirements. This is a position that Zip has supported since January 2019.⁴

Credit licencing provides ASIC with an early view into a new provider entering the market. It ensures a baseline level of compliance, experience and systems are in place and will provide consumers with additional confidence and security.

⁴ See Zip 2019 submission to Senate Standing Committees on Economics “Credit and financial services targeted at Australians at risk of financial hardship”, www.aph.gov.au.

Credit Licensees have general conduct obligations including:

- acting efficiently, honestly and fairly;
- being competent to engage in credit activities;
- having appropriate dispute resolution systems (including both internal systems and being a member of an external dispute resolution scheme);
- having appropriate and accessible hardship programs in place including set time frames in which to respond to a hardship notice from a consumer;
- having appropriate compensation arrangements in place (which for some will include holding professional indemnity insurance);
- having adequate resources (including financial, technological and human resources) and risk management systems; and having appropriate arrangements and systems to ensure compliance.

Option 1 suggests inclusion of bespoke provisions in the Credit Act to check that the BNPL product is not unaffordable for a person before offering it to them. We do not think this approach goes far enough to give protections to vulnerable customers and those who are already in hardship or cannot afford the repayments. We note that Option 1 only requires income and expenses information to be considered against a risk assessment if a person is identified as a risky borrower. Furthermore, it does not contain a hard requirement for a credit score check to be undertaken in every situation, nor is there a requirement to verify a customer's financial situation or check if the provision of credit aligns with a person's needs or objectives. We caution that this approach may not effectively address the consumer harm that Treasury is committed to eradicating.

While Option 1 proposes the introduction of bespoke affordability provisions, which is an improvement on the BNPL Industry Code, Option 2 ties the obligations of the BNPL industry with the responsible lending obligations contained in the Credit Act. This is a much stronger position to take in addressing suitability assessment and subject to appropriate scaling that acknowledges the lower risk profile of BNPL products. As such, our support is for Option 2.

We note that Zip has conducted the Zip Pay product customer origination and credit management process since inception in a manner broadly consistent with Option 2 - including the provision of identity and credit checks on all customers, and affordability checks on the majority of accounts. Technology allows for these verifications to be performed in real time, with a simple customer experience, and even with the inclusion of these additional consumer protections, Zip's Australian business has been profitable for 5 years.

Option 2

Zip strongly advocates for Option 2. We consider that it has the right balance between consumer protections and minimum standards, building confidence in the sector, while encouraging innovation.

We strongly believe that amending the Credit Act to require BNPL providers to hold an ACL will ensure the right obligations for internal and external dispute resolution, hardship provisions, compensation arrangements, fee caps and marketing rules.

Authorised credit representatives

We support Option 2, which would not require merchants who offer BNPL products to consumers to be an authorised credit representative of the BNPL provider.

Zip Pay is advertised and promoted in partnership with Zip Pay merchants. Potential customers of Zip are required to apply for an account directly with Zip, via an online process using their own mobile phone or computer. We do not consider the merchants to be "regulated persons" for the purposes of the Design and Distribution Obligation (DDO) laws on the basis that they are not responsible for disclosing product terms and conditions; and they do not hold an Australian Credit Licence or otherwise fall within one of the other categories of regulated person. While these merchants are not "regulated persons", we have implemented a number of measures as part of our own responsibilities to ensure that retail product distribution conduct in relation to Zip Pay is consistent with our Target Market Determination.

Spending limit

Zip does not automatically increase a customer's credit limit. If a customer wishes to increase their credit limit, they must make an explicit request to Zip via the App or the web wallet.⁵ The customer will only be provided with a spending increase (to a maximum of \$2000), if they meet Zip's eligibility criteria.

We therefore support the approach as outlined in Option 2, that BNPL providers would be prohibited from increasing a consumer's spending limit without explicit instructions from the consumer.

Affordability

Embedded into Zip's onboarding process is an assessment based on credit checking and reviewing bank data to ensure that credit decisions are data driven and that approvals are granted only once a thorough process has been undertaken. We undertake credit checks for all customers with the majority of applicants having their banking data assessed for affordability, identification and credit scoring.

Zip already has a robust approval framework and we do not believe that requiring Zip to undertake bank data checking on 100% of applicants will have a material benefit in reducing the extension of credit to consumers who present a higher risk. In support of this view, we would be open to the option of sharing our assessment process to ASIC and other relevant regulatory authorities, to ensure there is transparency on the processes we undertake.

We acknowledge the widening of CDR into the non-bank sector may improve ease of access to bank data, streamlining the application assessment process. Zip's objectives, which can coexist, are to ensure that we are a responsible lender, remain a competitive alternative to other products in the market, and that our onboarding processes for new customers are appropriate for our products and dollar size.

⁵ See <https://help.zip.co/hc/en-us/articles/360001587115-Can-I-increase-my-Zip-Pay-credit-limit->

Capping of late fees

Zip currently has a low incidence of consumers being charged late fees. Our credit assessment process delivers better outcomes, with a very small number of customers paying a late fee each month. Our late fee is \$5, charged only after a series of reminders and payment messages are provided, when the customer is 21 days in arrears. The fee is capped to being charged once, meaning that if a customer goes to 180 days in arrears, they will only be charged a single \$5 late fee. Our model does not rely on customers falling into arrears to generate revenue.

Moreover, as discussed in AFIA's *BNPL report*, late fees are capped and users cannot make additional purchases until their account is settled (i.e. if they have missed a minimum repayment on their account). This breaks the cycle of revolving debt enabled by traditional credit products such as credit cards.

In order to assist customers to make repayments without incurring late fees, where a customer misses a repayment we:

- outline the minimum repayment and the due date in the statement;
- send repayment reminders via SMS and email prior to the repayment being debited;
- automatically debit the repayment from the customer's nominated account;
- send payment failed messages to the customer via SMS and email if the debit from the customer's nominated account fails;
- suspend the customer's account once they are one day in arrears (such that they cannot make additional purchases until their account is settled);
- notify a customer if they are charged a late fee and advise them we will reverse it if they make their repayment within 24 hours; and
- utilise in-app messaging and web wallet messaging to advise customers of overdue amounts and amounts to repay.

As such, we support measures outlined in Option 2 that minimise the incidence of customers in paying late fees, including fee caps for charges related to missed or late payments, combined with additional warning and disclosure requirements (if they are beyond those that Zip currently undertakes).

Since January 2019, Zip has advocated that the simplest and most effective means of controlling late fees is a monthly cap regardless of the outstanding balance, original purchase amount or number of missed repayments within that month.

Furthermore, late fees should be capped as a percentage of the monthly repayment due and not the account balance, otherwise these fees could be seen as a proxy replacement for interest.

Late fees should compensate the provider for commercial costs from late repayments and not be out of proportion to the transaction amount, exorbitant or unconscionable. Late fees that are disproportionate to a repayment amount and accrue quickly within a specific month may cause unnecessary consumer harm and must be addressed.

We recommend that all BNPL product late fees should be capped at a maximum of \$10 per month, subject to indexation.

Option 3

We do not support this option primarily because of the large impost to participants from having to conduct affordability verifications by checking one or more sources of financial information including applicants payslips, Centrelink statements or bank statements.

The Credit Code provides lenders some flexibility to assess to a reasonable standard based on the applicant's circumstances, the types of credit product and maximum limit and it is up to the lender to apply their own judgment in determining what is reasonable in individual circumstances.

That said, Zip's current processes are robust and achieve the same objectives as the Credit Code which:

- have regard to the consumer harm they are intended to address;
- take into account the circumstances of the individual consumer;
- consider whether the credit product involves a higher risk of harm to the individual consumer if the product is unsuitable; and
- understand that the regulatory environment is not static and what is assessed as reasonable will change over time.

New regulation should be fit for purpose and tailored to the BNPL sector to ensure these products remain a viable alternative payment, as well as foster continued innovation and competition in the industry. Fit for purpose regulation needs to balance appropriate controls to manage consumer protection based on low credit limit loans, against the cost impost of BNPL participants having to participate with a new regulatory framework which is more suitable for more complex financial products. Customers need to be protected whilst providers must be able to operate in an environment that will facilitate competition.

Responsible lending obligations (RLO) are designed to protect consumers seeking funding in higher risk arrangements, such as mortgages or longer term higher value loans. In these arrangements, the element of consumer harm is far greater and more complex, noting the consequences for defaulting on those loans. We agree that in these types of arrangements RLOs are necessary as the minimum standard. However, for small credit limit, BNPL products with far shorter repayment terms, the existing RLOs are certainly not fit for purpose. We support the position that introducing modified RLOs will be sufficient, scaled to the level of risk of the BNPL product or service.

It is in the best interest of both regulators and industry participants to agree on a framework which encourages innovation and competition, that drives positive consumer outcomes while ensuring an appropriate level of consumer protections are in place. The achievement of these outcomes does not require compliance to the Credit Code.

In support of our view that a fit for purpose regulatory regime is preferred (Option 2), and the fact that that we already exceed the obligations required under the AFIA BNPL Code of Conduct, we would, if requested, provide to ASIC our assessment process so that there is transparency on how we undertake due diligence for new applications.

Supplementary reforms to support a new BNPL regulatory framework

Treasury's Options paper also considers various improvements to the Credit Act. Zip's position is outlined in more detail below.

Improving the financial capability of BNPL consumers

Zip strongly supports initiatives that improve the financial capability of BNPL consumers. We support the Australian Government's programs such as the Moneysmart website, the Money Managed website, and the Commonwealth Financial Counselling resources.

Zip has also been focused on responsible lending and putting our customers first. We know that financial inequality is one of the greatest global challenges and that many people in our communities do not feel empowered, or in control of their financial lives.

In 2021 we launched a partnership with Young Change Agents through which Zip provides financial support, tech and skilled volunteering in order to bolster financial literacy and entrepreneurial programs to young Australian entrepreneurs.

Zip also partners with Australian debt solutions charity *Way Forward* to support Australians in financial hardship. While Zip offers financial hardship assistance programs to customers each month, the relationship with *Way Forward* is also to recognise that often people need help with a number of debts and independent advice.⁶ *Way Forward* is a not-for-profit organisation offering free, long-term support for people to manage and repay their debts. *Way Forward* can help customers who have debts across multiple creditors, have an income but are experiencing financial difficulty and would benefit from someone working with the lenders on their behalf.

Australia's comprehensive credit reporting framework is required by law to be reviewed

When the initial review of the Privacy (Credit Reporting "CR") Code (Credit Code) was undertaken in 2017, it was indicated that further independent reviews would be undertaken every four years. This process is now underway with the release of the 2021 Independent Review of the Privacy (Credit Reporting) Code issued in September 2022.

The Office of the Australian Information Commissioner has indicated that as part of this review other credit entities will be considered for inclusion into the CR Code. Buy Now Pay Later providers — along with other non-ACL entities — have been identified as a sector that should be considered for inclusion in the CR Code.

While Zip acknowledges the reasons why OAIC are looking to extend the reporting requirements to other sectors and the public benefit this may achieve, an incremental roll-out is our preferred option. We believe an appropriate way forward is to include the remaining banks and APRA regulated financial institutions who represent the next largest group of lenders after the major banks. Thereafter a threshold test and risk based assessment should be applied, and additional sectors be included based on credit under management and credit losses.

⁶ See press release: <https://wayforward.org.au/zip-joins-way-forward/>

An enhanced role for ASIC as the regulator of BNPL

We accept that as part of formally regulating BNPL under the Credit Act, it may warrant a corresponding extension of ASIC Industry Funding arrangements as part of its cost-recovery for regulating the BNPL sector.

We consider that any changes to such arrangements should be in line with what we as an industry have advocated for. Most recently these are contained in AFIA's submission to ASIC's *Industry Funding Model (IFM)* review from October 2022, where the industry noted that ASIC licensees would always strive to act in accordance with the highest standards of propriety and comply with all legal obligations.⁷ The IFM must be designed to ensure good corporate citizens do not disproportionately bear the burden of financing ASIC's efforts to enforce the law against those who may not be meeting the necessary standards. Moreover, the IFM must always be designed to ensure costs are apportioned appropriately among the relevant subsectors, according to risk. The scheme should be calibrated to set standards and incentivise good behaviour by encouraging compliance to reduce regulatory costs.

We strongly support the Options Paper's consideration to monitor and measure outcomes arising from BNPL use and the effectiveness of any reforms and initiatives. This would be consistent with the Australian Government's *Guide to Regulatory Impact Analysis* which expects departments to have an evaluation plan that monitors how well the policy option was implemented and assesses whether the policy was effective and efficient in achieving its intended outcomes.⁸

Undertaking an evaluation, for example after 2 or 3 years, is particularly important where technology and consumer preferences may change over time, which thereby affect the appropriateness or effectiveness of any policy regulations.

⁷ <https://afia.asn.au/post/ASIC-Industry-Funding-Model-IFM>

⁸ Australian Government Office of Impact Analysis (2020), *Australian Government Guide to Regulatory Impact Analysis*; Second Edition. <https://oia.pmc.gov.au/resources/guidance-impact-analysis/australian-government-guide-regulatory-impact-analysis>