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Afterpay submission to OAIC independent review of the Privacy (Credit Reporting) Code 2014

Afterpay Limited (Afterpay) welcomes the opportunity to provide a submission to the Office of the Australian Information Commission (OAIC) as it undertakes an independent review of the Privacy (Credit Reporting) Code 2014 (the CR Code).

In this submission we provide an overview of Afterpay, how we have designed our product to ensure consumers are protected, and the importance of strong consumer outcomes and fit-for-purpose regulation in Australia's credit reporting regime.

We also outline some of the emerging solutions to the issues facing credit reporting, which highlight the consumer benefit of looking beyond traditional reporting models for making credit decisions.

About Afterpay

Afterpay is an Australian financial technology company and a wholly owned subsidiary of Block, Inc. (NYSE: SQ). Afterpay employs over 1,300 staff across New Zealand, Australia, Asia, the United States, Canada, the United Kingdom, and Europe.

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 16 million customers globally.

Afterpay offers a simple and highly effective platform for consumers and merchants.

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, with 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.

Merchants benefit significantly by being part of the Afterpay ecosystem, as it delivers them value, reduced risk, and deeper engagement with customers. 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.

Growth and diversity of the BNPL sector

The Australian BNPL sector has grown significantly in recent years with an increasingly diverse range of providers offering materially different services under the banner of BNPL.

Government and regulators have recognised this diversity, finding that the market for these arrangements is evolving and growing rapidly. Key differences within the BNPL industry centre around borrowing limits, fee structure and interest charges.

Afterpay's product is purposefully designed with important consumer safeguards in place. Unlike a traditional credit product, Afterpay does not charge interest. This means we do not charge interest (or 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 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.

While the BNPL sector is rapidly evolving, it is still in its nascent stages of development. According to analysis by Accenture, BNPL payments in Australia account for only 5% of total retail spend. Despite the short period since its inception, the sector has made significant strides in self-regulation; unilaterally raising standards as well as working cooperatively with regulators.

This includes the development of the Australian Finance Industry Association (AFIA) Code of Practice (BNPL Code) that has been in force since March 2021. This Code sets international best practice standards for the sector and provides consumers with protections that go beyond what the law requires us to do.

The BNPL Code has been recognised as an important initiative by an Australian Senate Inquiry and Australian Securities and Investment Commission (ASIC). The Senate Inquiry found that:

> *The development of an industry code of practice in the Buy Now Pay Later (BNPL) sector is an example of where industry is working constructively to*

> *respond to stakeholder concerns and seek to achieve appropriate regulation that benefits consumers.*[1]

The BNPL Code is not only lifting the standards across the industry but has created standards that traditional credit could not meet. For example, we have codified the fact that BNPL accounts should be paused at the first sign of non-repayment.

Credit reporting and BNPL

Regulations in Australia do not require products like Afterpay to conduct credit checks or participate in the credit reporting regime under the *Privacy Act 1988*. This is because Afterpay's product does not meet the definition of consumer credit in the *National Consumer Credit Protection Act 2009* (NCCP Act) because we do not charge consumers for the provision of credit. This recognises that Afterpay's product is inherently safer than traditional credit products, which can charge interest rates of 20% or more, and trap consumers into a cycle of revolving debt.

Although Afterpay is not regulated under the NCCP Act, we are subject to formal oversight by ASIC. ASIC has a broad product intervention power that can be used in relation to BNPL products if it believes there is significant consumer detriment arising. Afterpay is also subject to the Design and Distribution Obligations, which ensure products (including BNPL products) deliver good consumer outcomes.

In addition, Afterpay is a founding signatory to the BNPL Code, which incorporates a range of important consumer protections that are relevant to the BNPL sector. The BNPL Code requires Afterpay to be a member of the Australian Financial Complaints Authority (AFCA). In fact, Afterpay has been a voluntary member of AFCA (and its predecessor scheme) since 2016. 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.

However, as the consultation paper notes, the credit reporting landscape is evolving with new industries participating in the regime and innovative forms of credit being introduced to consumers. The diversity of the BNPL sector means that some providers participate in credit reporting. For example, some providers perform soft or hard credit checks on consumers before making a decision about whether to allow them to use their product. Likewise, some BNPL providers hold an Australian Credit Licence and others do not.

Afterpay acknowledges the need for a modern credit reporting regime that strikes the appropriate balance between the protection of consumers, strong consumer outcomes, responsible lending and financial inclusion.

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[1] https://parlinfo.aph.gov.au/parlInfo/download/committees/reportsen/024366/toc_pdf/SelectCommitteeonFinancialTechnologyandRegulatoryTechnology.pdf;fileType=application%2Fpdf, at page 216.

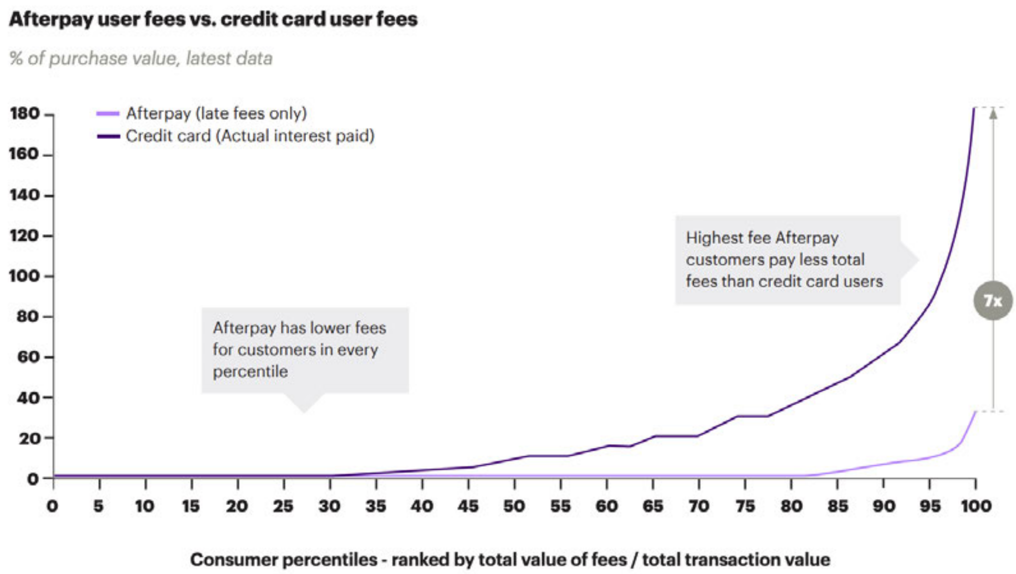
However, as the BNPL sector has evolved, the credit reporting regime has failed to keep in step with the shifting economic and consumer credit environment. The credit reporting system was not designed with a product such as Afterpay's in mind, a product that is inherently different to traditional credit products. This includes the fact that Afterpay:

- Starts a customer on a low initial spending limits that only increases gradually with proven on-time repayment behaviour
- Provides dynamic spending limits, which may increase or decrease depending on the customer's repayment performance
- Does not provide a guaranteed line of credit
- Does not perform a one-time assessment of a customer's capacity to pay
- Is based on regular, relatively small-value transactions, with an average order size of around $150
- Prevents a customer from spending as soon as they are in arrears.

Enabling financial inclusion

Afterpay is proud of the role it has played in promoting financial inclusion with a product that has been purposefully designed to be the opposite of traditional credit products. Consumers choose Afterpay during times of uncertainty as well as stability, while avoiding a cycle of debt they might face from other products.

Recent research by Accenture, commissioned by Afterpay, identified a number of benefits to Australian consumers of using Afterpay. For example, the research found that vulnerable consumers that are often excluded from accessing traditional credit, 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 users.[2]



[2] https://afterpay-corporate.yourcreative.com.au/wp-content/uploads/2021/04/Afterpay-Economic-Impact-report-2020-Accenture.pdf, at page 38.

The credit reporting system presents a number of access barriers for a range of vulnerable people in Australian society. One of the key hurdles is credit checks.

Because the credit reporting system pre-dates the creation of BNPL products, credit checks - done in a traditional manner - are not suited to Afterpay's product. Instead of performing credit checks, Afterpay conducts more advanced customer risk assessments which deliver consistently better outcomes for customers and do not discriminate against more vulnerable consumers. Evidence of this can be seen in Afterpay's credit losses and impairment charges, which are significantly lower compared to traditional credit and other BNPL competitors. Further, the overwhelming majority of Afterpay transactions are from repeat customers who have shown positive repayment behaviour.

Credit checks result in higher costs for more vulnerable consumers as lenders use credit checks to enable price discrimination on the cost of credit. Instead Afterpay starts everyone off equally - everyone starts on very low spending limits and is given the opportunity to prove themselves on the system. 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.

Credit checks are also a lagging customer indicator and increasingly unhelpful for younger adults with no credit bureau history. While Afterpay customers tend to have higher than average incomes and lower financial liabilities, around half do not have an established credit file. In addition, from analysing our own data against that of a credit bureau we see that those that may have performed badly with traditional credit or have had an incident in their lives, like a bankruptcy, actually perform well on a safer product like Afterpay.

As a result of these issues, there is a move towards more advanced customer assessment tools. These alternatives to the traditional credit reporting regime are dynamic, flexible and focused on delivering positive consumer outcomes.

Emerging assessment tools

Two examples of emerging customer assessment tools include the soon to be launched Indebtedness Indicator in New Zealand and Australia's emerging open banking framework.

Indebtedness Indicator

The New Zealand BNPL industry, including Afterpay, is developing an Indebtedness Indicator in partnership with New Zealand credit bureau, Centrix. We believe this initiative represents a tailored and effective response to the risk of vulnerable consumers using multiple BNPL accounts when they are in financial difficulty.

Once live, each BNPL industry participant accessing the Centrix service will be alerted if a new account applicant has an active overdue account with another BNPL participating provider.

The service will operate based on a daily feed from each participant denoting every active account that is overdue, and where a customer has consented to this sharing of information for this purpose. Where one or more payments is more than seven days overdue, we will become aware of that new customer's status, and the number of BNPL providers that have provided an overdue status on that customer.

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

The proposed Indebtedness Indicator 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.

We anticipate that the BNPL indebtedness indicator could be implemented by the middle of 2022 and believe it has potential to be an important tool to assist in protecting vulnerable consumers in the New Zealand market.

The BNPL indebtedness indicator is also an example of industry and credit bureaus working together to find solutions. We note that credit bureaus in other countries have announced other initiatives designed to accommodate BNPL product data sets. However, we are concerned that these initiatives are being announced unilaterally, without sufficient stakeholder input.

In the US and the UK, some credit bureaus have announced new products designed to capture BNPL data in real time and report BNPL use and payment behaviour on a customer's credit file or within a specialty reporting bureau. However, as yet, there are very few details about how these new approaches will work and what the impact might be on consumers. Protocols and guidelines for credit information sharing are being developed in the UK by the Steering Committee on Reciprocity. At present, this group does not feature any BNPL sector representatives which risks the development of a system that has not had the benefit of expertise and insight from the BNPL providers who will be the heaviest users of this new system. This has been raised with the Government and the Financial Conduct Authority as part of the ongoing consultation process on the new regulatory framework for BNPL.

Open banking

In other countries, open banking is also providing opportunities for firms to access up-to-date financial information, without having to perform credit checks. Real-time insights enable firms to gain a broader understanding of their customer's individual circumstances, and protect vulnerable customers.

Open banking can provide a more holistic picture of a customer, and unlike the current credit reporting regime, can ensure that consumers are not unfairly excluded from safe forms of unsecured credit.

As these assessment tools develop and mature, the current credit reporting regime must also evolve to address potential consumer harms and suitably accommodate new products and services. Such reform remains outside the scope of this review but could be addressed through a more comprehensive review of Part IIIA of the Privacy Act, ensuring the public policy objectives of credit reporting and the CR Code are better balanced and achieved.

Conclusion

Thank you for the opportunity to make this submission. We look forward to the outcomes of this review. Please do not hesitate to contact us if you require further input or clarification.

Yours faithfully

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