31 January 2020

Head of Payments Policy Department
Reserve Bank of Australia
GPO Box 3947
Sydney NSW 2001

By email: pysubmissions@rba.gov.au

Dear Dr Richards,

**RBA Review of Retail Payments Regulation: Issues Paper**

This submission is made on behalf of the following organisations:

- CHOICE
- Consumer Action Law Centre
- Financial Counselling Australia
- Financial Rights Legal Centre

Information about our organisations can be found at Appendix A at the end of the submission.

Thank you for the opportunity to comment on the Reserve Bank of Australia’s (*RBA*) Review of Retail Payments Regulation Issues Paper (**the Issues Paper**).

The payments landscape has changed rapidly since the RBA’s last review of retail payment systems. The emergence of new payment schemes such as buy now, pay later (**BNPL**) has skewed the market and left consumers without protections offered by other credit providers. The result is a marketplace where BNPL providers are not playing by the same rules as other payment providers as merchants are prevented from passing on fees they incur for this payment method. Consumers ultimately bear the cost of this as merchants are forced raised the costs of goods and services to cover the high costs imposed by BNPL providers.

For reasons set out below, our organisations strongly support action by the RBA to level the playing field and allow merchants to send price signals to customers based on how they choose to pay for a product. The RBA should also aim to future-proof the payment system to accommodate new and emerging payment methods.

Additionally, we support giving merchants greater control over routing options and for the RBA to retain caps on interchange fees with a view to potentially remove these fees altogether, as has been done in Canada and New Zealand.

Finally, we would welcome the RBA’s intervention to coordinate regulatory and industry action on direct debit and recurring payment problems. Many of our clients face difficulties and barriers when trying to cancel recurring payments and we believe a coordinated approach is needed to address this
issue. Consideration should also be given to how the roll out of the Consumer Data Right will affect the payments system generally.

Our comments are detailed below.

Developments in the payments landscape

Q1: What major recent or prospective developments in the broader payments industry are particularly relevant to this review? More specifically, are there any gaps in functionality available to end users or any shortcomings in industry governance or operating arrangements that require regulation or coordinated industry action?

Q2: Are there aspects of retail payments regulation that lead to market distortions or that create opportunities for regulatory arbitrage? If so, what options should be considered as a means of addressing these? Are there gaps in the regulatory regime that need to be addressed or any elements where regulation is no longer required?

The explosion in growth of new payment options such as BNPL providers have altered the payments landscape for Australian consumers in recent years. The Issues Paper notes that these providers are reliant on existing payment rails – using traditional card payment methods to facilitate payments to these businesses. However, the diversification of online and in-store payment methods means the payments regulatory regime that must address these new players and also future-proof the system to accommodate new and emerging payments systems.

BNPL providers are thriving in a regulatory black hole, and the inability for merchants to allow surcharging for this payment option is distorting the market. While BNPL tout their payments options as ‘free’ for consumers when payments are made on time, there is clearly a cost to using these services. This cost is ultimately borne by consumers through increased prices, as merchant payment fees are built into the overall price of goods and through payment of late fees and other charges. That model however might change with new or existing market participants conceivably introducing new fees in the future. This was the trajectory for credit cards which were also “free” when first introduced but many now charge annual fees.

Late fees are most likely to impact the people who can least afford to pay them - people who cannot pay on time. These fees are unregulated and can vary between providers and can increase financial hardship for some people.¹

As noted above, while using BNPL might indeed appear ‘free’ for consumers who can pay on time, the industry profits in other ways. Merchants offering BNPL as a payments option are charged a percentage for each sale paid for using a BNPL provider, and often a set fee per purchase. ASIC’s review of BNPL arrangements noted that:

> For each buy now pay later arrangement in our review, merchants are charged a fee equal to a percentage of the amount of the purchase. Some providers also charge merchants a fixed fee for each arrangement.

¹ We note that the Australian Finance Industry Association has released a draft voluntary ‘Buy Now, Pay Later Code’ for consultation, which states that fees will be capped, but does not set a limit. While we haven’t yet responded to AFIA’s consultation, we do not consider this Code replaces proper regulation of BNPL finance.
The size of these fees depends on factors such as the volume of buy now pay later arrangements used by the merchant, the risk profile of the merchants, and the types of goods and services offered by the merchant.

BNPL providers prevent merchants from passing on the costs of customers that use the service. These costs range from 3 to 6 per cent of an item’s purchase price. These costs are being passed on to all consumers through higher prices.

BNPL costs are very high when compared to merchant service fees for four-party scheme cards which range from 0.6 per cent for large merchants to 1.5 per cent for merchants with a turnover of less than $100,000. This means that the regulatory framework is no longer driving effective competition in the payments system through, for example, sending price signals to customers about the true cost of using different types of payments.

Payments regulation should be guided by what is in the best interests of end users – customers that use Australian payment systems to buy their groceries at the supermarket, shop for goods online or pay for their morning coffee on the way to work. The Payment Systems (Regulation) Act 1998 (Cth) identifies a number of public interest factors the RBA is to have regard to the desirability of payment systems including being:

- financially safe for use by participants; and
- efficient; and
- competitive; and
- not (in its opinion) materially causing or contributing to increased risk to the financial system.

We consider that permitting surcharging for BNPL payments is consistent with these factors, and would encourage a more efficient and competitive payments market. Our organisations support a simpler, fairer system that effectively regulates BNPL payment options, and includes strong enforcement mechanisms. Increased transparency through surcharging will help consumers to better navigate the complex system of payments currently on offer, choose the least expensive payment method, and stop all consumers from cross-subsidising more payment expensive options.

Additionally, we encourage the RBA to ‘future-proof’ payments regulation to prevent regulatory arbitrage and emerging businesses from acting in ways that are not in the public interest.

It is our view that BNPL is not a financially safe payments option for many. By not charging interest on the credit extended to users, BNPL providers have avoided being captured by the National Consumer Credit Protection Act 2009 (Cth) (National Credit Act) and accompanying consumer protections. These protections include:

- responsible lending checks;
- caps on fees and charges;

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3 RBA Review of Retail Payments Regulation: Issues Paper, 20

4 Payment Systems (Regulation) Act 1998 (Cth) s 8

5 National Consumer Credit Protection Act 2009 (Cth)
• external dispute resolution including mandatory membership of the Australian Financial Complaints Authority; and
• access to financial hardship arrangements.

Compliance with these requirements under the National Credit Act promotes good customer outcomes and is in the public interest, particularly in the context of ballooning household debt. As it stands, when a customer opts to pay for a purchase using BNPL, they are denied a raft of rights and protections compared to using other payments options.

Consumer Action’s caseworkers have seen an increase in BNPL debts held by consumers, in line with increased popularity of these services. These debts are often held alongside other problem debts to creditors such as payday loans. Our lawyers also report instances of poor internal dispute handling and hardship assistance that is ad-hoc and difficult to navigate.

We consider that appropriate safeguards through the regulation of BNPL products under the National Credit Act, in addition to allowing surcharging, would reduce consumer harm and level the playing field across the credit sector.

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**Buy Now, Pay Later and financial harm**

Our organisations have previously documented the financial harm caused by BNPL providers. Additionally, ASIC’s Review of BNPL arrangements report noted a number of risks with this industry including:

• Pushing users into debt - one in six users had either become overdrawn, delayed bill payments or borrowed additional money because of a buy now pay later arrangement. Concerningly, 23% were making repayments with a credit card.
• Encouraging people to overspend – 81% of people believed that these arrangements allow them to buy more expensive items than they would otherwise and 64% of users were spending more than they normally would.
• Over 40 per cent of BNPL users had incomes of under $40,000, and of this group, almost 40 per cent were either students or in part-time work.
• Providers using behavioural techniques to influence consumers to make a purchase without careful consideration of the costs.

Financial Counselling Australia has recently surveyed financial counsellors Australia-wide. Financial counsellors offer free and independent advice on dealing with debt. 21% of respondents said that half of their clients had BNPL debts and 23% said that most of their clients had BNPL debts. Financial counsellors also rated BNPL companies’ hardship policies as worse than banks (both larger ADIs and non-major banks) and debt collectors.

Currently late fees make up a substantial proportion of a BNPL provider’s income. Afterpay, for example, reported that $28.4 million or 24% of its income in the 2017-18 financial year is made up of late fees. And this is increasing – this represented a 365% surge from the $6 million worth of late fees from the 2016-17 financial year. In the last financial year Afterpay made $46 million in late fees.
There is therefore a financial incentive to lend irresponsibly and offer credit to people who will be unable to make payments on time. These late fees, when charged to consumers already in debt, only exacerbate financial harm.

Ensuring effective competition and innovation

Q3: Are there barriers to innovation and/or competition that may affect the costs of or provision of electronic payments and should be addressed in this review?

While we support the development of innovative services and business models that meet the needs of consumers, we urge caution about innovation or competition being pursued as an end unto itself. Innovation and competition should only be pursued to the extent that it ensures good consumer outcomes. This approach has been adopted in in reviews of regulation of other essential services. For example, in the Victorian Thwaite’s Review, one of the guiding principles of that review is that ‘competition is a means to deliver benefits to consumers, but not an end to itself.’

We see often harmful products labelled as ‘innovative’, when in fact they are engaging in regulatory arbitrage or simply available through an app. There are particular risks in complex markets such as financial services, where the risks of bad product design and mis-selling can have catastrophic consequences. For example, we have recently seen “innovation” from payday lenders which has led to more online targeting and quick loan applications for high-cost debt. We need to ensure that innovation leads to services that genuinely meet the needs of Australian consumers rather than exploit regulatory gaps and sell debt in a more effective way. One example of this is the emergence of

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7 Dr Vivien Chen, Payday Lenders: Trusted friends or debt traps?, 15 October 2019, https://www2.monash.edu/impact/articles/banking/payday-lenders-trusted-friends-or-debt-traps/
BNPL providers who have become increasingly prevalent in the payments landscape since the last Review.

Financial Rights Legal Centre and Consumer Action’s recent submission to the Senate Select Committee on Financial Technology and Regulatory Technology noted that companies invoking a halo of ‘innovation’ may fall through the gaps of consumer protection requirements.

The RBA should consider appropriate barriers to entry and consumer safeguards actually enhances effective competition, as consumers are able to make informed choices between safe payment options. Setting high minimum standards would provide a strong foundation. It would also prevent a regulatory ‘race to the bottom’ and a culture that seeks to undermine regulators or exploit loopholes. Australian consumers are rightfully wary of the digital economy and current data practices. Ensuring appropriate regulatory protections are in place will enhance effective competition and innovation giving consumers confidence that their engagement with different payment services and innovations are safe, secure and will not lead to consumer harm.

Payment regulation therefore should be competitively neutral. New and emerging payment methods should play by the same rules that apply to other payment providers.

Merchant Choice of Default Routing

Q4: How do stakeholders assess the functioning to date of least-cost routing (LCR) of contactless debit card payments? Do additional steps need to be taken regarding LCR to enhance competition and efficiency in the debit card market?

Our organisations support an approach which would give merchants the ability to choose the default network to route contactless transactions for dual-network cards. However, this recommendation should only proceed if those payment options offer equivalent protections to consumers. Merchants should only be replacing apples with apples, rather than apples for oranges.

The current system of routing is costly and inefficient, and this adds costs to the economy. Previously, our organisations have opposed merchant routing because the least-cost option (Eftpos) offered lower standards of security protection in cases of fraud, among others.

This situation has evolved somewhat. For example, previously, Visa and Mastercard payment options offered a chargeback option for consumers; Eftpos did not. Now, Eftpos offers chargeback options for customers so they can recoup funds in cases of fraud or merchant failure to deliver. Chargeback protections are important to consumers, who often rely on them if a product fails, a service isn’t delivered or in instances of fraud. In these cases, a chargeback is the simplest and most effective remedy for many people.

We encourage the RBA to carefully assess the different payment options from the consumer perspective. Merchant routing should only be allowed if merchants are switching between services that offer equivalent protections for customers.

Consumers should also retain the right to choose which network they want to use. This would allow merchants to set the default payment option, ideally driving use of low-cost options, but would still

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see consumer choice and control respected. The RBA has previously noted that “it would be desirable for a merchant implementing least-cost routing to disclose this to customers”. However we note that there is a strong evidence base that disclosure is an inadequate consumer protection. For example, ASIC in a joint report with the Dutch Authority for the Financial Markets found that reliance on mandated disclosure and warnings has often proved ineffective, and at times even backfired contributing to more consumer harm. Any consumer disclosure therefore needs to be thoroughly tested for effectiveness.

Interchange fees

Q10: Is there a case for a further lowering of the credit or debit interchange benchmarks or any change in the way they are applied?

We support the RBA retaining caps on interchange fees and, over time, moving toward reducing or removing interchange rates to increase transparency in the payments system and to decrease overall costs for consumers. Some countries – such as New Zealand and Canada – have set interchange fees to zero without any broader impact on card offerings: both countries still have a range of low-interest cards on the market. This demonstrates that fees and interest rates should not excessively rise if interchange fees are banned.

Further, recent research from Monash University found that, “it is clear that any regulation of the interchange fee can be circumvented by channelling payments through the system provider”. As a result, the researchers call for ‘anti-avoidance’ regulation to be tied to any changes to the interchange fee system.

Surcharging and BNPL

Q15: Is the surcharging framework working well? Are there any changes that should be considered?

Q16: Is there a case for policymakers to require that BNPL providers remove any no-surcharge rules, consistent with earlier actions in regard to card systems that applied such rules?

Consumer Action has consistently advocated for tighter controls on surcharging, which in certain industries have been used excessively and effectively amount to price gouging. This has a negative impact on consumer confidence, and particularly impacts on low-income consumers who are poorly placed to absorb the additional, unjustified cost. While we strongly support caps on excessive surcharging, we are generally supportive of merchants being able to impose reasonable surcharges as this improves transparency about the true cost of using different payment methods and drives efficiencies in the payments system by encouraging people to choose lower cost options.

We strongly support a requirement for BNPL providers to remove the no-surcharge requirements they currently impose on merchants. The Issues Paper identified that several payment schemes were not captured by the RBA’s surcharging standard following the 2015-16 Review. The surcharging rules should apply to all payment schemes including new entrants in the payments space. We also agree with the RBA’s principle that regulation should aim to be technology-neutral. The approach taken should ensure that end users of different payment methods are treated equally.

Buy now pay later services increase the costs of goods for all consumers not just those who use the service

The majority of revenue for BNPL services is derived from relatively high per-transaction fee (ranging between 3 and 6 per cent according to the Issues Paper) charged to the merchant for accepting the payment. However, this means that costs are simply passed on to consumers indirectly through the pricing of goods and services. Professor Dutta\(^3\) from Curtin University has explained this is traditionally called factoring of accounts receivable:

This is when a company sells its accounts receivables (money owed for a good or service that has already been delivered) to a lender, typically at a discount.

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An example of traditional factoring would be a company selling A$100 in accounts receivables to a lender for A$95. The company gets A$95 cash up front (to spend on wages or ingredients) and eliminates the risk of not being paid. The lender makes a A$5 profit once the A$100 has been collected.

Dutta then recommends that:

Customers making cash or credit card purchases may soon demand that online merchants give them a 4% cash discount – the same amount they pay Afterpay.

The current practice whereby merchants are prevented from passing on costs they incur when customer pay using BNPL is distorting the market. Because BNPL prevent surcharges being passed on, customers using BNPL are also unaware of the high cost of this payment method and could lead to cross subsidisation by other payments methods.

BNPL and price inflation

Consumer Action’s Sunny Side Up report detailed issues in the solar panel industry including unregulated finance arrangements with BNPL providers.\(^4\) We raised concerns that companies such as Certegy Ezi-Pay may not disclose the true cost of their finance to consumers in order to avoid regulation under the National Credit Act. Hidden costs could include, for example, financial arrangements and incentives they have with partnered retailers which were concealed by increases in the cost of the solar system components above market value. Similarly, ASIC’s report on BNPL arrangements found that some merchants inflate the costs of goods underlying some of these arrangements, obscuring the actual cost of the agreements.\(^5\) If true in the case of rooftop solar, this

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would mean that Australians are paying a hidden surcharge for products and also being denied rights under the National Credit Act by companies that have structured their operations to avoid regulation.

Our organisations strongly support the RBA making changes to payments regulation to enable merchants to pass on surcharges they incur for payment methods such as BNPL. This approach is fair as it signals to customers the costs of using different payment options and encourages customers to choose cheaper payment methods. It also prevents other customers from cross-subsidising other more expensive forms of payments and means that businesses do not inflate the cost of goods and services to cover costs they incur but cannot recoup through surcharges.

Other issues

Cancelling direct debit payments

Another issue relating to the functionality of the retail payments system that needs to be addressed is the:

> capabilities around and management of automated and recurring payments, in particular arrangements for management of direct debits. End-users have periodically noted to the Bank that cancellation or redirection of direct debit and other automated payment arrangements is not always straightforward.16

This issue is particularly frustrating for consumers and has been equally frustrating for consumer representatives for many years in seeking common sense changes to industry practice.

Firstly, consumers have long held significant concerns with the way banks deal with requests to cancel direct debits on eftpos cards. In our casework experience, subscribers routinely fail to comply with requests to cancel direct debits, instead regularly sending customers to the debit user. Interactions with the card issuer – Mastercard or Visa – also regularly result in being

The Customer Owned Banking Code Compliance Committee (COBCCC) for example recently undertook further research into whether Customer Owned Banking Association (COBA) members are complying with Section 20 of the Code of Practice to act promptly to cancel a direct debit facility linked to your transaction account.17 They found that:

> although there has been some further improvement, non-compliance is still unacceptably high. Customer service representatives gave a compliant response to an enquiry in only 57% of calls. At the same time, institutions’ online information needs improvement and was found to be readily accessible on just 38% of websites.

Consumers are reliant on Australian Banking Association (ABA) member banks and COBA member banks to meet commitments under Codes of Practice which as the above demonstrates they are not meeting to satisfactory levels.

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16 RBA Review of Retail Payments Regulation: Issues Paper, 12

At least ABA and COBA banks have made moves to commit to improve direct debit cancellation practices. The same cannot be said of their commitment to improve the cancellation of recurring payments.

The difference between cancelling a direct debit and cancelling a card payment is, understandably, very confusing to consumers. More and more people are being encouraged to establish recurring payment arrangements using Mastercard or Visa facilities. The rollout of new security measure such as ‘Tokenization’ and Authentication also prevent new difficulties when trying to cancel recurring payment arrangements. We understand that even in circumstance where an individual is issued a new card, this may not result in payments being stopped.

Both the new ABA Code and current COBA Code are inadequate on the obligations of subscribers to address customer requests to cancel recurring payments. Banks argue that they cannot cancel these recurrent payments and that customers should instead request a chargeback from the credit card company.

As we understand the matter – the issue is one that requires significant negotiations between banks and Visa and Mastercard, and decisions about where costs will be borne. Given this, and the fact that there is little incentive to resolve the issue – no movement has occurred in resolving this basic problem.

This lack of movement has significant impact upon people – particularly those facing financial hardship and experiencing other forms of vulnerability that make it difficult or impossible to shut down a recurring payment.

Regulators need to intervene to ensure that the same rules apply whether a customer has a direct debit using a BSB and account number, or a recurring payment using Mastercard or Visa numbers. Banks and card issuers should be obligated to respond to requests to cancel recurring payments and provide simple online functionality to resolve this problem.

One further problem with the cancellation of direct debits – one that has a huge impact upon the financially vulnerable is the practice of establishing multiple direct debits. Businesses authorise multiple direct debit authorities so when a consumer cancels one direct debit, the business moves on to use another authorisation in an effort to stymie the cancellation of direct debits by consumers. We are aware of some companies using up to eight authorisations. The practice is particularly prevalent in the payday lending sector.

**Consumer Data Right**

Additionally we note that Treasury have recently announcement an inquiry into expanding the functionality of the Consumer Data Right. The Consumer Data Right will provide consumers with access to their personal financial data – in its first Open Banking iteration - giving them the power to instruct lenders to provide safe and secure access of their data to accredited third parties who will provide various services. This is currently only a “read” access right – that is the third parties will be able to read the financial data and use this data for particularly services. The new inquiry will be looking to expand this functionality to include a “write” access to enable consumers “to apply for and manage products (including, for Open Banking, by initiating payments).” This will have a potentially

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18 We note for example, that Cigno’s Third Party Direct Debit Authority Request includes eight direct debit user ID’s of Ezidebit Pty Ltd: https://cignoloans.com.au/third-party-direct-debit-agreement/

19 Treasurer, Building on the Consumer Data Right, 23 January 2020
significant impact upon the payments system and consideration needs to be given to regulatory requirements that will need to apply to Open Banking fintechs and tools.

Please contact Policy Officer Patrick Sloyan at Consumer Action Law Centre on 03 9670 5088 or at patrick@consumeraction.org.au if you have any questions about this submission.

Yours Sincerely,

Gerard Brody  
Chief Executive Officer  
Consumer Action Law Centre

Karen Cox  
Chief Executive Officer  
Financial Rights Legal Centre

Fiona Guthrie  
Chief Executive Officer  
Financial Counselling Australia

Erin Turner  
Director – Campaigns and Communications  
CHOICE

Appendix A – About our organisations

CHOICE

Set up by consumers for consumers, CHOICE is the consumer advocate that provides Australians with information and advice, free from commercial bias. CHOICE fights to hold industry and government accountable and achieve real change on the issues that matter most. To find out more about CHOICE’s campaign work visit www.choice.com.au/campaigns

Consumer Action Law Centre

Consumer Action Law Centre is an independent, not-for profit consumer organisation based in Melbourne. We work to advance fairness in consumer markets, particularly for disadvantaged and vulnerable consumers, through financial counselling, legal advice and representation, and policy work and campaigns. Delivering assistance services to Victorian consumers, we have a national reach through our deep expertise in consumer law and policy and direct knowledge of the consumer experience of modern markets.

Financial Counselling Australia

FCA is the peak body for financial counsellors in Australia. We are the voice for the financial counselling profession and provide support to financial counsellors including by sharing information and providing training and resources. We also advocate on behalf of the clients of financial counsellors for a fairer marketplace.
Financial Rights Legal Centre

Financial Rights is a community legal centre that specialises in helping consumers understand and enforce their financial rights, especially low income and otherwise marginalised or vulnerable consumers. We provide free and independent financial counselling, legal advice and representation to individuals about a broad range of financial issues. Financial Rights operates the National Debt Helpline, which helps NSW consumers experiencing financial difficulties. We also operate the Insurance Law Service which provides advice nationally to consumers about insurance claims and debts to insurance companies, and the Mob Strong Debt Help services which assist Aboriginal and Torres Strait Islander Peoples with credit, debt and insurance matters.