USE NOW, REGULATE LATER? THE COMPETING REGULATORY APPROACHES OF THE BUY-NOW, PAY-LATER SECTOR AND CONSUMER PROTECTION IN AUSTRALIA

Jacob Rizk*

The Buy-Now, Pay-Later ('BNPL') sector in Australia provides a stark example of the challenge facing regulators in balancing consumer protection with innovation. This article examines the current regulatory responses and recommends reforms to enhance consumer protection outcomes and better achieve this balance. Firstly, it determines the actions of the Reserve Bank of Australia and the Australian Securities and Investments Commission ('ASIC') inadequately protect consumers. Concurrently, the industry's self-regulatory Code of Practice *lacks sufficient regulatory oversight to be meaningfully effective. Two recommendations are given: firstly, allowing merchants to surcharge the costs of the BNPL service; and secondly, giving ASIC oversight of the* Code of Practice*, in conjunction with targeted regulatory action. These recommendations would protect consumers, better enable competition, and facilitate the BNPL sector's continued growth.*

I Introduction

Regulators worldwide have struggled with how to best regulate FinTech and other innovations within the financial services sector.[1] In Australia, the relevant financial regulators have been slow to act in response to these innovations. This difficulty to regulate arises because there is a trade-off between an increased regulatory burden and innovation.[2] Naturally, these competing concerns permeate through to consumer protection regulation.

* Corrs Chambers Westgarth, Australia.

1 See Weihuan Zhou, Douglas Arner and Ross Buckley, 'Regulating FinTech in China: From Permissive to Balanced' in David Lee Kuo Chuen and Robert Deng (eds), *Handbook of Blockchain, Digital Finance, and Inclusion* (Academic Press, 2017) vol 2, 45; Marlene Amstad, 'Regulating FinTech: Objectives, Principles, and Practices' (Working Paper No 1016, Asian Development Bank Institute) 1.

2 Wolf-George Ringe and Christopher Ruof, 'Regulating Fintech in the EU: The Case for a Guided Sandbox' (2020) 11(3) *European Journal of Risk Regulation* 604, 605.

At a broader level, there are two main justifications for consumer protection regulation, broadly described as the 'Economic' and 'Social' Rationale.[3] The Economic Rationale seeks to remedy market failures by promoting a market's efficiency, and thereby move closer to the idealised 'perfect market'.[4] Consumer protection regulation often focuses on information failures,[5] justifying a broad range of interventions to ensure that consumers have access to sufficient information to make an informed decision.[6] In response to the criticism of neoclassical economic assumptions,[7] recent reforms have incorporated insights from behavioural economics.[8] This rationale has particular pertinence in financial services, where information asymmetries are rife – consumers are unlikely to be able to find relevant information themselves and will have to seek information from the supplier of the given financial product.[9]

The Social Rationale, at its core, focuses on the ideal of 'distributive justice'.[10] Under 'distributive justice', measures to protect both the ordinary and 'vulnerable' consumer are enacted.[11] Consumers, therefore, require additional protections beyond the mere remedy of information asymmetries to prevent predatory practices.[12] Similarly, the threat of predatory practices by financial sector entities is magnified by these biases and information asymmetries.[13] Naturally, there is overlap between the two

3 See David Llewellyn, 'The Economic Rationale for Financial Regulation' (Occasional Paper Series No 1, Financial Services Authority, 1999) 11–2 <https://www.fep.up.pt/disciplinas/pgaf924/PGAF/Texto_2_David_Llewellyn.pdf>; George J Benston, 'Consumer Protection as Justification for Regulating Financial-Services Firms and Products' (2000) 17(3) *Journal of Financial Services Research* 277.

4 Peter Cartwright, *Consumer Protection and the Criminal Law* (Cambridge University Press, 2009) 18.

5 Productivity Commission, *Review of Australia's Consumer Policy Framework* (Inquiry Report No 45, 30 April 2008) vol 2, 33 <https://www.pc.gov.au/inquiries/completed/consumer-policy/report/consumer2.pdf>.

6 Alan Schwartz, 'Legal Implications of Imperfect Information in Consumer Markets' (1995) 151(1) *Journal of Institutional and Theoretical Economics* 31, 35.

7 See Adam Triggs and Andrew Leigh, 'A Giant Problem: The Influence of the Chicago School on Australian Competition Law, Economic Dynamism and Inequality' (2019) 47(4) *Federal Law Review* 696.

8 Joshua G Sans, '"Protecting Consumers by Protecting Competition": Does Behavioural Economics Support this Contention?' (2005) 13(1) *Competition & Consumer Law Journal* 1, 1–2. Incorporating behavioural economics into consumer protection policy has been expressly approved by the Productivity Commission and is now commonplace in designing consumer protection law, see Productivity Commission (n 5) vol 2, 32–5.

9 John Campbell et al, 'Consumer Financial Protection' (2011) 25(1) *Journal of Economic Perspectives* 91, 92–3.

10 Cartwright (n 4) 28; Iain Ramsay, 'Framework for Regulation of the Consumer Marketplace' (1985) 8(4) *Journal of Consumer Policy* 353, 366.

11 Cartwright (n 4) 29; Stephen Lumpkin, 'Consumer Protection and Financial Innovation: A Few Basic Propositions' [2010] 1 *OECD Journal: Financial Market Trends* 1, 6.

12 See Paul Ali et al, 'Consumer Leases and Indigenous Consumers' (2017) 20 *Australian Indigenous Law Review* 154; Yvette Maker et al, 'From Safety Nets to Support Networks: Beyond 'Vulnerability' in Protection for Consumers with Cognitive Disabilities' (2018) 41(3) *University of New South Wales Law Journal* 818, 824.

13 Kevin Davis, 'The Hayne Royal Commission and Financial Sector Misbehaviour: Lasting Change or Temporary Fix?' (2019) 30(2) *Economic and Labour Relations Review* 200, 207. In Australia, this risk is intensified by relatively poor financial literacy: see Paul Ali et al, 'The Financial Literacy of Young Australians: An Empirical Study and Implications for Consumer Protection and ASIC's National

Rationales.[14] The most recent consumer protection development in the financial services sector in Australia remains the Hayne Royal Commission.[15] The Hayne Royal Commission adopted a case-study approach to present the broader issues within the financial services sector.[16] The core issue identified was the pursuit of profit over and above any other purpose,[17] which manifested itself in the form of agency issues,[18] poor culture, conflicting duties, and regulatory ineffectiveness in the provision of financial advice.[19] This led to a central critique of the culture and governance of the major financial institutions.[20] The 76 recommendations that emerged from the Hayne Royal Commission have yet to all be implemented.[21] While some authors have criticised the Royal Commission for exaggerating the level of misconduct in Australia,[22] or failing to effectively address the deep-seated issues that cause the miscreance in the first place,[23] the need for a stronger regulatory response to protect consumers has not been challenged.

In Australia, these issues are prominent in the struggle to regulate the buy-now, pay-later ('BNPL') sector, which has grown significantly since first coming to prominence in 2015–16. Approximately 6.1 million BNPL accounts have been approved as of June 2019, and the number of active accounts grew by 38% from FY 2017–18 to

Financial Literacy Strategy' (2014) 32(5) *Company and Securities Law Journal* 334, 351. This further justifies prohibitions and regulations in favour of consumer protection, given the more acute impacts on vulnerable consumers.

14 See Cartwright (n 4) 32–3; Ramsay (n 10) 367–6. Paternalism perhaps best typifies this, where governments should design laws that allow individual choice while guiding consumers towards the socially optimum decision: see, eg, Cass R Sunstein and Richard Thaler, 'Libertarian Paternalism is Not an Oxymoron' (2003) 70(4) *University of Chicago Law Review* 1159.

15 *Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry* (Interim Report, September 2018) vol 1 54 <https://www.royalcommission.gov.au/sites/default/files/2019-01/fsrc-interim-report-volume-1.pdf> ('*Royal Commission Interim Report*'). There have also been increased enforcement action that has rendered important consumer protection principles: see, eg, *Australian Securities and Investments Commission v Cassimatis (No 8)* (2016) 336 ALR 209; *Australian Securities and Investments Commission v Kobelt* (2019) 267 CLR 1; *Australian Securities and Investments Commission v Mayfair Wealth Partners Pty Ltd* [2020] FCA 494.

16 Davis (n 13) 207.

17 *Royal Commission Interim Report* (n 15) vol 1, 54.

18 Ibid vol 1, 98.

19 Ibid vol 1, 155.

20 Ibid vol 1, 301.

21 *Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry* (Final Report, February 2019) vol 1, 20–42 https://www.royalcommission.gov.au/sites/default/files/2019-02/fsrc-volume-1-final-report.pdf ('*Royal Commission Final Report*'); Josh Frydenberg, 'Parliament Passes Legislation to Implement Further Hayne Royal Commission Recommendations' (Media Release, 10 December 2020) <https://ministers.treasury.gov.au/ministers/josh-frydenberg-2018/media-releases/parliament-passes-legislation-implement-further-hayne>.

22 See John Singleton and James Revely, 'How Exceptional is Australian Financial Sector Misconduct? The Hayne Royal Commission Revisited' (2020) 14(2) *Law and Financial Markets Review* 77.

23 See Davis (n 13).

FY 2018–19.[24] The total value of BNPL arrangements as of FY 2019–20 is approximately AUD 9 billion, more than quadrupling its value from 2015–16.[25] Yet, despite four years of strong growth, increasing salience in consumer choices for payment and growing brand recognition, the regulation imposed on BNPL providers remains quite light.[26] This explosive growth has posed an issue to Australia's financial regulators: how to best balance assertive regulatory action to protect consumers and ensure market stability without stifling innovation.[27] Relevant regulators have expressed concerns about the sector,[28] yet so far have not taken any action.

Accordingly, the article addresses how the BNPL sector should be regulated. Part II gives a technical background to the operation of a BNPL arrangement and how it differs from existing credit arrangements. Part III considers the existing regulatory regime applied to BNPL providers, being the basic consumer law protections and inapplicability of Australia's consumer credit law. Part IV then reviews the competing regulatory approaches of the Reserve Bank of Australia ('RBA'), Australian Securities and Investments Commission ('ASIC'), and industry self-regulation, examining each for their efficacy. Part V considers the relevance of a particular consumer protection issue for the BNPL sector, that of surcharging, and whether calls to allow merchants to surcharge the costs associated with providing a BNPL service are correct. Finally, Part VI examines three potential regulatory stances that could be taken (see list below) and recommends reforms from there.

II Overview of BNPL Arrangements

A BNPL arrangement involves three parties: the BNPL provider; the consumer; and the merchant. First, the consumer agrees to purchase a good or service from the merchant. The BNPL provider then purchases the given good or service from the merchant on behalf of the consumer. For each BNPL transaction, merchants are

24 Australian Securities and Investments Commission, *Buy Now Pay Later: An Industry Update* (Report 672, November 2020) 6 <https://download.asic.gov.au/media/5852803/rep672-published-16-november-2020-2.pdf> ('*2020 Report*').

25 Chay Fisher, Cara Holland and Tim West, 'Developments in the Buy Now, Pay Later Market' (2021) *Bulletin* 59, 60 <https://www.rba.gov.au/publications/bulletin/2021/mar/pdf/developments-in-the-buy-now-pay-later-market.pdf>.

26 See *Australian Securities and Investments Commission Act 2001* (Cth) pt 2 ('*ASIC Act*').

27 Saule Omarova, 'Dealing with Disruption: Emerging Approaches to Fintech Regulation' (2020) 61 *Washington University Journal of Law & Policy* 25, 32–3. Global competitiveness is also an implicit consideration when determining the regulatory environment: see Select Committee on Financial Technology and Regulatory Technology, Parliament of Australia, *Interim Report* (September 2020) 110 [4.90].

28 Phillip Lowe, 'Innovation and Regulation in the Australian Payments System' (Speech, Australian Payments Network, 7 December 2020) <https://www.rba.gov.au/speeches/2020/sp-gov-2020-12-07.html>.

charged either a percentage amount of the purchase price or a fixed fee,[29] and this amount is subtracted from the BNPL provider's payment to the merchant. Finally, the consumer then repays the BNPL provider over several instalments (typically, four).[30] Importantly, there are no fees or interest charged, beyond any fees charged for late repayment to encourage prompt repayment by the consumer. This model differs between the various BNPL providers; for example, the maximum value of the arrangement and loan term can differ.[31]

These newer BNPL arrangements differ from the more 'traditional' forms of BNPL and consumer credit. Under a lay-by agreement, the good or service is paid for in instalments but is only received upon full payment, differing from the asynchronous nature of the modern BNPL arrangement.[32] Similarly, a credit card offers credit or a short-term loan on interest. BNPL arrangements generally do not use interest, nor do they offer the supplementary benefits that credit cards often do.[33] BNPL arrangements also differ from existing forms of consumer credit by enabling consumers greater choice where many merchants sign-up with the BNPL provider,[34] acting as a medium to connect consumers to merchants. Merchants also benefit from BNPL, bearing little credit risk as they will receive payment by the BNPL provider shortly following the consumers' purchase.[35]

An additional difference to existing credit arrangements is the target audience of BNPL offerings and the increased focus on technology. An interesting component of BNPL arrangements is their relative popularity with young individuals, with the 18–34 demographic representing the largest proportion of both completed transactions and those that have missed at least one late payment.[36] Likewise, BNPL offerings are heavily integrated into existing technological ecosystems, such as QR codes or barcodes, obviating the need for credit cards.[37] Given the industry's explosive growth and novel structure, the regulatory questions that this essay will explore are pertinent.

29 Australian Securities and Investments Commission, *Review of Buy Now Pay Later Arrangements* (Report No 600, November 2018) 24, 101-102 <https://download.asic.gov.au/media/4957540/rep600-published-07-dec-2018.pdf> ('*2018 Report*').

30 Ibid 6, 18–19.

31 Australian Securities and Investments Commission, *2020 Report* (n 24) 10.

32 Di Johnson, John Rodwell and Thomas Hendry, 'Analysing the Impacts of Financial Services Regulation to Make the Case that Buy-Now-Pay-Later Regulation is Failing' (2021) 13(4) *Sustainability* 1, 2.

33 Australian Securities and Investments Commission, *2018 Report* (n 29) 23 [96].

34 Fisher, Holland and West (n 25) 63.

35 Allen Sng Kiat Peng and Christy Tan Muki, 'Buy Now Pay Later in Singapore: Regulatory Gaps and Reform' (Working Paper, 5 May 2021) 6 <http://dx.doi.org/10.2139/ssrn.3819058>.

36 Australian Securities and Investments Commission, *2020 Report* (n 24) 27.

37 Fisher, Holland and West (n 25) 59–60.

III Existing Regulatory Regime and Issues

A *Existing Consumer Protections*

It is relevant to consider the current regulatory regime that applies to the BNPL sector. By virtue of being a 'credit facility',[38] a BNPL arrangement is a 'financial product' under the *Australian Securities and Investments Commission Act 2001* (Cth) ('*ASIC Act*').[39] Therefore the basic consumer protections under the *ASIC Act* accordingly apply to BNPL providers,[40] including requirements to not engage in misleading or deceptive conduct, unconscionable conduct, and avoid the use of unfair terms in their standard form contracts. However, these provisions lack specificity to the BNPL sector and provide only a baseline for behaviour as principles-based regulation.[41] This is not to downplay their importance in protecting consumers; rather, it is to acknowledge their limitations in the BNPL context.

Further, the substance of the prohibitions themselves possess issues. The unfair contracts regime only applies to the terms in standard-form contracts,[42] and any non-contractual conduct is outside the regime's reach. Misleading or deceptive conduct,[43] by focusing on whether the business' conduct is likely to lead a consumer into error,[44] is only effective in altering the presentation of given conduct. Any alterations to the substantive outcome are not within the regulation's scope.[45] Finally, unconscionable conduct requires a very high level of misconduct such that it falls well below community expectations to warrant condemnation.[46] This is therefore highly fact-specific in its application and provides protection only against serious forms of misconduct. For example, absent of other circumstances, it is unlikely the presence of late fees is themselves unconscionable.

As the definitions of 'financial product' in the *ASIC Act* and *Corporations Act 2001* (Cth) ('*Corporations Act*') are not equivalent,[47] BNPL providers appear to not require an Australian financial services license for BNPL services. Even if they did apply,

38 *Australian Securities and Investments Commission Regulations 2001* (Cth) reg 2B(1).

39 *ASIC Act* (n 26) ss 12BAA(6), 12BAB(7).

40 Ibid pt 2.

41 Andrew Godwin, Vivienne Brand and Rosemany Telle Langford, 'Legislative Design: Clarifying the Legislative Porridge' (2021) 38(5) *Companies & Securities Law Journal* 280, 286.

42 *ASIC Act* (n 26) s 12BF(1).

43 Ibid s 12DA(1).

44 *Australian Competition and Consumer Commission v TPG Internet Pty Ltd* (2013) 250 CLR 640, 651–2 [39] (French CJ, Crennan, Belle and Keane JJ).

45 See Kayleen Manwaring, 'Will Emerging Information Technologies Outpace Consumer Protection Law? The Case of Digital Consumer Manipulation' (2018) 26(2) *Competition and Consumer Law Journal* 141, 163–4.

46 *Australian Securities and Investments Commission v Kobelt* (2019) 267 CLR 1, 39–40, 91–92 (Gaegler J).

47 *Corporations Act 2001* (Cth) s 763A(1) ('*Corporations Act*').

however, they would be insufficient, especially the requirement to act 'efficiently, honestly and fairly'.[48] Traditionally interpreted as a composite phrase that, in essence, required licensees to adhere to a reasonable standard of performance in their actions,[49] this again represents a principles-based method of regulation that provides a baseline, but is ultimately insufficient in addressing the core issues to the BNPL sector. It follows that the key regulatory issue is whether a BNPL sector-specific regulatory regime is required.

B *The Relevance of Consumer Credit Regulation*

The potential application of Australia's consumer credit laws remains a significant issue. Under the *National Consumer Credit Protection Act 2010* (Cth) ('*NCCP Act*'), the providers of consumer credit, among other obligations, have responsible lending obligations such as mandatory information checks on consumers before lending.[50] Given the prima facie similarity of BNPL services with consumer credit, there have been repeated calls for BNPL services to be regulated as consumer credit.[51]

However, absent legislative reform, it is unlikely that BNPL arrangements will fall within the consumer credit regulation's scope. The *NCCP Act* establishes the *National Credit Code* ('*NCC*').[52] The *NCC* defines 'credit' where, under a contract, the payment of a debt is owed by one person to another or one person incurs a deferred debt to another.[53] A BNPL service meets this definition. The issue is that the *NCC* only applies where, among other things, a 'charge is or may be made for providing the credit'.[54] BNPL arrangements generally lack interest payments or other fees. In addition, BNPL arrangements often possess repayment periods below the statutory minimum period.[55] Accordingly, they fall outside the scope of the *NCC*. This interpretation of the legislation is ASIC's view,[56] notwithstanding vociferous opposition by consumer law advocates.[57] Accordingly, absent legislative reform, it is unlikely that BNPL is going to

48 Ibid s 912A(1).

49 *Australian Securities and Investments Commission v Camelot Derivatives Pty Ltd (in liq)* (2012) 88 ACSR 206, 225, 69–70 (Foster J).

50 See *National Consumer Credit Protection Act 2009* (Cth) s 117(1) ('*NCCP Act*').

51 See, eg, Financial Counselling Australia, 'Buy Now Pay Later Sector Must Be Regulated by Government Not Itself' (Media Release, 24 February 2021) <https://www.financialcounsellingaustralia.org.au/buy-now-pay-later-sector-must-be-regulated-by-government-not-itself/>.

52 *NCCP Act* (n 50) sch 1.

53 Ibid sch 1 s 3(1).

54 Ibid sch 1 s 5(1)(c).

55 Ibid sch 1 s 6(1)(a); Paul Gerrans, Dirk G Baur and Shane Lavagna-Slater, 'Fintech and Responsibility: Buy-Now-Pay-Later Arrangements' (2021) *Australian Journal of Management* 1, 2.

56 Australian Securities and Investments Commission, *2018 Report* (n 29) 35, 155.

57 See Consumer Action Law Centre, 'Buy Now Pay Later Sector Must be Regulated by Government Not Itself' (Media Release, 24 February 2021) <https://consumeraction.org.au/buy-now-pay-later-sector-must-

be regulated as a credit service. Yet, the application of Australia's consumer credit laws is not well-suited for the BNPL industry as it continues to develop. Currently, most BNPL offerings are business-to-consumer transactions. However, the core elements of BNPL are transferable to other commercial contexts – in this sense, it is more innovative than the mere provision of credit which is equivalent in offering regardless of context. Accordingly, BNPL offerings are increasingly available in business-to-business transactions or to provide advances on an employee's salary.[58] These are clearly outside the remit of the *NCC* as the credit is not to a natural person, and the credit is not provided for personal, domestic or household purposes.[59] Regulating only those BNPL offerings to consumers as consumer credit, while not others with analogous business models, is not a satisfactory basis for sound regulation. Further, the compliance costs associated with credit licensing could be substantial and likely passed onto consumers.[60] Therefore, there are valid reasons why BNPL transactions should not be regulated as consumer credit.

IV The Competing Regulatory Approaches

A *Reserve Bank of Australia*

To understand the RBA's current regulatory approach, it is necessary to first outline the 'no-surcharge rule' as the issue pertinent to them. The 'no-surcharge rule' used by BNPL providers prevents merchants from passing on the costs to consumers associated with processing the transaction through a BNPL scheme.[61] These are not illegal in Australia (although excessive surcharging is)[62] and thus operate only through the contractual agreements between the BNPL provider and the merchant.[63] More broadly among payment systems, these have been prevalent in Australia since

be-regulated-by-government-not-itself/>.

58 See Sarah Thompson, Anthony MacDonald and Yolanda Redrup, 'BNPL for Recruiters: Applyflow Ready to Roll', *Australian Financial Review* (online, 29 June 2021) <https://www.afr.com/street-talk/bnpl-for-recruiters-applyflow-ready-to-roll-20210629-p5857m>; Paul Smith, 'Fintech Funding Start-Up Banks $12.5m Before IPO', *Australian Financial Review* (online, 21 February 2021)<https://www.afr.com/technology/fintech-funding-start-up-banks-12-5m-ahead-of-ipo-20210217-p573gh>; Miranda Ward, 'Beforepay Kicks Off TV Dd Campaign to Push User Growth', *Australian Financial Review* (online, 27 June 2021) <https://www.afr.com/companies/media-and-marketing/beforepay-kicks-off-tv-ad-campaign-to-push-user-growth-20210716-p58abl>.

59 *NCCP Act* (n 50) sch 1 s 5(1).

60 Consumer Affairs Victoria, *Using Licensing to Protect Consumers' Interests* (Research Paper No 9, November 2006) 15.

61 Reserve Bank of Australia, *Payment Systems Board Annual Report* (Report, September 2020) 50 <https://www.rba.gov.au/publications/annual-reports/psb/2020/pdf/2020-psb-annual-report.pdf> ('*Payment Systems Board Annual Report*').

62 *Competition and Consumer Act 2010* (Cth) s 55B ('*CCA*').

63 See Australian Securities and Investments Commission, *2018 Report* (n 29) 10 [34].

the RBA removed the no-surcharging requirements that apply to debit and credit cards.[64] In effect, this passes on the cost of a BNPL surcharge to *all* consumers, not just those using BNPL arrangements.[65] The issue posed by maintaining the 'no surcharge rule' represents a trade-off between furthering innovation within the BNPL sector, as against competition amongst payment systems and harm arising to consumers.

The RBA's comments concerning consumer protection in the BNPL sphere indicate an emphasis on innovation over competition and the protection of consumers. In late 2020, Phillip Lowe, Governor of the RBA noted that the issues posed by the 'no surcharge rule' do not currently justify its removal.[66] Yet, the RBA's 'longstanding view' is that merchants should have the right to surcharge.[67] The innovation objective appears to have such influence on the RBA's regulatory decision-making that it outweighs all competing objectives, including competition and consumer protection.

This is a curious proposition for the RBA to assert considering the Payment Systems Board regulatory objectives.[68] While not strictly contradicting these, it does indicate a clear preference for innovation over competition. Generously interpreted, the comments of the Governor could be the RBA employing moral suasion as a policy tool to direct BNPL providers to emphasise the innovativeness of their services over consumer protection and competition.[69] In any event, the Governor's remarks stem from a limited regulatory philosophy, akin to that expressed by the Productivity Commission.[70]

B *Australian Securities and Investments Commission*

ASIC has described its broad regulatory stance towards FinTech as, among others: technology neutral; ensuring consistency in compliance obligations across businesses; possessing a wide range of regulatory tools to protect investors and consumers; and promoting competition as a complementary objective.[71]

64 Reserve Bank of Australia, *Review of Card Surcharging: A Consultation Document* (Report, June 2011) 2 <https://www.rba.gov.au/publications/consultations/201106-review-card-surcharging/pdf/201106-review-card-surcharging.pdf>.

65 Johnson, Rodwell and Hendry (n 32) 8.

66 Lowe (n 28).

67 Fisher, Holland and West (n 25) 66.

68 See *Reserve Bank of Australia Act 1956* (Cth) s 10B(3)(b).

69 See J T Romans, 'Moral Suasion as an Instrument of Economic Policy' (1966) 56(5) *American Economic Review* 1220, 1221.

70 Productivity Commission (n 5) 39.

71 Australian Securities and Investments Commission, Submission to the Senate Select Committee on Financial Technology and Regulatory Technology, Parliament of Australia, *Australia as a Technology and Financial Centre* (December 2020) 4–5 <https://www.aph.gov.au/DocumentStore.ashx?id=ce348c03-2cb2-4be0-8cc8-9a0bc212c8a1&subId=675231> It is worth identifying that, as a result of the Hayne Royal Commission, the *ASIC Act* was amended to require ASIC consider the competitive implications of its actions: *ASIC Act* (n 26) s 1(2A).

Thus far, ASIC has not engaged in considerable regulatory action. As referred to above, ASIC's view is that BNPL providers are not credit providers under the *NCC* despite opposition from consumer groups.[72] As a corollary of this, the responsible lending obligations under the *NCCP Act* do not apply.[73] Accordingly, ASIC's regulatory response has mostly been the observation and identification of consumer protection that the sector faces, broadly following a 'wait and see' approach that generally occurs at the beginning of a FinTech's development.[74] Otherwise, ASIC is utilising its existing consumer protection powers and retrofitting them to the BNPL sector.[75]

The relevant consumer protection issues ASIC identified following its observations of the BNPL sector are: consumer over-commitment; potential unfair terms; and surcharging issues.

1 *Consumer Over-Commitment and BNPL Provider Interactions*

This occurs where the additional credit a consumer acquires leads to new or additional financial difficulty.[76] The particular structure of the BNPL transaction (that is, its length and term) impacts the level of financial distress caused – for example, a longer-term arrangement will drag out repayment over a longer period, while a short-term arrangement requires large repayment instalments to be made.[77] This represents an issue for BNPL providers, as consumers' perceptions of the cost of a transaction can decouple from the benefit as time passes.[78] Over-commitment, therefore, is apt to occur among BNPL consumers without additional restrictions.

ASIC estimates that 21% of BNPL users have missed a payment in the last 12 months.[79] This financial stress can lead to significant individual and social harms, such as cutting back on essential meals.[80] The financial distress that late payments can cause, can lead to deteriorated mental health outcomes,[81] including worsened

72 See part II(B) above.

73 See *NCCP Act* (n 50) s 117(1).

74 See Amstad (n 1) 8.

75 This is an application of the 'same risk, same rules' regulatory approach, where the consumer protection risks posed by BNPL are no different to those in other financial services and thus warrant the same regulatory framework: see Johannes Ehrentraud et al, 'Policy Responses to Fintech: A Cross-Country Overview' (Insights on Policy Implementation No 23, Financial Stability Institute, January 2020) 26–7 [58] <https://www.bis.org/fsi/publ/insights23.pdf>.

76 Australian Securities and Investments Commission, *2018 Report* (n 29) 33 [146].

77 Ibid 34 150–153.

78 Jennifer Christie Siemens, 'When Consumption Benefits Precede Costs: Towards an Understanding of "Buy Now, Pay Later" Transactions' (2007) 20(5) *Journal of Behavioural Decision Making* 521, 528.

79 Australian Securities and Investments Commission, *2020 Report* (n 24) 12.

80 Ibid 15.

81 See Lisa Fiksenbaum et al, 'Impact of Economic Hardship and Financial Threat on Suicide Ideation and Confusion' (2017) 151(5) *Journal of Psychology* 477.

self-esteem and personal agency,[82] and increased rates of obesity.[83] Among younger individuals specifically, the risk of mental health issues and worsened academic results are intensified.[84] Similarly, concerns were raised regarding a lack of information relating to key terms, a complaints process and the absence of assistance for those suffering from financial hardship.[85] Given that younger individuals tend to have lower financial literacy,[86] the lack of information provided can compound the over-commitment issues.

2 *Potential Unfair Terms in Contracts*

ASIC also identified that the standard form contracts offered by some BNPL providers included potentially unfair contract terms.[87] Given the likely ineffectiveness of further informational disclosures given weak financial literacy, the paternalist voiding of certain terms under law is likely to be more effective.[88] Accordingly, the enforcement action ASIC has taken in this area is encouraging.[89]

Inherent limitations exist in the unfair contract legislative scheme as it currently exists, however. The terms themselves are not strictly prohibited – they must first be proven to be unfair in a court.[90] This is problematic given the concerns raised around ASIC's enforcement culture.[91] The Commonwealth Government's intention to create a rebuttable presumption that certain terms are unfair if used in similar circumstances would go some way to improving this issue.[92]

82 Charlotte Frankham, Thomas Richardson and Nick Maguire, 'Psychological Factors Associated with Financial Hardship and Mental Health: A Systematic Review' (2020) 77 *Clinical Psychology Review* 101832:1–24, 7–8.

83 Susan Averett and Julie Smith, 'Financial Hardship and Obesity' (2014) 15 (December) *Economics & Human Biology* 201.

84 See Thomas Richardson et al, 'Financial Difficulties and Psychosis Risk in British Undergraduate Students: A Longitudinal Analysis' (2018) 17(2) *Journal of Public Mental Health* 61; James Harding, 'Financial Circumstances, Financial Difficulties and Academic Achievement Among First-Year Undergraduates' (2011) 35(4) *Journal of Further and Higher Education* 483; Kim M Kiely, 'How Financial Hardship is Associated with the Onset of Mental Health Problems Over Time' (2015) 50(6) *Social Psychiatry and Psychiatric Epidemiology* 909.

85 Australian Securities and Investments Commission, *2018 Report* (n 29) 37–9.

86 See Annamaria Lusardi and Peter Tufano, 'Debt Literacy, Financial Experiences, and Overindebtedness' (2015) 14(4) *Journal of Pension Economics & Finance* 332, 340; Annamaria Lusardi, Olivia S Mitchell and Vilsa Curuto, 'Financial Literacy Among the Young' (2010) 44(2) *Journal of Consumer Affairs* 358.

87 Australian Securities and Investments Commission, *2018 Report* (n 29) 39.

88 Michael Faure and Hanneke Luth, 'Behavioural Economics in Unfair Contract Terms: Cautions and Considerations' (2011) 34(3) *Journal of Consumer Policy* 337, 353–4.

89 Australian Securities and Investments Commission, *2018 Report* (n 29) 39 [177].

90 *ASIC Act* (n 26) s 12B(2); *Australian Competition and Consumer Commission v Chrisco Hampers Australia Ltd* (2015) 239 FCR 33, 42 [44] (Edelman J).

91 *Royal Commission Final Report* (n 21) vol 1 442–6.

92 Legislative and Governance Forum on Consumer Affairs, 'Meeting of Ministers for Consumer Affairs' (Joint Communique, November 2020) 2 <https://consumer.gov.au/sites/consumer/files/inline-files/CAFCommunique-20201106.pdf>.

3 *Increases in Prices Caused by Surcharging*

ASIC's surcharging concerns were not focused on the presence of the 'no-surcharge rule' itself. Rather, they focused on the potential of excessive surcharging by merchants in circumstances of a high-value purchase, where the price is not transparent and negotiable or where a BNPL arrangement is used to acquire a service.[93] Joint action with the Australian Competition and Consumer Commission ('ACCC') has been taken to inform merchants that misleading consumers over surcharging is illegal, but no information regarding the efficacy of such actions has been released.[94] Regardless, this is indicative of a regulatory action by ASIC under the existing framework.

C *Industry Self-Regulation*

On 1 March 2021, the BNPL *Code of Practice* entered into effect.[95] Broadly, the implementation of this code is indicative of the broader Australian trend towards a self-regulatory model in the financial sector. Self-regulatory models occur where the norms and standards of conduct are determined at the industry-level, rather than at the government or firm-level.[96] The reasons behind an industry's choice to self-regulate include to reducing risk, enhancing its reputation and promoting innovation[97] – more simply, it is where the net benefits of collective action outweigh the costs of private action.[98]

The *Code of Practice* imposes nine key commitments on its participants. While all are relevant from a consumer protection perspective, some bear special emphasis. These include the commitment to consider any customer vulnerability if raised,[99] a commitment to act ethically,[100] and various provisions over late fees, which ensure that they are written in easily understandable language and involve notifying the customer before charging the fees.[101] Perhaps most importantly, an assessment

93 Australian Securities and Investments Commission, *2018 Report* (n 29) 10 [36].

94 Australian Securities and Investments Commission, *2020 Report* (n 24) 19.

95 Australian Finance Industry Association, 'AFIA's Buy Now Pay Later Code of Practice Comes into Effect' (Media Release, 1 March 2021) 1 <https://afia.asn.au/files/galleries/BNPL_launch_Media_Release_FINAL.pdf>; Australian Finance Industry Association, *Buy Now Pay Later Code of Practice* (at 1 March 2021) <,https://afia.asn.au/files/galleries/AFIA_Code_of_Practice_for_Buy_Now_Pay_Later_Providers.pdf> ('*Code of Practice*').

96 Neil Gunningham and Joseph Rees, 'Industry Self-Regulation: An Institutional Perspective' (1997) 19(4) *Law and Policy* 363, 364.

97 Virginia Haufler, *A Public Role for the Private Sector: Industry Self-Regulation in a Global Economy* (Carnegie Endowment for International Peace, 2001) 20.

98 Jan Sammeck, *A New Institutional Economics Perspective on Industry Self-Regulation* (Sringer Gabler, 2012) 135.

99 *Code of Practice* (n 95) s 8.1, 8.4–5.

100 Ibid s 9.

101 Ibid s 10.1.

process is mandated for new and existing customers. For new customers, the BNPL provider will need to be 'reasonably satisfied' that, among other things, the customer is not vulnerable, that the initial upfront payment can be made within 25 days of receipt, and that the repayment term is determined to be suitable.[102] Accordingly, an objective test is imposed, limiting the discretion of BNPL providers. Depending on the size of the BNPL transaction, the BNPL provider may have to undergo further checks, using either customer data or third-party data like credit checks (or both) to further satisfy themselves that the customer is suitable for the BNPL service.[103] For existing customers, the BNPL provider needs to be satisfied that, among other criteria, the customer is up to date on all payments, that the repayment term is appropriate and that the customer is not vulnerable.[104] If the BNPL service is for an amount greater than AUD 3,000, checks equivalent to those for new customers are undertaken.[105]

These provisions of the *Code of Practice* ostensibly address the issues raised by ASIC; for example, the implementation of credit checks should theoretically limit consumer over-commitment and better inform the BNPL provider of the consumer's financial situation. Likewise, the caps on late fees should limit to some extent the financial pressure they impose on consumers.[106] Further, the various commitments and the potential sanctions for breaching the *Code* provide an incentive for participants to adhere to it.[107] The various sanctions available include a compliance review, publication of the breach, and a compliance audit at the BNPL provider's expense,[108] but do not include any pecuniary penalties. However, the issues raised concerning unfair contracts are subject only to a commitment to comply with the relevant laws.[109] Theoretically, these provisions serve as constraints on the behaviour of BNPL providers, such that consumers are better protected.

Yet, the *Code* lacks sufficient supervision and enforcement to be a fully effective mechanism for consumer protection. As the *Code* has not been approved by ASIC,[110] it acts as a form of voluntary self-regulation,[111] lacking regulatory oversight.[112]

102 Ibid s 11.3.
103 Ibid s 11.4–6.
104 Ibid s 11.11.
105 Ibid s 11.12.
106 Ibid s 10.1(g).
107 See ibid s 13.19.
108 Australian Finance Industry Association, *Buy Now Pay Later By-Laws* (1 March 2021) [9.11] <https://afia.asn.au/files/galleries/AFIA_BNPL_Code_of_Practice_By-Laws.pdf>.
109 *Code of Practice* (n 95) s 15.1.
110 *Corporations Act* (n 47) s 1101A(1).
111 Gunningham and Rees (n 96) 365.
112 Australian Securities and Investments Commission, 'Approval of Financial Services Sector Codes of

Self-regulation generally raises allegations of regulatory capture,[113] and the *Code of Practice* has failed to gain support from consumer groups.[114] At a minimum, any concerns regarding accountability concerns are valid,[115] given decision-making under the *Code* is performed by the BNPL provider. Appeals to the Australian Financial Complaints Authority ('AFCA') and the independent Code Compliance Committee mitigate these concerns somewhat,[116] but remain present absent formal regulatory oversight. Ultimately, the *Code of Practice's* efficacy in practice cannot be conclusively determined yet given the short period it has been operative, but it serves as an effective foundation for regulation of the sector.

V SURCHARGING: PRO OR ANTI-COMPETITIVE?

A *Efficiency of Surcharging*

The efficiency or inefficiency of the no-surcharging rule is central to whether it should be maintained or not. Competition law tends to use underlying economic theory to justify a given policy outcome.[117] Indeed, the economic expression of 'enhance the welfare' is an explicit objective of Australia's competition and consumer law.[118] Accordingly, examining whether the banning of surcharging is efficient is necessary to arrive at an effective policy outcome.

The economic literature is not unanimous in assessing the efficiency of surcharging.[119] By imposing additional costs when using a given payment method, surcharging incentivises the use of alternative payment methods.[120] The ability to price discriminate is the core to surcharging's claim to efficiency – imposing higher surcharges on more costly payment methods thereby allows the merchant to offer a lower price to all customers and recoup the costs of supplying a given payment

Conduct' (Regulatory Guide 183, March 2013) 28 [183.140]–[183.141] <https://download.asic.gov.au/media/1241015/rg183-published-1-march-2013.pdf> ('RG 183').

113 Ian Bartle and Peter Vass, 'Self-Regulation Within the Regulatory State: Towards a New Regulatory Paradigm?' (2007) 85(4) *Public Administration* 885, 886; Javier Núñez, 'A Model of Self-Regulation' (2001) 74(1) *Economics Letters* 91.

114 Fiona Simon, *Meta-Regulation in Practice: Beyond Normative Views of Morality and Rationality* (Routledge, 2017) 189.

115 Robert Baldwin, Martin Cave and Martin Lodge, *Understanding Regulation: Theory, Strategy, and Practice* (Oxford University Press, 2011) 142–3.

116 *Code of Practice* (n 95) ss 13.9–19.

117 Roger Van den Bergh, *Comparative Competition Law and Economics* (Edward Elgar Publishing, 2017) 1.

118 See *CCA* (n 62) s 2.

119 Given the nascency of the BNPL sector, the economic literature has focused primarily on credit card surcharging. Regardless, the basic principles and findings remain applicable here.

120 Wilko Bold, Nicole Jonker and Corry van Renselaar, 'Incentives at the Counter: An Empirical Analysis of Surcharging Card Payments and Payment Behaviour in the Netherlands' (2010) 34(8) *Journal of Banking & Finance* 1738, 1743.

method.[121] Surcharging thus assists consumer choice and directs them towards a retailer's preferred method of payment.[122] This is grounded in the 'loss-aversion' theories of behavioural economics,[123] notwithstanding the criticism such an approach has received.[124] Enabling surcharging itself encourages competition between the various payment platforms to reduce their costs, and in turn, lower the value of a merchant's surcharge.[125] Similarly, surcharging itself prevents some broader negative implications, like encouraging overconsumption and de facto subsidising the non-surcharging payment platform.[126]

However, other research indicates that surcharging is inefficient and prone to harm consumers. The steering by merchants is heavily reliant upon a consumer's individual preferences, such that surcharging often fails to encourage the use of a given payment platform.[127] Likewise, inherently part of surcharging is the merchant extracting economic rents from consumers.[128] A corollary of this is the likelihood of excessive surcharging, or where the surcharge is larger than what it costs the merchant to accept a given payment method.[129] In effect, this allows surcharging to act as an additional revenue stream for merchants.[130] There is also an implied bias towards large retailers under a system with surcharging. Large retailers possess stronger bargaining power to influence the costs imposed by a payment network – smaller retailers do not possess this power,[131] and thereby experience larger merchant

121 Cameron Dark et al, 'Payment Surcharges: Economics, Regulation and Enforcement' [2018] (December) *Bulletin* 1, 5 <https://www.rba.gov.au/publications/bulletin/2018/dec/pdf/payment-surcharges-economics-regulation-and-enforcement.pdf>.

122 Bold, Jonker and van Renselaar (n 120) 1743.

123 See, eg, Daniel Kahneman, Jack L Knetsch, and Richard H Thaler, 'Anomalies: The Endowment Effect, Loss Aversion and Status Quo Bias' (1991) 5(1) *Journal of Economic Perspectives* 193.

124 See Todd J Zywicki, 'The Behavioural Economics and Behavioural Law and Economics' (2018) 5(3–4) *Review of Behavioral Economics* 439. Zwyicki notes that previous analyses that have recommended maintaining a ban on surcharging have used substantially the same theoretical underpinning: at 452. On this basis, he argues that the use of loss aversion as a rationale for allowing merchant surcharging is to rely on a 'vague and elastic' theory: at 452.

125 Dark et al (n 121) 5.

126 Adam J Levitin, 'The Antitrust Super Bowl: America's Payment System, No-Surcharge Rules, and the Hidden Costs of Credit' (2005) 3(1) *Berkeley Business Law Journal* 265, 297.

127 Joanna Stavins, 'Consumer Preferences for Payment Methods: Role of Discounts and Surcharges' (2018) 94 (September) *Journal of Banking & Finance* 35, 49.

128 Todd J Zywicki, Geoffrey A Manne and Kristian Stout, 'Behavioral Economics Goes to Court: The Fundamental Flaws in the Behavioral Law & Economics Arguments Against No-Surcharge Laws' (2017) 82(3) *Missouri Law Review* 769, 815.

129 Dark et al (n 121) 5.

130 Zywicki, Manne and Stout (n 128) 818–8. In the credit card context, the threat to consumers posed by excessive surcharging saw the introduction of amendments to the *CCA* that prevents 'excessive' payment surcharging: *CCA* (n 62) s 55A(1).

131 Jeffrey C Arnier Jr, 'Encouraging Surcharge: Toward a Market-Driven Solution to Supercompetitive Credit Card Interchange Fees' (2021) 99(3) *Texas Law Review* 621, 631.

fees;[132] in turn, potentially leading to larger consumers surcharges.[133] Given these ambiguous effects, what are the economic implications of abolishing the no surcharge rule? Bourguignon, Gomes and Tirole perhaps describe it best: abolishing the rule will substitute certain inefficiencies for others.[134] Given this trade-off, the economic rationale for abolishing the no-surcharge rule will therefore depend on the competitive conditions within a given market.[135]

B *Implications for the BNPL Sector*

The presence of a no-surcharging rule gives BNPL providers an advantage vis-à-vis other payment methods. In part, price competitiveness is partially responsible for the large growth of the industry. Yet despite significant growth already, the BNPL sector has significant room to grow. Total BNPL payments are a small fraction of total card purchases,[136] and the average value of a BNPL transaction remains above that of a credit card, at AUD 178 and AUD 100,[137] respectively. On this reading, maintaining the no-surcharge rule provides the BNPL sector with further support to expand as a payment system and competitor to existing means of payment.[138]

However, it is questionable whether government policy should be actively supporting one payment system over others. Likewise, most of the downsides that may arise following the prohibition of the no-surcharge rule poses within the realm of consumer law and can largely be dealt with by existing mechanisms.[139] The imposition of a ban on 'excessive' payment surcharging especially would play a key role in limiting broader harms to consumers. Keeping in mind the broader objectives of regulation as the balancing of factors like competition, innovation and

132 Kateryna Occhiutto, 'The Cost of Card Payments for Merchants' [2020] (March) *Bulletin* 20, 21 <https://www.rba.gov.au/publications/bulletin/2020/mar/pdf/the-cost-of-card-payments-for-merchants.pdf>.

133 Dark et al (n 121) 3.

134 Hélène Bourguignon, Renato Gomes and Jean Tirole, 'Shrouded Transaction Costs: Must-Take Cards, Discounts and Surcharges' (2019) 63 (March) *International Journal of Industrial Organisation* 126.

135 See David Henriques, 'Cards on the Table: Efficiency and Welfare Effects of the No-Surcharge Rule' (2018) 17(1) *Review of Network Economics* 25.

136 *Payment Systems Board Annual Report* (n 61) 31.

137 Australian Securities and Investments Commission, *2018 Report* (n 29) 18 [84]; Stephen Mitchell and Hao Wang, 'New Payments Insights from the Updated Retail Payments Statistics Collection' [2019] (March) *Bulletin* 1, 8 <https://www.rba.gov.au/publications/bulletin/2019/mar/pdf/new-payments-insights-from-the-updated-retail-payments-statistics-collection.pdf>. The 2018 figures are somewhat outdated, given the increased proliferation of BNPL providers that deliberately target larger transaction values: see Australian Securities and Investments Commission, *2020 Report* (n 24) 10. It is highly unlikely, however, that the relative position of the transaction values has changed.

138 However, it should again be noted that this support is in effect a subsidy given by users of more traditional payment towards BNPL users: see Johnson, Rodwell and Hendry (n 32) 8.

139 For example, the imbalance in bargaining power smaller retailers have could be addressed under the unfair contracts regime: *ASIC Act* (n 26) div 2 sub-div BA.

consumer protection,[140] the broader economic benefits that would flow following prohibitions on no-surcharge rules would likely outweigh the ensuing harms if properly regulated. Maintaining the 'no-surcharge rule' is unlikely to aid the growth of new BNPL providers, considering new providers are tending to charge considerably lower merchant fees than existing providers.[141] Moreover, it is also doubtful that the prohibition of the no-surcharge rule would activate any obligations under Australia's consumer credit laws. The merchant would be surcharging the customers, not the BNPL provider. As the BNPL provider would not be directly surcharging the consumer in the provision of the debt, the provision of credit would lack a charge,[142] and therefore remain outside the scope of consumer credit regulation.

In summary, a prohibition should be imposed on the inclusion of no-surcharge rules between the merchant and BNPL provider, with the merchant's surcharging behaviour then subject to broader consumer law protections.

VI Potentials Options for Reform

A *The 'Wait and See' Approach*

The first potential option for reform is to effectively 'wait and see' whether the *Code of Practice* will effectively address the issues raised. As identified above, these issues include inadequate credit checks, surcharging behaviour and the presence of potentially unfair terms. These are all ostensibly addressed within the *Code of Practice*. In line with the current regulatory approach to only intervene where there is a demonstrable market failure,[143] such a 'wait-and-see' approach would follow existing government practices.[144]

Consumers would not be entirely without recourse in this scenario. The *Code of Practice* states that complaints can be directed to either the AFCA or the CCC.[145] Should a decision by either of these bodies be unsatisfactory to the consumer, it is arguable that they could be challenged under judicial review.[146] The prospect of

140 Stan Wallis et al, Treasury (Cth), *Financial System Inquiry Final Report* (Report, March 1997) 244.

141 See, eg, 'CommBank Unveils New Buy Now, Pay Later Offering', *Commonwealth Bank of Australia* (Web Page, 17 March 2021) <https://www.commbank.com.au/articles/newsroom/2021/03/commbank-unveils-bnpl-offering.html>.

142 *NCCP Act* (n 50) sch 1 s 5(1)(c).

143 Productivity Commission (n 5) 29–30.

144 See, eg, Anton Didenko, 'Regulating FinTech: Lessons from Africa' (2018) 19(Index 2) *San Diego International Law Journal* 311, 329.

145 *Code of Practice* (n 95) ss 13.9–13.19.

146 See Gail Pearson, 'Business Self-Regulation' (2012) 20(1) *Australian Journal of Administrative Law* 34, 38–9. Pearson's argument turns on the applicability of *R v Panel on Take-overs and Mergers; Ex parte Datafin plc* [1987] QB 815, 837, 847–8, 852 (Lloyd LJ) ('*Datafin*'), where a self-regulatory body may be subject to judicial review if, where making a decision, it involves a power with a public element or a public duty.

judicial review by a private body is not an established principle in Australia,[147] and clarity from the High Court of Australia would be needed to definitively determine its existence.[148] Even if the *Datafin* principle is accepted, it may not apply to contractually-established bodies like the AFCA.[149] Notwithstanding compelling contrary arguments asserting the AFCA would be subject to judicial review irrespective of its contractual nature,[150] such an avenue for redress has not yet been closed should BNPL customers be aggrieved under the *Code of Practice*.

Likewise, actions under the basic consumer law protections could be pursued. For example, a misleading or deceptive conduct claim may have grounds to succeed.[151] Under a misleading or deceptive claim, 'conduct' is given a broad definition,[152] and goes beyond mere representations.[153] Subscribers to the *Code of Practice* clearly state that they will abide by the *Code*,[154] a clear representation that members will adhere to its provisions. Depending on the given factual circumstances, this could satisfy the causation requirements under a misleading and deceptive conduct claim if the *Code of Practice* is not followed.[155]

The issue with both approaches above is that they rely on litigation. Litigation is notoriously costly and timely, and advantageous to those with greater material resources.[156] At the risk of generalising, many BNPL users are vulnerable and may not

147 Victoria has been the jurisdiction that has most readily adopted the *Datafin* principle: see, eg, *CECA Institute Pty Ltd v Australian Council for Private Education & Training* (2010) 30 VR 555, 576 [100] (Kyrou J) *Mickovski v Financial Ombudsman Service Ltd* [2011] VSC 257; *Durney v Unison Housing Ltd* (2019) 57 VR 158. In contrast, other jurisdictions have been less receptive to the doctrine: *Chase Oyster Bar Pty Ltd v Hamo Industries Pty Ltd* (2010) 78 NSWLR 410–3, [74]–[81] (Basten JA); *Australasian College of Cosmetic Surgery Ltd v Australian Medical Council Ltd* (2015) 232 FCR 225, 240 [72].

148 The most recent authority has indicated that the *Datafin* principles are unlikely to be definitively adopted by inferior courts without approval from the High Court of Australia: see *Vergara v Chartered Accountants Australian and New Zealand* [2021] VSC 34 [174] (Digby J).

149 See *R v Disciplinary Committee of the Jockey Club; Ex parte His Highness the Aga Khan* [1993] 1 WLR 909, 924 (Lord Bingham).

150 See AJ Orchard, 'Disputing the Resolution: Why the Australian Financial Complaints Authority Will be Subject to Judicial Review' [2018] 91 *Australian Institute of Administrative Law Forum* 30, 40–3. Cf Camilla Pondel, 'Legitimacy in Australia's Financial System External Dispute Resolution Framework: New and Improved or Simple New?' (2019) 42(1) *University of New South Wales Law Journal* 335, 358–9.

151 See *ASIC Act* (n 26) s 12DA(1).

152 Ibid s 12BA(2).

153 *S & I Publishing Pty Ltd v Australian Surf Life Saving Pty Ltd* (1998) 88 FCR 354, 361 (Hill, RD Nicholson and Emmett JJ); *Butcher v Lachlan Elder Realty Pty Ltd* (2004) 218 CLR 592, 603 (Gleeson CJ, Hayne and Heydon JJ).

154 *Code of Practice* (n 95) s 15.1.

155 *Australian Competition and Consumer Commission v TPG Internet Pty Ltd* (2013) 250 CLR 640, 651–2 [39] (French CJ, Crennan, Bell and Keane JJ).

156 See Marc Galanter, 'Why the "Haves" Come Out Ahead: Speculations on the Limits of Legal Change' (1974) 9(1) *Law & Society Review* 95; Albert Yoon, 'The Importance of Litigant Wealth' (2010) 59(2) *DePaul Law Review* 649, 669.

have the resources to sustain litigation. Thereby, they would be locked out of potential recourse to any disputes that could arise.[157] On this basis, a 'wait and see' approach is not an acceptable basis for regulation of the BNPL sector.

B *Regulating the BNPL Sector Directly*

Generally, direct regulation of the BNPL sector is the approach taken in overseas jurisdictions, with the Financial Conduct Authority in the United Kingdom currently urging Her Majesty's Government to bring BNPL providers within the scope of its credit regulation.[158] Direct regulation will occur via the newly introduced design and distribution obligations or product intervention powers.[159]

Direct regulation would have the benefit of providing oversight and control over the BNPL sector, enabling the better protection of consumers. However, significant costs would be associated with it, including compliance costs and the costs associated with ASIC's oversight and enforcement.[160] Moreover, absent a bespoke regime, it is difficult to effectively retrofit existing regulations for a new and disruptive financial service without exemptions.[161] As outlined above, the *NCC* is ill-suited to apply.[162]

A bespoke regime could be developed but this would take considerable time and require substantial public consultation. Even assuming that prior regulation like the *NCC* can apply to the BNPL sector with little alteration, such a blunt tool is more likely to inhibit the creation of newer business models and BNPL offerings to consumers, hindering further innovation of the BNPL sector and the development of new BNPL models.[163] In light of the competing regulatory objectives, direct regulation is not the ideal model.[164] This, however, is not to preclude the use of direct regulation entirely –

157 See Murray Gleeson, 'The Purpose of Litigation' (2009) 83(9) *Australian Law Journal* 601, 608.

158 Christopher Woolard, *The Woolard Review: A Review of Change and Innovation in the Unsecured Credit Market* (Report, February 2021) 52 <https://www.fca.org.uk/publication/corporate/woolard-review-report.pdf>. Given this recommendation, it is not surprising that making Australia's consumer credit regime apply to BNPL providers is one of the more common direct regulatory regimes suggested: see, eg, Consumer Action Law Centre (n 57).

159 See *Treasury Laws Amendment (Design and Distribution Obligations and Product Intervention Powers) Act 2019* (Cth) ('*Design and Distribution Obligations and Product Intervention Powers Amendment Act*').

160 See Cento Veljanovsku, 'Economic Approaches to Regulation' in Robert Baldwin, Martin Cave and Martin Lodge (eds), *The Oxford Handbook of Regulation* (Oxford University Press, 2010) 17, 28.

161 See Douglas W Arner et al, 'FinTech and RegTech: Enabling Innovation While Preserving Financial Stability' (2017) 18(3) *Georgetown Journal of International Affairs* 47, 50.

162 See part II(B) above.

163 See Philippe Aghion, Antonin Bergeaud, and John Van Reenen, 'The Impact of Regulation on Innovation' (Working Paper No 28381, National Bureau of Economic Research, January 2021) <https://www.nber.org/papers/w28381>. Of course, not all regulation will hamper innovation – regulation that can be specialised in its application to individual firms can encourage innovation: see Jacques Pelkmans and Andrea Renda, 'Does EU Regulation Hinder or Stimulate Innovation?' (Special Report No 96, Centre for European Policy Studies, November 2014) <https://core.ac.uk/download/pdf/76797108.pdf>.

164 Douglas W Arner, Janos Barberis and Ross P Buckley, 'The Evolution of FinTech: A New Post-Crisis

the more targeted applications presented by the design and distribution obligations are better suited to the BNPL sector.[165] The potential of the design and distribution obligations in protecting consumers warrants further comment.

These obligations relevantly require the BNPL provider to make a target market determination that describes the class of targeted retail consumers, and monitor and review these determinations.[166] Reasonable steps must then be taken to ensure that the product is sold only to that target market.[167] This has the effect of integrating consumer protection considerations into the provision of their product by utilising their superior information.[168] ASIC argues that the application of these obligations from October 2021 will force BNPL providers to continually review their arrangements and assess whether their products are appropriately targeted.[169] This effectively means that BNPL providers must choose whether their product is targeted towards high or low-value transactions, in addition to considering the potential financial literacy of their customers. With adequate oversight and enforcement, these obligations should limit the likelihood of poorly targeted BNPL services. Such direct regulation is sufficiently flexible to adapt to the needs of individual products and providers, such that it can simultaneously protect consumers while limiting any efficiency losses.

C *Mandating the Code of Practice*

As identified above, the *Code of Practice* is merely voluntary for participants – this reform proposal would see ASIC or ACCC mandate the *Code of Practice*.[170] In effect, this would represent a shift from the current model of self-regulation to co-regulation,[171] a more pluralist form of governance that involves the collaboration of both private and public actors.[172]

Paradigm' (2016) 47(4) *Georgetown Journal of International Law* 1271, 1307.

165 Such an approach aligns with ASIC's existing view: see Senate Standing Committee on Economics, Parliament of Australia, *Credit and Hardship: Report of the Senate Inquiry into Credit and Financial Products Targeted at Australians at Risk of Financial Hardship* (Report, February 2019) 72 [5.39]–[5.41].

166 *Design and Distribution Obligations and Product Intervention Powers Amendment Act* (n 159) ss 994B(1)– (5), 994C(1).

167 Ibid s 994E(1).

168 Rosie Thomas, 'Regulating Financial Product Design in Australia: An Analysis of the UK Approach' (2017) 28(2) *Journal of Banking and Finance Law and Practice* 95, 105.

169 Australian Securities and Investments Commission, *2020 Report* (n 24) 21.

170 *Corporations Act* (n 47) s 1101A; *CCA* (n 62) s 51AE(1)(b).

171 Australian Law Reform Commission, *National Classification Scheme Review* (Discussion Paper No 77, September 2011) 191 [11.11] <https://www.alrc.gov.au/wp-content/uploads/2019/08/final_report_118_for_web.pdf>.

172 Avshalom Ginosar, 'Co-Regulation: From Lip Service to a Genuine Collaboration' [2013] 3 *Journal of Information Policy* 104, 105.

Balleisen and Eisner identify that for co-regulation to be successful, several principles need to be adhered to, including the 'seriousness of accountability'.[173] Mandating the *Code of Practice* would enable this in two ways: first, penalties of up to 1,000 penalty units could be imposed for any civil penalty provisions of the *Code*; and secondly, ASIC would need to approve any variations that are not merely technical.[174] The potential of a pecuniary penalty would provide deterrence at both a specific and industry-wide level,[175] thereby providing an external constraint on how BNPL providers act.[176] Combining a pecuniary penalty with the negative publicity that could arise following a publication of a breach under the *Code* would compound the deterrence effect.[177] The improved oversight brought by mandating the *Code of Practice* would help ensure BNPL providers would adhere to the *Code*.[178] Such an approach was endorsed in the Hayne Royal Commission and represents a healthy medium between the two extremes outlined above.[179]

Similarly, mandating the *Code* would give confidence to consumers in the BNPL sector, further facilitating its growth.[180] While there may be some inhibitions on innovation under a mandatory code,[181] it would be less than under command-and-control regulation and also signal the severity of the issues if complaints reveal systemic concerns within the BNPL sector.[182] It must also be recognised that the *Code* would act in conjunction with the foundational consumer protection provisions and the design and distribution obligations.[183] This co-regulatory model, as all are, is imperfect,[184] and if implemented, should be reviewed periodically to assess its efficacy. However, this mix of regulatory systems would enable growth and innovation within the BNPL sector while better protecting consumers than they currently are, and mitigate the

173 Edward Balleisen and Marc Eisner, 'The Promise and Pitfalls of Co-Regulation: How Governments Can Draw on Private Governance for Public Purpose' in David Moss and John Cisternino (eds), *New Perspectives on Regulation* (The Tobin Project, 2009) 127, 131.

174 *Corporations Act* (n 47) ss 1101AA(1), 1101AE(3); Australian Securities and Investments Commission, 'RG 183' (n 112) 27 [183.134].

175 See Cartwright (n 4) 75.

176 See, A Ogus, 'Rethinking Self-Regulation' in Robert Baldwin, Colin Scott and Christopher Hood (eds), *A Reader on Regulation* (Oxford University Press, 1998) 374.

177 Cartwright (n 4) 76–7.

178 Jodi Short and Michael Toffel, 'Making Self-Regulation More than Merely Symbolic: The Critical Role of the Legal Environment' (2010) 55(3) *Administrative Science Quarterly* 361, 386–7.

179 *Royal Commission Final Report* (n 21) 111–2.

180 Australian Securities and Investments Commission, 'RG 183' (n 112) 4 [183.3].

181 Alex Cukierman, 'Reflections on the Crisis and on its Lessons for Regulatory Reform and for Central Bank Policies' (2011) 7(1) *Journal of Financial Stability* 26, 28.

182 Gail Pearson, *Financial Services Law and Compliance in Australia* (Cambridge University Press, 2009) 540.

183 See part III(A) above.

184 Simon (n 114) 221.

potential downsides of self-regulation.[185] The enforcement and oversights costs ASIC would incur would also be less than that under a direct regulatory model.[186]

ASIC has expressed that they cannot approve the *Code of Practice* as BNPL arrangements are not regulated as credit.[187] Given the structure of a BNPL Transaction,[188] the provisions under the *Corporations Act* or the *NCCP Act* that give ASIC the power to approve and declare mandatory industry codes regarding financial services and consumer credit respective do not apply.[189] To facilitate ASIC's approval of the *Code of Practice*, reforms would be necessary to either the *Corporations Act* or *NCCP Act*. As BNPL providers are not captured by either piece of legislation,[190] reforms to either piece of legislation would be needed to facilitate ASIC's approval of the *Code* but should be targeted to avoid subjecting BNPL providers to the broader provisions of the legislation. In the absence of approval by ASIC, the ACCC should approve the *Code*.[191] This would not take advantage of ASIC's expertise and breach the governing 'twin peaks' model of financial regulation,[192] but is still beneficial given the Commission's enforcement powers like issuing infringement notices and ensuing pecuniary penalties.[193]

VII Recommendations and Conclusion

Two broad recommendations derive from the above analysis:

- the RBA should allow merchants to surcharge consumers for the cost of BNPL arrangements; and
- the *Code of Practice* should be mandated and overseen by ASIC by means of legislative reform, with targeted individual regulatory actions taken where necessary.

185 See Cartwright (n 4) 59–60.

186 Cary Coglianese and Evan Mendelson, 'Meta-Regulation and Self-Regulation' in Robert Baldwin, Martin Cave and Martin Lodge (eds), *The Oxford Handbook of Regulation* (Oxford University Press, 2010) 148, 163.

187 Select Committee on Financial Technology and Regulatory Technology, Parliament of Australia, (n 27) 107 [4.78].

188 See parts II(B), VI(B) above.

189 *Corporations Act* (n 47) ss 1101A(1)–(2), 1010AE(1); *NCCP Act* (n 50) ss 238A(2), 238F(1).

190 Except for the design and distribution obligations by virtue of the expanded definition of 'financial product': see *Corporations Act* (n 47) s 994AA(1).

191 *CCA* (n 62) s 51AE(1)(b).

192 See John Crawford, 'Wargaming Financial Crises: The Problem of (In)Experience and Regulator Expertise' (2014) 34(1) *Review of Banking and Financial Law* 111, 120–1; See Andrew Godwin, Timothy Howse and Ian Ramsay, 'A Jurisdictional Comparison of the Twin Peaks Model of Financial Regulation' (2017) 18(2) *Journal of Banking Regulation* 103, 106–7.

193 *CCA* (n 62) s 51ACC.

If legislative reform to allow ASIC to oversee the *Code of Practice* cannot be implemented, then the ACCC should assume the same role. Such an approach would achieve the balance between innovation and consumer protection.

There is no one 'correct' method of regulating the BNPL sector, but the article has sought to consider the pertinent consumer protection and competition issues that they face, including the 'no-surcharge rule' imposed on merchants and over-commitment of consumers. Considering the dual economic and social consumer protection objectives, the existing regulatory approaches by Australia's regulators are inadequate to effectively address the issues the sector poses. Accordingly, undertaking the recommendations above would engender greater confidence within the sector, further facilitate its growth and limit the harms to consumers.