Hamilton Locke

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9 April 2024

Consumer Credit Unit
Financial System Division
Treasury
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Hamilton Locke Submission – Buy Now Pay Later regulatory reforms

Dear Treasury,

We welcome the opportunity to submit a response in relation to the Exposure Draft bill and regulations as part of the Buy Now Pay Later regulatory reform (**Draft Reforms**).

We support the Government's reform agenda for the unregulated credit industry. We understand that, for many in the sector, regulation is anticipated and welcomed, and we stand committed to assisting the sector and the Government in developing a fit for purpose credit regulatory framework.

We recognise that the Draft Reforms serves as an opportunity to ensure that the appropriate legislative framework is developed to ensure the consumer harm that may arise due to unregulated products is addressed whilst ensuring that technology development and innovation continues to flourish.

We welcome any feedback you may have in respect of this submission, and we look forward to the outcome of this process. We would be happy to discuss any aspect of this submission with you.

Yours faithfully

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Submission Paper

Buy Now Pay Later regulatory reforms

About Hamilton Locke – Funds and Financial Services

Hamilton Locke is Australia's fastest growing law firm, which is focused on transforming the traditional approach to corporate and commercial legal services. Hamilton Locke is a full-service corporate law firm, which is a part of the HPX Group, that delivers essential corporate services across legal, governance, risk and compliance helping businesses grow and thrive.

The Funds and Financial Services Team at Hamilton Locke (formerly, The Fold Legal) has become one of the go-to teams for credit, payments, cryptocurrency, blockchain, fintech and insurtech businesses seeking regulatory advice. Our Funds and Financial Services team is also one of Australia's largest as a result of the merger between The Fold Legal and Hamilton Locke.

We are known for our technical expertise and industry knowledge, which we use to provide practical solutions for a range of sectors, including credit, payments, wealth management, crypto, funds and general insurance. Our expertise in credit and financial services is recognised by our ranking in Chambers and Partners Asia-Pacific and FinTech Legal Guides and The Legal 500. Reflecting our commitment to client service, we also won Best Law & Related Services Firm (<$30mil) across several specialist categories the past 4 years based on direct feedback from our clients.

Collectively, we have been deeply steeped in the fintech space since early 2013 and we continue to deepen and strengthen this experience as one of Australia's largest and most diverse financial services practices.

We are technical and industry-focused specialists that have a broad and deep understanding of the Australian regulatory environment and the impacts that it has on our client's products and service offerings. Our financial services expertise is market leading, and we use our industry knowledge and expertise to deliver practical, compliant, and innovative solutions for our clients.

We are a partner and member of FinTech Australia, Blockchain Australia and InsurTech Australia.

Executive Summary

The introduction of Buy Now, Pay Later (**BNPL**) has had a positive impact on encouraging competition with traditional forms of credit. The industry has seen rapid growth over the years and a clear regulatory approach is needed to ensure that BNPL providers have regulatory certainty and consumers are protected.

A limited form of regulation in the BNPL industry has been in place for several years, including in respect of the design and distribution obligations as well as through voluntary initiatives such as the BNPL Code of Practice.

We see the benefit in applying a consistent approach to the regulation of the BNPL industry and capturing BNPL providers as part of the broader concept of low-cost credit contracts (**LCCCs**). However, it is critical that regulatory design enables rather than stifles innovation and competition.

We support Treasury's proposed Draft Reforms and are encouraged by Treasury's efforts to engage with industry to ensure that the development of regulation broadly aligns with the realities and risks of the industry, as well as the expectations of key stakeholders in the industry.

The proposed regulatory framework delivers welcomed regulatory clarity for BNPL. However, if the reforms wish to enable innovation and competition to continue to thrive, and reduce the risk of regulatory arbitrage, greater clarity and guidance is needed for BNPL, particularly in relation to the modified responsible lending obligations framework.

We consider that a regulatory regime that is fit for purpose and easy to adopt by those regulated should be the main priority for Treasury in developing further regulation for the industry.

1. Proposed Responsible Lending Reform

Modifying the existing Responsible Lending Obligations Framework

Presently, holders of an Australian credit licence are required to comply with the responsible lending obligations (**RLO**) set out in Chapter 3 of the *National Consumer Credit Protection Act 2009* (Cth) (**the Act**). The obligations impose both disclosure obligations as well as a requirement to undertake an unsuitability assessment before a consumer is provided or assisted with credit.

At a high level, credit licensees are required to make an assessment as to whether the loan is unsuitable before entering into the credit contract, no more than 90 days before the contract is entered into. As part of this assessment, the licensee must:[1]

- make reasonable inquiries of the consumer's requirements and objectives;
- make reasonable inquiries about the consumer's financial situation; and
- take reasonable steps to verify the consumer's financial situation.

'Reasonable inquiries' are not defined in the Act, but ASIC has provided regulatory guidance on the topic.[2]

Opt-in Model

The reforms propose a modified RLO framework to create an opt-in RLO framework for LCCCs. It is intended that this framework will enable the scaling of risks that are posed to consumers by certain types of LCCCs. This includes a requirement that LCCC providers develop and review a written policy to assess whether each LCCC would be unsuitable to the consumer. LCCC providers will be able to choose whether to comply with the modified RLO framework or with the existing RLO framework in Part 3-2 of the Act.

[1] s 130 of the *National Consumer Credit and Protection Act 2009* (Cth).

[2] ASIC Regulatory Guide, RG 209 *Credit licensing: Responsible lending conduct*, December 2019.

The Exposure Draft Explanatory Materials states that the factors by which reasonable inquiries and verification are to be determined are included to ‘effect a reduction in what is reasonably required in conducting responsible lending assessments’.[3] These factors include: [4]

- the nature of the LCCC;
- the nature of the target market;
- whether the consumers are likely to be financially vulnerable;
- whether the licensee has in place any policies that reduce the risk of unaffordability or harm to the consumer; and
- any matters prescribed by the regulations.

BNPL providers would also be required to consider any additional matters that the regulations may prescribe.

Although the changes have been described as a ‘modified’ RLO framework with a ‘reduction’ in what is reasonably required, it is difficult to see how these modified obligations fundamentally differ to the existing RLO framework or how they otherwise ease compliance for BNPL providers. We consider that the existing RLO framework is already scalable in nature; that is, an assessment of what is reasonable (as part of the requirement to make reasonable inquiries and verification) will vary based on the circumstances. ASIC calls this out in paragraph 81 of Regulatory Guide 209: *Credit licensing: Responsible lending conduct*. The key distinction for BNPL appears to be that scalability, that is, whether the LCCC provider has made reasonable inquiries or taken reasonable steps to verify, is to be determined by reference to the prescribed list of matters in the Exposure Draft.

By comparison, the full RLO has guidance provided by ASIC on the matters to be considered by credit providers in making more or less inquiries and taking reasonable steps to verify.

In substance, it seems that the only real difference between the full RLO and the modified RLO is that one has ASIC guidance on scalability and once has a legislated list of factors to be considered. ASIC guidance also is not law, or comprehensive, so it is arguable that the application of the full RLO and the modified RLO could produce similar outcomes in any case, because an LCCC provider who opts in to the full RLO is still entitled to make an assessment of what is ‘reasonable’ in light of all applicable circumstances, which will include the prescribed list of factors in any case.

In our view, this is not a meaningfully ‘reduced’ RLO obligation for LCCC. Rather, there is likely to be a convergence between applications for BNPL and applications for fully regulated credit products like credit cards, because:

- in most cases, an unsuitability assessment still needs to be done;
- it is practically impossible to do an unsuitability assessment without data from both sides of the ledger i.e. the income or expenses of a consumer are meaningless without comparing the two. That is, no matter how high a person’s income, their expenses could be commensurately high as to make a loan unsuitable, and vice versa; and
- the ‘scalability’ of RLO is a subjective assessment which is open to challenge, meaning that there may be a reluctance to adopt a reduced approach to RLO in circumstances where LCCC providers have no certainty that they will actually be complying with the obligation. This is particularly so because it is unclear what practical effect the listed prescribed factors will actually have on an RLO assessment.

We expect this to lead to increased friction in the BNPL application process, which will make it less appealing to consumers, and / or an increased cost to BNPL providers, which will make BNPL more expensive and / or less viable. This is likely to have an impact on innovation and availability in the BNPL sector.

[3] [1.33] *Treasury Laws Amendment Bill 2024: Buy now, pay later*: *Exposure Draft Explanatory Materials.*
[4] s 133BXD(3) *Treasury Laws Amendment Bill 2024: Buy now, pay later*.

If we consider the example of a $100 toaster which a consumer wishes to split into 4 fortnightly payments for cash flow management and / or convenience, under the proposed reforms, a BNPL provider would be required to obtain certain information from a credit reporting body (because the value of the loan is less than $2,000 - where the value of the loan is greater than $2,000, the BNPL provider will be required to obtain the same information as well as certain consumer credit liability information prescribed under the *Privacy Act 1988* (Cth)) as well as collect and verify the income and expenses of a customer (scaled to some indeterminate degree in accordance with the prescribed factors) in order to demonstrate compliance with the proposed RLOs. This seems a disproportionate burden for the nature of the credit offered, especially in circumstances where the customer pays no fees or interest (which is the case for some LCCCs).

Benefits of the new framework

We do see some key benefits to BNPL providers from the modified RLO framework outlined in the Draft Reforms, including:

- the ability to rely on information provided by the consumer;[5]
- the flexibility of same-day approval;[6] and
- the presumption that LCCCs will be not unsuitable in cases where the credit limit or subsequent increases to the credit limit are less than $2,000.[7]

However, in relation to the not unsuitable presumption, we note that the Act has the following requirements:

- a credit provider must not enter into a contract that is not unsuitable; and
- a credit provider must conduct reasonable inquiries and take reasonable steps to verify.

The obligation to not enter into a contract that is not unsuitable is absolute – that is, it is not a defence to a breach of this obligation that the lender has made reasonable inquiries. This means that lenders in general, but BNPL providers specifically, can be reluctant to scale inquiries because they can still be in breach of the obligation to not enter into a contract that is unsuitable. It therefore makes sense to provide relief from this obligation.

However, providing a presumption that a contract is not unsuitable without also providing relief from the obligation to conduct reasonable inquiries provides little real reduction in obligations. This is because:

- most of the work (and all the friction for the consumer) exists in the process of making inquiries and verifying information supplied; and
- because all the inquiries need to be made anyway, the presumption may be easily rebutted, and once the information is collected, the provider would need to review / assess the information to check it does not rebut the presumption.

This means that providing relief from the unsuitability requirement but not the reasonable inquiries requirement results in a provider still conducting more or less a full unsuitability assessment – there is minimal reduction in effort, if any.

The intersection of the unsuitability obligation and the reasonable inquiries obligation, and that relief needs to be provided from both in parallel, is why, as outlined below, we believe that a more prescriptive approach is needed in this case.

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[5] s 133BXD(6) *Treasury Laws Amendment Bill 2024: Buy now, pay later.*
[6] [1.50] *Treasury Laws Amendment Bill 2024: Buy now, pay later. Exposure Draft Explanatory Materials.*
[7] s 133BXF *Treasury Laws Amendment Bill 2024: Buy now, pay later.*

Challenges of a principles-based approach

Although we are generally proponents of principles-based regulation, which offers better flexibility and longevity, given that the existing RLO framework is already scalable, and given that the intent is to create a reduced obligation for LCCC products that acknowledges the reduced risks of these products and fosters continued innovation, it is our view that a modified RLO regime might benefit from being more prescriptive. This would better set clear parameters for LCCC providers to operate and sufficiently distinguish the modified RLO regime from the existing regime. This is necessary to avoid the outcome currently promulgated by the Draft Reforms, which is two regimes that are both scalable and arguably not meaningfully distinguishable. We also recommend that this prescriptive approach be incorporated in the proposed regime and not left to regulators to determine.

We note that historically scalable principles-based obligations (e.g. the best interests duty for financial planners) have not been well-handled by industry. For example, there has been a trend in financial advice where financial advisers adopted the approach that they could only meet their best interests duty obligation via holistic advice (rather than adopting a scalable approach, as permitted by law). The result was that advisers either exited the retail client market (as they found providing holistic advice to be too onerous) or had to set fees that priced many retail clients out of the market. The industry in this case is now seeking to address the rising price of advice and the inability for clients to seek discrete issue advice as a result of the best interests duty, which is part of the reason for the current Quality of Advice Review. We believe that the proposed scaled RLO framework will result in a similar outcome, leading to the exit of some providers or otherwise raising the cost to consumers and making the product less affordable. We also see significant risks in applying an opt-in model, as some BNPL players may likely prioritise the compliance approach that is the least stringent or alternatively, may leave the industry entirely. We consider that a consistent set of rules should apply to the industry.

Timing

We note that the unsuitability assessments are only valid for 120 days before a new assessment must be conducted.[8] We question the suitability of this timeframe particularly where BNPL products are operated as separate credit contracts rather than under one continuous line of credit. We understand that there is generally a 50 / 50 split in the market with which model is used and for those using separate contracts they would be required to reconduct an unsuitability assessment every 120 days (i.e. 3 times a year). Instead, we believe that it would be more appropriate for this to be conducted on an annual basis unless a trigger event occurs which suggests that a new assessment is required, especially since those operating under a continuous line of credit would not be required to re-conduct these assessments at all once established, which may lead to industry players moving to this model to avoid regulation (depending on the cost / benefit ratio).

Potential RLO Solutions

We consider that the scale of responsible lending requirements should be proportionate to the relative risk posed by the loan (i.e. it should depend on the nature, amount, and cost of the loan) but that these should be prescriptive requirements so that LCCC providers can operate with certainty inside a set of genuinely reduced obligations.

We believe that there is merit in prescribing the type of responsible lending obligations that apply to loans based on certain categorisations that seek to quantify the risk to the consumer. We envisage that this might include a combination of the loan amount and the cost to the consumer e.g. the larger the loan amount, the higher the cost; the lower the fees, the lower the cost, where each category has prescriptive requirements. It may also include the period over which the credit is repayable. By way of example to illustrate our point:

- all LCCCs with a loan limit under $500 might be presumed to be not unsuitable in all cases and not require any reasonable inquiries to be made or verified unless something is known to the LCCC provider to rebut the presumption e.g. information in the credit check;

[8] s 133BXC *Treasury Laws Amendment Bill 2024: Buy now, pay later.*

- no cost LCCCs under $1,000 might also be presumed to be not unsuitable in all cases and not require any reasonable inquiries to be made or verified unless something is known to the LCCC provider to rebut the presumption e.g. information in the credit check;
- LCCCs that have fees and / or interest and a loan limit over $500 but under $2,500 might require the collection and verification of income information but not the collection of expense information other than other debts, and the LCCC provider is only required to make a suitability assessment on the basis of that information and the LCCC is presumed not to be unsuitable for any other reason.

We do not necessarily represent that these thresholds or prescriptive requirements are the correct ones but use them to illustrate our point.

That said, we do consider that where a BNPL arrangement is for a significant amount, with or without fees, the risk to the consumer is much higher and therefore it is appropriate that more comprehensive responsible lending practices are employed including collecting and verifying the borrowers financial information. It might be worth considering that the full RLO should apply at this point, as consumers are now committing to either a large repayment in a short period of time, which is more likely to be higher risk, or consumers are committing to a long term obligation, which is more likely to impact their ability to access other regulated credit. We are not sure what this threshold is exactly - $5,000 or $10,000 may be the appropriate threshold, given these are amounts more consistent with personal loans.

There are risks attached to providing presumptions that loans are not unsuitable, as it may not always be the case, and consumer harm may result. If there are policy concerns about possible consumer harm arising from presumptions of suitability, one possible option is to put rules in place to mitigate such consumer harm. For example, if a BNPL provider is relying on a presumption that a loan is not unsuitable under a modified RLO regime, the risk of consumer harm arising could be mitigated by not allowing the BNPL provider to enforce the loan in circumstances where (in the event of a dispute) it can be shown that had the loan been subject to full RLO, the loan would have been assessed as unsuitable. This shifts the risk of non-compliance from regulatory and legal risk to commercial risk and could operate as a check in circumstances where LCCC providers get a broader exemption from RLO, to deter them from abusing the privilege of a reduced RLO regime.

Any thresholds set by reference to monetary value should be indexed annually.

2. Regulatory Arbitrage

We are concerned that the Draft Reforms have not considered the definition of low-cost credit contract in the context of regulatory arbitrage. Proposed section 13C of the draft bill reads that: [9]

(1) *A contract is a low cost credit contract if:*

a) …

b) …

c) …

d) The contract satisfies any requirements prescribed by the regulations for the purpose of this paragraph that relate to fees or charges that are, or may be, payable under the contract; and

e) …

The draft regulations then prescribe fees and charges as follows:[10]

[9] s 13C *Treasury Laws Amendment Bill 2024: Buy now, pay later.*

69E Definition of low cost credit contract—fees and charges

(1) For the purposes of paragraph 13C(1)(d) of the Code, this regulation prescribes requirements that relate to fees or charges that are, or may be, payable under a contract under which credit is, or may be, provided. Note: A contract under which credit is, or may be, provided must satisfy these requirements in order to be a low cost credit contract within the meaning of the Code.

Total amount of fees and charges (other than default fees and charges)

(2) The total amount of fees and charges (other than default fees and charges) that are, or may be, payable under the contract (the eligible contract) in a 12-month period must not exceed the maximum amount for the 12-month period under the following table.

Maximum amount for a 12-month period

Item	*Column 1* *If:*	*Column 2* *Then the maximum amount for a 12- month period is:*
1	*the debtor is not already a party to a low cost credit contract with the credit provider, or with an associate of the credit provider, when the eligible contract is entered into*	*(a) for the 12-month period commencing when the debtor enters into the eligible contract—$200;* *(b) for any later 12-month period during which the eligible contract is in effect—$125*
2	*when the eligible contract is entered into: (a) the debtor is already, or was within the previous 12 months, a party to a low cost credit contract with the credit provider or with an associate of the credit provider; and* *(b) neither the credit provider nor the associate of the credit provider is an ADI*	*(a) for the 12-month period commencing when the debtor enters into the eligible contract—nil* *(b) for any later 12-month period during which the eligible credit contract is in effect—nil*

We note that this table appears to be a duplication of the fee caps for the exemption (**Continuing Credit Contract Exemption**) contained in section 6(5) of the National Credit Code (**the Code**). There is a second table also specifying caps for default fees, which we have not replicated here. Our understanding of the effect of these tables is that a contract will only be a LCCC if it falls within all of these fee caps.

BNPL providers currently rely on two key exemptions – the Continuing Credit Contract Exemption and the exemption (the **Short Term Credit Exemption**) in section 6(1) of the Code. Some also rely on there being 'no charge' for the credit, so that it does not fall under section 5 of the Code, but that is not relevant to this issue.

[10] r 69E *National Consumer Credit Protection Amendment (Low Cost Credit) Regulations 2024.*

The LCCC upfront fees in Regulation 69E are aligned to the fees in the Continuing Credit Contract Exemption. However, this is not the case for the Short Term Credit Exemption, which allows a fee of 5% of the loan amount and interest at the rate of 24% p.a. The cost of credit under the Short Term Credit Exemption will exceed the fee caps in Regulation 69E for a first contract at around a loan amount of $2,500 if the provider charges maximum fees. For a second and subsequent contract in the same 12-month period, any fee charged of any amount more than nil will exceed the fee caps in Regulation 69E for a second and subsequent contract.

This issue is important because these fees are not a 'fee cap' – rather, they are part of the definition of LCCC.

To explain the issue, both the Continuing Credit Contract Exemption and the Short Term Credit Contract Exemption operate on this basis:

- If the fees and charges are under the fee cap – the loan is exempt from regulation under the Code.
- If the fees and charges exceed the fee cap – the Code applies in full.

However, the definition of LCCC is an exemption from an exemption (or, in other words, it is carving some currently exempt products into the Code). This means that the fee limits in the LCCC definition operate on this basis (which can be contrasted to the above basis for the exemptions):

- If the BNPL contract has fees and charges under the fee cap – then it is an LCCC with a reduced RLO;
- If the BNPL contract has fees and charges that exceed the fee cap – then it is not an LCCC and it will continue to be completely unregulated under the Short Term Credit Exemption with no application of the Code. This occurs because these contracts will remain exempt (as they currently already are) and will not be brought into the Code.

This problem only arises for BNPL loans under the Short Term Credit Exemption – it cannot occur under the Continuous Credit Contract Exemption, because for that exemption, the fees are aligned with those in regulation 69E, meaning all BNPL loans offered under that exemption will always be LCCCs.

To illustrate our point, our reading of the above is that if certain BNPL loans that rely on the Short Term Credit Exemption are not within these fee caps, then they will not be regulated as LCCC and will remain exempt and wholly outside the regulation and this includes:

- any 62-day (or less) loan that falls within the Short Term Credit Exemption which, through a combination of fees and interest, charge more than $200. We are aware of 62-day loans for real estate marketing which can run to the tens of thousands of dollars and charge a 5% fee which will fall in this category and will not be regulated as a LCCC. The threshold for falling into this category is approximately $2,500, which means many BNPL loans for whitegoods and furniture, for example, can be completely exempt from the Code by charging maximum fees and interest. This means providers who currently charge nothing can move themselves outside of regulation by charging maximum fees and interest for loans over $2,500; and
- any 62-day loan that falls within the Short Term Credit Exemption, which is a second or subsequent loan in the same 12 months with the same provider. This means *all* second or subsequent loans with the same provider inside the same 12 months *will not* be an LCCC and *will not* be regulated under the Code at all if they charge any kind of upfront fee whatsoever (no matter how minimal) because a second and subsequent loan within the first 12 months will only be a LCCC if it is completely free.

We have not considered the $125 cap for the second year in this analysis because 62-day loans, by their nature, do not have a second year.

We doubt that this outcome is intended, as it is contrary to the regulatory intent, since it seems to mean that many BNPL contracts may be exempt, and in fact creates an incentive for BNPL providers to charge higher fees to avoid regulation. For example, if providers who currently charge no fees were

to introduce a minimum $5 fee per transaction, the second and subsequent transactions would not be LCCCs.

This also means that the highest risk short term credit contracts (i.e. those with larger loan amounts, and therefore larger fees and interest) are the ones that will be completely exempt. This also seems contradictory to the policy intent.

This also creates regulatory arbitrage as BNPL providers can elect to minimise the degree of regulation that applies to their products by changing their fee structures to charge more fees than they currently do in order to move themselves outside the regulated area.

We suspect that this was not the intent. We suggest that it could be addressed by:

- specifying that if the BNPL product is a continuing credit contract, it must fall under the fee caps already specified in Table 1 in regulation 69E;
- specifying that if the BNPL product is a loan of 62-days or less, that it falls under the fee caps specified for the Short Term Credit Exemption, i.e. a fee of 5% of the loan amount and 24% p.a. interest; and
- specifying that if the BNPL product is not a continuing credit contract and has a term of more than 62 days, that it charges no fees and charges for the provision of the credit.

This structure would capture all BNPL products relying on all available exemptions and ensure they are all pulled within the definition of LCCC.

Separately, but on a related point:

- the default 'fee caps' operate on a similar basis – that is, BNPL providers who charge higher default fees will be unregulated. Therefore, the default fee caps need to be removed from regulation 69E so that they don't form part of the definition of LCCC and allow BNPL providers to avoid regulation by charging higher default fees. If there is a regulatory intent to cap default fees, this needs to appear in a separate section that explicitly prohibits LCCC providers from charging default fees in excess of specified caps (which could sit in a separate regulation for this purpose); and
- there is no prevailing clause. That is, many of the BNPL products which will meet the definition of an LCCC will also meet the definitions in the Continuing Credit Contract Exemption or the Short Term Credit Exemption. Meeting the definition of the LCCC means the Code applies. Meeting the definition of the Continuing Credit Contract Exemption or the Short Term Credit Exemption means the Code does not apply. Ordinary interpretation principles mean that ordinarily once would consider what is excluded, and then what is excluded, meaning many BNPL products would first be in because of the LCCC definition, and then finally out because of one of the two exemptions. This defeats the policy intention to regulate BNPL. We suggest this can be corrected by including drafting in section 13B (for which we note no drafting has been supplied in any case) that specifies that the Code applies to low cost credit contracts notwithstanding the application of the Continuing Credit Contract Exemption or the Short Term Credit Exemption, or even if the credit does not meet the requirement in section 5(1)(c) of the Code that a charge be made for the provision of credit in order for the Code to apply.

3. Retail Client

We note that the Draft Reforms make continued use of the term 'retail client'.

Whilst we understand that this reference is intended to have its ordinary meaning as used (i.e. that of a client in a retail setting), we consider that this term will create significant confusion and uncertainty as to the application of the broader credit and financial services regulatory regime. This is because 'retail client' is already used elsewhere in financial services and consumer credit regulation. The first of these is the use of retail client for financial services legislation to trigger additional regulatory obligations, which continues to be haunted after 20 years by the belief that 'retail' denotes 'customer-facing'.

The second of these is the fact that when certain credit products were brought within the ambit of the design and distribution obligations (**DDO**) under the *Australian Securities and Investment Commission Act 2001* (Cth) and *Corporations Act 2001* (Cth), it was done by making the DDO regime apply to credit that is provided to a 'retail client', which is a difficult proposition given the definition and terminology of 'retail client' is not used in the Act and none of the retail client definitions were constructed with credit in mind. The ambiguity of this usage is currently the subject of ASIC litigation.[11]

The use of 'retail client' in connection with LCCCs would then introduce a third usage, which would actually be more consistent with the misconception that applies to the financial services definition – that it denotes customer-facing. This usage might then not only mean that the LCCC usage is misunderstood, but may create new ambiguity and misunderstanding in relation to the financial services definition.

Currently, the definition of 'consumer' is used throughout the Act to broadly describe a person that is generally akin to a retail client for the purposes of the *Corporations Act 2001* (Cth) (although there are significant differences between these definitions). We therefore suggest that the term 'customer' be used instead of retail client for this purpose as it is more accurate and less likely to cause confusion.

4. Debt Factoring

We note that there are a series of models for the BNPL regime operating in Australia: the traditional model (as generally described in the Draft Reforms) and a debt factoring white-label model.

As currently drafted, it does not appear that the Draft Reforms will capture the debt factoring models. These models are generally characterised by the use of a white-label arrangement with a merchant. The merchant is responsible for providing the credit to the customer under existing exemptions from the Act, and this debt is then immediately sold to a debt factoring BNPL provider at a discount and recovered. In our view, it is unlikely that this arrangement is captured under the Draft Reforms given that there is no credit provided to a customer by these third-party providers and there is no relationship until after the debt is purchased. However, functionally it fills the same purpose as a direct BNPL arrangement.

It is also unclear if using this type of arrangement is likely to trigger the anti-avoidance provisions proposed in the Draft Reforms and currently in the Act, as we understand that generally the intention behind these arrangements is to allow for a white labelling of the BNPL product rather than avoidance of regulation (as it relies on the same exemptions as the direct model). If direct BNPL providers were to restructure their arrangements we suspect this might fall foul of anti-avoidance, but we doubt existing providers would.

[11] *ASIC sues crypto exchange alleging design and distribution failures,* ASIC Media Release, 21 September 2023.