

Economic OUTLOOK

Mitigating the Risk of BNPL



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As the Government flags new regulations for the buy now, pay later (BNPL) sector, the question of how to mitigate risk has been the cause of much conjecture.

While some argue that legislation stifles innovation, others believe reforms to BNPL arrangements are integral to strengthening consumer protections. While solid consumer demand for flexible payment options continues to

drive the popularity of BNPL, the tension between user experience and responsible lending must find common ground if this new wave of immediate, low-cost financing is to remain future-fit.

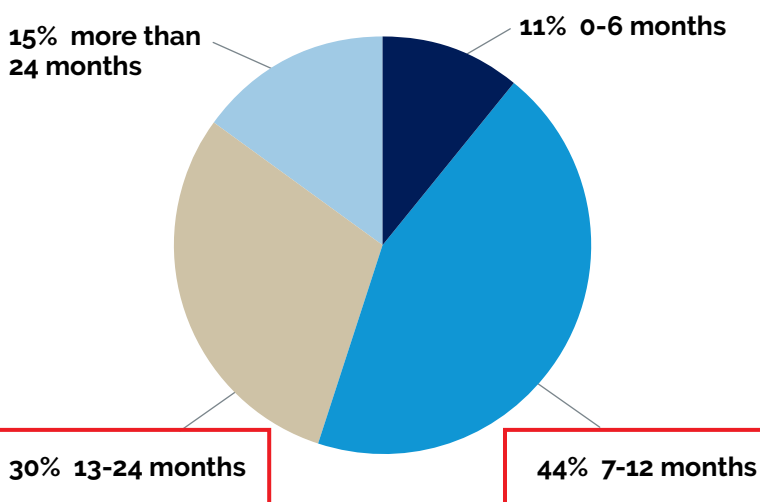
The merchant view of BNPL

With merchants fuelling BNPL's success by supporting and normalising this payment option to their customers, the opinions of this stakeholder group are integral to this debate. We recently conducted a quantitative survey of Australian merchants¹ to determine what retailers think about BNPL and regulation. The results showed that BNPL is normalising as a payment option, with 44% of merchants expanding into BNPL in the last 12 months.

Here are some key findings:

- 6 in 10 merchants believe reform of the BNPL market will positively impact consumers and businesses.

FIG 1: Merchant adoption of BNPL



- The usage of BNPL is as high as traditional credit cards but not as frequent: 65% of customers use BNPL regularly, while 80% regularly use credit cards.
- 48% have seen a growth in BNPL credit sales, and 57% have seen a growth in consumer usage in the past 12 months.
- 57% viewed the new legislation as positive.
- 59% believe reforms would protect younger consumers, and 63% believe it will encourage smaller businesses to adopt BNPL and use it as a line-of-credit solution.
- 53% believe BNPL will enable greater financial inclusion for consumers over the next 12 months.

Merchants see the positive potential of reforms, but they're aware of the need to strike the right balance, with 48% of merchants concerned that proposed changes could increase customer barriers to using BNPL.

Over half the merchants anticipate competitive pressures brought about by reforms will put some BNPL providers out of business. And 57% believe

that if a well-known or established international player enters the market, consumers will prefer a global brand over a local one.

Our survey shows that merchants use BNPL predominantly because it increases the value of sales and attracts new customers. They prioritise fees, reliability and value for money when selecting a BNPL provider, and they seek improvements in service, reliability and fee flexibility.

Only 24% of merchants view BNPL as strongly associated with safety and security (43% believe it is "somewhat associated"). Given this low trust perception, the new legislation is likely to bring an opportunity for BNPL to become synonymous with value and protection for both the consumer and merchant, especially in light of Australia's recent high-profile data breaches.

BNPL demand slows down

Although the BNPL sector has seen rapid growth over the past few years, fueled by shoppers moving online during the pandemic, we already see some contraction in the market.

The perceptions merchants have about BNPL legislative reform

New legislation positive: 57% agree that new legislation is a positive move

Protect younger less savvy: 59% agree legislation will protect younger less savvy customers

Not impact sales: 41% remain neutral on legislation impact to sales

Force BNPL out of business: 54% agree some BNPL will be forced out of business

Smaller business adopt BNPL: 63% agree that more merchants will take up BNPL offering

The challenges merchants believe BNPL reforms will encounter

Increase in barriers for consumers to use BNPL: 39% neutral, 48% agree

BNPL bought out by bigger companies/banks: 53% agree that smaller BNPL providers will be bought out

Consumers will find it hard to get approval, BNPL usage to drop: 37% neutral, 51.5% agree

FIG 2: Improvements merchants would like to make to BNPL

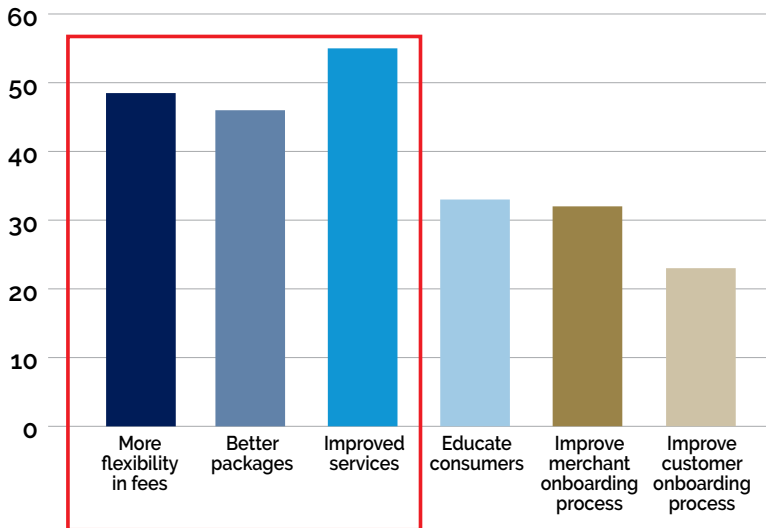
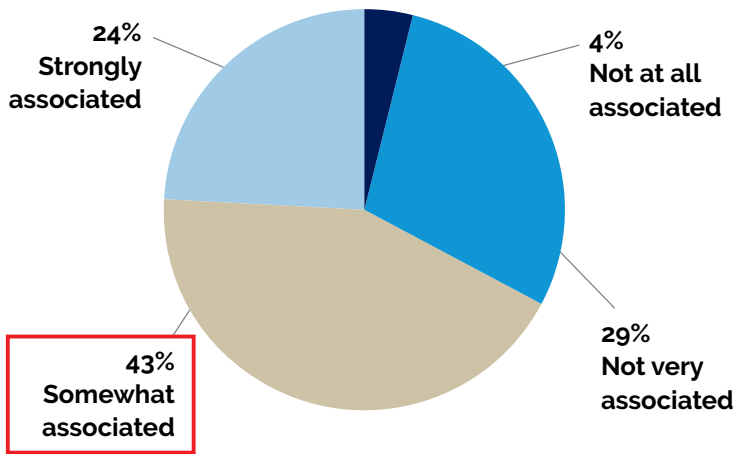


FIG 3: Merchant perception of the safety and security of BNPL



Equifax consumer credit demand data saw BNPL demand slowing over the second half of 2022 and marginally declining (-0.2%) year-on-year in Q4 2022. Additionally, the number of new BNPL entrants has slowed over the past six months, suggesting that the segment may be reaching saturation.

This slowdown supports the case that legislative reform must aim for a win-win scenario that

bridges the gap between consumer protection and user experience. A customer's ability to shop instantly and cost-efficiently is core to BNPL's appeal. The red tape of regulation must not hamper its popularity and growth by impeding its automated, low-friction origination experience.

On the flip side, protecting Australians from bad debt and helping customers understand the implications of their spending habits is crucial to BNPL's long-term survival.

The opportunity to shift BNPL perception

With BNPL products not regulated under Australia's National Consumer Credit Protection (NCCP), Treasury is reviewing its options for regulating the sector. The first option incorporates an affordability assessment and strengthening the existing BNPL Industry Code of Practice. The second option includes a sliding unsuitability test and requires BNPL providers to obtain an Australian credit licence. Option three is the strictest model,

bringing BNPL completely under the NCCP, requiring full compliance and rules as per other credit products.

Our merchant survey shows that legislative reform brings with it the opportunity to build trust with merchants and consumers, enabling BNPL to become synonymous with value and protection. Reforms aimed at strengthening oversight will likely benefit consumers, the

financial services industry and the BNPL business model.

Just as other credit products are subject to oversight, there's a case for ensuring a range of BNPL metrics are reported on and made available as government-published aggregated insights. Introducing a level playing field of credit reporting among all BNPL providers benefits the financial services industry by contributing to the 360-degree view of credit risk necessary to assess credit inquiries more accurately and reduce default risk. Ensuring credit decisions are aligned with a customer's financial situation requires insights from a myriad of sources, of which BNPL repayment history data is one.

Tightening the regulatory gap may have the added advantage of encouraging financial inclusion. For those Australians not eligible for mainstream credit due to limited or non-existent credit history, BNPL represents a stepping stone into the credit system. Not needing to jump through hoops to get credit is an alluring prospect for many young Australians and those disenfranchised by traditional finance. With increased consumer trust, confidence, and inclusion comes greater spending potential.

Effective credit evaluation

While the industry awaits the government's review, technology and innovation are already paving the way for BNPL providers to deliver fast, secure and responsible credit decisioning.

Data analytics coupled with technologies like machine learning and artificial intelligence provide greater visibility into customer risk and creditworthiness. Without sacrificing the user checkout experience, BNPL providers can enable real-time decisioning across the entire purchase journey to reduce default and fraud risk. This includes satisfying important risk mitigation

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questions like ‘How do I check to ensure the applicant is who you say they are?’ ‘How do I reduce second pay default rates?’ ‘How do I optimise cross-sell opportunities?’ ‘How can I forecast delinquencies?’

Be it using credit checks, alternative data sources, the analysis of data patterns, or the exploration of data linkages – BNPL providers who tap into data intelligence will be first out of the starting blocks to protect their customers and secure growth in a competitive market.

The expansion of BNPL services across the globe represents the evolution of innovation. Let's not forget to pay attention to working together as an industry to ensure this spirit of invention carries forward. ♦

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FOOTNOTES:

- 1 Equifax Merchant BNPL Quantitative Research Insights Report, December 2022, n=315, respondents made up of 68% owners/directors, 65% mid-size business of 11-250 employees, 56% across health & lifestyle categories and 87% within the top three regions of NSW, VIC and QLD. All respondents offered BNPL and expanded offerings like E Wallets, with the value of transactions between \$50-\$500.