

Buy now pay later

Understanding and addressing the risks to consumers

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Executive Summary

- Buy Now Pay Later (BNPL) products, which allow users to spread the cost of a purchase interest free over a set period of time, are an increasingly popular way to pay. A third (33%) of UK consumers report using this innovative form of lending.
- Many consumers find this new, cheap form of borrowing beneficial. However all credit products involve some risk, and both the government and the Financial Conduct Authority (FCA) agree that further regulation of these products is needed to manage the risks in this market.
- Which? research has previously shown that BNPL users are on average more affluent, but are more likely to be experiencing other challenges, including the expenses associated with raising a family and other life events. While BNPL products may help smooth costs through these challenging times, these circumstances may also increase the risk these products pose to consumers.
- This paper offers new qualitative insight, drawing on in-depth interviews with 30 BNPL users to understand how and why consumers use BNPL products, and the risks they face while doing so.
- Research participants mostly used BNPL in an ad hoc way, rather than every time it was available. The decision to use BNPL was typically informed by the perceived need for the item, its cost and the participant's immediate financial situation.
- Two sets of factors influenced participants' use of BNPL products:

1. The affordability, clarity and ease of using BNPL

- Low cost – the fact that BNPL is interest free was an important draw for consumers
- Clarity over repayment schedules – users appreciate the transparency of BNPL products, particularly knowing exactly when the debt will be repaid
- Ease of use – paying with BNPL is quick and simple
- Clear communication from BNPL providers – consumers find messages from BNPL providers are usually easy to understand
- Perceived safety – some BNPL users thought that BNPL was a safer way to pay, avoiding entering card details on unfamiliar websites.

2. Users' financial situations

- Needing to spread payments – some BNPL users had little choice but to use BNPL if they wanted to make purchases immediately
- Wanting to spread payments - other participants chose to spread payments, despite being able to pay outright, typically in order to maintain a financial 'cushion', treating BNPL as a money management tool
- Perceived affordability – BNPL users reported that breaking larger purchases into smaller instalments made these feel more affordable
- Lack of access to alternative credit – some participants used BNPL when they were unable to borrow in other ways, due to previous debt problems or a thin credit file

- We identified four distinct patterns of BNPL use within our sample:

Table 1 – A typology of BNPL users

	Frequency of use	Access to alternative ways to pay	Engagement with terms and conditions	Perceptions of BNPL products and brands
<p>1. Spending Smoothers The largest group in our sample, with typically reliable income. They use BNPL where they feel there are benefits to doing so, and typically only have one BNPL product ‘live’ at a time. BNPL is used as an affordable way to buy anticipated, rather than unexpected items, usually between £50 and £150.</p>	Medium/High	High	Low	Very positive
<p>2. Experimenters The second largest group, very infrequent users of BNPL, but otherwise similar to spending smoothers.</p>	Low	High	Low	Positive
<p>3. No Choicers A smaller but not insignificant group in the sample, who used BNPL because it was the only form of credit they could access, or were comfortable accessing. Not intense users of BNPL, but with strong affinity for BNPL brands, and who engaged actively with terms and conditions.</p>	Low/Medium	Low	High	Very positive
<p>4. Plate Spinners The smallest group in the sample, but perhaps most worrying, with complex financial lives and low, unpredictable incomes. Juggling multiple BNPL brands and other types of borrowing.</p>	Medium/High	Medium	Low	Positive/ Very Positive

- The BNPL users we talked to were, on the whole, enthusiastic advocates of these products. However as we explored their understanding and use of these products in depth, we found evidence of considerable risks in the way these products are currently being used:

1. A lack of understanding of the product.

- Most participants thought of BNPL as a way of spreading payments, not as a form of borrowing. While, when prompted, BNPL users in our research understood that the product was a form of credit, this wasn't how they conceptualised it for themselves.
- This misunderstanding arose from the speed and simplicity of using the product, low engagement with terms and conditions, and an implicit assumption that safeguards were in place and the product was regulated.

To address this risk, we recommend that:

- a. Some element of friction is introduced to the borrowing process, ensuring all BNPL users acknowledge that they are borrowing money. This friction should be proportionate to the risk associated with this lending, and need not be arduous.
- b. Key information, such as payment terms, late fees and the potential consequences of missed payments, should be communicated at the point of transaction to enable informed choices. Given the immediate risk of detriment, BNPL providers should proactively work to make their key terms and conditions more accessible, rather than waiting for regulation.
- c. HM Treasury should ensure the boundary for BNPL regulation is appropriately drawn, and is spread wider than it currently proposes, on the basis that consumers are unable to distinguish between regulated and unregulated products and assume that all products are regulated.

2. Affordability risks

- Throughout the research we identified a lack of engagement by consumers with the prospect that they might struggle to repay the agreement. Behavioural biases make it difficult for consumers to accurately assess the affordability of borrowing, and without proper assessments from lenders this is creating risk, particularly given the challenging circumstances we know many BNPL borrowers are in.

To address this risk, we recommend that:

- a. Outcomes-based affordability assessments should be undertaken for all BNPL transactions. Given the limitations of the credit information market and the development of real-time affordability assessment mechanisms, we do not believe this should be prescriptive in the short-term, but in the long-term consistency must be ensured.
- b. In the long-term, BNPL borrowing should be reflected on consumers' credit files in a proportionate way. HMT should work with credit reference agencies and wider industry to implement this urgently.

Introduction

Buy Now Pay Later (BNPL) products are an increasingly popular way for consumers to pay for goods and services. UK consumers' use of BNPL products from major providers tripled in 2020, with transactions worth £2.7bn processed between January and December.¹ With providers innovating at speed, the market is expected to grow rapidly over the next three years.

Research published by Which? in June 2021 shows that a third (33%) of UK consumers have used BNPL products,² such as those provided by Klarna, Laybuy and Clearpay. BNPL products let users spread the cost of a purchase over a set period of time without incurring interest, usually varying from simply delaying the whole payment by 30 days, to splitting it into fortnightly or monthly instalments over six weeks or three months.³ While spreading or delaying payments can make purchases more manageable for consumers, many BNPL products are exempt from the requirements of the Consumer Credit Act and sit outside of the Financial Conduct Authority's (FCA) regulatory remit due to an exemption on agreements that are up to twelve months in length and do not charge interest.⁴ As such, in addition to the usual consumer risks associated with credit, BNPL comes with the additional risk of being an unregulated form of unsecured borrowing. These products are now widely offered at the checkout in online stores, and a growing number of providers offer plug-in, app-based or virtual card functionality which allows users to pay using BNPL at any online store, and increasingly in-store too.

In February 2021 the Woolard Review, a review of change and innovation in the unsecured credit market, recommended that BNPL products be brought within the FCA regulatory framework.⁵ This was accepted by the government⁶ who published a consultation into the best way to regulate BNPL products in October 2021.⁷ The consultation sets out the government's intention to introduce proportionate regulation which targets consumer detriment in the market closely, to reduce the risk of stifling innovation.

Which?, as the UK's Consumer Champion, is keen to use our expertise to inform the conversation about the scope of this regulation to ensure consumers can benefit from these innovative products while being protected from detriment. In June 2021 we published research based on a survey of over 15,000 adults, which for the first time provided a statistical profile of BNPL users in the UK.

1 Woolard Review: A Review of Change and Innovation in the Unsecured Credit Market, 2021. Available at: <https://www.fca.org.uk/publication/corporate/woolard-review-report.pdf>

2 Which? Under Pressure: Who uses BNPL? Available at <https://www.which.co.uk/policy/money/7601/buynowpaylater>

3 These represent the products currently offered by market leaders; alternative product durations and payment schedules up to 12 months are also offered in the market

4 This exemption is set out in the Financial Services and Markets Act 2000 (Regulated Activities) Order 2001 (the RAO).

5 Woolard Review: A Review of Change and Innovation in the Unsecured Credit Market, 2021. Available at: <https://www.fca.org.uk/publication/corporate/woolard-review-report.pdf>

6 Letter from John Glen MP, Economic Secretary to the Treasury, to Chris Woolard, 28th January 2021. Available at: <https://www.fca.org.uk/publication/correspondence/woolard-review-est-letter-to-christopher-woolard.pdf>

7 HM Treasury. Regulation of Buy-Now Pay-Later Consultation, October 2021. Available at: <https://www.gov.uk/government/consultations/regulation-of-buy-now-pay-later-consultation>

This data challenged stereotypes about who uses BNPL products, revealing that, while younger people are more likely to have used BNPL, all things being equal, people are also more likely to have used BNPL if they have:

- Dependent children;
- Higher incomes;
- Experienced a life event in the last 12 months; or
- Defaulted at least once on a household bill or repayment of another form of credit in the last 12 months,

with the presence of multiple characteristics having a cumulative effect on the likelihood of BNPL use.⁸

Overall, our statistical analysis suggests that while BNPL users are more likely to be affluent, they are more likely to be experiencing other challenges, including the expenses associated with raising a family and other life events. While BNPL products may play a valuable role in helping people smooth costs in these circumstances, the stress that accompanies these challenges may also increase the risk that these products cause harm to consumers.

In light of these findings, to build our understanding of how and why consumers use BNPL products and the risks they face while doing so, we have conducted primary qualitative research with typical BNPL users to understand how these products fit within consumers' financial lives. This research will inform our response to the government's consultation, and, we hope, the eventual regulatory framework for these products in order to minimise consumer harm.

Our new research and analysis provides a rich picture of why people choose to use BNPL and how they use these products. The data highlights the risks some consumers currently face when using BNPL products, particularly:

- **A lack of understanding of BNPL products**, and specifically a misconception that these products are a payment mechanism, rather than a form of borrowing. This misunderstanding arises from the speed and simplicity of using the product, low engagement with terms and conditions, and an implicit assumption that safeguards are in place and the products are regulated.
- **Limited engagement with affordability** as behavioural biases make it difficult for consumers to accurately assess the affordability of borrowing. Without proper assessments from lenders this is creating risk in the system, particularly given the challenging circumstances we know many BNPL borrowers are in.

The granular insight into consumer behaviour and the potential risks of BNPL provided by this paper allows us to make specific recommendations for proportionate regulation, aiming to ensure consumers can continue to capture the inarguable benefits of these innovative forms of lending, while being protected from the biggest risks as they are in other credit markets.

⁸ Which? Under Pressure: Who uses BNPL? Available at <https://www.which.co.uk/policy/money/7601/buynowpaylater>. Life events included in our survey were those used by the FCA in their categorisation of vulnerable consumers, namely: Getting married, Receiving an inheritance, Moving house, New baby, Losing your job/ being made redundant, Reduction in working hours that you didn't want, Being made bankrupt, Relationship breakdown/ separation from your partner, Divorce, Serious accident or illness (myself), Serious accident or illness of a close family member, Death of a parent, Death of your partner, Death of a child, and Becoming the main carer for a close family member.

Methodology

Our core aims for this research were to understand why consumers use BNPL products rather than alternative payment options (both credit and debit), how consumers understand BNPL products in relation to other payment options, and consumers' relationships with BNPL providers and the retailers that enable them to pay with BNPL.

We conducted in-depth interviews with 30 consumers who had used BNPL products in the last 12 months. Participants were recruited to reflect the characteristics of 'typical' BNPL users identified as part of Which?'s profiling research, which in practice meant we did not recruit less affluent consumers (incomes below £10,000 a year), and recruited larger samples of consumers who have dependent children at home, have missed a bill or credit repayment in the last 12 months, and/or have experienced a major life event in the last 12 months than would be typical in the UK population. Further details of our sampling framework can be found in Annex 1.

Participants were asked to discuss their purchasing habits, experience using BNPL, perception of BNPL and other debit and credit products and their understanding of whether and how BNPL products are regulated in a structured interview. Fieldwork took place in September 2021. Participants were recruited by Roots Research Ltd, a specialist, independent research recruitment agency accredited by the Market Research Society (MRS) and the Association for Qualitative Research (AQR).⁹ Participants were offered a £40 thank you gift for participating in this research.

Further details on our methodology are available in Annex 1.

Report structure

- **Chapter 1: Understanding when, how and why consumers use BNPL:** This chapter builds on our previous research identifying who is using BNPL, to understand the circumstances and ways in which these products are used. We outline the key factors driving BNPL use, as identified in our new research, and offer a typology of the ways in which consumers use BNPL.
- **Chapter 2: Affordability and risk:** Building on the typology established in Chapter 1, this section examines two significant types of risk associated with BNPL use which emerge in our data: risks that consumers do not fully understand the nature of the BNPL agreements they are entering, and the risk that borrowing is unaffordable. We offer recommendations as to how proportionate regulation could help to manage these risks, without limiting consumers' abilities to benefit from these innovative products.

In our final chapter, we offer brief conclusions.

9 Roots Research Ltd <https://rootsresearch.co.uk/>

Chapter 1: Understanding when, how and why consumers use BNPL

Our earlier research told us about who was using BNPL and, in identifying factors that were associated with a higher likelihood of using the product, told us some things about the potential reasons why. Through this qualitative research, we explored the accuracy of our hypotheses about the drivers of BNPL use, digging deeper to understand when, why and how people use BNPL. Our findings are described in this chapter.

When do people use BNPL?

Unsurprisingly given BNPL products are mostly available online, our participants were mostly confident online shoppers, who had made greater use of these services through the COVID-19 pandemic. This preference for online shopping meant that participants typically had the option of using a BNPL provider for many, if not all, of their purchases.

But although online shopping was routine for most participants, BNPL use was not. Instead, participants thought of themselves as considered shoppers who used BNPL on an ad hoc basis, rather than habitually. With a few exceptions, most participants in our research said they had one active BNPL purchase at a time; concurrent use of multiple BNPL products or brands was atypical.

People usually started online shopping searching for a specific item or occasion. This informed their intended budget, product research and choice of retailer. The decision to use BNPL was typically informed by perceived need for the item, its cost and participants' short-term financial outlook. Purchases made using BNPL were rarely essential items in the strictest sense (i.e. food, medicines). Instead, they were usually perceived as:

- Items where participants saw practical benefits to acquiring the items at a specific point in time (e.g. to take advantage of a sale).
- Inevitable purchases, for instance, replacing something which was broken.
- Providing psychological benefits, making the purchaser feel good.
- Providing social benefits, for example meeting social expectations around gift giving or attending social events.

In some cases, these categories overlapped: some participants, particularly parents, saw some purchases as essential (for example, electronic devices for homeschooling during the pandemic) and purchased these at an opportune time to take advantage of discounts.

Purchases were made on the expectation that installments could be paid back with future income (or, if necessary, with savings). Consumers typically did not consider having the ability to use BNPL as a deciding factor in whether they bought an item at all, although in some cases access to BNPL influenced where some consumers bought from and the value of the items they purchased.

Why do people use BNPL?

We identified two sets of factors that influenced consumers' use of BNPL products:

1. The affordability, clarity and ease of using BNPL

- Low cost
- Clarity over repayment schedules
- Ease of use
- Clear communication from BNPL providers
- Perceived safety

2. Users' financial situations

- Needing to spread payments
- Wanting to spread payments
- Perceived affordability
- Lack of access to alternative credit

1. The affordability, clarity and ease of using BNPL

The BNPL users we spoke to were, on the whole, advocates of the product, and particularly viewed it as an attractive proposition in contrast to other forms of borrowing, pulling them towards using these products. The following features were mentioned by our sample of BNPL users:

• Low cost

All our participants mentioned, without prompting, the fact that BNPL is interest free. Interest tended to be resented by consumers, so avoiding it was seen as very attractive.¹⁰

*"I'm anti-interest – I don't like paying money that I don't need to pay.
That's why I like [BNPL]"*.

• Clarity over repayment schedules

The second most commonly mentioned feature was the fact that users know exactly when payments are due and can choose a product with a repayment schedule that works for them. We found BNPL users had different preferences for repayment periods, usually based on their pay periods, but having a clear date when repayments would end was both highly attractive, and a key differentiator between BNPL and credit cards for many people. Whereas credit card debt was seen as open-ended and unbounded, BNPL let consumers make a Ulysses pact binding their future selves to make repayments at specific times and on specific dates.

This fed an underlying need for certainty and control.

"You know how much you've got to pay off and it's done for you... you don't make the decision as to how much you pay... BNPL is good because your time is limited with it, but with a credit card it can go on forever."

These factors were often defined by participants in direct contrast to other credit products, particularly credit cards. In some cases these were grounded in participants' lived experience of overindebtedness. There was a common concern among BNPL users that credit card debt could easily get out of control due to the interest charged on balances and the open ended nature of the

¹⁰ Note, some BNPL providers charge a transaction fee. However, the participants in our study were not aware of this.

debt. While consumers understood that they could only borrow a certain amount on a credit card, there was a general sense that credit card debt could have a long lifespan and that the total amount repaid could vastly exceed the total purchase price of the items bought on a credit card, if users were to only make minimum repayments.

“If you use a credit card up to its limit it will be harder to pay off as the amount is larger, whereas with BNPL you know you don’t have that big amount and you are paying much less for it”

Concerns about the risks of interest and out of control debt meant that consumers who had access to credit cards often said they tried to avoid using them, only used them for specific purchases, such as high value items (e.g. large white goods, holidays), or where they did not have an alternative way to pay¹¹ (e.g. BNPL, 0% financing) and had a pressing need to make the purchase.

Three other process factors distinguished BNPL for users:

- **Ease of use**

Users reported that paying with BNPL was quick and simple, and that it was easy to see when repayments were due, and what they were for. Being able to store their BNPL payment details on retailers’ websites also made payments faster and reduced friction.

- **Clear communication from BNPL providers**

Communications from BNPL brands were very highly rated by their users. Participants appreciated being sent reminders and notifications when payments were due, and the flexibility to defer repayment when they needed to without having to contract the provider directly. BNPL users who had missed repayments felt BNPL brands had communicated with them clearly.

- **Perceived safety**

There was a perception among some consumers that BNPL was a safer way to pay. In part this was because the consumer did not have to enter their card details to the retailer’s website. Some BNPL users felt this meant that, like when they used online payment systems providers such as PayPal, there was additional distance between the consumer and a potential scammer and that using BNPL to make a payment was safer as a result. A few participants also assumed that BNPL brands conducted checks on retailers to ensure they were reputable before agreeing to allow them to use their payment tools. This, and the fact that you take possession of the goods before you have made the full payment, meant a few people felt they were less likely to be scammed.

“It’s a layer of separation. If someone is trying to scam you and your card is linked to Klarna that’s another layer of security.”

“It’s obviously not a scam as you get it [the product] before you pay for it and I assume if you don’t get it you just don’t pay for it.”

2. Users’ financial situations

The individual’s financial situation is a very significant factor in the decision to use BNPL products, pushing them from paying up front or using other payment methods towards this form of borrowing. We found that this took two forms: some people needed to spread payments,

¹¹ Despite some BNPL brands, such as Klarna, having features that allow consumers to use BNPL anywhere regardless of whether it’s offered by the retailer, not all participants were aware of this.

being unable to pay for things upfront, while others had a psychological preference for spreading the cost, despite being able to pay in one go.

- **Needing to spread payments**

Some participants' incomes meant they had little choice than to use credit if they wanted to make purchases immediately, take advantage of time sensitive offers or bridge short-term shortfalls in income (e.g., in the days leading up to payday). BNPL represented a low cost and, in some people's view, low risk way of shopping.

"£50 that's a lot for me. I have to think, 'do I need that for something else?', my living costs for instance. If it's an item where I think I really need that and I can't afford it ... then I will use [BNPL]"

"If it's the right time of month I always pay by debit card but if it's beyond the middle of the month I'll use credit. If there's the option of [BNPL] at the till I'll opt for that."

- **Wanting to spread payments**

Others chose to use BNPL despite being able to afford products outright. These consumers typically wanted to maintain a financial "cushion", avoid using savings and even out large, but expected, purchases (e.g., school uniforms). These people typically saw BNPL as a money management tool.

"If I was just paying for one item I might just pay it on my [debit] card but if I'm buying the kids' seasonal clothes I tend to use [BNPL] because it's quite a large lump sum ... so I find it easier to spread that across 3 payments"

"You never know what expenses might come up and it is better to have funds available if possible."

- **Perceived affordability**

Closely linked to the desire to spread payments, consumers also reported that breaking large expenditure items into smaller 'bite-sized' chunks made these purchases feel more affordable, even if the total amount paid was the same. Essentially, the cost of the product became anchored to the lower installment cost – participants tended to talk about the monthly or weekly repayment, rather than the total amount. This made some consumers feel less concerned about making purchases they would not otherwise view as necessary, appropriate or affordable.

"If something is twenty quid and I think that is twenty quid I shouldn't be spending... if they offer flexipay where I'm paying something ridiculous like £3.50 then I buy it as that's affordable to me. That's nothing. That's just a cup of coffee."

"It softens the blow psychologically. It almost doesn't feel like I'm blowing £100 on shoes."

- **Lack of access to alternative credit**

Some participants used BNPL because they lacked access to alternative forms of credit. For some, this was a result of previous debt problems which limited their access to affordable alternative credit products. Some of these people also did not want to start using traditional credit again after their experiences. Others were foreign nationals and did not have a credit history in the UK. For these consumers, BNPL was an expedient way of making purchases that would otherwise be unaffordable, result in high interest payments or take a lot of time to save for.

How do people use BNPL?

The analysis above sets out the factors that drive BNPL use across all participants. We found that it was possible to identify four distinct ways in which these factors combined to create specific patterns of behaviour, varying in the frequency, intensity and nature of their BNPL use. While this typology is not perfect, and there will be some overlap between groups, this can provide a helpful tool for understanding the circumstances and behaviour of BNPL users.

Table 2 - a typology of BNPL users

	Frequency of use	Access to alternative ways to pay	Engagement with terms and conditions	Perceptions of BNPL products and brands
1. Spending Smoothers	Medium/High	High	Low	Very positive
2. Experimenters	Low	High	Low	Positive
3. No Choicers	Low/Medium	Low	High	Very positive
4. Plate Spinners	Medium/High	Medium	Low	Positive/ Very Positive

Spending Smoothers

The largest group in our sample, Spending Smoothers, typically had reliable incomes and considered BNPL an affordable way to manage the cost for medium-value items, defined by this group as between £50–£150.

Spending Smoothers commonly used BNPL regularly, but not habitually. On each purchase occasion they actively considered how to pay and whether to use BNPL based on their understanding of their own financial circumstances, rather than using BNPL automatically everywhere it is offered.

“I get a bit worried about paying a lot upfront. We have the money but I prefer taking the pressure off. It’s an internal thing, I don’t know why I lean towards it but I just do. It’s easy as well, there’s nothing stopping me. Instead of pay now it’s pay later. You never know what’s coming up. Even though we’ve been fortunate [during the pandemic] we know people who haven’t been. If you pay over a couple of months it means you have a bit more in the bank this month”.

Spending Smoothers typically had one ‘live’ BNPL product at any one time and used it for items that were outside of normal ‘day-to-day’ spending, but which were not unexpected or impulsive. Examples included birthday presents, school uniforms and trainers. Where Spending Smoothers had more than one ‘live’ BNPL product (i.e. they were making repayments on two different purchases at the same time) they were typically on different repayment timelines. For example, they may only have one repayment left on a ‘pay in three’ at the time they started another plan or had one low repayment plan over a longer period (e.g. as was the case for one participant for £10 for ten months), at the same time as having a product with a shorter repayment timeline.

Spending Smoothers often had a strong affinity for BNPL and were advocates for trusted brands. Spending Smoothers tended to take these products and their claims at face value, engaging only superficially with terms and conditions, if they engaged with them at all, assuming that they would be able to cover repayments regardless.

Spending Smoother case study: Claire

Claire is a mum of two and lives with her husband Steve in the Northeast of England. During the pandemic, although Claire's employment was stable, her husband lost his job and for a time money was tight. Now her husband has a new job which means they are much more financially secure.

During the pandemic Claire was quite reliant on BNPL to help make items more affordable. She used it for presents for Christmas and birthdays and also her daughter's uniform for her new secondary school.

"I was elated to find out that my school uniform shop take Klarna. I was like, oh my goodness. Because of Covid and finances and my husband [was] out of work, when I found out they took Klarna I couldn't believe it because I was stressing out over how I was going to get my daughter's uniform as it was going to cost over £200. I am just about to do my third purchase at [the school outfitters] for her school uniform. It gave me the ability to get one hundred odd pounds worth of uniform and pay over three months. Given my financial situation it was a God send."

Claire was a strong advocate of BNPL. She uses it on a regular basis to buy items and pay for them in a way she considers affordable.

"I've become a bit of a robot now - as part of my monthly bills I go onto [BNPL provider] and pay it off - it's become a habit... I love it"

Experimenters

The next most common group in our sample were those who had only used BNPL once or were very infrequent users of BNPL.

This group has many similarities with 'Spending Smoothers', typically using BNPL for the same core reasons, to even out the cost of purchases that were medium cost and outside of their normal spending, with low engagement with terms and conditions. However, Experimenters had more distant relationships with BNPL.

Experimenter case study: Marabel

Marabel is 60 years old and lives in Manchester. Her 23 year old son sometimes lives with her, when he's not with his girlfriend. Marabel was made redundant 5 years ago and has taken on a few temporary jobs since then. Her main source of income is her pension which covers her bills, a few new clothes and the odd night out.

How Marabel pays for things depends on how she's feeling in the moment, what is offered and her immediate financial circumstances. Recently, Marabel used BNPL to buy a rug and a Hoover - these purchases were slightly more expensive than normal and she appreciated being able to spread the cost of these items over a few months.

"It actually varies depending on how much money I have at the time. With the phone it was something like £300 and more and I paid for that in cash. Whereas I bought a rug that was something like £90 and I paid for that with Klarna over three payments. There's no hard and fast rule. Some things on credit cards. It just depends where I am with my money."

Marabel considers BNPL to be a good way to pay for things that you may not otherwise be able to afford outright, but as something which equally needs to be used with caution. She says she would not use it to buy cheaper or lower cost items, such as dresses, instead preferring to use it for more expensive items. Ultimately, however, she thinks saving up for items and then paying for them outright, rather than using credit, is preferable.

"It is affordable. It's just an easy way to get things and buy things. I'm not that frivolous. I wouldn't go buying everything and anything on it."

No Choicers

A small but not insignificant group of BNPL users in our sample used BNPL as it was the only form of credit they could access, or felt comfortable accessing. This group were diverse and included:

- Consumers with poor credit histories who can not afford other forms of credit;
- Consumers on very low income who could not afford to incur interest; and,
- Consumers with thin credit files who were not eligible for other types of credit.

No Choicers typically had the strongest affinity for and reliance on BNPL as a payment option. Although they did not make intensive use of BNPL, using it infrequently and commonly only having one BNPL product at a time, they recognised they had few alternative options other than BNPL as a way to borrow. This group were the most likely to actively engage with BNPL brands' terms and conditions, as making an informed decision about whether or not they could afford to use the products was important for their overall financial management, and were extremely mindful about not missing payments. This was in part because they wanted to avoid any additional charges but also because they did not want to lose the 'opportunity' that BNPL represented to them.

*“If my income increased, would I still use it? Maybe less.
But... in my situation it works for me. I'm grateful that I have the choice.”*

No choicers case study: Sarah

Sarah has a long term mobility problem due to a back injury and is a recipient of Universal Credit. She is a single mum to a 17 year old who is in full time education.

Sarah does most of her shopping online as she finds it difficult to get to the shops. Although she prefers to buy things outright, she finds BNPL a useful resource for when she needs to make a larger purchase. That it doesn't charge interest is particularly helpful. Her credit history means she can't use a traditional credit card.

Sarah most recently used BNPL to buy her daughter a prom dress. She found the process simple and easy. While the prom dress was a luxury, she felt buying it was important. She didn't want her daughter to miss out on this important life event and wanted her to have the same experiences as her friends.

Because of her financial situation, Sarah was careful to engage with the terms and conditions of BNPL brands to make sure that she wouldn't be charged interest or incur costs by using them. Overall she is really happy with these brands and believes she will continue to use them.

Plate Spinners: the most precarious users of BNPL

The smallest group in our sample, but perhaps the most concerning, Plate Spinners typically had complex financial lives and low, unpredictable incomes. They also tended to be younger and less experienced credit users.

Plate Spinners reported using multiple BNPL brands in addition to other forms of credit, if they had access to them. The choice of what to use when, and which BNPL brand to use if there were multiple options, often depended on when payments were due, how much was on a particular card or with a particular BNPL brand and when they expected to be paid. Some Plate Spinners were managing multiple repayments across different BNPL brands and on different schedules (e.g. fortnightly, over six months etc.).

The Plate Spinners in our sample had typically experienced a life event in the last 12 months, had reduced incomes and had missed repayments on other bills or credit. BNPL was a useful way of maintaining their lifestyle as much as possible in challenging or stressful times. This group were the most likely to report using BNPL to buy food, typically through delivery apps (such as Deliveroo) where they were able to buy both meals and groceries.

Plate Spinner case study: Casey

Casey is aged 25 and lives alone. During the lockdown, she had lost her job and had a relationship breakdown, both of which caused her hardship. Casey started using BNPL products in March 2021, and they have been an important way for her to buy things when she did not have the full amount to pay for items outright.

"I can use Zilch in a shop, for groceries, for absolutely anything. If I ran out of money, I could use it for food, like a proper shop."

Casey has a bad credit history and prefers to use BNPL as a way to spread out the cost of buying things, explaining that it helps her with money management - specifically with scheduling repayments:

*"I am not sure if I will get another credit card as I prefer to use BNPL as it forces you to pay off...
with a credit card you can just forget about it and get in trouble."*

Casey has asked for BNPL providers for payment extensions twice, and has also missed a payment and was charged a late fee of £6.

*"£6 is quite high for each payment that is late... especially because I have had to watch everything I spend...
£6 is like a travel fare for the day."*

The qualitative data analysed in this chapter clearly shows that, for most users, BNPL is a clear improvement on earlier credit products, allowing consumers to manage payments in a way that works for them, at a lower cost. However, in the emerging typologies and the way that BNPL changes perception of affordability of goods and services, we start to see the potential risks of these products. These risks, and the scope for proportionate regulation, are explored further in the next chapter.

Chapter 1: Key insights

- Research participants mostly used BNPL in an ad hoc way, rather than every time it was available. The decision to use BNPL was typically informed by the perceived need for the item, its cost and the participant's immediate financial situation.
- Two sets of factors influenced participants' use of BNPL products:
 - 1. The affordability, clarity and ease of using BNPL**
 - Low cost – the fact that BNPL is interest free was an important draw for consumers
 - Clarity over repayment schedules – users appreciate the transparency of BNPL products, particularly knowing exactly when the debt will be repaid
 - Ease of use – paying with BNPL is quick and simple
 - Clear communication from BNPL providers – consumers find messages from BNPL providers are usually easy to understand
 - Perceived safety – some BNPL users thought that BNPL was a safer way to pay, avoiding entering card details on unfamiliar websites.
 - 2. Users' financial situations**
 - Needing to spread payments – some BNPL users had little choice but to use BNPL if they wanted to make purchases immediately
 - Wanting to spread payments – other participants chose to spread payments, despite being able to pay outright, typically in order to maintain a financial 'cushion', treating BNPL as a money management tool
 - Perceived affordability – BNPL users reported that breaking larger purchases into smaller instalments made these feel more affordable
 - Lack of access to alternative credit – some participants used BNPL when they were unable to borrow in other ways, due to previous debt problems or a thin credit file.
- We identified four distinct patterns of BNPL use within our sample:
 - a. Spending Smoothers**
The largest group in our sample, with typically reliable incomes. They use BNPL where they feel there are benefits to doing so, and typically only have one BNPL product 'live' at a time. BNPL is used as an affordable way to buy anticipated, rather than unexpected items, usually between £50 and £150.
 - b. Experimenters**
The second largest group, very infrequent users of BNPL, but otherwise similar to spending smoothers.
 - c. No Choicers**
A smaller but not insignificant group in the sample, who used BNPL because it was the only form of credit they could access, or were comfortable accessing. Not intense users of BNPL, but with strong affinity for BNPL brands, and who engaged actively with terms and conditions.
 - d. Plate Spinners**
The smallest group in the sample, but perhaps most worrying, with complex financial lives and low, unpredictable incomes. Juggling multiple BNPL brands and other types of borrowing.

Chapter 2: The risks of BNPL use

The BNPL users engaged in our research were advocates of these products - they found them useful, perceived them as being affordable, and often planned to make use of them again in future. However our interviews also allowed us to identify some of the ways in which these products currently pose risks to users, particularly those captured in our typology as 'Plate Spinners'. These fall into two main areas:

1. A lack of understanding of the product.

- Most participants thought of BNPL as a way of spreading payments, not as a form of borrowing. While, when prompted, BNPL users in our research understood that the product was a form of credit, this wasn't how they conceptualised it for themselves.
- This misunderstanding arose from the speed and simplicity of using the product, low engagement with terms and conditions, and an implicit assumption that safeguards were in place and the product was regulated.

2. Affordability risks

- Throughout the research we identified a lack of engagement by consumers with the prospect that they might struggle to repay the agreement.

In most cases, this research provides new evidence around elements of BNPL borrowing previously identified as potential drivers of risk, including in the recent HM Treasury consultation. This chapter presents evidence of these risks, and our recommendations for how they can be managed through regulation.

Risks around lack of understanding of BNPL products

The BNPL users who participated in our research widely viewed the product as a low-risk, affordable way to spread the cost of purchases. While this reflected participants' largely positive experiences of using BNPL products, these views are nonetheless based on some misconceptions of BNPL products which suggest consumers are not currently fully aware of the risks associated with this form of borrowing.

Consumers don't think of BNPL as a form of credit

Firstly, we found that BNPL users often did not think of BNPL as a form of borrowing. We explored participants' understanding of these products in several ways, including analysing the natural language used by consumers to describe these products and by asking them explicitly whether BNPL was a form of credit.

Participants commonly described BNPL as simply a "way to pay", a "money management tool", or a means of deferring payments.

"It's a way of spreading out the cost a bit if you can't afford to pay for it all at once."

“It’s where if you do not have all the money upfront then they help you to pay in installments, it’s really helpful because it helps you budget and helps you keep track of payments.”

This reflects the language used to market BNPL products to consumers, which rarely refers to credit, borrowing, or debt, and instead positions products as a way of splitting or spreading payments. In one case, a participant directly contrasted these products to the need to ‘borrow’ money.

“It allows payments to be spread out for budgeting. It made things possible which in one go would have been extremely difficult and I would have probably had to borrow money from elsewhere.”

These views were based, in part, on the mechanisms through which consumers’ made BNPL repayments, through automated charges to registered cards or via direct debit, which reinforces the perception that these are installment payments rather than borrowing.

Only when asked explicitly whether they knew BNPL was a form of credit did participants describe it as such.

“I don’t really view it as credit. I know it is in a way but I see it as a budgeting tool and way of spreading the payment until when I get paid. I suppose it’s more like a loan.”

This lack of understanding of BNPL raises concerns that consumers using these products may not fully understand the implications of doing so; a finding that is particularly worrying when a recent Which? Investigation demonstrates that lenders are increasingly asking about BNPL use as part of their affordability assessment processes for mortgage lending.¹² Uninformed use of this product may have wider ramifications for a consumers’ credit worthiness, as well as potentially leading to less affordable lending or increased risk of missed payments.

This misperception of BNPL seems to stem from three, interrelated factors:

1. The speed and simplicity of the lending process
2. Very limited engagement with terms and conditions
3. An implicit trust in retailers and assumption that safeguards are in place.

1. The speed and simplicity of BNPL feels more like a payment mechanism than borrowing

Participants reported finding the process of using BNPL very easy, often describing it as ‘smooth’. They did not experience a higher level of friction for using BNPL compared to other payment mechanisms, which appears to contribute to users viewing the product as a way to pay, rather than a form of borrowing.

“It seems really convenient and no hassle. It just asks a few questions so it doesn’t feel like you’re committing to a credit agreement. It’s just like ‘here’s your goods and we’ll be dividing up the payments into 3 to make it easier’.”

¹² Which?, Can shopping with ‘buy now, pay later’ schemes impact your chance of getting a mortgage? November 2021. Available at: <https://www.which.co.uk/news/2021/11/can-shopping-with-buy-now-pay-later-schemes-impact-your-chance-of-getting-a-mortgage/>

“I already had a [store] account so it was very easy to do. There was no questionnaire to fill in, no information was collected. Maybe that’s because I was already known to [the store]. They sent me the statement a month later and it mentioned that an instalment was due. I went on and made payment with my Apple Pay which puts in all my card details for me and it’s really quick”.

In several cases, participants describing their most recent use of BNPL explained that they hadn’t set out to use it, but when seeing the products on offer at the checkout decided to use it. This was evident among both first-time and repeat BNPL users, and indicates the lack of friction consumers currently experience when using BNPL, which may lead them to view the product as a payment mechanism rather than form of borrowing.

“You put things in your basket and it says payment method and it says pay with Clearpay and you just think ‘why not?’”

“Klarna jumped out at me. I didn’t expect it to be there and it meant only paying a third upfront.”

This further reinforces that transactional friction for BNPL is very low. This reflects both the actual nature of the BNPL checkout process, and consumer’s cognitive experiences. Consumers put much greater emphasis on acquiring the goods they’re buying than on the BNPL product they use to pay — potentially as a result of ‘anchoring’ where people pay more attention to the first piece of information acquired in making a decision (in this case, the product they want to buy) than subsequent pieces of information (here, the nature of the payment mechanism).

2. Consumers’ engagement with BNPL’s terms and conditions is very limited

Given BNPL users considered BNPL products to be affordable and low risk, and the speed of the sign up process, it is perhaps unsurprising that engagement with these products’ terms and conditions was low. Most BNPL users said they had either skimmed BNPL products’ terms and conditions or simply ‘ticked the box’ to say they had read them in full, behaviour common across a range of markets and consumer products.¹³

“With house insurance... or something like that, there’s a lot of terms and conditions, and with credit cards there’s a lot of red tape. There doesn’t seem to be as much with these. I didn’t get the impression that there were a lot of terms and conditions to sign up to. It was just basically, what’s your address, what’s your telephone number, a few clicks and you’re set up.”

“I had this in my head, I thought wow this is crazy. You put your name and your phone number in and it just lets you buy and buy and buy.”

Given this, some BNPL users’ understanding of the consequences of missed payments, spending limits, safeguards and checks was limited and based on assumptions. Some participants were not aware there were late payment fees, or what these were.

13 Self-reported rates of reading terms and conditions varies from 1% to 65% of online users (Milne and Culnan, 2004; Gordon, 2004), but a US study drawing on actual browsing data of over 90,000 households suggested that only one or two out of every thousand retail software shoppers checked the licensing agreement (Bakos, Marotta-Wurgler, and Trossen, 2014). Milne, George R., and Mary J. Culnan. 2004. “Strategies for Reducing Online Privacy Risks: Why Consumers Read (or Don’t Read) Online Privacy Notices.” *Journal of Interactive Marketing* 18 (3): 15–29; Gordon, Sarah. 2004. “Privacy: A Study of Attitudes and Behaviors in US, UK and EU Information Security Professionals.” Symantec White Paper. <http://sarc.com/avcenter/reference/privacy.attitudes.behaviors.pdf>; Bakos, Yannis, Florencia Marotta-Wurgler, and David R. Trossen. 2014. “Does Anyone Read the Fine Print? Consumer Attention to Standard-Form Contracts.” *The Journal of Legal Studies* 43 (1): 1–35.

*“When you go to extend the due date you can extend for up to seven days.
But I don’t know if you then extend again that they will charge you...
[missing a payment] could potentially get you into the issue of interest and charges.
There could be a hidden element there.”*

There were, however, a population of BNPL users who did engage with their terms and conditions: those whose financial situations were particularly fragile. These consumers typically read product’s terms and conditions in detail to ensure they would not experience negative consequences or incur charges.

3. Consumers expect safeguards to be in place

In line with low engagement with terms and conditions, the BNPL users we interviewed tended not to question the nature of BNPL products until we prompted them to consider them more closely. Their comfort with the product, and the speed of the process, was often based on an implicit assumption that safeguards were in place around these products, and that someone else was taking steps to ensure they couldn’t get into serious financial difficulties.

Participants engaged in our research had typically had positive experiences using BNPL products and positive views of BNPL brands and the retailers who offered these products at checkout. They trusted that BNPL providers were reputable and responsible, in part because they had little evidence to the contrary based on their personal experiences using their services.

“If I see something has Klarna on, I probably trust it more. I just think like why is it going to let you buy something and have it before you’ve paid if it’s not legit. Do you know what I mean? I just think I trust it more because that website has obviously teamed up with Klarna and I know that Klarna is legit because I’ve used it loads before.”

Having had positive experiences, and in the absence of conducting checks or research on BNPL brands’ business models, conduct or ways of working (e.g., detailed reading or terms and conditions, looking at review sites etc.), users assumed that retailers check on BNPL providers and vice versa so both parties are clear the other are legitimate business partners. Participants assumed the potential for reputational risk would encourage responsible action by both parties.

“I would hope they would check to see the record of the BNPL company and [whether they have] had many negative interactions with other retailers, what their reputation is... Their relationship has to be a good one as both brands are going to elevate each other and keep their reputations going. No company is going to want to work with a brand that will dent their reputation.”

“I’d assume they check who they are, where they get their things from, checking their anti-slavery stuff. Making sure they’re a reputable company.”

“[The BNPL provider] would have oversight. They wouldn’t want their reputation marred. I wouldn’t anticipate too much in the way of trouble as they want to retain their reputation.”

Underpinning this was a belief that BNPL products are regulated.

“It would be logical for them to come under FCA regulation but I don’t know. They’ve got to be licensed and registered with someone.”

“You just assume that they are [regulated] to some extent. Because if you can have a platform like that on say a company website you just assume that they must be ok, that they’ve been vetted or have some kind of licence... you just don’t think about it in the moment.”

At the end of our interviews we explained to participants that BNPL products are not currently regulated by the FCA and that this meant they did not have the same protections when they were using BNPL as they did when using other forms of credit. Most participants were surprised by this:

“That’s surprising. I assumed that to offer any form of credit they’d need to be regulated... I assumed that they would be regulated like any other financial company.”

“I am surprised, I am shocked, they should be regulated. If you have a service that is not regulated you have no protection for consumers. “

“It’s quite scary to hear but it makes complete sense because I wasn’t checked out. With my mortgage and credit card there was a process and I had to prove what I could afford. It’s a bit unsettling to hear it out loud.”

Overall, our new research provides considerable evidence that BNPL users generally have a poor understanding of the nature of the product. They tend to think of it as a way of smoothing payment, rather than as a form of borrowing, and the fast, simple sign up process further reinforces this association. Very few users engage in detail with the terms and conditions of products. Users generally assume that they are protected while using these products – both by due diligence on the part of retailers and providers, and by regulation.

This lack of understanding of BNPL products is particularly concerning when we reflect on our previous research exploring who is using these products. In that study, we found that BNPL customers were more likely to be experiencing possible challenges, including the expenses associated with raising a family and other life events, and recent missed bill or credit repayments. While our interviews suggest BNPL products are playing a valuable role in helping people smooth costs in these difficult circumstances, the lack of understanding of the nature of the product, and the inaccurate assumption that protections are in place, could leave consumers in difficulties if their situations worsened.

Our recommendations to address poor consumer understanding of BNPL products

When our participants were informed that BNPL products were not regulated, they were concerned.

“The customer base they are trying to build is basically for people who can’t necessarily afford to buy something in one go. They want to afford it over a period of time... there should be the same rules as other ways of borrowing as the consumer is going into a contract in good faith”.

Our research has shown that BNPL products are generally well received and well used by consumers, so regulation must be proportionate. These products have offered consumers a new alternative to other forms of credit, often at a more affordable price. However, our research also clearly demonstrates that there are risks to consumers here, stemming from consumers’ understanding of the product and behaviour, which is in turn shaped by structural features of the market.

In sum, our research has demonstrated that BNPL users are predisposed to trust BNPL providers, on the assumption that all financial products in the UK are regulated. From this starting point, consumers trust brands’ marketing and do not usually feel the need to interrogate firms’ terms and conditions, trusting that they will be fair.

Our insight has shown that consumers do not intuitively recognise BNPL as a credit product, instead thinking about it as a ‘payment smoothing mechanism’. Implicit in our interviews was a sense of cognitive dissonance – consumers simply didn’t think that it could be so simple to take on

debt, given their experiences of applying for other credit products like credit cards. This is a clear risk: fundamentally, consumers should not be able to borrow money without realising it. We are concerned that a significant number of BNPL users may thus be entering a credit agreement unwittingly - an issue which is driven by the lack of friction consumers experience when using this product. This lack of friction in the transaction process creates a clear risk that consumers are taking on debt without being fully aware of the implications.

We suggest that implementing some element of friction may help address consumers' understanding, ensuring all BNPL users as part of the lending process acknowledge that they are borrowing money. Given the relatively small size of most of these credit lines, this does not need to be arduous: we are not suggesting that a consumer should face the same process to use BNPL as when applying for a credit card, for example. The intervention must be proportionate, to ensure that the majority of consumers who are using BNPL products without detriment remain able to do so, while managing the risks associated with unconscious credit usage. The design of this intervention should be carefully considered and tested, but options could include a straightforward statement to acknowledge this is a credit product, or something along the lines of an e-signature to demonstrate that a commitment is being entered into.

Our research also shows that many BNPL users engage with terms and conditions in a very limited way, if at all – partly as a result of their assumption that this is not a credit product, and that in any case they are protected by regulation. While we know the issue is more widespread than BNPL, as part of the effort to address these consumer misunderstandings and the risks they entail, BNPL providers could be more proactive and look to make their key terms more accessible.

Clearer terms and conditions alone may not suffice to increase the understanding of the product. Consumers must be given the type of information at the point of transaction to make informed choices. Key information such as payment terms, late fees and how missed payments can affect future credit assessments should be clearly presented.

BNPL providers should take this transparency work further as a matter of urgency to avoid consumer detriment, particularly where the use of BNPL is already affecting other lenders' decisions. Waiting for the regulations to come into force before improving these areas of concerns may leave a number of consumers adversely impacted.

On the last point, it is clear that lenders are already making affordability decisions based on use of BNPL products, many of which are for higher value products. In its recent consultation, HM Treasury stated that it was minded to draw the scope of regulation so that short term interest free credit agreements for such value products could continue outside the regulatory boundary. We believe this position is misplaced: cutting the line as proposed would further complicate consumers' understanding of the market and also omit the affordability practices being implemented by other lenders. We recommend the proposed regulatory boundary be amended to ensure that consumers' understanding of the product is not further inhibited.

Risks around affordability

Our previous research exploring who BNPL users are identified that, although people using these products are, on average, more affluent, they are also more likely to have experienced a recent life event, have dependent children at home, or to have recently missed a bill or credit repayment – all possible indicators of financial stress. In light of this finding, we explored the perceived and actual affordability of BNPL borrowing in our interviews.

Typically, research participants judged BNPL to be an affordable way to pay because of the product's core features:

- BNPL is interest free, meaning users viewed it as a no-cost way of borrowing.
- Repayments were often perceived to be low – consumers could easily see how these amounts fit into their budgets.
- The mechanisms around BNPL repayments ensure they are structured enough to provide a sense of certainty over when the total amount would be paid, and flexible enough that consumers were reassured that they could make adjustments were something to come up. For instance, they could 'snooze' repayments for a short time.
- Users could access the goods they had purchased almost immediately, enabling them to make use of what they had purchased at a lower upfront cost than they would otherwise.

“This is just set up like a direct debit so if anything it's a lot better, no, 100% better than getting a credit card. And once you've paid it back, it's just gone.”

“No one wants to take out finance where you end up having to pay 30% on top of the cost, whereas [BNPL] you just pay for the item. It is a far better scheme I think.”

Some users also noted the flexibility offered by providers if they were unable to make payments as planned:

“It's nice that they let you snooze payment so you get a bit of extra time if you need it... and if you're late they don't charge you a late fee straight away as well, you get a reminder.”

Many of the BNPL users we spoke to had adopted their own rules of thumb to ensure their purchases remained manageable; however, as the quotes below illustrate, these rules differed between participants, demonstrating that there is no single consumer understanding of the 'best' way to use these products.

“I wouldn't go for big items like furniture. I just buy affordable things that I can pay each month. I know I can do £40 each month max without being skint.”

“I'm not that frivolous. I wouldn't go buying everything and anything on it. I wouldn't buy a dress or things like that. I'd spend cash on that, but anything bigger I'd do on BNPL.”

“One thing I wanted to mention – you know there are two elements [to BNPL]. I try to avoid the 30 day one because, as I mentioned, my purchases tend to be £30 and above and generally I can't afford to pay that in the next month. I do have a pending 30 day one, but I definitely prefer the other one.”

However in discussing these rules, participants commonly articulated the fact that they could not afford to pay for items upfront. Some also acknowledged that they spent more when BNPL was available than they would otherwise, either by facilitating purchases, especially of 'treats', that would not otherwise have been made, or allowing the buyer to buy a more expensive option which they could not usually afford upfront.

“Now that I have that option I can spend more because I'm not having to pay everything upfront. It's probably made my spending habits increase.”

“There have been occasions when I've spent when I probably wouldn't have otherwise.”

Those on the lowest incomes, with previous debt problems or with poor credit ratings were arguably the most mindful of the trade-offs they had to make and the need to use BNPL carefully: typically they were preoccupied with not ‘losing the opportunity’ of making repayments in this way. However, despite their somewhat precarious circumstances these consumers still considered BNPL an affordable way of making payments.

“I’m being really vigilant as I got myself in a lot of trouble over the years and it can get really difficult. I just thought that if you don’t have the cash you can’t buy it. If you’ve not got it on the [debit] card you can’t buy it. That was very restrictive in itself... [BNPL is] an easier option. I’ve put the work in, now I assess each situation and it just works for me. I don’t overstretch myself and I find it really convenient”.

However, affordability should not just consider whether payments can be made today. The FCA says lending affordability should be assessed by exploring whether the customer is able to make repayments under the agreement, without having to borrow to make these repayments, or experiencing other financial difficulties, including missing other payments, as a result.¹⁴

This is a difficult judgement for consumers to make themselves, as optimism bias means we systematically overestimate the likelihood of positive events occurring and underestimate the likelihood of negative events occurring.¹⁵ Consumers’ ability to adequately assess lending affordability can also be negatively affected by egocentric bias, where we think we have greater control over external events than is truly the case, and will be able to manage if things do go wrong. In the context of BNPL products, users’ biases mean they considered it highly unlikely that something would occur which would mean they could not make repayments. BNPL purchases were considered affordable, even if consumers would not be able to buy them outright, because they were confident their circumstances would remain the same for the relatively short repayment period of these products.

Moreover, BNPL users commonly assumed that lenders were undertaking some sort of affordability check, allowing them in some cases to delegate responsibility for this assessment to the lender.

“I presume they offer it to you on the basis that you can pay it back.”

Several participants expressed surprise that they had been offered the option to use BNPL, given their poor credit ratings or historic debt problems.

Although we did not seek to recruit those experiencing difficulties with BNPL products, we did find people in our sample struggling to juggle repayments, suggesting that these affordability risks are, in some cases, biting.

“If you’re talking about the last six months, no [I couldn’t have bought the things I bought outright]... the last 6 months I’ve been using it almost every month for various reasons. I would say that it’s been slightly inconvenient. They’ve asked for payment upfront and then one or two payments and that’s because of how difficult it’s been to cover that first payment. Then I’ve just had to put it on a credit card and that’s just because my financial situation has not been great.”

14 FCA, Consumer Credit Sourcebook, CONC 5.2.A.12 – 25, <https://www.handbook.fca.org.uk/handbook/CONC/5/2A.html>

15 <https://www.behavioraleconomics.com/resources/mini-encyclopedia-of-be/optimism-bias/>

This evidence, taken alongside the findings of our quantitative research which identified that BNPL users are more likely to be experiencing financial challenges, implies that there are significant systemic risks around the affordability of BNPL lending. The fact that BNPL providers are not currently required to undertake a creditworthiness assessment before extending credit is leaving consumers exposed to this risk.

Our recommendations to ensure BNPL lending is affordable

Earlier, we set out the type of information that should be presented to a consumer, in order for them to better understand the BNPL product, and therefore make an informed choice as to whether to proceed with this payment method. Once the consumer confirms that decision, it is essential that the BNPL provider accurately assesses whether it is affordable to lend to the consumer. Undertaking appropriate affordability assessments is essential in mitigating potential consumer harm in the BNPL market.

Our research shows that due to features of the market, such as the ability to break large purchases into smaller instalments, BNPL users view purchases as inherently more affordable. However, we know that inherent optimism bias means people struggle to assess long-term affordability, and that BNPL users are more likely than those who are non-users to consider themselves to be more time-poor and present-oriented.¹⁶

Coupled with our insight from our May 2021 report; which highlighted that people who use BNPL are more likely to have experienced a significant life event in the past year, or to have recently defaulted on a household bill or the repayment of another form of credit, our findings suggest that BNPL is being used by consumers whose circumstances may make them more vulnerable to harm and open to risk.

There is an evident need for appropriate affordability assessments. We recognise that there are currently limitations in the credit information market and that other, more innovative and real-time methods of assessing affordability such as open banking are in development and may, in time, offer an appropriate alternative.

With that in mind, we feel affordability assessments should be outcomes-based, rather than prescriptive in the first instance, allowing flexibility in the approaches taken by BNPL providers in the short term. However, the inconsistencies in such approaches need to be addressed, as soon as there is a proportionate, workable solution for providers to follow.

We recommend that any lasting solution should acknowledge an individual's exposure to all debts and that this is reflected on consumers' credit files in a proportionate way. We call on HM Treasury to work with credit reference agencies and wider industry on how this information can be reported on consumers' credit files with urgency.

16 Which? Under Pressure: Who uses BNPL? Available at: <https://www.which.co.uk/policy/money/7601/buynowpaylater>.

Chapter 2: Key insights

- The BNPL users we talked to were, on the whole, enthusiastic advocates of these products. However as we explored their understanding and use of these products in depth, we found evidence of considerable risks in the way these products are currently being used:

3. A lack of understanding of the product

- Most participants thought of BNPL as a way of spreading payments, not as a form of borrowing. While, when prompted, BNPL users in our research understood that the product was a form of credit, this wasn't how they conceptualised it for themselves.
- This misunderstanding arose from the speed and simplicity of using the product, low engagement with terms and conditions, and an implicit assumption that safeguards were in place and the product was regulated.

To address this risk, we recommend that:

- a. Some element of friction is introduced to the borrowing process, ensuring all BNPL users acknowledge that they are borrowing money. This friction should be proportionate to the risk associated with this lending, and need not be arduous.
- b. Key information, such as payment terms, late fees and the potential consequences of missed payments, should be communicated at the point of transaction to enable informed choices. Given the immediate risk of detriment, BNPL providers should proactively work to make their key terms and conditions more accessible, rather than waiting for regulation.
- c. HM Treasury should ensure the boundary for BNPL regulation is appropriately drawn, and is spread wider than it currently proposes, on the basis that consumers are unable to distinguish between regulated and unregulated products and assume that all products are regulated.

4. Affordability risks

- Throughout the research we identified a lack of engagement by consumers with the prospect that they might struggle to repay the agreement. Behavioural biases make it difficult for consumers to accurately assess the affordability of borrowing, and without proper assessments from lenders this is creating risk, particularly given the challenging circumstances we know many BNPL borrowers are in.

To address this risk, we recommend that:

- a. Outcomes-based affordability assessments should be undertaken for all BNPL transactions. Given the limitations of the credit information market and the development of real-time affordability assessment mechanisms, we do not believe this should be prescriptive in the short-term, but in the long-term consistency must be ensured.
- b. In the long-term, BNPL borrowing should be reflected on consumers' credit files in a proportionate way. HMT should work with credit reference agencies and wider industry to implement this urgently.

Conclusions

Our extensive engagement with consumers through this project has shown that in many ways, BNPL is an example of excellent innovation, providing consumers with access to more affordable and attractive credit. It's no surprise that millions of consumers are taking advantage given the demonstrable benefits of these new products.

However, as in many other markets where innovation happens rapidly, our analysis has identified a range of risks which need to be appropriately addressed. Given the speed of BNPL's growth, it is perhaps not surprising that consumers don't quite understand the nature of the product. But fundamentally, nobody should be borrowing money without being explicitly aware that is what they are doing.

Equally, for many BNPL users the perceived affordability of these products is one of the biggest benefits. We recognise and value the additional consumer surplus offered by these low-interest forms of credit. But the credit being free doesn't make the lending affordable, and our research indicates that better affordability assessments are needed to ensure consumers receive the protection they deserve and expect in this rapidly growing market.

In this, we call for change – but recognise that forthcoming regulation must be carefully balanced, to avoid stifling a market which has undoubtedly improved consumer welfare overall. We look forward to working closely with the government, Buy Now Pay Later providers, and the Financial Conduct Authority in the months ahead to build a balanced and proportionate regulatory regime that ensures these products continue to benefit consumers for years to come.

Which?

Which?, 2 Marylebone Road,
London NW1 4DF
Phone +44 (0)20 7770 7000
Fax +44 (0)20 7770 7600