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Date: January 6 2022

Consultation Response

Which? Response to HM Treasury Consultation on *Regulation of Buy-Now Pay-Later*

Headline Messages

- Which? welcomes the opportunity to respond to HM Treasury's consultation on the regulation of Buy Now Pay Later (BNPL).

- **The proposal to regulate Buy Now Pay Later is both welcome and necessary.** While our research shows that consumers enjoy and value BNPL as a payment option, as a credit product, there is the potential risk that future payments could become unmanageable. All credit products involve some risk and although the risk for BNPL may be lower compared to other credit products, regulatory oversight of this market is needed - particularly given that our research shows consumers already think BNPL is regulated.

- **We agree with the government's objective of taking a proportionate approach to regulation.** When used appropriately, BNPL is capable of improving consumers' financial positions. We agree that regulation should seek to protect consumers without unnecessarily stifling innovation or unduly restricting consumers' access to the product. We are particularly supportive of HMT's proposed consumer protections - specifically affording consumers Section 75 rights and access to the Financial Ombudsman Service (FOS) - as consumers' access to redress is an essential part of appropriate financial protection.

- **However, the need for regulation to be introduced as a matter of urgency remains.** We were pleased with HMT's swift commitment to regulate BNPL following the Woolard Review in February 2021. However, we have concerns over the timeline for effective action, given the length of time that has elapsed so far and the market developments that continue to emerge. As well as the need for urgent regulation, we are concerned that failure of the regulation to keep up with the fast-paced evolution of BNPL could lead to avoidable detriment within the sector, deepening consumer harms while BNPL providers continue to consolidate their market shares and normalise the product's use. **The government should set an ambitious timetable for legislation, and for implementing the specified requirements.**

- **Our research provides valuable insight into the potential harms in the BNPL market.** To place ourselves in a position to seek targeted and proportionate solutions to potential harms in the BNPL market, we conducted both quantitative and qualitative research, and found that:

- The typical BNPL user has characteristics that contribute to consumer vulnerability: they are more likely to have dependent children, to have experienced a major life event, or to have defaulted on another form of credit or household bill in the last twelve months than non-BNPL users.[1]
- BNPL users are predisposed to trust BNPL brands' marketing, not interrogate firms' terms and conditions and make snap decisions when it comes to making payments.
- Some BNPL users believe they could not access alternative forms of credit at short notice.
- The proportion of BNPL users who have missed payments and the amount of debt held differs across brands within the BNPL market: consumers who use smaller BNPL providers report higher amounts of outstanding debt and are more likely to have missed a payment.
- Some BNPL brands were prepared to take action against users who have missed payments, such as reporting late or missed payments to Credit Reference Agencies (CRAs) and/or issuing debt collectors to recover missed payments. However, the measures taken by providers are inconsistent.
- There is a lack of understanding of the product: most participants did not see BNPL as a form of borrowing, instead describing it as a 'way to pay' or a 'money management tool'.[2]
- Consumers lacked engagement with the prospect that they may struggle to repay their BNPL agreement. BNPL agreements also distort consumers' views of assessing affordability, anchoring them to the instalment payment rather than the total cost of the item.

Our research suggests that adding appropriate friction to the borrowing process to ensure consumers understand the nature of the product, and the prominent provision of key information such as payment terms, late fees and how missed payments can affect future credit assessments, could help reduce potential harm.

- **While we agree that certain activities under the exemption, such as invoicing, should fall outside the scope of regulation, we feel that BNPL cannot be easily distinguished from Short Term Interest Free Credit (STIFC).** We recognise the challenges faced by the government in determining the regulatory scope of BNPL, especially given the diversity of products. However, our research has shown that the wider financial services market already makes decisions impacting consumers that cut across the proposed parameters outlined in the consultation. For example, some providers specifically target private healthcare bills, vet costs and other larger transaction items over a longer period of time. **As such, we believe the scope of the proposed regulated activities requires widening**; especially given that consumers

[1] Which? (May 2021) Under Pressure: Who uses BNPL?. Available at: https://www.which.co.uk/policy/money/7601/buynowpaylater
[2] Which? (Jan 2022) Buy now pay later: Understanding and addressing the risks to consumers, pp.11-12. Available at: https://www.which.co.uk/policy/money/8573/buynowpaylater2.

already believe that the BNPL market is regulated.[3] To only regulate part of a market where providers currently operate will increase confusion for consumers, providers and retailers, and potentially lead to harm.

- **We are concerned that the proposals as currently set out could allow BNPL providers to make small changes to their activities to avoid being covered by regulation, should they wish.** We are mindful that the regulation must be 'future proofed' and should not quickly become redundant. The proposed separation between BNPL and STIFC creates this risk. There has already been a significant proliferation of providers and offerings within the BNPL market since the Woolard Review, with expectation of further growth and expansion. As BNPL is a fast-evolving sector, the regulator will need the necessary remit to keep on top of developments to ensure consumer protections are applied consistently, and that firms are not able to side-step regulation. **We recommend that the government works closely with the FCA to ensure the regulator will have the necessary powers to regulate the market in the future, and be able to adapt swiftly to expected market changes.**

- **We urge the government to review the provider-merchant relationship within the BNPL model and to ensure the FCA has powers to continue to monitor it.** We agree that, in the first instance at least, retailers may not need to be FCA regulated - so as not to disproportionately impact SMEs. Retailers stand to gain from the provider-merchant relationship, with providers promising higher conversion rates, higher average order values, increased consumer loyalty and lower abandoned baskets at checkout when consumers use BNPL.[4] Given this, there is a risk of them prioritising their relationship with each other over obligations to offer affordable credit to consumers. This balance has already been called into question over how BNPL is being marketed to consumers and how BNPL providers are competing for business by guaranteeing higher customer approval rates. **We recommend that the government should ensure the FCA has powers to amend the obligations on retailers should current intervention, such as those relating to advertising, fail to deliver the appropriate protections.**

- **Undertaking appropriate affordability assessments is essential in mitigating potential consumer harm.** Providers are taking varying approaches when it comes to both affordability and credit risk. Appropriate affordability assessments should be undertaken to mitigate the risk of harm to consumers. Our research found a need for this, on the basis that consumers often misjudge their ability to afford BNPL agreements. We recognise that there are currently limitations in the credit information market and that other methods of assessing affordability, such as open banking, also have limitations. With that in mind, we feel affordability assessments should be outcomes-based, allowing flexibility in the approaches taken by BNPL providers. However, it is essential that when

[3] Ibid, pp.21-22.
[4] Bain & Company (2021) Buy Now, Pay Later in the UK, pp.38-39. Available at: https://www.bain.com/globalassets/noindex/2021/bain_report_buy_now_pay_later-in-the-uk.pdf.

an affordability assessment is made, all lenders are able to see an individual's exposure to all debts, and that this information is reflected on the consumers' credit file in a proportionate way**.**

- **A review of the CCA and reform to the current credit framework is required, but this should not delay the regulation of BNPL.** We welcome that HMT has recognised that aspects of the current consumer credit regulation will not be appropriate for the regulation of BNPL, and ask the government to consider reviewing the infrastructure in its totality. We welcome the recently resumed Credit Information Market Study (CIMS) that is underway, as we believe that the current CRA infrastructure is under-serving many consumers and is in need of reform.[5]

Answers to Questions in the Consultation Document

Question 1: Do you agree with our analysis of the business models that underpin the BNPL market?

Question 2: Do you have information to provide the government with a more granular and up-to-date understanding of the BNPL market?

We answer Questions 1 and 2 together.

We broadly agree with the government's analysis of the business models that underpin the BNPL market. However, BNPL is an emerging area, and new entrants and developments in the market continue to lead to further nuances in business models and a proliferation of products.

We agree that there are substantial differences across the business practices of BNPL providers, with these major inconsistencies likely contributing to the difficulties consumers face in understanding the BNPL market. In addition to the different approaches adopted by BNPL providers towards consumers in financial difficulty, there are other key areas of variance between providers' approaches to:

- Affordability checks.
- Credit risk.
- Credit limits.
- Late fees.
- Repayment terms.
- Products offered/available.

Originally, BNPL was mainly used for lower value purchases, such as fashion items. Increasingly, BNPL providers are partnering with merchants that offer big-ticket, higher value goods, driving the average transaction total up. Average order value (AOV) has recently been

[5] Update found at: https://www.fca.org.uk/publications/market-studies/ms19-1-credit-information-market-study.

reported as being between £75-£100[6] - higher than the figures set out in HMT's consultation document.[7]

We are also seeing a limited number of providers of unregulated BNPL products offering repayments due on a weekly or monthly basis. Predominantly, BNPL is offered over a period of 6 weeks, consisting of 4 equal fortnightly instalments, with the first payable at the point of purchase.

Furthermore, the growth of BNPL has accelerated during the COVID-19 pandemic, as consumers have increasingly turned to online shopping. With the reopening of physical stores, we are seeing more and more providers turning to in-store offerings. We expect to see continued innovation in this market.

As stated above, we are broadly in agreement with the current dominant business models as set out in the consultation document. However, in the course of our engagement with industry, we found many variations on the dominant business models, which we believe the government should consider when determining the scope of BNPL regulation.

Customer Led v Provider Led

A distinction should be made between transactions that are led by the consumer and the more common BNPL provider-led products. With customer led products, it is the consumer who actively seeks to use the scheme. To make a purchase under this model, the consumer must first apply with the provider directly or go through a designated portal. Provider-led products are more common, being presented and offered at checkouts, on website banners and through advertising and marketing.

Online Point of Sale (POS) vs Instore POS

Online: This is the most common version of BNPL and represents instances where BNPL is presented at online checkouts, typically embedded in e-commerce websites for a seamless customer journey. While this is the most mainstream presentation of BNPL, it is worth noting that a number of BNPL providers choose not to be present at POS.

Instore POS: This represents instances where BNPL is offered in physical stores, allowing consumers who are not making an online purchase to realise the benefits of splitting their shopping into instalments.

The customer usually requires an existing agreement with the BNPL provider and can access a portal on the provider's app to facilitate the transaction. The most common forms of in-store use generate a barcode for consumers to present at the till.

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[6] Bain & Company (2021) Buy Now, Pay Later in the UK, pp.15.
[7] On p.10 of the consultation, HMT states the average amount of BNPL transactions and agreements as being £65-£75.

It should be noted that, while in-store use is not as common as the online options, several BNPL providers are beginning to expand into that area. Regulation should anticipate growth in this area.

Virtual Cards

A potential limitation for a consumer's use of BNPL schemes is whether the provider has a pre-existing partnership with the particular retailer. As a way round this, BNPL providers are increasingly offering virtual cards. This allows consumers to spend with retailers that do not have an existing agreement with the BNPL provider.

This represents instances where BNPL is provided through the use of a generated card number linked to the consumer's account. The consumer is not limited by the need for a merchant-lender relationship and is able to make purchases directly with merchants of their choosing.

Browser Extensions

Desktop shopping has been reported as accounting for 32% of ecommerce. This model enables consumers who shop on their desktops to make use of instalment payments.

BNPL providers are beginning to embed BNPL solutions via browser extensions,[8] allowing consumers to shop more freely at online stores as this option does not require pre-existing merchant partnerships.

This model also frequently includes access to coupons and cashback offers, with some providers offering price drop notifications for saved items. Process-wise, the transaction works akin to virtual cards in that a card number is generated to pay for the online purchase.

Over the credit model

There are also BNPL models where BNPL is only offered within a consumer's existing line of credit, hence consumers need to have a credit card with available credit. The transaction amount is then ring-fenced by the BNPL provider for the entirety of the repayment period, preventing the consumer from spending beyond their existing credit limit.

Consumers are choosing to use these over the credit models, as opposed to simply making the purchase on their credit card, largely because they feel BNPL options are more disciplined in terms of repayment schedules.[9] The consumer is therefore able to make the purchase on credit, without having to worry about running the risk of paying more in interest down the line.

[8] Finextra (Dec 2021) Klarna rolls out BNPL browser extension. Available at: https://www.finextra.com/newsarticle/39376/klarna-rolls-out-bnpl-browser-extension.

[9] Which? (Jan 2022) Buy now pay later: Understanding and addressing the risks to consumers, pp.10-11.

A key benefit that these kinds of BNPL providers are citing is that this form does not have the risk of placing their customers into further debt, as they rely on existing credit lines. The detriment to the consumer is that Section 75 does not appear to apply in these scenarios, unless the provider offers a voluntary buyer protection scheme.

Evidently, the BNPL market has become much more complex. The proliferation of products on offer to consumers and the many variations of business models that have emerged has led to consumers considering all these offerings as BNPL products. It is therefore vital that these are observed as forms of BNPL, and are included in the scope of regulation.

Question 3: Do you have further analysis or evidence of consumer detriment in the BNPL market?

In the past year, we conducted quantitative and qualitative research to understand:

- Who uses BNPL credit.
- Who may be most at risk of harm in the BNPL credit market.
- Why consumers use BNPL and how it fits in with other financial options available.

Our research did not support the perception that BNPL users are typically young, female, spending on clothes and fast fashion.

Who uses BNPL credit

We used a nationally representative sample of 15,008 people to generate a statistically robust profile of BNPL users. We found that BNPL users come from a diverse range of backgrounds, but some groups are more likely to use BNPL than others. All things being held equal, we found that people were more likely to have used BNPL if they have:

- Dependent children;
- Higher incomes;[10]
- 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.

Having multiple characteristics has a cumulative effect on the consumer's likelihood of using BNPL.[11]

[10] While having an income of between £10,000 and £50,000 increases the odds someone will have used BNPL by a half (50%) when compared with someone earning less than £10,000, further increases in income also have a modest positive effect on the odds of BNPL use (14%). See Which? (May 2021) Under Pressure: Who uses BNPL?, p.16.

[11] Life events included were those used by the FCA in their categorisation of vulnerable consumers, namely: Getting married, receiving an inheritance, moving house, a 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,

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

Harms and groups who might be most at risk

Our large-scale study showed that just under a third of people have used BNPL. We found potential for harm in four key areas:

1. BNPL users hold attitudes about themselves, their finances and financial services providers which may **predispose them to trust BNPL brands' marketing, not interrogate firms' terms and conditions and make snap decisions when it comes to making payments.** These attitudes and beliefs were more concentrated among consumers under the age of 40.

2. **Some BNPL users believe they could not access alternative forms of credit at short notice,** with younger people and those with dependent children more likely to hold these views. This may suggest BNPL is providing an effective solution to households who are financially stretched, but could also mean that BNPL brands make credit available to people for whom other forms of credit are not affordable.

3. **The proportion of BNPL users who have missed payments and the amount of debt held differs across brands within the BNPL market.** Those who have used the larger, more prominent providers were less likely to have missed a payment and have higher outstanding balances than users of more niche BNPL brands. This suggests BNPL brands that service particularly unique/niche parts of the BNPL market may need to do more to support their users.

4. **Some BNPL providers were prepared to take action against users who have missed payments.** Action included reporting late or missed payments to Credit Reference Agencies (CRAs) and/or issuing debt collectors to recover missed payments. There is also evidence to indicate brands are taking different approaches in applying or enforcing their repayment terms, and it will be important to ensure that consumers are fully aware of any differences and their implications when choosing to use BNPL, or when choosing a specific BNPL provider when multiple providers are on offer.

More recently, we conducted 30 in-depth interviews with consumers who had used BNPL products in the last 12 months. Participants were asked to discuss their purchasing habits,

death of your partner, death of a child, and becoming the main carer for a close family member. See Which? (May 2021) Under Pressure: Who uses BNPL?, p.3.

experiences using BNPL, perceptions of BNPL and other debit and credit products, and their understanding of the extent of regulation within the BNPL space in a structured interview.[12] We found evidence of considerable risks:

1. **A lack of understanding of the product.**

   Most participants did not see BNPL as a form of borrowing, instead describing it as a 'way to pay' or a 'money management tool'. When prompted, BNPL users understood that the product was a form of credit, but this was not how they conceptualised it for themselves.

This misunderstanding arose from a combination of:

- The speed and simplicity of using the product;
- Low engagement with terms and conditions; and,
- An implicit assumption that safeguards were in place and that the product was already regulated.

2. **Affordability risks**

   In our research, we identified that consumers lacked engagement with the prospect that they may struggle to repay their BNPL agreement. Behavioural biases can make it difficult for consumers to accurately assess the affordability of borrowing, and without proper assessments from lenders, this is a risk of greater harm for consumers; especially given the challenging circumstances we know many BNPL borrowers are in.

Question 4: Do you have analysis that would support us in identifying which specific elements of the BNPL business model pose particular risks?

Retailer Practices

In October 2021, Which? conducted an investigation into the practices of 111 of the largest online retailers.[13] Some risks highlighted included:

- **Retailers are not always following the guidelines provided by BNPL providers.** As part of the investigation, we requested copies of the guidelines BNPL providers gave to their retail partners when the retailer first signs up with the provider, including the information retailers were asked to present to consumers. We found instances where retailers did not follow guidance on standalone information pages and/or the specific wording of risk warnings.

[12] Which? (Jan 2022) Buy now pay later: Understanding and addressing the risks to consumers, p.8.
[13] Which? (Oct 2021) Online shoppers bombarded with 'buy now, pay later' schemes. Available at: https://www.which.co.uk/news/2021/10/online-shoppers-bombarded-with-bnpl-at-the-checkout/

- **No information on key terms.** We found that many retailers did not provide information about the nature of BNPL and key terms such as approach to late fees and credit checks. In many cases, it is the retailer that is introducing the consumer to BNPL and so it is important that enough information is available for the consumer to make an informed decision to use BNPL. This must be consistent across all retailers.
- **Multiple BNPL schemes.** Almost 70% of online retailers who offered BNPL schemes presented consumers with more than one option at checkout. While the average number of schemes offered was two, some retailers had as many as 6 for the consumer to choose from. With very little information on key terms and the features that distinguish one option from the other, consumers are at risk of not being able to make the selection that best suits their needs.
- **Website ads:** We found that 3 in 10 retailers advertised BNPL on their homepage, some of which featured in prominent locations and banners which were clearly visible as soon as consumers clicked onto their website. We also found 87% of retailers that offered BNPL promoted it on their product listing pages. More often than not, key information on credit checks and late fees was not included.

<u>Retailer- Provider Relationships</u>

Providers of BNPL encourage retailers to offer BNPL by promising higher conversion rates, higher total spend and lower abandoned purchases. Our engagement with providers shed light on how, in a bid to compete with one another, some providers also took to committing higher customer approval rates. This level of pressure to perform and guarantee custom raises concern. This creates a scenario where the best interests of the consumer and that of the retailer may sometimes be in conflict. The imposition of appropriate affordability assessments is essential in managing this scenario.

<u>Provider Practices</u>

Advertising and Promotions: We have concerns over how BNPL is being marketed and promoted, and that consumers are being induced into spending more than they intended to. Our research showed evidence of consumers focussing on instalment amounts instead of total transaction amounts, causing difficulties in assessing affordability.[14] We recommend that the regulator should seek to take account of consumers' behavioural biases when designing the appropriate remedies.

Late Fees: Generally, the main revenue stream for providers is the merchant fee they charge retailers directly. However, our engagement with industry highlighted that some firms are also generating revenue from late fees, in addition to charging fees to merchants. We are concerned of the implications of profiting from inducing higher spend on the one hand, and also a consumer's inability to pay on the other. There is also an inconsistent approach by providers

[14] Which? (Jan 2022) Buy now pay later: Understanding and addressing the risks to consumers, pp.24-26.

themselves; with some charging no late fees at all, to others voluntarily capping their fees, while others have placed no such measures.

Question 5: Do you agree with our analysis of the business models that underpin the short-term interest-free credit market?

Question 6: Do you have information to provide government with a more granular and up-to-date understanding of the use of short-term interest-free credit?

Question 7: Do you have further analysis or evidence that supports or undermines our understanding that there is limited consumer detriment in the short-term interest-free credit market?

Question 8: Do you have analysis that would support us in identifying which specific elements of the short-term interest-free credit business model serve to protect the consumer from harm?

Question 9: Do you agree with the distinction between BNPL and other forms of short-term interest-free credit that has been drawn in this consultation?

We answer Questions 5, 6, 7, 8 and 9 together.

Short Term Interest Free Credit (STIFC)

We have concerns that, due to the manner in which BNPL has already evolved, it is not appropriate to separate some forms of BNPL from STIFC in the manner the consultation document proposes. We are worried that consumers will not recognise the difference between the two forms of credit.

With the emergence of BNPL, we are seeing noticeable shifts in consumers' attitudes to spending and saving, as well as a move away from the more traditional interest-bearing credit options. While STIFC was able to operate on an unregulated basis in the past, these recent shifts suggest that some forms of STIFC may well require regulation to tackle the same type of detriment seen in the BNPL market.

Which? recently investigated the impact of the use of BNPL on prospective mortgage applications. We found that the major mortgage providers who take BNPL into account tend to focus on transactions that are higher in value and over longer repayment terms.[15] This is in contrast with the part of the market that HMT intends to regulate, and suggests at the very least some forms of STIFC should be within scope. A copy of our investigation, which shows that

[15] For more detail, see: Which? (Nov 2021) Can shopping with 'buy now, pay later' schemes impact your chance of getting a mortgage?. 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/.

mortgage providers are taking lending decisions on the part of the market that the government proposes should not be regulated, is attached.

We recognise there will be some STIFC products that would continue to benefit from being unregulated and do not seek to cause unintended consequences for the relevant healthcare services, club memberships and gym memberships that stand to be affected.

Question 10: Do you have any comments on our analysis of the drivers of risk for consumers in the BNPL market?

Question 11: Do you have any suggestions on how a clear distinction could be drawn between BNPL and short-term interest-free credit?

We answer Questions 10 and 11 together.

We agree with the government's analysis of the drivers of risk in the BNPL market. However, as we have already set out, we do not think it is appropriate to draw a clear distinction between BNPL and STIFC in the manner the consultation document sets out.

Our research has shown that consumers are using BNPL for larger ticket items taken out over longer repayment periods - the types of transactions we now know some lenders are using to make decisions on affordability.[16] We understand that these purchases could fall under STIFC; the part of the market HMT is proposing does not require regulation. We feel the same harms found in the BNPL market, as set out in the consultation, will exist in these circumstances.

In our research, we saw that consumers assumed all products were regulated and that they were unable to differentiate between regulated and unregulated products.[17] We feel that a distinction between BNPL and STIFC would lead to further confusion.

A wider scope will prevent providers tweaking business practices so as to avoid regulation, which is a risk the government acknowledges to exist. It will also assist in tackling confusion by making it easier for consumers to understand what is and is not regulated; something we know to be a major cause of detriment in other areas such as investments. This is further amplified when we acknowledge that BNPL users are less financially resilient than the population average; another finding which emerged from our research.[18]

It is entirely feasible that providers will have increasing instances of having both regulated and unregulated products. We recognise that determining a clear boundary is challenging and recommend the government and the FCA work closely together to determine where scope may need to be amended to future-proof regulation. This may involve explicitly removing certain

[16] Ibid.
[17] Which? (Jan 2022) Buy now pay later: Understanding and addressing the risks to consumers, pp.21-22,27.
[18] Which? (May 2021) Under Pressure: Who uses BNPL?, pp.18-22.

STIFC products like insurance premiums and gym memberships - products not intended for scope of regulation.

Question 12: Do you have any comments on the option to draw that distinction by restricting the extension of regulation to interest-free credit agreements where there is a third-party lender involved in the transaction? What impact do you think this would have on short-term interest-free credit providers that would be drawn into regulation?

We have concerns about making a distinction along these lines. There is nothing to suggest that the evidence we have uncovered only exists because of the involvement of a third party lender. For example, harms around the framing of a transaction based on instalment repayments and not the total transaction will continue to exist, regardless of whether the credit is provided through a third party lender or not.

Such a distinction will lead to asymmetries in the market and consumers would not be able to tell the difference at the point of purchase. In addition, there is a risk that drawing this distinction could draw in part of the STIFC market into regulatory scope, as well as part of the BNPL market. This could lead to further obfuscation for consumers in the BNPL sector, especially when differentiating between products on offer.

It is easy to see why this option has been suggested as a way to determine scope, given that the popularity of BNPL has grown exponentially as a result of third party providers establishing to bring consumers to merchants over the pandemic. However, now that the known propensity for consumers to choose BNPL exists, there is a risk that merchants will turn to providing in-house solutions and avoid regulation.

Question 13: Do you have any comments on the option to draw that distinction by defining a BNPL agreement as one where there is a pre-existing, overarching relationship between the lender and consumer, under which the lender agrees to finance one or more transactions but where any repayments made are toward specific agreements made as part of that relationship?

We are unclear on the definition of this distinction. If the intention is that only pre-existing relationships are regulated, we worry that given the proliferation of products, features of products and the different ways products can be accessed, drawing this distinction will make the market difficult for consumers to navigate. As an example, this distinction does not make clear what the position would be for the instances where it is the merchant, and not the BNPL provider, who introduces the consumer to the payment option. This happens frequently online, through retailers promoting BNPL schemes on homepages or product listing pages. In this case, we are of the view that this relationship could not be said to be pre-existing. Therefore, we believe that whether there is a pre-existing relationship between the lender and consumer, or not, regulation must cover it.

Question 15: Do you agree that in any regulatory intervention merchants that offer BNPL as a payment option should not be subject to FCA regulation as credit brokers?

Question 16: If merchants offering BNPL are exempted from credit broking regulation, do you have any views on other ways to mitigate any potential risks to consumer detriment arising from merchants?

Question 17: Do you have any views on whether such an exemption from credit broking should extend to all merchants, or whether there should be limited exceptions (such as for domestic premises suppliers)?

We answer Questions 15, 16 and 17 together.

In the course of engaging directly with BNPL providers, we learned that the majority of their partnerships are with SMEs. We learned that 68% of commercial start-ups offering BNPL would cease to do so if there was additional compliance introduced.[19] We therefore consider that it would be disproportionate to require all merchants to be subject to FCA regulation as credit brokers at this stage, due to the potential impact on consumer choice.

Our recent investigation found instances where retailers were not following guidelines given by BNPL providers and did not display recommended risk warnings relating to the potential risks of BNPL.[20] This is particularly detrimental to consumers where the retailer is the one introducing the consumer to the BNPL line of credit.

If the financial promotions regime is extended to BNPL, we understand that retailers will need to get any promotions approved by an FCA authorised person, if not authorised themselves. On this basis, we think that retailer obligations in most circumstances have the potential to be managed without requiring them to be FCA regulated. It would therefore be disproportionate for credit brokerage rules to apply to all retailers. However, if it turns out that the rules on financial promotions are not effective or effectively enforced, this exemption should be reviewed.

We do recommend however that the government give consideration as to whether there is an appropriate threshold whereby major retailers should be regulated as credit brokers.

Question 18: Do you think that the current requirements on BNPL merchants and lenders around advertising and promotion are sufficient?

Question 19: If you think that the requirements need strengthening, would the application of the financial promotions regime be appropriate, or are there any features specific to BNPL products that warrant different requirements?

We answer Questions 18 and 19 together.

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[19] Coadec (July 2021) Regulate Credit Now, Reform it Later, pp.11-13. Available at: https://coadec.com/wp-content/uploads/2021/07/Regulate-Now-Reform-Later-July-2021.pdf
[20] Which? (Oct 2021) Online shoppers bombarded with ‘buy now, pay later’ schemes.

We welcome the application of the financial promotions regime on BNPL merchants and lenders as we have concerns that the current requirements have not been sufficient thus far.

ASA guidance stipulates that it must be made clear to consumers that BNPL is a form of credit. [21] However, our research has shown that consumers do not see BNPL as such, instead referring to it as a 'money management tool' or a 'way to pay'. This suggests that the effectiveness of the remedies already in place need to be strengthened.

There have been rulings against BNPL providers' approach to advertising,[22] and while we commend the proactive approaches taken by some providers to form a social media council that creates self-regulatory guidelines to advertising on social media, it is critical that there is consistency across the market.[23]

In our investigation of online checkout practices, we found evidence of retailers incentivising the use of BNPL schemes by offering free delivery.[24] We found evidence of consumers being inundated with various BNPL options at the checkout, with little to no explanation of the key differences between providers. The order BNPL appears in at the checkout has also been called into question. We ask the government to review how merchants decide the order of BNPL options, to ensure that any promotions in this regard are made clear to consumers.

Question 20: Do you agree that the approach to pre-contractual information outlined is consistent with a proportionate approach and the government's objectives for BNPL regulation?

Question 21: Do you agree with the government's assessment that BNPL agreements are likely to need bespoke form and content requirements?

Question 23: What are your views on applying CCA provisions on improper execution to BNPL agreements? Do you think the consequential sanctions for improper execution should apply to BNPL agreements under any regulatory intervention?

We answer Questions 20, 21 and 23 together.

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[21] Committee of Advertising Practice (Dec 2020) Guidance on advertising delayed payment services. Available at: https://www.asa.org.uk/static/dcb7c4f7-82f8-458b-98a4ef02d298f470/Guidance-on-advertising-delayed-payment-services.pdf

[22] In December 2020, the Advertising Standards Agency (ASA) banned several Klarna advertisements promoted by 4 Instagram influencers, concluding that in the context of the challenging circumstances caused by the Covid-19 lockdown, and the impact it has had on people's financial situation and mental health, the adverts irresponsibly encouraged the use of credit to improve people's mood. The adverts were ruled to have breached Committee of Advertising Practice (CAP) guidance. See FCA (2021) The Woolard Review, p.48, available at: https://www.fca.org.uk/publication/corporate/woolard-review-report.pdf & ASA (2020) ASA Ruling on Klarna Bank AB, available at: https://www.asa.org.uk/rulings/klarna-bank-ab-a20-1081031-klarna-bank-ab.html.

[23] Klarna introduced their 'Influencer Council' in March 2021, in order to develop "a best practice guide for influencers and brands advertising online and to help shape responsible marketing practices for the financial services sector." See Klarna (2021) Klarna 'Influencer Council,' p.3. Available at: https://www.klarna.com/assets/sites/3/2021/08/03165528/7527-KLA-Influencer-Council-Whitepaper_AW4_Web-02.08.21.pdf

[24] Which? (Oct 2021) Online shoppers bombarded with 'buy now, pay later' schemes.

We welcome the government's proportionate approach to pre-contractual information and we agree that BNPL agreements are likely to require bespoke form and content requirements due to the nature of BNPL.

It is important that the provisions on improper execution apply to BNPL so that providers appreciate that failing to follow the necessary requirements would mean the agreements could not be enforced. We believe this deterrent will serve BNPL products well.

Our research demonstrates that there are risks to BNPL consumers, stemming from consumers' understanding of the product, which is in turn shaped by structural features of the market. Our findings show 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 research shows that consumers simply do not believe that it can be so simple to take on debt given their experiences of applying for other credit products like credit cards.[25] 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 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 over 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,[26] 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. 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

[25] Which? (Jan 2022) Buy now pay later: Understanding and addressing the risks to consumers, pp.22-23.
[26] Ibid, pp.20-21.

payment terms, late fees and how missed payments can affect future credit assessments should be clearly presented.

More generally we note the power contained in Section 37 of the Financial Services Act 2021, and acknowledge that not all provisions of the CCA will be appropriate in relation to the regulation of BNPL agreements, but we will closely monitor any divergences in the protections given to consumers.

Question 24: What are your views on the role of creditworthiness assessments as part of a proportionate approach to BNPL regulation?

Question 25: Do you have any views on whether there should be specific requirements for creditworthiness assessments for BNPL agreements?

Question 26: Do you have any views on how BNPL agreements should be reported to consumers' credit files?

We answer Questions 24, 25 and 26 together.

We consider appropriate affordability assessments to be a crucial part of a proportionate regulatory regime. We understand from our engagement with industry that this is not always carried out by providers - with some instead opting to start consumers with low credit limits and then extending this over time, while others are performing hard checks on individual transactions, a practice our recent findings showed could impact consumers' ability to take out a mortgage.[27] We do not consider this practice to be sustainable. Our research clearly showed that consumers are not able to assess affordability when using BNPL and so it is imperative that providers are doing so.[28]

We know that credit checks alone do not provide a full sense of a consumer's ability to afford the credit extended. Therefore, given the limitations of the current CRA infrastructure, we are of the view that at this stage, the focus should be outcomes-based, rather than prescribing specific requirements. Open banking could help bolster affordability checks by providing BNPL providers with a more accurate assessment of a potential user's finances, using transactional analysis and account data. It could also serve to extend access and widen financial inclusion. However, open banking itself has limitations - offering only a partial view of a consumer's finances. Open banking offers the sight of one transactional account, meaning it can fail to get a holistic picture of a household or consumer's finances, and many consumers are still nervous about sharing financial data in this manner.

Some BNPL providers are already using a combination of open banking and CRAs to assess creditworthiness. However, the various approaches taken by lenders within the market has left consumers unsure about the impacts of checks on their credit file, and whether checks are

[27] Which? (Nov 2021) Can shopping with 'buy now, pay later' schemes impact your chance of getting a mortgage?.
[28] Which? (Jan 2022) Buy now pay later: Understanding and addressing the risks to consumers, pp.23-26.

being carried out at all. Hence, there must be greater consistency in approach. Whatever approach to creditworthiness is deemed acceptable, it is essential that when an assessment is made, all lenders are able to see an individual's exposure to all debts, and that this information is reflected on the consumers' credit files in a proportionate way.

While a more consistent creditworthiness approach within the market is needed, work is also needed to modernise the framework to accommodate BNPL as a new form of credit. As an example, BNPL agreements paid on time could help to boost the files of those with thin files/ lower credit scores. This is particularly relevant for consumers who are new to credit and start off with using BNPL - a credit building facility could assist with larger loans and mortgage applications in the future.

The government should continue to engage with industry and CRAs, and be in a position to facilitate the sharing of best practice and guidelines. Our engagement with CRAs has shown there is the capability for more sources to be pooled together to provide a more holistic view of a consumer's financial position. We ask that the government sets out a clear timeline for the further work, given the impact it will have on the line of visibility of BNPL agreements in the interim**.**

Question 27: Do you have any views about how customers in financial difficulty should be treated under BNPL agreements?

It is key that BNPL providers treat customers in financial difficulty consistently. We recognise that other financial areas have required some adaptations to the FCA rules in this regard. We await further information as to which aspects may require adaptation for BNPL products.

Question 28: What are your views on the proportionality of applying CCA provisions on arrears and defaults to BNPL agreements?

It is key that BNPL providers operate consistently when it comes to arrears and defaults, and that consumers are given appropriate signals to prompt them to take action. We believe that the prescribed form and content can be applied to BNPL agreements without being disproportionate.

Question 29: Do you agree that under any regulatory intervention for BNPL, Section 75 of the CCA should apply to agreements?

Question 30: What are your views on amending the scope of the exemptions from elements of the CCA for small agreements to include BNPL agreements under £50.

We answer Questions 29 and 30 together.

It is essential that Section 75 should apply to BNPL. Many providers actively promote their products by making direct comparisons to the use of credit cards. With this in mind, affording

Section 75 rights enables consumers to benefit from the same protections they would have had were they to have made the purchase through a credit card.

Consumers are able to pay for BNPL instalments with their credit card. There are also providers whose models mean that their BNPL offerings sit on top of existing credit. Given the concerns regarding the scope and the proliferation of products, navigating Section 75 protections could become further complicated still.[29] It will need to be clear where the consumer can turn for redress in these circumstances to avoid situations where both the BNPL provider and the credit provider fail to act.

As we set out earlier, BNPL is a complicated market that is not easy for the consumer to navigate. Currently, when credit card payments are made through an agent or a third party, Section 75 may not apply. The terms of Section 75 protections will therefore need to be explicitly set out and should cover all forms of BNPL, including those referred to as third parties.

Question 32: Do you agree that under a regulatory intervention for BNPL, consumers should be able to bring a complaint to the FOS?

We agree that consumers should be able to bring complaints to the FOS. Our research showed that consumers already expect this level of redress given that BNPL is a form of credit.[30]

We believe this will provide a truly independent avenue for consumer redress. The exposure and correction of unsavoury practices will also serve to shape and drive consistencies within the BNPL market.

Question 33: What impacts do you expect the regulation of BNPL would have on BNPL providers, consumers that use the product, and merchants that offer it as a payment option?

We anticipate the following:

- More providers will operate responsibly, have greater clarity on regulatory obligations, engage further with CRA data and increase the monitoring of their merchant partners. We are already seeing providers tightening up creditworthiness assessments of their own volition, in readiness for regulation.
- Consumers will be better protected against making unaffordable purchases, be treated more consistently when in financial difficulty, be enabled to make more informed decisions to use BNPL and be better protected against aggressive marketing and promotions. This could lead to increased consumer confidence in using BNPL.
- Merchants should have increased confidence that consumers making purchases via BNPL are able to afford them, and while merchants may see a fall in customer approval rates due to tightened affordability assessments, credit should only be extended when it is appropriate.

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[29] Coadec (July 2021) Regulate Credit Now, Reform it Later, p.7.
[30] Which? (Jan 2022) Buy now pay later: Understanding and addressing the risks to consumers, pp.21-22.

About Which?

Which? is the UK's consumer champion. As an organisation we're not for profit - a powerful force for good, here to make life simpler, fairer and safer for everyone. We're the independent consumer voice that provides impartial advice, investigates, holds businesses to account and works with policymakers to make change happen. We fund our work mainly through member subscriptions, we're not influenced by third parties and we buy all the products that we test.

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January 2022