



Regulation of Buy-Now Pay-Later – Consultation

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HM Treasury has [published](#) its much-anticipated consultation on the Regulation of 'Buy-Now Pay-Later' products (Consultation). This action was launched in response to the concerns and recommendations raised in the Woolard Review, which (amongst other topics) considered potential consumer detriment in relation to the unregulated Buy-Now-Pay-Later products (BNPL), which are currently exempt from regulation. The Consultation proposals seek to strike a balance between ensuring consumers have appropriate protection, and access to useful financial products. The prospect of further regulation for BNPL will have consequences for merchants, third-party BNPL finance providers, and the consumer.

BNPL vs Other Short-Term Interest-Free credit

The Consultation focuses on two agreement types: (i) BNPL and (ii) other more traditional short-term interest-free credit.

For the purposes of the Consultation, it is important to know and understand how the Consultation defines BNPL. It describes the current most common type of BNPLs allowing a consumer to enter into an agreement with a third-party BNPL finance provider (BNPL Provider) to split the cost of a purchase from a merchant into equal amounts taken at regular intervals, while the BNPL Provider remits funds to the merchant, minus the merchant fee. Alternatively, it looks at BNPL taking the form of a simple deferred payment, whereby a lender provides a period of time in which a customer does not have to pay, with payment then taken from the customer's account a set time after the purchase is made, and only then, if the item is not returned by the customer.

These forms of arrangements are different to other available short-term interest free credit (SIC) financial arrangements, which fall under the same exemption from regulation. SIC can be divided into two types: (i) those where merchants themselves extend credit in order to offer payment by instalments, and (ii) arrangements where an independent third-party lender provides credit to consumer. The Consultation considers examples such as formal interest-free instalment loans, repayable in under a year, such as for items like white goods, electronics, furniture and dental procedures, and those allowing monthly payments for club memberships and season tickets.

Risk of Consumer Detriment

The Consultation takes place in the context of growth in use of BNPL in purchases of lower-value consumer goods particularly attributable to COVID-19 buying patterns where online purchases have increased.

The Woolard Review highlighted concerns that aspects of BNPL agreements are likely to present a greater risk of consumer detriment than other financial agreements which are currently exempt from regulation.

As highlighted in the Woolard Review, some of the potential sources of consumer detriment identified include (i) how the product is promoted to consumers and presented as a payment option, (ii) misunderstanding of the product by consumers, and the absence of information to consumers about key features of the agreement (iii) the absence of any requirements to undertake creditworthiness assessments, (iv) the potential to create high levels of indebtedness, (v) inconsistency of treatment of customers in financial difficulty and (v) impacts on the wider credit market including little visibility of BNPL debts on an individual's credit file.

The Consultation recognises that to date, evidence of wide-scale of consumer detriment has not materialized. The Consultation is attempting to draw the scope of regulation to those aspects of the BNPL model which are most likely to be linked to consumer detriment.

Scope of New Regulation

The Consultation seeks to emphasise the importance of the requirement to impose regulatory controls on BNPL agreements. However, it is difficult to define the scope of regulations given the overlapping characteristics of BNPL and other SICs. SICs share some, but not all, of the potential risks for consumer detriment as BNPL, especially when it is a third-party that provides the credit.

SOME PROPOSED OPTIONS TO SCOPE THE NEW REGULATION INCLUDE:

- restricting the extension of regulation to short term interest-free credit agreements where there is a third-party lender involved in the transaction, and keeping arrangements directly between a merchant and a consumer exempt from regulation; or
- 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 on a fixed sum credit basis.



Proportionate Regulatory Controls for BNPL

The Consultation recognises that the risks of BNPL agreements are “inherently lower than an interest-bearing credit product” and that over-regulation can limit consumer choice and innovation. Therefore, this Consultation aims to develop a proportionate approach to ensure that:

- BNPL activities are subject to an intervention which is proportionate to the level of risk that they present and is not burdensome;
- Consumers are adequately and fairly protected from detriment and can access dispute resolution;
- Regulation for BNPL does not adversely impact competition and innovation; and
- Small and Medium Enterprises (SMEs) are not disadvantaged over larger merchants.

The table below illustrates the existing regulatory framework and the proposed changes as discussed above.

KEY REGULATORY AREAS	POTENTIAL HARM TO CONSUMERS	CURRENT REGULATORY FRAMEWORKS	PROPOSED CHANGES FOLLOWING REGULATION OF BNPL
Application of credit broking regulation	Credit broking is considered a lower risk activity where a business' main trade is not the provision of financial services.	Merchants that offer BNPL and SIC agreements are not treated as credit brokers under current regulatory frameworks.	A merchant that brokers BNPL credit would not be subject to regulation as a credit broker.
Financial Promotions	Current levels of advertising and promotion do not give consumers an opportunity to properly consider if they can afford the financial commitment.	Not all forms of BNPL are subject to the financial promotion regime. Some existing requirements of advertising and promotion are monitored by the Advertising Standards Authority, and the Consumer Protection from Unfair Trading Regulations 2008.	BNPL agreements would fall within the financial promotions regime.

KEY REGULATORY AREAS	POTENTIAL HARM TO CONSUMERS	CURRENT REGULATORY FRAMEWORKS	PROPOSED CHANGES FOLLOWING REGULATION OF BNPL
Pre-contractual Information	BNPL providers can provide pre-contractual information in a form of their choosing. This poses a risk that important information is not given sufficient prominence.	Pre-contractual information for regulated credit agreements is prescribed in Consumer Credit Act (“CCA”).	Information prescribed in CCA would not apply to BNPL; rather FCA rules would apply, subject to any relevant amendments, to make sure there is “adequate” pre-contractual information in place in order for the customer to assess whether the agreement is right for them. This would include payment amounts, potential significant adverse effects of the agreement and consequences of failure to pay on time.
Form of credit agreement	Transparency and customer understanding considerations.	Mandatory form and content rules under the CCA and regulations.	Develop bespoke legislation appropriate to the characteristics of BNPL e.g. risks and the way it is used.
Creditworthiness Assessments	No checks on the risks to lenders that the customer will not repay the credit, or the customer is able to afford the repayments without a detrimental impact.	FCA rules require lenders to undertake creditworthiness assessments of borrowers before entering into a regulated credit agreement, or before significantly increasing credit limits.	FCA’s current rules on creditworthiness assessments will be applied to BNPL agreements, subject to FCA consideration of proportionality ; and requirements for clear and consistent credit reporting by the BNPL Providers would be implemented.
Arrears, Default and Forbearance and treatment of consumers in financial difficulty	Lack of consistency and clarity as to how BNPL providers treat customers who have missed payments.	Regulations around post-contractual information on arrears and defaults apply to regulated firms. There are currently no requirements on BNPL providers as to how they should treat customers in financial difficulty or communicate with customers who have missed payments.	Introduce some of the FCA requirements around how firms treat customers in financial difficulty and how they should communicate with borrowers that have missed payments, such as notices or notice periods for BNPL.
Improper Execution	An agreement which is not properly executed becomes unenforceable by the lender, unless the lender obtains a court order.	The CCA sets out the requirements for a properly executed credit agreement, and the consequences of improper execution.	Introducing the CCA’s requirements for proper execution into the BNPL regulatory framework would give customers greater opportunity to consider whether credit agreements meet their needs.
Section 75 Consumer Credit Act	It is unclear what protections are in place for consumers in the circumstance of a breach of contract or misrepresentation.	For some types of debtor-credit-supplier credit product, creditors are jointly and severally liable for suppliers’ breach of contract or misrepresentation Some BNPL providers provide their own buyer protection scheme.	There is a view that a statutory protection could apply as part of regulation of BNPL to be in line with other regulated credit agreements.

KEY REGULATORY AREAS	POTENTIAL HARM TO CONSUMERS	CURRENT REGULATORY FRAMEWORKS	PROPOSED CHANGES FOLLOWING REGULATION OF BNPL
Small Agreements (A regulated consumer credit agreement for credit not exceeding GBP50, other than a hire-purchase or conditional sale agreement)	The average BNPL payment is under GBP50 – GBP75, and would be classed as a small agreement. Small agreements do not qualify for the protections provided by the CCA.	CCA protections for consumers would not apply to many BNPL agreements under any regulatory intervention	The scope of section 17 of the CCA could be narrowed, so that CCA requirements apply to BNPL agreements under GBP50.
Financial Ombudsman Service	Customers have no official complaints or redress process.	Some BNPL providers have a complaints process, separate from a customer services team, but not all.	Consumers should be able to access the FOS for issues concerning the conduct of lenders. Available to consumer to help resolve disputes between financial services firms and claims management companies as an alternative to the courts.

Key Points to Note

KEY POINTS FOR BNPL PROVIDERS

- The Consultation attempts to strike a balance between the risks of overregulation, restricting innovation and disrupting competition. It recognizes that BNPL finance agreements have a role to play and can be an attractive offering to the consumer
- However, to mitigate against the prospects of detriment to consumers:
 - the Financial promotions regime may apply;
 - the FCA may prescribe pre-contractual information to be provided to consumers;
 - bespoke legislation on the form and content requirements is proposed for BNPL agreements;
 - the FCA's current rules on creditworthiness assessments may apply to BNPL agreements; and
 - Requirements around how firms treat customers in financial difficulty may be introduced.
- A significant (and costly) development is the prospect of FOS access for BNPL related customer complaints. Currently the FOS charges each respondent to a FOS complaint, GBP750 per complaint (from the 26th complaint submitted onwards). Is that a feasible complaint charging mechanism given the acknowledged average value of a BNPL transaction is between GBP50 – GBP75? Firms may want to consider offering in consultation feedback a more balanced and standardized customer complaint dispute mechanism process.

KEY POINTS FOR MERCHANTS

- It is proposed that merchants that do not extend credit but make third party BNPL products available to customers be exempt from the full scale of proposed regulation, as it is recognized that with regulation, can also come increased authorization, reporting and financial burdens which would be difficult to implement by SME businesses, but more capable for larger merchants, creating the potential for imbalanced trading advantages.
- However, caution is necessary as the Government may require the merchant to improve its notifications and advertising so that the consumer is fully aware that they are using a BNPL Provider.



Next Steps

While the government considers BNPL Agreements a potential source of consumer detriment, the Consultation shows that *"there is relatively limited evidence of widespread consumer detriment materializing at this stage"*. It suggests that the BNPL be subject to regulation that is *"proportionate"* but not *"so burdensome that it inhibits the product being offered, or reduces consumer choice"*.

The precise content of regulatory requirements and scope of changes is not yet clear.

The Consultation suggests that a bespoke approach to BNPL Agreements would be more appropriate than imposing the CCA provisions in their entirety.

The Consultation closes on 6 January 2022. It will be followed by proposals and steps for regulation. An FCA consultation on relevant rules would follow although no timetable has been specified.



Contacts

For further information on how the BNPL Regulation may impact your business or if you would like to discuss any of the above, please contact Sophie Lessar or Leontia McArdle.



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