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StepChange Debt Charity response to HM Treasury consultation on Regulation of Buy-Now Pay-Later

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Introduction

StepChange Debt Charity is the largest specialist debt advice charity operating across the UK. In 2021, 500,000 people contacted us for advice and information on problem debt. We welcome this consultation on unregulated buy-now pay-later (BNPL) products.

The utility of BNPL as a means of no-cost income-smoothing is valid; existing credit models such as credit cards and retail revolving credit (now largely online) lead many consumers to make retail purchases that slip into expensive long-term debt that can cause and compound financial difficulty. StepChange has argued that regulation should require higher minimum repayments to shift the balance towards prompt and affordable repayment. While we do not yet know enough about BNPL to draw definitive conclusions, it is plausible that BNPL is providing a positive benefit to some consumers by providing a safer and lower cost alternative to revolving credit, in addition to any wider value it has to consumers as a form of deferred payment.

This noted, our experience as a debt advice provider means that we are also acutely aware that even interest-free credit not only can, but often does, cause financial difficulty. BNPL is marketed, embedded in the online retail journey and presented in ways that exploit consumer behavioural bias and has the potential to exploit consumer vulnerability. BNPL customers tend to be younger and have less experience with financial products; effective marketing has normalised BNPL credit as a means of payment (rather than what it is: a form of credit), and there is little friction to prevent consumers accumulating significant credit balances through cumulative BNPL borrowing.

The size and impact of BNPL in the retail market is being driven at least to some degree by a 'race for growth'. Economic commentators have noted that this investment is likely to have been made with a view to acquiring a large customer base and future business models such as operating an e-commerce platform.[1] The value of customer acquisition may have affected the willingness of firms to knowingly or otherwise engage in practices that are detrimental to consumers, such as relatively relaxed approaches to creditworthiness and affordability assessments.

StepChange conducted a public polling exercise in October 2021 to support a separate piece of research into borrowing among those in financial difficulty. We have set out relevant insight from that exercise in this response. While we do not have evidence to state that BNPL is *causing* significant financial difficulty, it is clear from our evidence that BNPL products are used by people *in, or at risk of*, financial difficulty. BNPL must therefore operate in a way that protects these consumers against

[1] 'Is "buy now pay later" a viable business model?', Kelly, J., Financial Times 21 October 2021.

avoidable harm. With these factors in mind, we support the government's decision to bring BNPL within the scope of financial services regulation and agree that this is a proportionate and necessary step. In this response, we set out our initial views on the design of regulation.

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

We broadly agree with the analysis and have no further comment at this time.

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

StepChange commissioned a representative national survey in October 2021 to support research into patterns of credit use. We asked respondents about specific BNPL products to avoid conflation with other forms of credit. We found that:[2]

- 10% of GB adults report holding one or more BNPL debt; 30% of those with a BNPL debt have two or more loans and 14% three or more.
- 87% of those who hold a BNPL debt also have at least one other type of consumer credit product with an outstanding balance.
- BNPL borrowers tend to be younger, with an average age of 44 compared to 51 among those who hold any credit product.
- 12% of women hold a BNPL loan compared to 8% of men.
- 15% of those in a minority ethnic group hold a BNPL loan compared to 10% of those who report a white ethnicity.
- Half (49%) of those with a BNPL loan say they find it difficult to keep up with household bills and credit repayments (compared to 30% of GB adults), rising to 59% among those with two or more BNPL loans.
- 32% of those who hold a BNPL loan are receiving one or more means-tested social security payments. This compares to 18% of those who hold any credit product with an outstanding balance.
- 23% of those who hold BNPL are 'safety net borrowers'. (This means they have recently borrowed to pay bills, make credit repayments or make it through to payday.) This compares to 12% of those who hold any credit product with an outstanding balance.

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[2] All figures are from YouGov Plc. Total sample size was 5,028 adults. Fieldwork was undertaken between 20th - 24th October 2021. The survey was carried out online. The figures have been weighted and are representative of all GB adults (aged 18+).

- 17% of those who hold BNPL debt meet our definition of severe financial difficulty. (This means they are showing three or more signs of financial difficulty.)[3] This compares to 9% of those who hold any credit product and 6% of all GB adults.
- 40% of those with a BNPL loan have taken negative coping actions to keep up with credit repayments in the last 12 months, including using credit to repay credit, falling behind on housing payments or utility bills, asking family or friends for help or cutting back to the point of hardship. This compares to 21% of those who hold any credit product with an outstanding balance.
- 39% of those with BNPL debt report that credit has recently had a negative impact on their health, relationships or work. This compares to 22% of those who hold any credit product with an outstanding balance.

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

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

Broadly, the profile of BNPL consumers appears similar to those who use other retail credit products such as online catalogue credit and store cards. That is, many BNPL consumers have characteristics of financial vulnerability and there are good reasons to think many BNPL users are motivated by reasons other than 'try first pay later'. The popularity of BNPL among a group of financially vulnerable consumers is a mark of utility of interest-free income smoothing for low value payments; however, it also indicates the potential of the products to contribute to detriment arising from over-indebtedness and unaffordable repayments.

StepChange is able to offer insight in light of our experience as a debt advice provider supporting clients struggling with problem debt. Considering the BNPL consumer journey as a whole, we see a number of potential sources of detriment and risk:

- BNPL products are marketed to consumers who are more likely to be younger and have less experience of financial products and/or have other characteristics of financial vulnerability such as low disposable income or savings that mean they are exposed to repayment

[3] We asked respondents if they experienced any of the following in the last 12 months: using credit, loans or an overdraft to make it through to payday; making just the minimum repayments on debts for three or more months; getting hit by late payment or default charges; missing a regular monthly payment on at least one debt; getting hit by overdraft charges on a regular basis; falling behind on essential household bills; using credit to keep up with existing credit commitments; and using credit to pay essential household bills.

difficulty. The products are also marketed in a way designed to normalise credit use. Effective marketing to vulnerable consumers with, at present, few regulatory checks, creates a clear potential for unaffordable borrowing.

- BNPL products are often placed more prominently (for example, listed and highlighted on product listings) and embedded in the checkout process more prominently than credit payment options have tended to be in an online retail context. This integration of credit and shopping serves as a powerful and apparently effective inducement to use BNPL products in a way that poses a challenge to existing regulatory approaches to credit inducements.
- Consumer understanding of BNPL can be limited, with evidence some consumers do not understand when payments will be taken (or must be made) and low awareness that the products form a credit agreement and of the consequences if repayments are missed. There appears to be substantial variation in the timing and mechanics of payment among firms that are grouped together by merchants (i.e. presented as comparable), heightening the potential for confusion.
- The growth model of BNPL firms means that there are strong incentives for firms to lend to acquire customers, with the value of growth potentially outstripping concerns about the cost of late repayment or losses through debt write-off. This does not, however, mean that consumers who struggle to repay experience no detriment, which may arise through coping actions such as further borrowing, missing bills, cutting back to the point of hardship or seeking support from family or friends; through the negative impact of unaffordable debt on health, relationships and work; and through continued repayment pressure if debts are sold on to collection agencies.
- BNPL is, by design, a low-friction credit product. This is true both in the sign-up process and with subsequent purchases. Ample literature on consumer behavioural bias tells us that consumers are likely to be over-confident and over-estimate their ability to repay loans affordably.[4] We see evidence of this among StepChange clients: for example, in a recent survey of clients, 24% of clients who had recently used BNPL products reported that doing so had caused them to spend more than they had meant to.[5] Certain BNPL products bear comparison to revolving credit in that, following sign-up, customers are allocated credit limits that can be increased over time. Just as the revolving credit model is central to over-

[4] Financial Conduct Authority (2013) *Occasional Paper No.1: Applying behavioural economics at the Financial Conduct Authority*

[5] We surveyed StepChange clients who first contacted the charity in 2021. The survey was conducted online and a link was sent to a representative sample of clients. The base for this question is 362.

indebtedness and harmful debt journeys for many of our clients, there is potential for problems of a similar nature to arise through BNPL.

- When firms lend to customers they engage in a mutual contract and accept their responsibility to treat customers fairly in the event of repayment difficulty. Regulation sets minimum standards but in BNPL there are indications of unclear or inconsistent forbearance policies. While we note the most prominent providers have reduced or waived late payment fees, this does not mean practice may not change in future should incentives for firms change (for example, if they are more concerned about recouping costs than acquiring customers).

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

We have no comment at this time.

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?

We have no comment at this time.

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?

We have no comment at this time.

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?

We have no comment at this time.

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 have no comment at this time.

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

We would add that BNPL firms have different objectives and incentives to short-term interest-free credit providers, such as customer acquisition and rapid growth. This can drive higher risk lending because the long-term value and benefits to firms of lending (reaching and acquiring new customers) outweigh the risks and cost of defaults. In turn, BNPL may carry a higher risk of financial difficulty than superficially similar short-term interest-free credit products.

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

We have no comment at this time.

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?

This approach appears most likely to be effective in providing a sustainable regulatory solution for the most common BNPL business model. However, we recognise the complexities involved in light of the variety of BNPL business models and that it may be the case that there is no single approach that will work for all models. We do not have special insight into the short-term interest-free credit market; however, we agree most firms affected are well-placed to adapt to FCA 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 have no comment at this time.

Question 14: Do you have any views on the need to amend the current exemption for running-account credit, so that it does not allow the unregulated BNPL model to re-emerge?

We agree with the government's analysis that any option to bring BNPL agreements within the scope of regulation must be supported by an amendment to 60F(3) to ensure BNPL products do not remain in, or transition to, an unregulated form.

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?

We accept this approach is proportionate, with the caveat that the BNPL model means merchants make important decisions about the placement and framing of BNPL credit. We understand that it would remain possible to ensure these decisions are subject to proportionate constraints and good practice through the financial promotions regime.

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?

Please see our response to question 18.

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)?

In the past, there have been examples of merchants conducting harmful 'hard sales' of goods on credit on the doorstep. As there is no new evidence to suggest these risks do not exist, we would strongly argue against new exemptions where the potential for consumer harm is very different than the risks that arise from BNPL.

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

BNPL firms are clear that their products increase merchants' sales. While this might arguably stem from value factors for consumers, as we note in our response to question 4, our own and wider evidence suggests that BNPL also causes people to spend more than they intend. Past regulatory interventions have recognised that retail environments create consumer vulnerability and sought to mitigate that vulnerability, for example with proscriptions against offering discounts as an inducement to take out store card credit.[6] This good practice has fallen into abeyance as retail credit has become digitised. Online retail credit, including BNPL, needs a set of refreshed good practice principles reflecting new products that operate in new contexts and pose new benefits and risks to consumers.

The FCA should, in particular, use the financial promotions regime to ensure that merchants do not embed BNPL in the retail journey or checkout process in a way that exploits consumer vulnerability or behavioural bias. The government and the FCA should pay particular attention to the placement of BNPL products by online merchants. Credit products are rarely (if ever) embedded as the default payment option in the same manner as BNPL, nor placed with such prominence in the checkout process. Consumers should always need to actively choose credit and make a considered decision

[6] See section 2C.3 of the Financial & Leasing Association Lending Code 2021, a voluntary agreement by industry not to offer retail discounts as an incentive to take out credit which was first put in place following the 2011 HM Treasury and Department for Business, Innovation and Skills Personal Credit and Personal Insolvency Review.

to do so; this is not just a matter of product information and disclosures, but of a retail journey that, by design, helps protect vulnerable consumers against behavioural bias.

More generally, in our experience, the ASA regime has not proved effective of itself in preventing bad practice in marketing of financial services (for example, in stopping misleading online ads by debt solution lead generators). Well-articulated FCA powers, and effective use of the financial promotions regime, is therefore an important safeguard against bad practice for financial services products.

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?

Please see our response to question 18.

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?

We are satisfied with the government's proposed approach with the caveat that consumer protection objectives should be clearly articulated to guide an alternative approach. We would be concerned should the CCA requirements be disapplied without a clear framework to achieve the aim of these disclosures through a more tailored approach.

We also note that BNPL exemplifies the reasons the CCA communications framework is in need of updating for the modern, digital credit market; ideally the framework itself would be updated, and made more flexible where appropriate, so that there remains a consistent cross-market approach, albeit applied as appropriate to individual products. We would welcome an update on the government's intentions following the recent FCA review of the CCA retained provisions.

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

We agree and have no further comment at this time.

Question 22: Do you have any views on what form agreements for BNPL should be required take, and what content they should contain?

BNPL agreements should be readily understandable with sufficient friction (and time) for consumers to consider the main terms before accepting the agreement. The manner in which, to-date unregulated, BNPL agreements have been carefully designed by firms taking into account extensive testing and design work illustrates a serious weakness in the current regulatory framework, which is that while elements of the consumer journey driven by firms are extensively developed taking into account behavioural evidence, the elements of that journey that are most important to consumer protection are not. Form and content agreements should be driven by evidence of what works to achieve good outcomes for consumers; as part of its work to develop rules and guidance, we would like to see the FCA develop and test approaches to BNPL form and content agreements with consumers.

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 believe the CCA provisions on improper execution, and consequential sanctions, should apply to BNPL agreements. These are arguably appropriate even to small sum agreements but, given the substantial value of some BNPL loans, it would appear inconsistent and not in the interests of consumers to exempt BNPL from these provisions.

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

Effective affordability and creditworthiness assessments are crucial to ensure credit plays a socially and economically positive role. BNPL appears to pose a unique challenge because consumers may access multiple small loans with multiple firms. This means there is no one size fits all solution based on the amount of a loan. If firms apply blanket policies based on the value of a loan, there will not be an effective check on lending that causes harm to consumers. Equally, we recognise the challenges of proportionality that BNPL presents in the context of credit reporting arrangements that make it difficult to offer interest-free small sum loans on an economic basis where a full credit record agency check is undertaken. We would like BNPL firms to work with one another and credit reporting agencies to ensure real time visibility of outstanding BNPL agreements and mitigate this problem.

The FCA's current creditworthiness and affordability rules and guidance (set out in CONC 5) already provide for proportionality in creditworthiness assessments: for example, firms must undertake a 'reasonable' assessment based on 'sufficient' information, drawing on information from a credit reference agency 'where necessary'. In our experience, these rules are insufficiently prescriptive to protect vulnerable consumers against unaffordable lending. We believe that one of the crucial benefits of the new Consumer Duty, which requires to firms to act to seek good outcomes for consumers, should be that firms must become more effective at tailoring their approaches to more vulnerable consumers. We therefore believe that BNPL firms should be required to meet the FCA's current creditworthiness and affordability rules in full (which we do not believe will be overly prescriptive) but also note that BNPL firms are likely to need to build their approach taking into account the new Consumer Duty, the rules and guidance for which are likely to be confirmed in early Summer this year.

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

Please see response to question 24.

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

StepChange has wider concerns that the present credit reporting system is driving harmful consumer behaviour and contributing to financial exclusion.[7] This is for a number of reasons: we see evidence that consumer anxiety about credit scores drives inappropriate borrowing, that worry about missed repayments and negative reporting prevents customers in financial difficulty seeking help from firms, and that reporting of missed payments and defaults can unnecessarily exclude consumers from mainstream credit. We would like HM Treasury to work with credit rating agencies and the FCA to address these issues. Given these concerns, we do not believe that missed payments or defaults on BNPL loans should automatically be permanently reported (i.e. for the standard six year term). The low value of many BNPL loans and payments means that recording missed payments and defaults could in many cases be disproportionate. In particular, it could drive financial exclusion among, as we have noted, a group of consumers that are financially vulnerable and at risk of financial exclusion. The priority for credit reporting should be to provide visibility of borrowing through BNPL products to facilitate effective affordability and creditworthiness checks. We accept that there are circumstances in which reporting missed payments and defaults is appropriate (such as for higher value loans or repeated defaults); however, reporting requirements should be carefully designed to balance competing risks to consumers.

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

We note the FCA is currently undertaking work to review its rules and guidance for authorised credit firms in this area; StepChange will continue to engage closely with this process. We believe BNPL firms should be required to meet the FCA's existing rules and guidance on the treatment of customers in financial difficulty (i.e., we do not think that BNPL should be subject to a more limited framework). FCA rules and guidance are already framed so as to allow firms to adapt processes to

[7] StepChange (2019) *StepChange Debt Charity response to FCA credit information market study terms of reference MS19/1.1*

individual products. Any lower standard for BNPL would undermine support for consumers in difficulty with multiple credit products. When such consumers experience difficulty, they need consistent support from firms and sustainable repayment options taking into account all of their financial commitments. Exceptions for BNPL providers to the FCA's rules and guidance would undermine coherent and sustainable solutions for customers who are unable to keep up with repayments.

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

We agree that applying CCA provisions on arrears and defaults to BNPL agreements is appropriate. As we note in question 20, we are keen to engage further with the process of updating CCA requirements and communications and, in particular, prevent unintended negative impacts such as negative coping behaviours that cause further financial difficulty (like further borrowing or falling behind on essential bills) and causing or exacerbating mental health problems.

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

We agree and have no further comment at this time.

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 believe that the government should amend section 17 of the CCA to bring BNPL agreements below £50 within scope; it appears unlikely the intent of this exemption was to exclude products like BNPL where significant repeat or cumulative borrowing may occur through small sums (making the product, in some ways, similar to revolving credit). Consumers benefit from CCA protections (even if there is scope to update and improve these requirements): the purpose of bringing BNPL into regulation is likely to be undermined if important elements of the regulatory framework are disapplied.

Question 31: Are you aware of any currently-regulated consumer credit products, in particular those which are debtor-creditor-supplier agreements, that are routinely offered with values less than £50?

We are not aware of any such examples.

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 it is crucial BNPL customers have access to an appropriate independent dispute resolution mechanism and redress concerning the conduct of lenders and that the FOS is the appropriate means of providing this mechanism.