

StepChange Debt Charity response to FCA consultation paper CP18/43 – Consultation on Buy Now Pay Later offers

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Introduction

StepChange Debt Charity is the largest specialist debt advice charity helping people across the UK, with 620,000 people contacting StepChange in 2017. We welcome the opportunity to respond to the Financial Conduct Authority's consultation on 'buy now pay later' (BNPL) offers.

There are fundamental problems with BNPL offers that are credit agreements. The FCA highlighted in CP18/12 that customers may over-estimate their ability to pay off BNPL debts, and that many do not regard store cards or catalogue credit a form of 'real' borrowing. Some people said they did not understand how interest charges worked and the impact this had on what they were charged. In some cases this led to spiralling debt problems.

These are not just problems of information disclosure. The term 'buy now pay later' implies that a customer can pay at a later date the amount that would be paid if they were to purchase the product at the point of sale. BNPL offers where interest is backdated during the offer period are misleading: they are credit offers that involves the repayment of a loan – there is simply a 'promotional' period in which the loan can be repaid without interest. The FCA notes that around half of customers purchasing through a BNPL offer do not repay the full amount within the offer period: for these customers the agreement is in effect a 'buy now, pay more later' offer.

Where firms offer credit products these should be marketed and sold as credit: BNPL offers obfuscate the contingent nature of the product being sold. The term BNPL should be used only where a customer agrees to pay at a later date the amount that would be paid if they were to purchase the product at the point of sale. Any automatic transition to a credit agreement, as is presently common for BNPL offers, should require a different moniker consistent with an offer of credit.

The increasing use of payment intermediaries that allow for a delayed payment or payment in instalments increases the risk that credit products will be sold without sufficient information for customers and in circumstances in which customers may not be in a position to make a good decision. There appear to be at least one example suggesting retailers using these services may not be fully aware of their responsibilities to be registered with the FCA under certain conditions or provide specific disclosures and information.¹ This is an evolving area of retail finance that the FCA should monitor and supervise closely.

We also note that in 2011, in response to concerns raised about the ease with which customers are tempted into expensive credit by retailers offering discounts on their purchases at the time they take out a store card, retailers agreed to end the practice of introductory discounts and ban the practice of offering direct commission to sales staff.² At the time, the government noted that:

¹ 'Buy now, pay later — the new debt trap for millennials?' Nicholas Megaw and Chloe Cornish in the *Financial Times*, 21 September 2018: ('Last month, mattress start-up Casper had to stop working with Klarna after the FT pointed out that it needed a licence from the Financial Conduct Authority to broker the product.')

² HM Treasury and Department for Business, Innovation and Skills (2011) *Personal Credit and Personal Insolvency Review: Formal Response on Consumer Credit*.

This ban will mean that stores will not be able to offer discounts, free gifts or similar incentives to encourage consumers to take out store cards at the point of sale, or for the first seven days.

The purpose of this intervention was to decouple the decision to take out a credit product with inappropriate incentives. There appears to be a difference between the way this agreement was presented by government and how it has been interpreted by retailers. The present Finance and Leasing Association Lending Code, which sets out the commitment (p. 25), states only that firms will not offer a discount 'which is redeemable on the initial purchase or within the first seven days'.³ A brief survey of the UK's largest online retailers shows that it continues to be common to offer discounts on BNPL offers at the point of sale: for example, two prominent catalogue credit retailers offer discounts of 10% and 20% on the first credit orders, while a large online clothes retailer offers £200 in 'instant credit' and a 20% discount 'when the card arrives' together with 'prize draws, treats and promotions' where customers take out a store card. The sole difference with practice prior to the voluntary code is that offers are deferred by a minimum of seven days. Given that these offers and discounts are typically offered in retail contexts in which there is a reasonable expectation that customers will make repeat purchases, there is little material difference between an immediate incentive and a briefly deferred incentive. Strikingly, BNPL offers themselves are excluded by the rules, even though they are clearly a form of retail incentive. We do not therefore consider that the underlying issue of offering incentives that are likely to lead potentially vulnerable consumers into poor decision-making has been addressed.

We welcome the FCA's proposals to clarify and strengthen the obligations on firms to provide consumers with adequate explanations when offering BNPL products and prevent the backdating of interest to outstanding credit repaid within the BNPL offer period. However, a revival of point of sale finance lending driven by new technology as well as current problems with BNPL offers mean that these steps are insufficient to address unfair practices that have the potential to cause consumer detriment.

The FCA's findings that some consumers get into difficulty after taking out BNPL loans suggest there may be problems with affordability assessments linked to BNPL products; both with assessing affordability at the point of sale and taking sufficient care to understand how a consumer's circumstances might foreseeably change six to twelve months in the future. For a twelve-month BNPL offer, a firm is effectively seeking to assess affordability over two years. It would be unsurprising if creditworthiness assessments were not always effective given the younger and more financially vulnerable demographic most likely to choose to use BNPL offers. Alongside monitoring the impact of the measures set out in this consultation, the FCA should clarify its expectations of creditworthiness assessments in BNPL contexts and how it will respond to recent developments in point of sale finance.

³ Finance and Leasing Association (2017) *Lending Code 2017*

Q1: Do you have any comments on our description of the BNPL market?

As outlined, we believe there is a case for a more comprehensive review of BNPL credit products. While we welcome the further work the FCA has conducted on BNPL offers outside of catalogue credit and store cards, such as those linked to point of sale finance, we have little information about the scope of this work or what the FCA has found. Given the concerns we have outlined about the nature of BNPL credit offers and the apparently rapid growth of point of sale finance services linked closely to BNPL offers, we believe the FCA should keep risks linked to this type of product under review and ensure continuing problems are addressed at the earliest opportunity.

Q2: Do you agree with our proposal to extend the rule on adequate explanations to all firms that offer BNPL deals?

We agree that the rule requiring firms to disclose the cost of credit if they fail to repay within the offer period should be extended to BNPL. The draft rules and guidance do not, however, appear tailored to address the problems some consumers have understanding BNPL offers that the FCA has identified, such as a tendency not to consider BNPL offers to be credit and a poor understanding of the implications of the credit aspects of the agreement. We suggest that the rules and guidance should include the expectation that firms provide worked examples of the amount of credit to be paid through a standard agreement if the principle is not repaid in the offer period, including the total amount to be repaid and the amount of the first payment that will fall due.

Experience suggests disclosure remedies have limitations given firms' exploitation of consumer behavioural biases. It is unlikely balanced consumer protection objectives can be achieved solely through the provision of notices and information. Consumers can be caught out and experience financial difficulty because BNPL products are marketed, designed and structured in a way that exploits behavioural bias and makes this likely, not because information is not available to them. BNPL offers are marketed and sold to consumers who tend to be younger and less financially resilient and knowledgeable in point of sale contexts (whether online, where careful behavioural marketing strategies are applied by firms, or in stores) in which consumers are particularly vulnerable to pressure and manipulation. As noted, one way to ensure these rules are more effective would be to require firms to market credit products as credit rather than BNPL offers, which would help more consumers to be able to make decisions with full consideration of the implications of the agreement.

We would also be interested in clarification from the FCA of the expectations of firms providing electronic point of sale finance, particularly where a BNPL product structure is a possible but not a definite outcome (as for services that allows consumers a grace period in which they can return a product or choose how they will pay – immediately, in a small number of instalments or through traditional revolving credit). At what point should such firms provide an adequate explanation: at the point of sale, even though a BNPL is possible but not definite, or at some intermediary stage before the purchase transitions into a BNPL product but when the purchase decision has effectively already been made? Broadly, payment methods that lead to a branching series of choices about payment seem likely to create ambiguity and exploit and exacerbate behavioural bias's that tend to lead to

worse outcomes for consumers. It may be that explanations are less effective in this context and that different regulatory approaches are necessary to ensure products work fairly for consumers.

Q3: Do you agree with our proposal to extend the rule on prompts to all firms that offer BNPL deals?

We agree that this proposal should be implemented and will benefit some consumers. However, the FCA should offer greater clarity around when such prompts should be sent and their purpose. We would expect a small proportion of people to have failed to repay because they have forgotten to do so. Most of those approaching the end of the offer period have not repaid because they are unable to do so. The earlier a prompt is provided, the more effective it is likely to be in supporting people to repay. Many offers are linked to running credit with a regular statement: this could be used as a platform to provide repayment prompts throughout an offer period so that those who have the opportunity to repay early are reminded to do so. The FCA could also require that any BNPL offer not linked to running credit that extends beyond three months and is above a minimum amount should be accompanied by a monthly statement that includes similar repayment prompts.

Following implementation of the new rules, the FCA should monitor the timing of prompts and respond with further measures if there is no meaningful reduction in the proportion of customers who do not repay the principal in full during the promotional period.

Q4: Do you agree with our proposal for new guidance on communications and financial promotions, applicable to all firms that offer BNPL deals?

We agree that all firms that offer BNPL products should be required to apply the same guidance governing communications and financial promotions to create consistency and ensure the guidance is effective in meeting its aims.

Q5: Do you agree with our proposal for a new rule that firms offering BNPL must not backdate interest on the amount of the principal that is repaid within the offer period?

We support this proposal, which we agree will ensure people are not disincentivised from repaying what they can of the outstanding balance during the BNPL offer period where they cannot repay the full amount. However, for the reasons noted above, we do not believe it is fair to consumers for firms to backdate interest at all on any BNPL offer (and if firms do backdate interest, the offer should not be marketed as BNPL). 'Buy now, pay later' carries the implicit meaning of an interest-free offer. Where firms describe a credit offer as interest free for a period, then it is not fair, clear and not misleading if they then go on to backdate the interest. BNPL offers should be treated in the same way.

Q6: Do you agree with our proposal that the rules will come into force three months after publication?

Yes, we agree that the rules should come into force promptly, and believe this is reasonable given that the proposals will apply only to purchases made after that date.

Q7: Do you agree with our proposal that the partial repayment rule should apply to purchases made after the date that the rule comes into effect, including where those purchases relate to an existing contractual agreement?

We agree that the partial repayment rule should apply to BNPL purchases made through an existing contractual agreement. BNPL is a common offer within revolving credit accounts linked to retail providers; to be effective the rules must apply to these products where they are already held by customers.

Q8: Do you agree with our cost benefit analysis?

N/A

Q9: Do you agree with our initial assessments of the impacts of our BNPL proposals on protected groups? Are there any others we should consider?

N/A