Buy Now, Pay Later - good, bad or ugly?

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Introduction

Consumer shopping habits have seen a significant change, particularly in recent years with developments in the consumer credit landscape. We had the era when High-Cost Short Term credit (HCSTC) initially took off and now in the past couple of years, there has been a significant increase in the use of Buy Now Pay Later (BNPL) arrangements.

This is a hotly debated topic and following the rise and spectacular fall of HCSTC when the likes of Wonga and Pounds to Pocket became household names, BNPL now seems to be taking off in a big way having been somewhat fuelled by the pandemic and the consequent increase in online transactions.

This is making some commentators jittery as many of these products, including those issued by the bigger players in the industry are short-term and interest free, and therefore not regulated by the Financial Conduct Authority (FCA).

One of the more significant recent developments was in February when the FCA secured changes to potentially unfair and unclear terms in customer contracts of some of the largest BNPL firms including Clearpay, Klarna, Laybuy and Openpay. Despite these types of contracts not being regulated, the FCA felt that the drafting of the terms may have led to potential risks to consumers.

This follows the publication of the BNPL consultation paper issued by HM Treasury in October 2021 and the Woolard Review on change and innovation in the unsecured credit market in February 2021. The heat is now definitely on BNPL with regulators and the Government seeing the need to protect consumers.

What's the big deal for such a niche product?

As with many forms of credit, what may initially have seemed to be a niche product has become very much part of the mainstream. In October 2021, Bain and Company published an in-depth report on the benefits and challenges of the BNPL market in the UK[1] and found that around 20,000 merchants in the UK were offering a BNPL option at checkout and that the volume of BNPL transactions was expected to grow 29% per annum to account for 10% of all e-commerce spending by 2024. This is very much in line with the Woolard Review[2], published by the FCA in February 2021, which found there to be "extreme growth" in the BNPL market, which had more than trebled in size in 2020, no doubt somewhat driven in part by the pandemic and the corresponding increase in online spending.

OpenMoney also conducted research on BNPL in December 2021[3] which highlighted that 57% of respondents have previously used BNPL schemes and the schemes tempted 43% to buy something they could not afford. The most popular purchases were for technology including laptops and phones followed by clothes, holidays and interiors and furnishings.

Of course, the supply of different forms of credit goes back many hundreds of years and this is merely the latest development. Whilst the explosion in its popularity has come as somewhat of a surprise, it is vital that these products are subject to appropriate scrutiny.

[1] bain_report_buy_now_pay_later-in-the-uk.pdf

[2] https://www.fca.org.uk/publication/corporate/woolard-review-report.pdf

[3] https://www.open-money.co.uk/blog/buy-now-pay-later-2021-research

Is it really so bad if consumers are not paying any interest? It seems like a great deal to me…

It's easy to think that due to their short-term nature and because consumers do not incur any interest that these types of products represent a win-win solution. However, there are a number of ways in which consumers may experience detriment:

- Given **these BNPL products are not currently regulated by the FCA**, there is no obligation for providers to conduct creditworthiness assessments as part of either the onboarding of new customers or when entering into individual agreements. This was a key concern raised by The Woolard Review. Furthermore, consumers lose S75 protections which are available for those purchasing with a credit card which protects them if the retailer were to become insolvent.
- Linked to this, due to the unregulated nature of these types of BNPL product, **providers are not required to report these loans to credit reference agencies** which means other credit providers may not be able to see a consumer's other commitments or know if they have missed a payment.
- All indicators show that BNPL is continuing to expand rapidly which means that **some consumers may start to use this option for essentials such as groceries, potentially then falling into the trap of paying for multiple shops at once** which may become untenable. Indeed, a poll carried out by Citizen's Advice[4] found that one in 12 people have used BNPL to cover costs for basics such as food and toiletries in the past six months.
- There seems to be a **gap in the understanding of some BNPL customers who believe that missed payments may not adversely impact their credit rating, which wouldn't necessarily be the case if the provider has reported it to credit reference agencies.** Furthermore, the Woolard Review found that some customers do not see BNPL as credit as it is deemed to be "zero cost". This may also be fuelling the increased take up of BNPL loans with some customers having multiple loans with different providers.
- Whilst no interest is charged on these loans, **missed or late payment fees are often incurred**. **There is a concern that lenders may not treat customers in financial difficulty consistently or fairly** with some collection practices not resulting in good consumer outcomes.
- Digitisation in the financial services industry has brought many benefits, including increased ease of use and efficiency of processing. However, once a BNPL account has been opened, the **lack of "friction" in the engagement process between consumers and providers may encourage users to use the easy BNPL option without considering the implications of further debt** in sufficient detail.

[4] https://www.citizensadvice.org.uk/about-us/about-us1/media/press-releases/one-in-12-now-using-buy-now-pay-later-to-cover-essentials/

Surely some good has come out of it as well?

Whilst BNPL no doubt has significant risks for some customers, there are a number of ways in which it helps retailers, consumers and the wider economy and there is an acceptance that a balanced approach is required. In particular, given the interest-free nature of these products, there is an argument that if managed appropriately such facilities are a cheaper and more convenient way of making purchases than many other methods.

Some of the key benefits include:

- With the significant number of BNPL transactions undertaken online, it allows **a wider range of retailers to sell products to consumers**. This opens the market for small and medium sized firms and allows them to compete more easily with the larger players, providing more choice for consumers.
- According to the Bain survey, a key benefit for retailers as part of the sales process was **an improved conversion rate** with 57% of merchants seeing a reduction in baskets being abandoned. Furthermore, 46% of retailers saw an increase in average order values. It could therefore be argued that some consumers may be better able to manage their spending by breaking it down into instalments.
- Whilst not a regulated product, there is some evidence that **BNPL providers recognise some of the challenges facing consumers and are addressing some of the concerns and supporting potentially vulnerable customers** through providing hardship assistance programmes.
- **Use of third-party lending allows merchants to offer the product more easily** as they do not have to administer the loan, and it also limits their exposure to credit risk.
- Merchants have **greater exposure to new customers** and through listing partners on the BNPL provider's website or app, they were able to increase their referrals. Bain also found that customer satisfaction increased, with 38% of merchants seeing an improvement.
- Whilst the effective use of credit cards can improve credit ratings, during 2020 it was estimated that **BNPL saved consumers £103m in credit card interest costs**.

Does the future look ugly?

It looks like BNPL is here to stay and earlier this year, Klarna launched a physical card which allows consumers to pay up to 30 days after purchase when transacting online and in physical stores in the UK and abroad. For many, this may be a preferable option to traditional credit cards and the inevitable high interest rates.

As BNPL becomes even more mainstream and is used to fund more expensive purchases, both consumers and the regulator need to think about the implications of how this may cause detriment to avoid repeating past mistakes. However, what is clear is that whilst BNPL does have a bad name in some circles, it is certainly not all bad news and channelled in the right way, can benefit all parties.

One of the bigger challenges facing the regulator is if these BNPL products fall within the regulatory perimeter, merchants would become credit brokers and with that they would be required to apply for FCA authorisation and comply with all relevant regulation. This would no doubt place a higher burden on them, particularly those who are smaller such as sole traders who only have an online presence. If caught by the requirements, they would need to regularly submit data to the FCA and pay fees to the regulator which may mean larger retailers gain a competitive advantage.

Conclusion

Given the significant increase in BNPL products and the understandable nervousness from some stakeholders, it is clear that there needs to be a greater focus on the approach and level of regulation.

BNPL is certainly an emotive topic and like many credit products, if used in the right way it can provide a number of benefits for consumers. However, there are undoubtedly risks to vulnerable customers or those who become overly reliant on these products which may lead to customer detriment. From recent interventions, it is clear that the FCA is taking this seriously and therefore BNPL providers should now be taking steps to review their processes and approach to ensure they adequately protect customers.

Get in touch

If you would like to discuss this further, please don't hesitate to get in touch.

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