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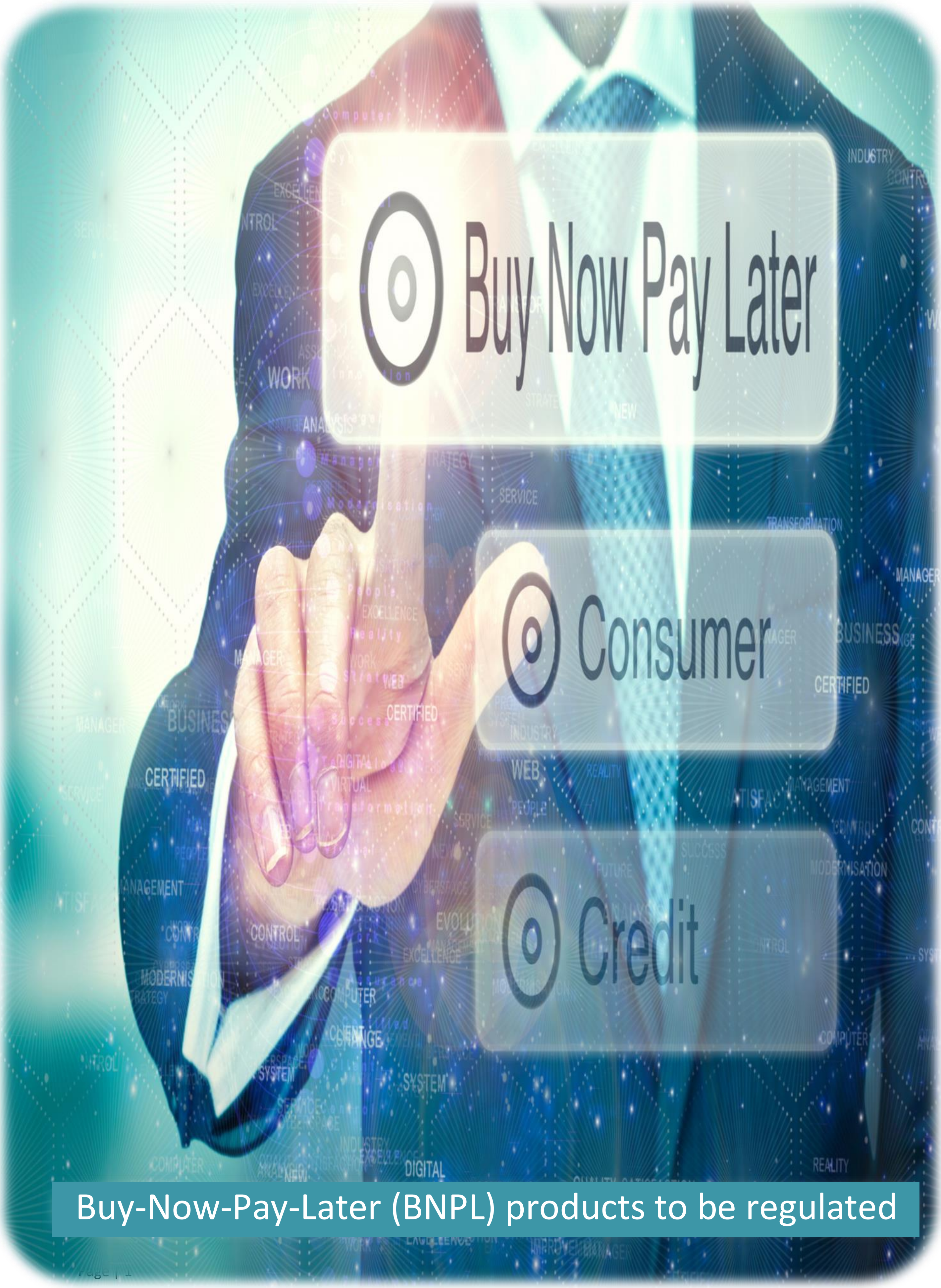

Buy-Now-Pay-Later (BNPL) products to be regulated

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On 2 February 2021, the Financial Conduct Authority ("**FCA")** published the 'Woolard Review - A review of change and innovation in the unsecured credit market', produced by the former interim Chief Executive of the FCA, Christopher Woolard ("the Woolard Review"). In this review, he describes how the interest free unregulated Buy-Now-Pay-Later ("**BNPL**") credit products create risks for consumers and the regulatory changes that are needed to manage these risks. In addition to a call to regulate BNPL products, the Woolard Review contains 26 other detailed recommendations relating to the unsecured lending market in the UK, which are based, amongst others, on the analysis of the feedback gathered from 3 roundtables, 64 submissions and 22 interviews.

Why regulate BNPL products?

Partly due to the coronavirus (Covid-19) pandemic, the use of BNPL products more than trebled last year as online shopping increased due to lockdown measures brought on by the pandemic. Even though these products can bring benefits to consumers since they are interest-free and are inherently lower-risk than many other forms of credit, the Woolard Review also identified a number of potential harms linked to BNPL products.

The problems which were identified in the Woolard Review include:

- Insufficient understanding of the BNPL products by consumers:
    - Certain consumers do not see it as credit and often associate it with payment technologies such as Google Pay, Apple Pay or Amazon one click. Consequently, they do not apply the same level of scrutiny as they would to a credit product;
    - Certain consumers viewed the BNPL products as a financial service and therefore thought that they came with the rights of consumer protection similar to regulated product, including the ability to refer complaints to the Financial Ombudsman Service.
- Issues with the ways in which the BNPL product is presented:
    - BNPL offers an overall consumer journey, which is designed to drive sales without due consideration for the affordability of the commitment the consumer is taking on, i.e. where the design of the customer's journey makes it more likely that the consumers will make impulsive decisions which are not in their best interest.
    - Presenting BNPL offers as a default payment method (even though it is not the cheaper payment method), or in a long list of indistinguishable options, without making each option clear.
- Lack of affordability checks:
    - Most BNPL providers complete a basic credit assessment based on 'soft' credit searches and previous repayment history, without checking affordability. As a result, the consumers with outstanding payments with one BNPL provider can seek credit from alternative BNPL providers.

- A possibility to use multiple BNPL offers from various BNPL providers with the potential to create high levels of indebtedness.
- Information on the fees for late payment not being presented clearly but rather hidden in the terms and conditions pages.

From a legal perspective, the Woolard Review explained that Buy-Now-Pay-Later (BNPL) is a broad term which covers a variety of credit agreements, some of which already fall inside the FCA's regulation/perimeter while other types are able to rely on an exclusion. The Woolard Review has focused on the BNPL agreements which currently fall outside of the FCA regulation/perimeter (i.e. which are currently not regulated and rely on an exclusion). They often take the form of either a "deferred payment" or "short instalment loans".

Currently, these BNPL agreements are exempt from the regulatory requirements of the UK Consumer Credit Act 1974 ("**CCA**"). It was noted in the Woolard Review that this exemption from the CCA, set out in Article 60F (2) of the Regulated Activities Order ("**ROA"**), was primarily set up to support short-term invoice deferrals, and it was not intended for the BNPL kind of product.

For illustration purposes, we have extracted from the Woolard Review, a non-exhaustive list of currently exempt BNPL credit agreements and products, which are being discussed here, and of their respective providers.

Summary of five providers of exempt BNPL credit agreements (non-exhaustive list)

Provider	Repayment	Soft Credit Check	Late fees
Clearpay	4 fortnightly instalments	No	For orders under £24, one late fee of £6. For orders over £24, fees are capped at 25% of original order or £36, whichever is less.
Klarna	Two options: Pay in 30 days or 3 monthly instalments	Yes	No late fees, will try to take funds after 7 days and again after a further 7 days. If payments remain outstanding, debt could be passed to debt collection agency.
LayBuy	6 weekly instalments	Yes	£6 after 24 hours, further £6 after 7 days. If payments remain outstanding, debt could be passed to debt collection agency.
Openpay	3-7 monthly instalments	Yes	£7.50 after 2 days, further £7.50 after 10 days, capped at £15. If payments remain outstanding, debt could be passed to debt collection agency.
Paypal	3 monthly instalments	Yes	£12

Extract from the Woolard Review

As the above table illustrates, the BNPL providers offer repayments by instalments with different instalment terms, they have implemented the so called 'soft' credit checks and they are charging late payment fees (with the exception of Klarna).

While the late payment fees paid by the consumers have been an important source of income for the providers of the BNPL products (representing for certain BNPL providers a significant portion of their total revenue), for an overall understanding of the economics of these products it is important to highlight, as per the Woolard Review, that the real target customer of the BNPL providers are not the borrowers (consumers) but rather the retailers, as they pay BNPL providers a fee which covers the cost of lending to the consumers.

Who is expected to be regulated?

In view of the potential harm to consumers, linked to issues set out above, the Woolard Review concluded that changes are urgently needed to regulate these BNPL products in order to protect consumers and to ensure the provision of debt advice to those who may need it. This means that the **providers of BNPL products** would need (i) to obtain the required authorisation from the FCA (provided they are not already authorised to provide regulated credit products) and (ii) to comply with any new regulatory requirements to be set out in the new legislation.

Quite importantly, the proposed changes will also have an impact on **the retailers** who are offering BNPL products to its buyers, as the retailers would need to be authorised for credit brokering. This is because, once the exempt BNPL agreements become regulated, the retailers, who offer these products, would fall within the scope of Article 36A1(a) of the ROA relating to credit brokering. The other alternative left to these retailers would be to become an Appointed Representative of an already authorised company or to withdraw from the market, neither of which is ideal for these retailers.

What's next?

The FCA is currently considering the recommendations made in the Woolard Review and will provide its response to the recommendations in its April 2021 Business Plan. In the meantime, in a press release dated 2 February 2021 the HM Treasury of the UK Government has already officially confirmed its intentions to regulate BNPL providers, and has confirmed that the legislation will be brought forward as soon as the parliamentary time allows. Firms providing BNPL products should therefore closely follow these developments so that they take timely measures to comply with any new regulatory requirements, including obtaining the necessary FCA authorisation, as needed, and implementing the affordability checks, if/when the new legislation comes into force.

If you need advice on certain legal and regulatory points set out in the Woolard Review, or an early assessment on how these developments are likely to impact your business, please do not hesitate to contact us.

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