

StepChange response to HM Treasury consultation on regulation of BNPL – Draft Legislation

November 2024

Summary

StepChange Debt Charity is the largest specialist debt advice charity operating across the UK. In 2023, 620,000 people contacted StepChange seeking debt advice or guidance with their problem debt and over 180,000 people completed full debt advice through StepChange's online and telephone service.

StepChange welcomes this consultation on unregulated deferred payment buy-now pay-later (BNPL) products. National polling commissioned by StepChange in late 2023 indicated that BNPL debt is now almost as common as overdraft debt among UK adults, with 6% of adults reporting one or more outstanding BNPL debt compared to 7% reporting overdraft debt.¹ The consultation document notes that a significantly larger proportion of people report regularly using BNPL.

Because firms that offer interest-free BNPL also typically also provide interest-bearing products, we are unable to give a precise estimate of the proportion of StepChange advice clients with BNPL debts, but we are able to identify a trend of increasing debts among clients to firms that offer BNPL products consistent with national data showing the growth in BNPL use.

BNPL is popular with consumers as a form of credit because it is free at the point of use, widely accessible and user friendly. However, there is also clear evidence that BNPL is associated with financial difficulty:

- Those with BNPL debt are three times more likely to be in problem debt (23%) than UK adults (8%).
- 38% of those with BNPL debt are using credit to make ends meet compared to 17% of UK adults.
- One in five (22%) of those with BNPL debt are in arrears on one or more household bill (14% are behind on a priority bill and 7% are behind on credit repayments).²

There are a number of reasons BNPL can cause or compound financial difficulty:

- affordability and creditworthiness checks that may fall short of good practice and regulated standards, affecting particularly consumers vulnerable to over-indebtedness or already in financial difficulty;

¹ All figures, unless otherwise stated, are from StepChange analysis of a survey conducted by YouGov Plc. Total sample size was 1,986 adults. Fieldwork was undertaken between 1st - 3rd September 2023. The survey was carried out online. The figures have been weighted and are representative of all UK adults (aged 18+).

² Ibid.

- a low friction customer journey embedded in online and offline retail settings that can exploit consumers behavioural bias and vulnerability, encouraging borrowing that would not otherwise happen;
- limitations in consumer understanding of BNPL that can have negative consequences such as unexpected costs due to late fees and customers not realising there is limited flexibility to reschedule repayments; and
- potentially poor or inconsistent responses to financial difficulty not aligned with Financial Conduct Authority (FCA) rules and good practice.

Consumer sector research shows that BNPL users often spend more than they mean to using BNPL, regret borrowing and struggle with repayments.³ In a survey of StepChange advice clients, 24% of clients who had recently used BNPL reported that doing so had caused them to spend more than they had meant to.⁴

While BNPL is associated with small sum borrowing, it can be used for significant retail purchases, and BNPL balances can otherwise become significant through cumulative borrowing, sometimes across providers. BNPL are more likely to report using credit to make ends meet, indicating that unaffordable lending is contributing to wider debt problems. These issues mean that while BNPL does not carry interest charges, it can nevertheless cause serious harm.

Broadly, we are supportive of the government's proposed approach to legislation and believe it is a proportionate and pragmatic means of bringing BNPL within FCA regulation as quickly as possible. We look forward to more in-depth dialogue with the FCA on detailed FCA rules and guidance: crucial aspects of the new regime will be affordability checks that work for customers in financially vulnerable situations, improving customer understanding and putting more friction in the BNPL sign-up and borrowing journey, and ensuring early engagement and effective support for customers in difficulty.

The government's proposals to remove CCA information requirements and the associated sanctions, transferring the former in a tailored form into FCA rules creates new regulatory challenges and risks. The consultation notes the government's belief that 'CCA sanctions can fall away for BNPL agreements without a significant impact on consumer protection' (p. 25). We do not agree with this analysis: CCA sanctions such as unenforceability and disentitlement act as a deterrent incentive to firms against wilful misapplication of information and communication standards that shape a customer's fundamental understanding of, and interaction with a product. FCA rules and its regulatory toolset and the role of the Financial Ombudsman Service do not currently function in an equivalent way.

Given that BNPL regulation is urgent, we do not think it would be the right approach to wait for CCA reform where revision of CCA requirements and sanctions, including transfer of some

³ Citizens Advice (2021) *Buy Now... Pain Later?*

⁴ 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 was 362.

elements into FCA rules, can be considered in the round. This means, however, that in taking forward BNPL regulation the government and the FCA should consider carefully how to ensure wilful misconduct or disregard for the FCA's expectations is pre-emptively identified and prevented.

The government and FCA can learn from the implementation of the FCA's persistent debt rules, where the FCA ultimately intervened to address poor practice in firm communications, with the FCA highlighting that some firms had not used mandated communications to encourage firms in persistent debt to contact them and/or had not signposted to debt advice.⁵ This situation shows how FCA rules and guidance on information and communications can be poorly interpreted by firms and function differently to CCA requirements. The FCA should take steps to prevent similar problems arising in newly regulated BNPL, for example through a process to pre-approve and monitor BNPL firms' approach to applying new rules on product design and communications before they go live (within a framework that recognises firms may understandably wish to iterate aspects of design or communications at pace).

We do not anticipate mainstream BNPL firms actively disregarding new expectations, but not all BNPL providers are of the same size or culture, and equally there is a recent history of non-BNPL firms with a large presence in the market being a source of misconduct and such risks should not be disregarded.

Ultimately, we would frame these concerns with a simple call that the government and FCA should ensure that in disapplying CCA information and communication requirements there is no reduction in consumer protection, and the equivalent requirements in FCA BNPL rules and oversight ensure equivalent or better outcomes than comparable products under the CCA.

More generally, past regulatory interventions have recognised that retail environments create consumer vulnerability and sought to mitigate that vulnerability, for example through a ban agreed with industry on offering discounts as an inducement to take out credit in a retail context.⁶ This voluntary industry agreement appears to have fallen into abeyance as retail credit has become digitised, and inducement to use credit in online retail contexts are common, including for BNPL products. BNPL regulation is an opportunity to refresh and clarify expectations of regulated firms and retailers in this area.

⁵ ['FCA tells credit card firms to review their approach to persistent debt customers'](#), FCA press release, 3 Feb 2020

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.

Response to consultation questions

Question 1: Do you have any comments on the proposed approach and/or drafting disapplying provisions on pre-contractual information (sections 55 and 55C)?

We agree that it would be impractical to apply CCA pre-contractual information requirements to BNPL products.

We do not agree that ‘CCA sanctions can fall away for BNPL agreements without a significant impact on consumer protection’ (p. 25). In our response to the government’s ongoing CCA review, StepChange has argued that CCA sanctions retain an important function as a measure that protects consumers and a deterrent incentive to firms against misapplication of information requirements and standards. However, StepChange agreed that the government should consider the proportionality of sanctions to ensure they do not create excessive costs to firms relative to the consumer harm caused, with the caveat that the sanctions should have a reasonable deterrent effect to ensure good practice. As such, we would like to see CCA requirements updated and enhanced but not removed. However, we recognise that BNPL is urgent cannot wait for wider CCA reforms.

The policy and regulatory challenge that now needs to be addressed is how to transition information requirements into FCA rules and ensure new expectations set in those rules are met in the absence of sanctions given that bad market actors and poor firm culture is a known risk. Given the relatively limited number of BNPL firms the FCA could, for example, seek to pre-approve firms’ information and communications approaches within a pragmatic framework as firms will understandably wish to retain the flexibility to revise and improve design and communications.

The CCA provisions are clear and prevent poor practice (accepting that the present requirements can be improved) through sanctions. In contrast, there are many examples of firms falling short of FCA rules and guidance and being held to account, if at all, only retrospectively. We would be concerned by an assumption that the FCA authorisation process and supervision and enforcement is sufficient to ensure firms ‘get it right first time’ in terms of information and communications as we do not believe this is a reasonable interpretation of recent market conduct. Given the reach of BNPL, consumers cannot afford poor practice to emerge that takes years to remedy.

Question 2: Do you have any comments on the proposed approach and/or drafting disapplying provisions on the form and content of agreements (sections 60, 61 and 61A)?

We agree with the government’s proposed approach to disapplying provisions on the form and content of agreements to BNPL products but would draw attention to our response in question 1 on the need for an FCA framework to proactively ensure firms meet equivalent expectations tailored to BNPL in FCA rules.

Question 3: Do you have any comments on the proposed approach and/or drafting disapplying provisions on ongoing information requirements (sections 77, 77A and 77B)?

We agree with the government's proposed approach to disapplying provisions on ongoing information requirements.

Question 4: Do you have any comments on the proposed approach and/or drafting disapplying provisions on varying agreements (section 82)?

We agree with the government's proposed approach to disapplying provisions on varying agreements.

Question 5: Do you have any comments on the proposed approach and/or drafting disapplying provisions requiring prescribed information on early repayment (sections 97 and 97A)?

We agree with the government's proposed approach to disapplying provisions on early repayment.

Question 6: Do you have any comments on the proposed approach and/or drafting disapplying provisions relating to arrears, default and termination (sections 76, 86B, 86E, 87, 97 and 103)?

We accept that aspects of arrears, default and termination notices are poorly suited to BNPL agreements but note that they are less obviously impractical than the above information requirements. The fact that products are primarily accessed by smartphones should not lead to an assumption that the interests of consumers is served by providing less information; in fact, engaging struggling customers (or disrupting disengagement common in digital journeys) may require information that departs from the normalised consumer journey within an app.

We also particularly note that these notices provide a 'skeleton' for interaction with customers in difficulty and to a degree still frame FCA CONC 7 requirements. The CCA information requirements can certainly be improved but equally removing them entirely without sufficient thought to how to retain a structured framework of engagement carries new risks of poor outcomes. We also note that arrears and default notices are normally accompanied by standardised signposting to free debt advice and as such form a point of engagement with wider implications than the wording required in the CCA.

There is a significant opportunity to improve engagement with people experiencing financial difficulty through CCA reform by refreshing arrears, default and termination requirements, retaining core expectations while embedding a new test and learn approach. We are somewhat concerned that the same opportunity could be missed in the case of BNPL regulation if time constraints encourage a minimalist approach. At worst, this could set a bad precedent for wider CCA reform.

As we note, we would like to see the FCA begin its consultation process on these elements of BNPL regulation with a clear expectation of achieving equivalent and better consumer

outcomes. In doing so, there must be a particular focus on the most vulnerable BNPL customers in or at risk of financial difficulty.

Question 7: Do the amendments to section 129 and section 86 sufficiently retain the effect of these provisions for BNPL agreements?

We agree with the government's proposed approach to retain access to time orders for regulated BNPL agreements.

Question 8: Are stakeholders aware of any further consequential amendments that may arise from the disapplication of CCA information requirements?

We have no further comment at this time.

Question 9: Do you have any comments on the proposed legislative approach to DMRs, credit broking and the Financial Promotions Order?

We agree with the proposed approach to credit broking, distance marketing and financial promotions as a proportionate way forward, and bringing BNPL promotions into the financial promotions regime will help to ensure consistency with other credit products. The FCA should, in particular, use the financial promotions regime alongside potential voluntary agreements with industry on aspects of conduct outside FCA regulation 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.

Question 10: Do you have comments on the proposed legislation that seeks to implement the TPR?

We have no comment at this time.

Question 11: What do you expect the impacts to be of this proposed legislation on: providers of agreements that will be brought into regulation, consumers that use them and merchants that offer them as a payment option?

StepChange anticipates significant benefits for consumers in reduced unaffordable lending, consistent responses to customers in difficulty facilitating engagement with support and effective forbearance, and greater choice and control for consumers through a customer journey with a responsible level of friction. We expect the benefits of regulation to be particularly powerful for people experiencing financial difficulty, who will experience a reduced risk of BNPL lending causing or deepening debt problems, and a greater likelihood that the actions of BNPL firms will help them to avoid desperation borrowing and move out of financial difficulty.

We cannot comment in detail on market impacts. There is some evidence that in recent years the rapid growth of BNPL lending was linked to a growth strategy in which the affordability of agreements was of secondary consideration to growing a customer base, and firms were

willing to incur losses in bad lending in pursuit of scale.⁷ It seems likely that this model is now maturing, with firms moving to more sustainable models where affordability is a central concern. As a result, expansion of BNPL may plateau (or already have done so) regardless of the impact of FCA regulation.

The long-term sustainability of an interest-free model with profit driven primarily by modest merchant fees appears to rest on low default levels. As such, FCA-regulation is likely to enhance sustainable BNPL models.

Question 12: Do you agree with the provisional assessment that, on balance, the government's proposed proportionate approach to reform mitigates the negative impacts on those sharing particular protected characteristics and retain the positive equalities impacts of the products?

We agree with the government's assessment that some groups with protected characteristics are more likely to use BNPL and that the government's proposed approach will have positive impacts for these groups. Those with protected characteristics are, on average, more likely to experience financial difficulty and to experience harm and poor outcomes as a result. Stopping troubling aspects of BNPL lending such as potentially ineffective affordability checks and enhancing support for struggling customers will have important benefits for those affected.

While it is true that the same groups can also be at risk of financial exclusion, proportionate regulation will preserve access for those who can sustainably afford to borrow. More generally, unaffordable lending is not a solution to financial exclusion. We would expect to see some reduction in BNPL lending to financially vulnerable groups following regulation but this, on balance, is likely to benefit these groups through reduced over-indebtedness and diversion to less harmful alternatives to desperation borrowing.

More generally, the credit market cannot safely meet the needs of many people for suitable budgeting tools and there is an urgent need for better alternatives than unaffordable borrowing for those in financial vulnerable situations struggling to meet essential costs or manage lumpy expenses. StepChange has called for a national financial inclusion strategy including a key focus on a significant expansion of responsible affordable credit models and credit alternatives such as grants.

Question 13: Do you have any further data you can provide on the potential impacts on persons sharing any of the protected characteristics?

StepChange would be happy to share its data from national surveys on BNPL use. This survey data is not sufficient in size to analyse impacts on specific protected groups individually, but can be used to analyse patterns at a high level among financially vulnerable groups such as those with a minority ethnicity and those receiving means-tested benefits.

⁷ Kelly, J., 'Is "buy now pay later" a viable business model?', *Financial Times* 21 October 2021.

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