

## Buy Now Pay Later: issues and remedies

### **The consumer credit directive under discussion at the EU level should make BNPL a safe credit for all**

Authors: Aoife Monaghan – Olivier Jérusalmy  
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#### ***Key message***

**The revision of the Consumer Credit Directive presents EU policymakers with the opportunity to protect European consumers from the risks associated with irresponsible lending. Creditworthiness Assessments based on the household's budget are essential to safeguard consumers from over-indebtedness. The CCD should ensure that both the creditworthiness assessment and corresponding repayment plans are tailored to the borrower's specific profile and repayment capacity, including in the case of the most vulnerable consumers. This is even more necessary for people with lower incomes, for whom all credit, regardless of its amount, can become a trap that can open the door to overindebtedness.**

"Buy now, Pay later" has been acclaimed by its providers as a safer alternative for consumers than that of more traditional forms of credit. They boast more transparency, lower fees, low-interest or interest-free products, and convenience for consumers. This product allows customers to purchase goods or services from merchants by paying the lender in a series of instalments. However, it has become the view of many in the consumer protection field that BNPL providers exploit regulatory gaps to facilitate dangerous lending practices. BNPL is a form of credit, and with all credit comes risk. The regulatory requirements that have been imposed on traditional credit products for the protection of consumers have not applied to BNPL products, which generally operate without such constraints.

#### ***Point One – Experiences with BNPL outside the EU***

In determining the future of these services in Europe, we must examine the impact BNPL has had in other jurisdictions. The growing popularity of the BNPL model amongst merchants and consumers has seen its swift rise on the global market. In the UK, BNPL purchases more than tripled to the value of £2.7 billion in 2020 (Deane-Johns, 2021). This number is estimated to grow, with over 20,000 UK merchants now offering BNPL as a payment option (Tijssen & Garner, 2021). Meanwhile, the US had an estimated \$100 billion in BNPL purchases for 2021 (Geron, 2021). These markets are prime examples of countries with access to such services, which went largely unregulated for many years.

BNPL providers have often persuaded regulators that the type of low-cost, interest-free credit services they provide on somewhat small amounts of money has neutralised the risk to consumers. The perception of this minimalised risk has allowed these lenders to operate with certain exemptions. However, the dismissal of regulatory importance in markets where minimal amounts of credit are accessed is an unstable narrative that has led to the exploitation of low-income

households. What is perceived as a small amount of credit or not, is relative to the consumer's income accessing the BNPL service.

A study of users in the US found that in a group analysed pre-pandemic, 61% of BNPL users had incomes of less than \$50,000; as the pandemic progressed, this rose to 70% (Cardify, 2020). The research found that those who experienced a full or partial loss of income during this period began to utilise BNPL services far more than people who experienced "no change to their income as part of COVID-19" (Cardify, 2020). This illustrates that consumers are vulnerable to accessing these services in times of financial difficulty to aid cash flow problems and risk over-indebtedness in the process. A study of UK users reported not having the appropriate funds to make the entire purchase as the third most common reason for using BNPL services, with 48% of people selecting this reason being on the lower end of the economic spectrum (Tijssen & Garner, 2021). Without performing hard credit checks "consumers may use multiple BNPL products—in addition to other credit products—and risk financial overextension" (Alcazar & Bradford, 2021). A UK report confirmed this suspicion with 6% of users surveyed revealing they have an open balance with three or more BNPL lenders, and 10% confessing to using BNPL services because they have maxed out their credit card limit (Tijssen & Garner, 2021). Therefore, without creditworthiness assessments, BNPL providers are essentially unaware of consumers ability to make repayments (Geron, 2021).

### ***Point Two – Evidence shows that BNPL is more high-risk than advertised***

Providers hype their services as a form of consumer protection for the modern consumer navigating an online market space, for people that have steady incomes and full repayment capacity. In reality, soft credit checks have led to one BNPL lender reporting that one-third of their US consumers "have fallen behind on one or more payments, and 72% of those said their credit score declined" (Irrera, 2021). While 9% of UK users reported that their BNPL repayments are unaffordable to them (Tijssen & Garner, 2021). To compare these figures with those of more traditional forms of credit that are highly regulated - the average Belgian default rate for 2020 was 5.1% (Centrale des crédits aux particuliers, 2021). This exemplifies that regulation can help to protect consumers from the risk of overindebtedness. Creditworthiness assessments for BNPL users are essential to ensuring that low-income users can access credit without over-extending.

The Consumer Federation of America has found that consumers "do not always understand the risks of these products" (Geron, 2021). The widely publicised harmful risks associated with credit card use has pushed consumers (particularly the younger demographic) to find an alternative solution to avoid getting into credit card debt (Geron, 2021). The misconception from consumers that the risk of debt associated with BNPL purchases is somewhat less financially damaging than other forms of debt is due to a lack of regulation allowing the manipulation of these associated risks. A UK study found that BNPL "is promoted to consumers as a payment option, rather than credit; the features are misunderstood by consumers; there are no checks on creditworthiness" which in turn leads to the potential for high levels of debt (Deane-Johns, 2021). A survey of merchants and users conducted by Bains in the UK shows that although BNPL has been branded as free credit, the data suggests that consumers "are paying for the lending, one way or another" (Tijssen & Garner, 2021). Their survey reported that 30% of merchants increased their prices by an average of 4.8% in order to compensate for fees charged by BNPL providers. In the US, one lender offered income-share agreements, which has since had a case brought against them by the Consumer Financial Protection Bureau (Geron, 2021). Nonetheless, this type of agreement is a startling indicator of the potential intentions of these lenders and the broader implications this may have on consumers if left unregulated.

## References

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