

United Kingdom: Treasury proposes to regulate BNPL market

In brief

On 21 October 2021 HM Treasury (HMT) published its much-anticipated [consultation](#) on the regulation of buy-now-pay-later (BNPL) products. The consultation arrives nearly seven months after HMT confirmed that it would formally consult on bringing BNPL products into the regulatory perimeter "as a matter of priority", following the [Woolard Review's](#) recommendation in that BNPL products should be brought within the regulatory perimeter "[a]s a matter of urgency".

In summary, the consultation sets out policy options to achieve a proportionate approach to regulation of BNPL, focusing on those elements of lending practice that are most closely linked to the potential consumer detriment as identified by the Woolard Review. HMT proposes:

- that BNPL lending be brought within the regulatory perimeter - although there are various options as to how widely to draw the perimeter.
- to disapply most of the Consumer Credit Act (CCA) formalities on disclosures, form and content to BNPL agreements, relying instead on the disclosure requirements set out in FCA's rules on consumer credit (CONC) (with any amendments the FCA might make to account for the specifics of the product).
- to apply some of the deterrent mechanisms in the CCA, including section 75 CCA (which enables customers to bring claims against lenders as well as merchants where goods have been mis-sold) as well as provisions on improper execution, and on customers in financial difficulties. Some CCA amendments may be required to bring small BNPL agreements within scope.
- to apply the FCA's rules on creditworthiness and customers in financial difficulties.
- to include access to the Financial Ombudsman Service (FOS).

For the merchant community, the consultation proposes that the BNPL regulatory framework include an exemption so that the broking of BNPL credit by a merchant would not lead to a requirement that the merchant is subject to regulation as a credit broker. However, the consultation has not settled on the precise scope of the to-be-regulated BNPL market. For lenders, it will be important to understand the regulatory position of merchants including, for example, how this may affect financial promotions and whether lenders might need to be involved in approving merchants' promotions of BNPL products if merchants do not ultimately require their own licence or authorisation as a credit broker.

We explore the proposals in more detail below.

Scope

Depending on their specific characteristics BNPL arrangements can fall within or outside the scope of current regulation, but are often unregulated, and it is these unregulated BNPL products that are the focus of HMT's consultation. At present, many BNPL products are able to rely on an exemption under article 60F(2) of the Financial Services and Markets Act 2000 (Regulated Activities) Order 2001 (RAO), which applies where there is an agreement for a fixed sum of interest free credit that is to be repaid within 12 months in no more than 12 repayments.

The Woolard Review concluded that unregulated BNPL arrangements pose a risk of harm to consumers. In particular, the Review identified a number of areas of potential consumer detriment including financial promotions, poor consumer understanding of the

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product, lack of affordability assessments and inconsistent treatment of customers in financial difficulty. For more on the Woolard Review's findings and recommendations, please see our earlier [client alert](#).

HMT agrees with the Review as to potential sources of consumer detriment but considers that there is "relatively limited evidence of widespread consumer harm materialising at this stage". For this reason, HMT's proposals aim to target within scope only those products where there is potential for consumer detriment, and to calibrate regulatory controls appropriately such that they are adapted to the BNPL business model and most closely linked to the potential consumer detriment.

Perimeter options

HMT recognises in its consultation that regulating the BNPL market will require boundaries to be drawn based on clear distinctions, which is a particular challenge given the many different BNPL arrangements that have developed and the different ways in which consumer detriment can manifest. While no specific boundaries are proposed in the consultation, HMT sets out the options currently under consideration:

Option 1	Option 2
Restricting the extension of regulation to interest-free credit agreements where there is a third-party lender involved in the transaction, and keeping arrangements directly between a merchant and a consumer exempt from regulation.	Defining a BNPL agreement as one where there is a pre-existing, overarching relationship between the lender and consumer, for example where a consumer opens an account with a lender, under which the lender agrees to finance one or more transactions but where any repayments made are toward specific agreements made as part of that relationship.
HMT is concerned that this option may draw the scope of regulation too widely, drawing in a large proportion of short-term interest-free credit (which HMT proposes to exempt – see further below) alongside BNPL. However, the boundary would be relatively clear and would be more likely to capture agreements identified as the most risky.	HMT is concerned that this option would leave open the possibility lenders making a relatively small change to the BNPL product, so that it bears more similarity to running-account credit, in order to avoid regulation.

Merchants to be (mostly) exempt

HMT is minded to exempt merchants from regulation as credit brokers where they offer BNPL payment options. This is because there are likely to be significant burdens and compliance costs if merchants which offer unregulated BNPL were subject to credit broking regulation, particularly for sole traders and micro-SMEs that exclusively trade online, and there is a risk that many merchants would instead cease to offer BNPL as a payment option limiting consumer choice and potentially conferring an unfair advantage on larger merchants who may already be authorised for credit broking.

However, this exemption is unlikely to be absolute - for example, merchants that sell goods or services when visiting customers in their homes may need to be regulated as credit brokers, given the particular risks of pressure selling that exist in that context.

Short-term interest free credit to be out of scope

Other financial arrangements using the article 60F(2) RAO exemption include formal interest-free instalment loans, repayable in under a year, generally offered by a third party and used to finance higher-value goods, as well as those which allow monthly payments for club memberships and season tickets, more often offered without third-party involvement, referred to in the consultation as "short-term interest free credit". HMT considers that these arrangements appear to share some of the same potential risks for consumer detriment as BNPL, but as the main drivers of consumer detriment identified by the Woolard Review are less pronounced, HMT is minded to keep them outside the scope of regulation for the time being.

Possible tightening of running-account credit exemption

HMT is also keen to examine the existing exemption from regulation for running-account credit, set out in article 60F(3) of the RAO, to ensure that it does not provide an opportunity for the unregulated BNPL model to transition to and re-emerge under this exemption.



Regulatory controls

HMT considers that the risk of consumer detriment in the BNPL market is inherently lower than in the mainstream credit market. As such, a number of regulatory controls that exist for the mainstream regulated credit market may be disproportionate to use for BNPL products. HMT is keen to ensure that any regulation of the BNPL market is proportionate to the risks involved – an approach which flows through to the key controls proposed.

Financial promotions

The Woolard Review identified specific concerns regarding the ways in which BNPL is currently advertised and promoted, and HMT is considering extending the scope of the financial promotions regime to include BNPL products. Together with the proposed [financial promotions gateway](#) regime (see our [client alert](#) for more detail), HMT takes the view that this extension will ensure effective oversight by improving due diligence and making sure approving firms have relevant expertise. It would also provide a substantial mitigation from any consumer detriment that could arise from merchants not being subject to credit broking regulation. It is not yet clear whether BNPL products would fall within the FCA's current financial promotion rules in CONC or whether they would be subject to their own bespoke regime.

In practice, this could mean that merchants would be required to obtain approval for promotions of BNPL products from an authorised person (which could, but does not have to, be their BNPL lender partner). Alternatively, merchants may find it more appropriate to enter into appointed representative arrangements with BNPL lenders.

Affordability and creditworthiness

HMT considers that the current CONC rules on carrying out affordability checks and creditworthiness should be applied to BNPL agreements, though the FCA may choose to tailor these rules to BNPL products. HMT also notes that it intends to work with credit referencing agencies to ensure clear and consistent credit reporting relating to BNPL.

Pre-contractual disclosures

The full extent of CCA-mandated pre-contractual information is unlikely to be proportionate to the risks posed by BNPL arrangements. As such, HMT proposes that BNPL lenders may be subject to rules requiring them to provide pre-contractual adequate explanations under CONC, subject to any bespoke rules the FCA may choose to introduce in respect of BNPL products.

Form and content of credit agreements

HMT considers that bespoke legislation should be developed as applying the CCA requirements for mainstream credit to BNPL products would be disproportionate.

Customers in financial difficulties

The consultation notes that the hardship policies offered by many BNPL providers are inconsistent and that there is no standard across the industry. HMT proposes to apply the FCA's rules on treating customers in financial difficulty to BNPL products to help create a standard approach, though these rules may require tailoring to make them more proportionate to the risks. HMT is also minded to apply the CCA requirements on the provision of post-contractual information on arrears and defaults, as well as the provision of information before a lender can take certain action to enforce a term of a regulated credit agreement, to further standardise the treatment of customers in financial difficulties.

CCA deterrent mechanisms

In addition to the CCA requirements relating to customers in financial difficulties mentioned above, HMT considers that section 75 CCA protection, which enables customers to bring claims against lenders as well as merchants where goods have been mis-sold, as well as the provisions on improper execution under sections 61 and 65 CCA should apply to BNPL.

CCA small agreements

Given their nature, the value of many BNPL agreements will fall below GBP50, and which means that they would be classed as small agreements under the CCA and consequently disappling some parts of the CCA. This means that some of the CCA protections for consumers discussed in HMT's consultation would not apply to many BNPL agreements under any regulatory



intervention. As a result HMT considers that it will likely be necessary to amend the CCA provisions on small agreements so that CCA requirements apply to BNPL agreements under GBP50.

Complaints

HMT proposes that the BNPL regulatory regime should include the ability for consumers to access the FOS for issues concerning the conduct of lenders.

Going forward

The consultation will close on 6 January 2022, with further consultations expected to follow on the more specific details of the regime from both HMT and, presumably, the FCA as it seeks to tailor the CONC rules to BNPL products. It is unlikely that the final BNPL regulatory regime will apply before the end of 2022 or into 2023.

While the consultation does not provide specific guidance or a firm indication as to the boundaries of the final regulatory perimeter, it is clear from the consultation that HMT remains open-minded as to how its proposals should be taken forward, giving the industry an opportunity to shape the future application of the regulatory regime. HMT also recognises that BNPL is a bespoke, relatively low-risk product and therefore it will not be appropriate or proportionate to apply all of the mainstream consumer credit regulatory rules.

The lighter-touch proposals in the consultation have been welcomed by the industry, given the prospect of more draconian application of mainstream consumer credit regulation in the wake of the Woolard Review's recommendations. The focus on third party lenders rather than merchants, together with the proposed credit broking exemption for merchants, is particularly favourable, as it will help ensure that BNPL products can still be offered as a means of payment during the checkout process (provided that any relevant financial promotions rules are complied with). Furthermore, applying consistent rules on issues such as financial difficulty and pre-contractual disclosures will help establish a level playing field through consistent industry standards and increased market certainty.

There are some important areas where clarification will be required as the consultation process moves forward. One such area is the interaction between the BNPL regime and other regimes - for example, whether firms who currently hold authorisation to provide other forms of regulated credit agreements, or to provide banking or payment services, will need to vary their existing regulatory permissions in order to offer BNPL. Clarification on the territorial scope of the new regime may also be helpful for firms based outside the UK who work with (or intend to work with) UK merchants and consumers. Alignment of the new regime with the scope of the existing consumer credit regime is likely to see cross-border providers of services into the UK require authorisation.

We would welcome engagement with you around the proposals, and if you would like to discuss them with us, please contact the individuals named on this alert.



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