UK Finance response to the HM Treasury consultation – Regulation of Buy-Now Pay-Later

CONFIDENTIAL

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Sent via email to: buynowpaylater@hmtreasury.gov.uk

1. UK Finance ("UKF") is the collective voice for the banking and finance industry. Representing more than 300 firms, we act to enhance competitiveness, support customers, and facilitate innovation.

2. We welcome the opportunity to respond to HM Treasury's (HMT) consultation paper on the draft regulation of Buy-Now Pay-Later ("BNPL"). Our members responded to HMT's previous consultation on the Regulation of Buy-Now-Pay-Later in October 2021 (the "first consultation")[1]

Executive Summary

3. The proposed amendments to the Regulated Activities Order seem to us to be unnecessarily complex. Our members would like to see the drafting simplified as per the simplification principle of broader CCA reform.

4. Members are concerned that, looking through a customer lens, it is not clear why lending by retailers should not fall within regulation if the same harms are potentially relevant. For mainstream lenders, a significant issue with BNPL facilities was the lack of affordability assessments and the lack of transparency of the lending to support the industry's assessment of a customer's financial circumstances. These concerns apply whether or not the lender is the retailer or a separate legal entity. HMT should consider exploring options to bring the most concerning merchant-based use cases into regulation.

5. There is a divergence of views across our members as to whether merchants should have to be authorised for credit broking. The majority of our members are keen that there is a level playing field and that the same or similar activities are regulated in the same way. As such, these members believe that there are other products which are equally likely not to cause consumer detriment and for which introductions to credit providers should not cause a firm to need to become authorised by the FCA. Our BNPL members support the proposal that merchants should not have to be authorised for broking.

6. Our members are supportive of removal of the pre-contract credit information (PCCI) for all products. However, there is a divergence of view across our members as to whether earlier reform of PCCI requirements should be made for BNPL products. Our BNPL members and certain other lenders would be accepting of changes to PCCI requirements for BNPL products pending broader reform of PCCI under the CCA. Our members (other than the BNPL lenders)

[1] https://www.ukfinance.org.uk/system/files/UK-Finance-response-to-the-HMT-BNPL-consultation-FINAL-060122.pdf

would not wish to see any other divergence in requirements and would support simultaneous reform across both BNPL and unsecured credit through the prioritisation of CCA reform.

Overarching comments

Consumer credit

7. We would repeat our observations in response to the first consultation in January 2022 that firms undertaking the same activity and posing the same levels of risk can face different levels of regulation, and firms can face the same regulation despite posing different levels of risk. As we noted, this is particularly problematic for customers, who might reasonably expect, but cannot currently be guaranteed, the same protections when consuming broadly substitutable products and services. Our general position continues to be that regulations should subject the same activities and risks to the same regulation, with the same consumer protection.

8. The basis for proportionate regulatory controls, as advanced by HMT for BNPL in the first consultation and short-term interest free products falling within article 60 (F)(2) RAO assumes that because no interest is charged the risks of the products are inherently lower than interest bearing products. The majority of our members disagreed with this assessment for BNPL and did not see the difference to the consumer between one off retail transactions provided through BNPL financed by a merchant or a third party.

9. The recent FCA discussion paper on the expansion of big tech into the retail financial sector[2] seeks to develop an effective competition regime for Big Tech's approach into financial services and recognises that in the longer term, *there is a risk that the competition benefits from Big Tech entry in financial services could be eroded if these firms can create and exploit entrenched market power to harm healthy competition and worsen consumer outcomes (Page 4).* As such our members continue to call for same activity, same risk, same regulation where BNPL is offered directly by merchants. In the discussion paper, the FCA finds a plausible entry strategy for big tech firms through providing BNPL. The FCA suggests that big tech firms might provide BNPL, "*to facilitate purchases on their own platforms, taking advantage of user data and purchase history as a simple form of credit reference… In the long-term, a competition risk may emerge where …in BNPL provision, a Big Tech firm could gain market power by leveraging its user base from its digital wallet or online marketplace, without necessarily having the superior product*." (page 32). Any future regulatory regime should take this into account.

10. We note that in Europe, the proposed Consumer Credit Directive II is looking to regulate credit provided by, "*large online suppliers of goods and service which have access to a large customer base*" (recital 15(d) proposed CCD II). The stated reasoning for this is precisely that, "*such large online suppliers, considering their financial capacities and their ability to drive consumers towards impulsive buying and potentially over consumption, would otherwise be able to offer deferred payment in a very extensive way without any safeguard for consumers*" (proposed recital 15(d) CCD II).

11. Since the First Consultation, HMT has now published its consultation on CCA reform which is to be welcomed. We note in our response to the CCA reform consultation paper that consumer credit reform will take time to do properly but we are keen that reform progresses in a timely fashion, not least because parts of the consumer credit regime currently do not result in good customer outcomes as required by the FCA's Consumer Duty. We therefore suggest in our CCA response that HMT consider whether there are areas where more timely reform can take place through the use of secondary legislation which avoids the need to secure parliamentary time. This resonates with our first consultation response on BNPL which suggested HMT examine whether there was scope to immediately amend the existing provisions of the CCA through

[2] https://www.fca.org.uk/publication/discussion/dp22-5.pdf

secondary legislation and apply a more proportionate regime across all regulated credit. This would alleviate competition concerns from the majority of our members and create the level playing field that is required.

12. In the Consultation response to the first consultation HMT articulates an expectation that firms report to all three CRAs. Given that the reporting of information to bureaus is part of the ongoing consultation through CIMS it appears to be premature to articulate a regulatory expectation for one sector only and that this should be more appropriately wrapped up as part of the CIMS review to ensure a level playing field.

13. The need for reform of the BNPL was highlighted in the Woolard Review and there is a significant desire from our members to see the recommendation that these products are brought into regulation without further undue delay.

CONSULTATION QUESTIONS

Question 1: do you have any comments on the proposed approach and/or drafting to bring agreements into regulation that are provided by a third-party lender in article 3(4) of the draft legislation?

We would make the following observations in relation to the drafting of the proposed amendments to 60F:

1. the drafting seems to us to be unnecessarily complex. This is because 60F is already an exemption from regulation. The proposed amendments draft exclusions from the amendment to bring BNPL agreements back into regulation, but it then excludes from the exclusions certain activities to bring them back out of regulation. In effect, the are 3 layers of negative scope to work through. However, even in working through what is captured as needing to fall back into regulation, this is defined negatively (i.e. where two conditions are NOT the case). This creates significant complexity and is not easy for lawyers not seeped in consumer credit regulation to work through. Given HMT's aim for the wider CCA reform is to simplify the legislation and regulation relating to consumer credit, which our members support, this style of drafting does not meet that objective.

2. The legislation brings back into regulation agreements where the lender and the supplier are not the "same person". From a drafting perspective, we assume that this would mean the same legal entity. If, therefore, a retailer managed its credit arrangements in a different central treasury entity or within a separate entity that provided credit facilities to its own retailer brands, this would seem then to fall within regulation. We can see that this could have unintended consequences.

3. Article (7A) requires consideration in the context of the wider legislative provisions. For example, the Article 60F(2) definition only applies to a borrower-lending-supplier (B-L-S) agreement, which itself has 3 limbs to the definition. The first limb of a B-L-S is a credit agreement financing a transaction between the borrower and the lender. We suspect that it would be possible to exclude merchant provided credit from the original definition of B-L-S as an alternative approach to the drafting.

Finally, we note HMT's decision only to amend the fixed-sum interest free exemption in 60F(2) and not to make any amendments to cater for running-account agreements. We would make the following points in relation to this:

1. We support the current exemption in Art 60F(3) in relation to its application to charge cards. We do not believe there is a case to remove that exemption and are very supportive that HMT has not made any amendments to that exemption to narrow it.

2. We are concerned, however, about the legal accuracy and basis for the commentary in para 2.18 of the consultation paper which states: "*The government is aware that some lenders currently offer products that appear to have some of the features of running-account agreements, but which in fact consist of numerous fixed-sum agreements taken out under an arrangement where a lender gives a consumer a credit limit which sets the maximum overall balances that can be outstanding at any one time. However, despite the existence of such a credit limit, these agreements appear to be a series of A60F(2) fixed-sum agreements*". Members believe that, if this legal view is correct, it could call into question a number of existing regulated running-account credit products already on the market which are created in reliance on the existing definition of a running account agreement. The current definition of a running-account credit agreement under the CCA is, "*a facility under a consumer credit agreement whereby the debtor is enabled to receive from time to time (whether in his own person, or by another person) from the creditor or a third party cash, goods and services (or any of them) to an amount or value such that, taking into account payments made by or to the credit or the debtor, the credit limit (if any) is not at any time exceeded*" (section 10 CCA). An agreement will be running-account where a facility is put in place that enables drawdowns under that overarching agreement and payments pay back and refresh the credit available to be drawn down by borrowers. These agreements are rightly treated as running-account and would not be capable of being run or documented as a series of fixed-sum agreements.

3. Our members agree with the points made at para 2.19 that it is not possible to use the 60F(3) exemption to create BNPL style agreements that fall outside regulation. However, our members are concerned that products that are rightly drafted as running-account agreements and operate within the framework of a credit limit, will not benefit from the same light touch regulatory regime as BNPL fixed-sum agreements. Our members believe that the same/similar activities should face the same/similar regulatory requirements. To the extent that there are carve outs given to fixed-sum BNPL agreements these should also be made available to running-account BNPL style agreements. In particular, it creates a competitive imbalance to require retailers to be authorised for credit brokerage if they introduce a running-account BNPL model, but not to require authorisation for a fixed-sum model.

While UK Finance members can understand HMT's policy desire not to bring into regulation a large amount of retailers who offer finance arrangements that have not been raised as giving rise to significant regulatory concerns, members are nonetheless concerned that, looking through a customer lens, it is not clear why lending by retailers should not fall within regulation if the same harms are potentially relevant. For mainstream lenders, a significant issue with BNPL facilities was the lack of affordability assessments and the lack of transparency of the lending to support the industry's assessment of a customer's financial circumstances. These concerns apply whether or not the lender is the retailer or a separate legal entity.

An alternative approach might be to seek to better define what should or should not amount to credit. For example, there are certain services which are more in the nature of a "pay as you go" arrangement where payment for services largely coincides with the services being provided for that period. For

example, credit use to fund certain insurance products can be more akin to a monthly subscription arrangement. If, under those arrangements, non-payment is managed by the customer being released from their ongoing obligations, but also losing the ongoing benefits, this type of arrangement may not be considered akin to credit. There may be scope, therefore, to narrow down what might be considered to fall within the definition of credit rather than creating artificial and ad hoc exemptions for specific types of lender or products being financed.

As noted, members consider that there is the same risk of harm to consumers through the provision of BNPL funded through merchants directly. Applying a blanket exemption to merchant provided BNPL might pose a number of risks (e.g. lack of consumer protection, unlevel playing field). HMT should consider exploring options to bring the most concerning merchant-based use cases into regulation – one might be a threshold-based approach.

Question 2: do you have any comments on the proposed approach taken to bringing agreements into regulation where a lender purchases goods or services from the original supplier in the way set out in new draft paragraph 7A(b) in A60F?

'Same activity, same risk, same regulation' should apply consistently across the range of business models set up to deliver the same customer outcome. Our members therefore agree with this anti-avoidance provision.

We do have views on the proposed drafting though. There is quite a lot of complexity involved in a lender taking ownership of the goods/services. Models such as these normally arise where the goods are to be funded under an arrangement that enables the lender to retain some form of rights over title to the goods. This would normally involve a Hire Purchase or a Conditional Sale structure. These structures are already excluded from the exemption by subsection 7(b). The exemption appears, therefore, to be focused on credit sale agreements, which normally involve the lender taking economic risk in relation to the goods or services being supplied.

There are other models of BNPL in the market which involve the merchant providing the credit, but under arrangements whereby a third party provides all the operations needed for the lender to run those loans. Often the platform is third party branded and the customer can believe that its loan is with a third party, even though it is with the merchant. These lending arrangements would, under the current proposals, remain potentially outside regulation.

Question 3: do you consider that there may be unintended consequences of the government's proposed drafting of the proposed legislation to capture these agreements?

As set out in relation to Question 2, we highlight that requiring the lender and supplier to be within the same legal entity could unintentionally bring into regulation retailers who are simply structured such that they have a separate financial services group entity that technically provides the finance to its other retailers in its group.

That said, our members believe that the lack of regulation across all lending activities that share the same characteristics appears to be a gap that does not make sense from a consumer protection

perspective, created the possibility for loopholes to be exploited and is inconsistent with the notion that the same activity should face the same regulation.

Question 4: do you have any comments on the proposed legislative approach and/or the drafting which seeks to ensure that agreements made by third-party lenders that finance premiums under contracts of insurance will continue to be exempt under A60F(2)?

Lending activity which is carried out by a third-party lender (as opposed to being provided by the insurer itself) also arises in the premium credit market. These arrangements tend to be structured as running-account credit agreements and so they would not fall within the exemption. If there are other third-party insurance funding arrangements in the market that utilise the fixed-sum exemption, UK Finance members are concerned that this does cause different regulatory treatment between these funders and premium finance providers, which does not appear to be justified on the basis of the activities being carried on.

It is also not clear why insurance products that spread payments across the year should be treated differently to other purchases. Often these insurance products are essential spend. Also, this would exempt products structured as "insurance", but the exemption would not be available for other types of warranties that may have a similar effect to insurance (e.g. breakdown cover on white goods). The rationale for this is not clear.

Please also see out comments in relation to Question 5.

Question 5: do you think it is appropriate for there to be an exemption for interest-free borrower-lender-supplier credit agreements repayable in under 12 months in 12 or fewer instalments, where they are provided by registered social landlords to their tenants to finance the provision of goods and services?

Yes. Members agree with government's intention to support low-income tenants and leaseholders, who are unlikely to access traditional forms of credit, to finance white goods and/ or repairs to buildings through affordable agreements. Nevertheless, members would suggest that HMT and the FCA monitor the evolution of this credit market area to assess the potential for consumer harm to arise in the future.

Question 6: do you have any comments on the proposed drafting which seeks to ensure that agreements that are offered by registered social landlords to their tenants and leaseholders, and where there is a third-party lender involved, will continue to be exempt under A60F(2)?

The drafting seems wider as it exempts any goods and services being financed. If an exemption is appropriate, it feels like the types of good and services ought to be limited.

Question 7: do you have any comments on the proposed drafting which seeks to ensure that agreements (i) where the borrowers are employees and, (ii) which result from an arrangement between their employer and the lender or supplier, will continue to be exempt under A60F(2)?

It may not be clear what is meant by an "arrangement". For example, there may be circumstances in which suppliers and lenders utilise companies that provide a range of employee benefits by

themselves partnering with lenders / suppliers. Would the definition of arrangement cover both direct and indirect arrangements of this type?

The position of employer / employee lending now needs to be reviewed more holistically by HMT. The existing employer lending exemption in 60G of the Financial Services and Markets Act 2000 (Regulated Activities) Order 2001 (**RAO**) is unnecessarily complex and limited and was drafted as it is due to the UK's implementation of the Consumer Credit Direct. This can now be reviewed in light of Brexit. Rather than add in another very specific exemption into this exemption, UK Finance members would advocate for a broader and more comprehensive exemption for employee benefit lending, which should not fall within the consumer credit regime at all as these loans tend to be limited for specific employee needs, come as a benefit of employment, and are often deducted direct from salary.

Question 8: do you have any comments on the proposed legislative approach and/or drafting taken to exempting merchants from credit broking regulation?

There is a divergence of views across our members on this question. The majority of our members are keen that there is a level playing field and that the same or similar activities are regulated in the same way. As such, our members believe that there are other products which are equally likely not to cause consumer detriment and for which introductions to credit providers should not cause a firm to need to become authorised by the FCA. In particular, running-account lending that may share similar features to BNPL lending (e.g. it is interest free) should be capable of being provided without retailers needing to be authorised as credit brokers.

On drafting points, 36FB exempts an "agreement to which paragraph (7A) of Article 60F applies". However, because paragraph (7A) itself then defines what agreements are not caught, it can be confusing trying to work out whether it is the agreements that are defined in Article (7A) as not being caught by the paragraph, or the agreements that are being caught by the paragraph that are meant to be captured in Art 36FB.

We make the point in Question 1 that we believe the drafting should be reconsidered and simplified where possible to aid understanding and application.

Question 9: do you have any comments on the proposed legislative approach and/or drafting to regulate merchants as credit brokers when they are a domestic premises supplier?

The concept of a "domestic premises supplier" is not one that currently exists in the RAO to define activities that are caught or not caught by the regulatory perimeter.

The RAO (which carried through the concept from the Consumer Credit Act) uses the notion of canvassing off trade premises. It is not clear how these definitions sit together and how the exclusion for certain canvassing off trade premises activities sits alongside this new concept.

We also believe that the definition is very wide and potentially not appropriate to be used as a determination for the perimeter of regulation. This is because:

1. A person appears to be capable of being a domestic premises supplier if they sell or offer to sell any goods or services in the customer's home (unless this happens only occasionally). This would mean that a retailer would not be able to benefit from the exemption from credit broking even if they do not sell any products for which they offer BNPL agreements in the customer's home. This is because there is currently no linkage between the goods / services being sold as a domestic premises supplier and the credit broking activities. This seems to unfairly prevent certain retailers ever being able to benefit from the exemption even if their BNPL brokerage activities took place only for different goods / services only ever sold online or by means that did not involve home sales. This is also likely to make it very difficult to provide oversight by lenders.

2. Given there is a desire to exempt social landlords, is it possible that the nature of a landlord relationship means that there will be an element of servicing borrowers in their homes. This carve out may have the effect of defeating the policy intention.

Question 10: do you have any comments on the proposed legislative approach and/or drafting which seeks to ensure that unauthorised merchants will be required to have their promotions approved by an authorised person?

Our members support the fact that unauthorised merchants will be required to have their promotions approved by an authorised person.

Question 11: do you have any comments on the proposed legislative approach and/or drafting which seeks to disapply the CCA requirements on pre-contractual information for agreements that are brought into regulation?

Our members are of the view that the current information requirements applicable to agreements do not work well for customers and need to be significantly reformed. Our members do not believe that the prescriptive form and content requirements applicable to the Pre-Contract Information, which derive from the EU Consumer Credit Directive, are appropriate.

Our members are therefore supportive of removal of the PCCI for all products. Our BNPL members and certain other lenders would be accepting of changes to PCCI requirements for BNPL products pending broader reform of PCCI under the CCA. However, our members (other than the BNPL lenders) would not wish to see any other divergence in requirements and would support simultaneous reform across both BNPL and unsecured credit through the prioritisation of CCA reform. See our response to question 16.

Question 12: do you have any comments on the proposed legislative approach and/or drafting to disapply the DMRs for unauthorised intermediaries where information is disclosed by lenders in accordance with the FCA's rules on distance marketing for authorised persons?

We do not believe that this amendment is necessary or desirable. The Distance Marketing Regulations (DMRs) would only apply in our view where there is a contract entered into between a customer and an intermediary for the provision of services. If the services are such that they require

DMR disclosures (e.g. in the context of the services of an IFA) then they should continue to apply as they do today. If the more likely scenario arises that the credit broking activity is not provided under a contract for services to which the DMRs would apply, then it is unhelpful for this provision to suggest that such activities need to comply with distance marketing rules at all.

Question 13: do you consider that this proposed approach will give firms sufficient flexibility to provide information in accordance with CCA pre-contractual requirements rather than the tailored regime for agreements that will be brought into regulation?

We agree that no legislative amendments are needed to allow a firm to over-comply should they wish to provide a Pre-Contract Information document in accordance with full consumer credit requirements. See also our response to question 11.

Question 14: do you have any comments on the proposed legislation which seeks to disapply the small agreements provisions for agreements that will be brought into regulation?

Our members believe that it is important that regulation does not unnecessarily regulate small agreements that do not give rise to consumer detriment. We are supportive of regulating BNPL agreements and so the carve out provided for those agreements only is welcome.

Question 15: do you have any comments on the proposed legislation that seeks to implement the TPR?

Generally members are supportive of the use of a temporary permissions regime to bring in regulation quickly, but proportionately for existing firms operating in the market. There are, however, aspects of the process that our members would want to ensure do not give rise to difficulties:

1. The intention is that a temporary permission would expire after the application has been approved, refused or withdrawn. In some cases, we understand that the FCA may be seeking withdrawals of applications that they deem not to be complete applications, rather than engaging with firms to obtain complete information. It would not be appropriate for the FCA to encourage withdrawal of an application on that basis if this means that a firm's temporary permission then lapses without an ability to keep it open pending ongoing authorisation discussions.

2. In some cases it is possible for a firm to notify the FCA that it does not intend to apply for a full authorisation even though they have obtained a temporary permission. This then appears to have the effect that the temporary permission will then expire automatically within the timeframes set out in legislation. This does not appear to have any ability for a firm to change their decision and to reignite their application during their temporary permission period. It might be sensible to build in flexibility for the FCA to allow such a continuation in appropriate circumstances.

Our members call for FCA rules for the TPR to be published as quickly as possible to allow firms to have sufficient time to prepare.

Question 16: do you think that the requirements for the content of agreements set out in the Consumer Credit (Agreements) Regulations 2010 are proportionate to apply to agreements that will be brought into regulation?

- Members do not believe that the requirements for the content of agreements set out in the Consumer Credit (Agreements) Regulations 2010 deliver the right outcomes for any regulated agreement to which they apply. As noted in the Industry response to the First Consultation the majority of our members do not consider why the nature of BNPL products should drive different regulatory requirements as they do not consider these products to be lower risk for the reasons set out in the Industry response to the First Consultation. As such as was noted in that response, the majority of members have called for the application of the regulations to BNPL to ensure a level playing field pending any broader reform of the CCA.

- Industry in its response to CCA reform has called for a considered review of the information requirements set out in the CCA. A less prescriptive, more principles-based, outcomes-focused consumer credit regime is sought which, amongst others, enables firms to tailor the content of agreements based on their customers' needs. Noting the impact on consumer duty obligations, industry has called upon HMT to consider whether there are more immediate amendments that could be made to the CCA in relation to the prescriptive requirements for agreements to enable FCA rules to come into force earlier by significantly slimming down the legislative requirements placed on firms only to very key information. This would help address the level playing field objections raised by members.

- Pending that broader reform, our BNPL members view is whilst the application of these requirements to BNPL products will cause friction this will be disproportionate, requiring as it will a level of friction to be applied every time a customer uses their BNPL account to pay for goods or services. Customers will have to review and accept a new agreement every time they transact and creditworthiness assessments would have to be applied at every transaction, even where these happen on the same day or in the same week. The friction will not improve consumer outcomes, consumers do not read agreements so this proposal will not improve outcomes/understanding and some providers believe this will have an impact on the way that BNPL products are structured in future as this approach incentivises switching to a running account model with a higher opening credit limit for consumers

Question 17: What do you expect the impact 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?

No comments.

Question 18: 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?

No comments.

Question 19: Do you have any further data you can provide on the potential impacts on persons sharing any of the protected characteristics?

No comments.

If you have any questions or comments, please do not hesitate to contact Ian Fiddeman (ian.fiddeman@ukfinance.org.uk) or Jackie Barodekar (Jackie.Barodekar@ukfinance.org.uk).

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