FLEXING THE FUTURE

Buy Now Pay Later in the UK

April 2025

The Centre for Social Justice

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About the Centre for Social Justice

Established in 2004, the Centre for Social Justice (CSJ) is an independent think tank that studies the root causes of Britain's social problems and addresses them by recommending practical, workable policy interventions. The CSJ's vision is to give people in the UK who are experiencing multiple disadvantage and injustice every possible opportunity to reach their full potential.

The majority of the CSJ's work is organised around five "pathways to poverty", first identified in our ground-breaking 2007 report Breakthrough Britain. These are: educational failure; family breakdown; economic dependency and worklessness; addiction to drugs and alcohol; and severe personal debt.

Since its inception, the CSJ has changed the landscape of our political discourse by putting social justice at the heart of British politics. This has led to a transformation in Government thinking and policy. For instance, in March 2013, the CSJ report It Happens Here shone a light on the horrific reality of human trafficking and modern slavery in the UK. As a direct result, the Government passed the Modern Slavery Act 2015, one of the first pieces of legislation in the world to address slavery and trafficking in the 21st century. Other CSJ policy initiatives include Universal Credit, Universal Support, and the Into Work Guarantee; Family Hubs; Housing First; Severe Absence from School; and Prisoner Work Placements.

Our research is informed by experts including prominent academics, practitioners, and policymakers. We also draw upon our CSJ Alliance, a unique group of frontline charities, social enterprises, and other grassroots organisations. These are curated by our CSJ Foundation and have a proven track-record of reversing social breakdown in some of the UK's most challenging communities, far beyond Westminster.

The social issues facing Britain are chronic. In 2025 and beyond, we will continue to advance the cause of social justice and connect the back streets of Britain with the corridors of power, so that more people can continue to fulfil their potential.

Acknowledgements

The CSJ would like to extend our thanks to the many individuals and organisations who shared their time, expertise, evidence, and feedback in the preparation of this report. We would like to specially thank the supporters of the Debt Unit, including, Lowell, Aryza, Equifax, and Money Wellness who make our work possible.

We would like to thank all the individuals who have shared their expertise, evidence, feedback and time in the preparation of this report.

Executive Summary

In October 2024, HM Treasury released its latest consultation on regulating Deferred Payment Credit, more commonly known as Buy Now Pay Later (BNPL). The market has grown significantly over the last few years, offering consumers a new form of credit that allows them to repay over multiple, interest free repayments.

Since its explosion in popularity, much attention has been directed towards the market and how consumers engage with it. This short paper is our contribution.

Using the Bank of England NMG Survey and our own polling research, we explore which consumers hold aggregate DPC and what their household finances look like. We find that 11 to 12 per cent of households – equivalent to about 3 million households – say they owe money on buy now pay later agreements. While the mean borrowing remains high at £874, the median is considerably lower at £350. In total, our analysis suggests households owe about £2.6 billion in aggregate, although this is likely to be an underestimate.[1]

Overall, we find that BNPL does not significantly affect households' debt to income ratios in our sample. In our analysis, 68 per cent of households' ratios change by 2 per cent or less. However, our analysis is limited to those households that currently owe money on the product, so it's possible that this underestimates the extent to which BNPL has become a means of financing purchases.

Importantly, our analysis suggests BNPL is particularly popular amongst subprime households, and this aligns with evidence emerging from the American Consumer Financial Protection Bureau. This suggests there is the genuine potential for BNPL products to substitute higher cost lending for consumers where they're managed appropriately.

But we also identify a cohort of BNPL users who say they are cutting back because they worry about further access to credit, and those households tend to have higher debt-to-income ratios. This suggests some users show heightened vulnerability, which will demand further attention throughout a consumer's lending journey.

In the final chapter of this paper, we propose a number of recommendations to prepare for regulation:

These include:

- Investigating the potential for channel-dependent disclosure requirements to insert friction for consumers,
- Bringing forward plans to reform the Consumer Credit Act,
- Reviewing the appropriate fee for complaints about DPC to the Financial Ombudsman Service,
- Refusing credit card payments for DPC,
- Asking the FCA to produce a market study alongside its future consultation on FCA rules for DPC.

1 Previous research has shown that the Bank of England NMG Survey – like all surveys – underestimates the use of unsecured debt compared to national accounts data. Institute for Fiscal Studies, *The Bank of England / NMG Survey of Household Finances*; Bank of England, *Research Datasets*. Office for National Statistics, *Families and Households in the UK: 2022.*

Introduction

Over the last few years, the consumer credit market has been evolving. Old forms of credit have departed from the market in the aftermath of regulatory intervention, while new forms have taken the market by storm.[2] Deferred Payment Credit – more commonly known as Buy Now Pay Later – has grown in popularity and leading providers have become household names.[3]

Deferred Payment Credit is a form of short-term, interest-free instalment credit that is accessed by consumers at the checkout of online and increasingly also physical retailers.[4] It allows consumers to spread payments across several monthly payments for zero interest, and usually charges them fees for late repayment.

As it stands, Deferred Payment Credit sits outside the Financial Conduct Authority's regulatory perimeter because it benefits from an exemption from regulation in the Financial Services and Markets Act 2000.[5] The Government has published draft legislation to amend this discrepancy and regulation is expected to come into force in 2026.[6] The rapid growth of Deferred Payment Credit paired with its regulatory exemption has provoked concerns among consumer groups about the potential for the product to cause consumer harm.[7]

This paper marks our first contribution to the topic. In it, we augment existing literature on Deferred Payment Credit by analysing survey data from the Bank of England's NMG Survey to understand the size of the market as well as which households are likely to be using DPC and how much of it they are using.[8] Finally, we discuss a number of issues and concerns about the future of Deferred Payment Credit complete with a series of recommendations for the Government and regulators.

2 Financial Conduct Authority, *Dear Chief Executive Officer: FCA Strategy for Consumer Lending*.

3 We use the term Deferred Payment Credit to make a distinction between other forms of credit where payment for goods and services is deferred. This is consistent with the of the term by the Financial Conduct Authority. Financial Conduct Authority, *Deferred Payment Credit: findings from the Financial Lives Survey*, October 2023.

4 Klarna, Zilch, and Virgin Money Slyce are three examples a Buy Now Pay Later form using a card for payment at a physical point of sale as well as online checkout.

5 Legislation.gov.uk, *Financial Services and Markets Act 2000 (Regulated Activities) Order 2001*.

6 Gov.uk, *Regulation of Buy-Now Pay-Later: consultation on draft legislation*.

7 Which?, *Under Pressure: Who uses BNPL?;* StepChange, *StepChange responds to launch of new Buy Now, Pay Later regulation proposals*; Citizens Advice, *Buy Now… Pain Later?*

8 For details of this analysis, please see Box 1 and Appendix 1.

Methodology

Quantitative Analysis:

To understand the market for Deferred Payment Credit, we have used the Bank of England's NMG Survey for 2023 and 2024. The 2023 wave of the survey interviewed 5,914 households and was carried out between 30th August – 19th September 2023. The 2024 wave of the survey interviewed 6040 households and was carried out between 24th August - 17th September 2024. The survey provides a timely update on household balance sheets ahead of other large scale surveys, such as the Wealth and Assets Survey and the UK Household Longitudinal Survey.

The NMG Survey is conducted online and weighted to be representative of the GB population in terms of age, gender, region, housing tenure, and employment. Within these criteria, the survey population is drawn randomly from the panel. Note, the NMG survey is conducted at the household level, so results are not comparable to other surveys that operate on the individual level. Further information about the survey can be found here.[9]

Analysis was conducted using the open-source coding software R.

Proprietary Polling:

The Centre for Social Justice undertook polling of 4,022 UK adults with polling firm Opinium. The results are weighted to be nationally and politically representative. As part of this polling, we segment the UK population.

Consumers are generally referred to as prime, near prime or sub prime and these terms relate to their credit score.[10] They help to articulate how great a risk consumers are perceived to represent to lenders. Having a subprime credit score can make it harder to access credit and can lead to less favourable terms where it is offered, such as paying a higher interest rate or being given a lower credit limit. For our methodology, see appendix 1.

9 Institute for Fiscal Studies, *The Bank of England / NMG Survey of Household Finances*; Bank of England, *Research Datasets*.

10 Lloyds Banking Group, *What is a credit score?*

What is Deferred Payment Credit?

Deferred Payment Credit – more commonly known as Buy Now Pay Later – is a consumer credit product that allows customers to borrow – usually small – sums of money on an interest free basis. The agreements are usually for a fixed amount – known as fixed sum credit – and are repaid on a monthly basis.

Currently, Deferred Payment Credit benefits from a regulatory exception under Article 60F of the Financial Services and Markets (Regulated Activities) Order 2003, due to its specific features. This means it sits outside of the Financial Conduct Authority's regulatory remit and is therefore not regulated like the rest of the consumer credit market. This, however, is set to change and the government announced a consultation on regulation in October 2024.

Table 1: Exemption for fixed sum (deferred payment credit) in legalisation.

(2) A credit agreement is an exempt agreement if –

a) the agreement is a borrower-lender-supplier agreement for fixed-sum credit other than a green deal plan

b) the number of payments to be made by the borrower is not more than twelve

c) those payments are required to be made within a period of 12 months or less (beginning on the date of the agreement)

d) the credit is

(i) secured on land, or

(ii) provided without interest or other charges

Source: Financial Services and Markets Act 2000 (Regulated Activities) Order 2001

Over recent years, the market has for deferred payment credit has grown substantially. Evidence pertaining to the size of the market varies significantly. Grant Thornton have suggested that total BNPL spending rose to £16.8 billion in 2023, a 12.8 per cent increase from 2022 while evidence from the Financial Lives Survey indicates that 17 per cent of people borrowed deferred payment credit in 2022, rising to 27 per cent in January 2023.[11]

11 Grant Thornton, *What's next for BNPL in 2024?*

According to our analysis of the Bank of England's NMG Survey, 11 to 12 per cent of households – equivalent to about 3 million households - said they had used Deferred Payment Credit in 2023 and 2024. Noticeably, however, the mean amount of borrowing outstanding on BNPL increased from £761 in 2023 to £874 in 2024. This suggests a market size of about £2.6 billion, although this is likely to be an underestimate.[12]

During this time, the market also welcomed new entrants from outside the collection of fintech providers that originally defined the market. High street providers have entered the market, and different providers have innovated to bring their own products to market.[13] For example, some providers have created credit cards that allow consumers to defer their payments, and these products are regulated by the Financial Conduct Authority.[14] Notably, however, not all forays into the market have been successful and some providers have already left the market.[15]

The intricate differences between products and the speed at which the market continues to develop makes segmentation difficult, but a number of key themes and directions of travel can be detected. These are:

- **Providers are diversifying their offer:** Typically, BNPL has been known for fixed sum models where consumers paid their credit off at zero interest in a few payments. While these products remain common, some providers are choosing to diversify their offer by creating new products or offering the opportunity to pay over a longer period with interest or fees.
- **Late fees are more common:** Over the course of the last few years, a greater number of providers have started charging late fees. Most notably, Klarna decided to introduce late fees in 2023.[16] Late fees are a common feature of BNPL options because it is suggested they encourage consumers to repay. Research produced by the Centre for Financial Capability suggest that almost 25 per cent of UK buy now pay later users have paid a late fee.[17]
- **App usage is a key feature:** App usage is important to some DPC providers who are able to aggregate different merchants and help consumers access the products they're seeking. The Bank of International Settlements shows a significant increase in the number of daily active users of BNPL apps over time.[18]

Growing Concerns:

The startling rate of growth in the use of Deferred Payment Credit prompted concern from across the market, including politicians, consumer groups, industry, and regulators. Concerns spanned from the belief that consumers are being induced to increase their total spend to limited consumer understanding of Buy Now Pay Later, particularly the fact it is a form of credit / debt.

12 Previous research has shown that the Bank of England NMG Survey – like all surveys – underestimates the use of unsecured debt compared to national accounts data. Institute for Fiscal Studies, *The Bank of England / NMG Survey of Household Finances*; Bank of England, *Research Datasets*. Office for National Statistics, *Families and Households in the UK: 2022*.

13 Financial Times, *UK banks pile into buy now, pay later in battle with fintechs*.

14 Virgin Money, *Buy now, pay better*.

15 PYMNTS, *NatWest to end BNPL option due to lower than expected use*.

16 CityAM, *Klarna: Late fees are in the interests of consumers taking on too much debt*; Money Saving Expert, *Klarna to start charging fees if you miss a payment – here's what you need to know*.

17 Financial Times, *One-quarter of UK buy now, pay later users hit by late repayment fees*. It should be noted. Affirm recently announced it will enter the UK BNPL market and it does not charge late fees. Financial Times, *US 'buy now, pay later' group Affirm launches in UK*.

18 Bank of International Settlements, *Buy now, pay later: a cross-country analysis*; Bain and Company, *Buy now, pay later moves center stage with consumers and regulators*.

Below, we categorise some of the concerns raised over the last few years.

Affordability Checks and Responsible Lending:

- **Affordability checks:** The Woolard Review first noted that many BNPL providers complete a very basic credit assessment via a soft credit search and previous repayment history. This meant that while firms appeared to be assessing credit risk, some firms did not appear to be conducting affordability assessments.[19]
- **Induced increased spending:** Merchants pay BNPL providers for their services and a key selling point for retailers is the promise that buy now pay later products can increase the total basket size consumers purchase.[20] Research from the United States has noted that the adoption of BNPL increases both the number of purchases made and the value of those purchases.[21] It has also shown that BNPL instalment payments reduce the perceived cost of purchases and that this works to increase the likelihood of making purchases.
- **Presentation of offers:** The Woolard Review noted that the presentation of offers seeks to play into consumers' behavioural biases, including present bias, availability bias, and confirmation bias.[22]
- **Supplying credit reference agency data:** For some time, BNPL providers did not pass data to credit reference agencies and there is no requirement for any firm (regulated or otherwise) to share data.[23] While this has begun to change, the limited credit reference agency data meant – and to some extent still does mean – that credit providers may have a difficult time detecting BNPL debt on consumers' credit reports.[24]

Repayment and Consequences of Delinquency

- **Paying with credit:** Research using UK credit card data has shown that 19.5% of active UK credit cards in December 2021 have a transaction with a BNPL firm charged to their card.[25] The median value of such charges across the year was £157 and 17.6 per cent spent £500 or more. It is more common amongst younger consumers and those living in the most deprived areas. This is concerning because credit cards generally carry a higher rate of interest than interest free BNPL products, meaning consumers end up paying more for their borrowing.
- It is complimented by work produced by Citizens Advice, which suggests that 26 per cent of BNPL customers borrowed money to make repayments.[26]
- **Late fees:** Many firms charge late fees to consumers who fail to pay on time. The Financial Lives Survey 2022 suggests that 11 per cent of consumers who borrowed deferred payment credit paid a late fee for repayment, rising to 19 per cent of those earning less than £15,000 a year.[27]

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19 Financial Conduct Authority, *The Woolard Review: A review of change and innovation in the unsecured credit market;* Financial Conduct Authority, *Assessing creditworthiness in consumer credit;* Financial Conduct Authority, *Understanding consumer credit: Creditworthiness and affordability: common misunderstandings*; Financial Conduct Authority, *Preventing financial distress by predicting unaffordable consumer credit agreements: An applied framework*.

20 BBC, *Buy now pay later: How does it work?*8

21 Stijin Maesen, Dionysius Ang, *Buy Now Pay Later: Impact of Instalment Payments on Customer Purchases*, Journal of Marketing.

22 Financial Conduct Authority, *The Woolard Review: A review of change and innovation in the unsecured credit market.*

23 HM Treasury, *Regulation of Buy-Now, Pay-Later: Consultation on draft legislation*.

24 Bobsguide, *Klarna partners with Experian, TransUnion on BNPL credit reporting*.

25 Benedict Guttman-Kenny, Chris Firth, John Gathergood, *Buy now, pay later (BNPL)… on your credit card*, Journal of Behavioural and Experimental Finance.

26 Citizens Advice, *Two fifths borrowed to pay off Buy Now Pay Later.*

27 Financial Conduct Authority, *Deferred Payment Credit: findings from the Financial Lives Survey*.

Limited Consumer Understanding:

- **Recognising DPC as credit:** Much research has suggested that many consumers who use credit do not view it as such.[28] Citizens Advice reported that 40 per cent of BNPL users did not view it as "proper credit" in 2021. By 2023, it was reported that 31 per cent of people still did not believe that BNPL could lead to debt, a figure that was higher amongst young people.[29]
- **Consumers think they are protected:** The Woolard Review first highlighted that while consumers didn't view BNPL as credit, many did consider it a financial service and, resultingly, believed they were protected. More recent research suggests this continues to be the case.[30]
- **Understanding late fees:** Research produced by Creditspring found that 43 per cent of consumers did not know that BNPL lenders add a late fee for missed payments. However, the Financial Lives Survey notes that 81 per cent of consumers were aware of late fees, although this dropped to 69 per cent amongst those with low financial capability.[31]

Sub-prime consumers: Evidence from the United States and elsewhere suggests that BNPL use is higher amongst consumers traditionally considered to be subprime. Subprime consumers are more likely to have lower credit scores and show signs of financial distress.[32] Evidence from the Federal Reserve Bank of New York implies that households with recent financial delinquency and low credit scores are much more likely to use BNPL than other groups of consumers.[33] It also suggests that consumers deemed to be financially fragile are both more likely to use BNPL than financially stable households and more likely to use it frequently.[34] Our own research shows some evidence to support this finding in the UK. In our paper *Beyond the Tipping Point*, we showed how 33 per cent of consumers using a form of high-cost credit were also using a form of Buy Now Pay Later, and, in this paper, we show that our survey indicates BNPL usage is much higher amongst consumers we categorised as subprime or near prime.[35]

This need not be a bad thing where Deferred Payment Credit is able to extend a reliable form of low-cost credit to consumers who previously had few options, but it is worthy of note. Subprime consumers are generally riskier and this has implications for the types of consumer harm they may be vulnerable to.

In response to these concerns, the Government announced it would regulate deferred payment credit by amending the Financial Services and Market Act to bring it into the Financial Conduct Authority's regulatory perimeter. A series of consultations were published in October 2021 and again in February 2023.[36]

A new regulatory framework: In October 2024, the new Labour government brought forward a further consultation, which set out to achieve their pledge of regulating the sector. The consultation addressed a number of themes and pledges, including:

Creation of a tailored regulatory environment: The government announced its intention to introduce a tailored regulatory environment for BNPL agreements by disapplying sections of the Consumer Credit Act 1974. Sections relating to pre-contractual information, information provided during the course of the agreement, arrears, default, and termination were earmarked for disapplication because of their unsuitability to nature of BNPL. Instead, the government opted to allow the Financial Conduct Authority to regulate these elements of BNPL agreements via the use of its rulebook and supervision.

28 Citizens Advice, *Buy Now... Pain Later?*
29 Note, these figures are not comparable. Credit Connect, *Third of adults don't think BNPL purchases can lead to debt*.
30 Financial Conduct Authority, *The Woolard Review: A review of change and innovation in the unsecured credit market*. Creditspring, *Financial Stability Tracker 2024*.
31 Financial Conduct Authority, *Deferred Payment Credit: findings from the Financial Lives Survey*; Creditspring, *Financial Stability Tracker 2024*.
32 Experian, *What does subprime mean?*
33 Liberty Street Economics, *Who uses buy now pay later?*
34 Liberty Street Economics, *How and why do consumers use buy now pay later?*
35 Centre for Social Justice, *Beyond the Tipping Point: Where after high cost credit*.
36 HM Treasury, *Regulation of Buy-Now, Pay-Later: Consultation on draft legislation*.

Introduction of formal responsible lending requirements: The Financial Conduct Authority (FCA) requires firms to carry out creditworthiness assessments, which assess if a customer has the ability to pay. The government noted that the FCA will consult on applying creditworthiness to new regulated agreements.

Creation of a Temporary Permissions Regime: In order to ensure existing providers can continue lending while they seek the required regulatory permissions, the government noted it will set up a temporary permissions regime. To enter the regime, a firm needs to already be engaged in the activity at the commencement date of the statutory instrument. The regime is set to last for two years, providing firms enough time to apply for permissions.

Credit Reporting: Sharing data with credit reference agencies allows firms accessing that data to understand the full extent of a consumer's lending. While there is no regulatory requirement to share data on firms, the government noted its support for the FCA's proposals to introduce mandatory data sharing requirements with designated credit reference agencies for regulated firms.

Access to the Financial Ombudsman Service: The Financial Ombudsman Service (FOS) is an independent body set up by Parliament to resolve complaints between consumers and financial services firms. The FOS will review complaints after a consumer has complained to the firm but been unable to reach a resolution.[37] In its October consultation, the government stated the FCA will consult on applying complaint handling rules to firms providing BNPL and enabling customers to refer to the FOS.

At the time of writing, this new regulation is set to come into force in 2026. We take the introduction of new regulation as our starting point. It will undoubtedly help to ensure that consumers who use deferred payment credit can do so with greater protections and the confidence that they will have recourse to recompense should they suffer harm.

But a new regulatory framework is just the beginning of an ongoing phase of work to ensure the market meets the high standards demanded by the Consumer Duty. In this paper, we use the latest two waves of the Bank of England's NMG Survey – undertaken in September 2023 and 2024 – to assess the state of the market before moving on to scan the horizon for new challenges that should be addressed in the months and years ahead.

37 Financial Ombudsman Service, *Make a complaint*.

Who uses Deferred Payment Credit?

To understand the size and nature of the Deferred Payment Credit market, we have conducted an analysis of the two waves of the Bank of England's NMG household survey that a question on deferred payment credit appears in, 2023 and 2024. The NMG Survey provides a timelier update of household balance sheets than other surveys, such as the Wealth and Assets Survey and Understanding Society.

In the 2023 and 2024 waves, the survey asks households the following question: *Do you or your household currently owe any money on any of the following types of loan or credit agreement? Please select all that apply: Buy now pay later agreements where payment is deferred or split into instalments, often with no interest (e.g. Klarna, Clearpay, Monzo Flex, Instalments by Barclays etc.)*

According to our analysis of the NMG Survey, 11 to 12 per cent of households – equivalent to about 3 million households - said they had used Deferred Payment Credit in 2023 and 2024. Noticeably, however, the mean amount of borrowing outstanding on BNPL increased from £761 in 2023 to £874 in 2024. This suggests a market size of about £2.6 billion, although this is likely to be an underestimate.[38]

But this usage is not spread evenly. While in 2024 the mean borrowing is £874, the median is considerably lower at £350. In figure 1 below, we visualise this by plotting the amount households owe outstanding as a cumulative percentage and we provide percentile breakdowns in figure 2.

As can be seen from the graphs, the overwhelming majority of households who use BNPL appear to be borrowing small amounts, although households generally report owing more than they did in 2023. In 2023, 66 per cent of households borrowed £350 or less, down to 57 per cent of households in 2024.

38 Previous research has shown that the Bank of England NMG Survey – like all surveys – underestimates the use of unsecured debt compared to national accounts data. Institute for Fiscal Studies, *The Bank of England / NMG Survey of Household Finances*; Bank of England, *Research Datasets*. Office for National Statistics, *Families and Households in the UK: 2022.*

Figure 1: Cumulative percentage of amount borrowed on Deferred Payment Credit

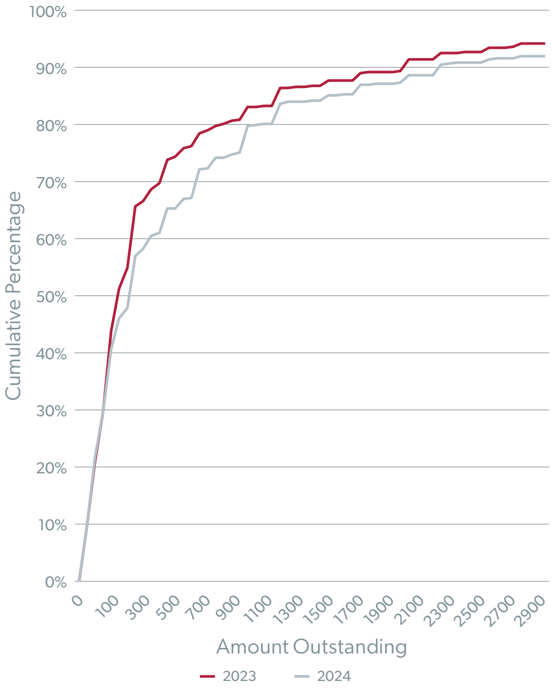
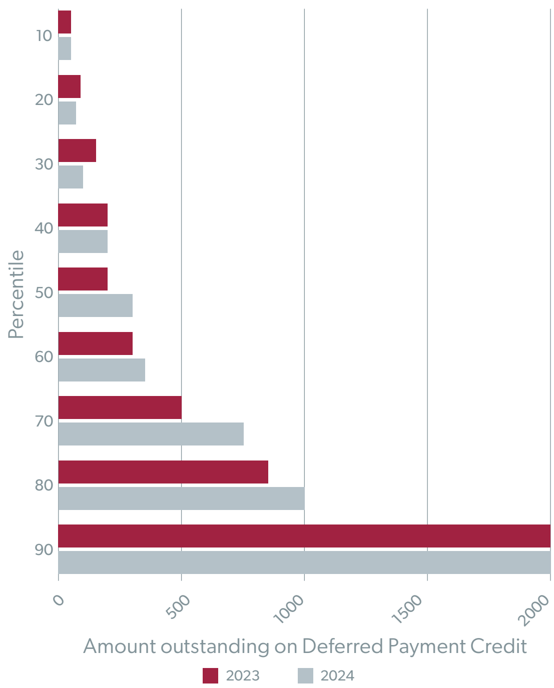


Figure 2: Amount borrowed on Deferred Payment Credit by percentile



Source: Analysis of the Bank of England's NMG Survey (n= x)

Source: Analysis of the Bank of England's NMG Survey (n= x)

Methodology Note: *espondents are asked how much they have borrowed in a free text answer in the NMG survey. Respondents are prompted to offer a band that indicates the range of their borrowing if they don't know or prefer not to answer the free text answer. Where respondents provide a band but not a free text answer, we impute the mid-point of the band as their borrowing total.*

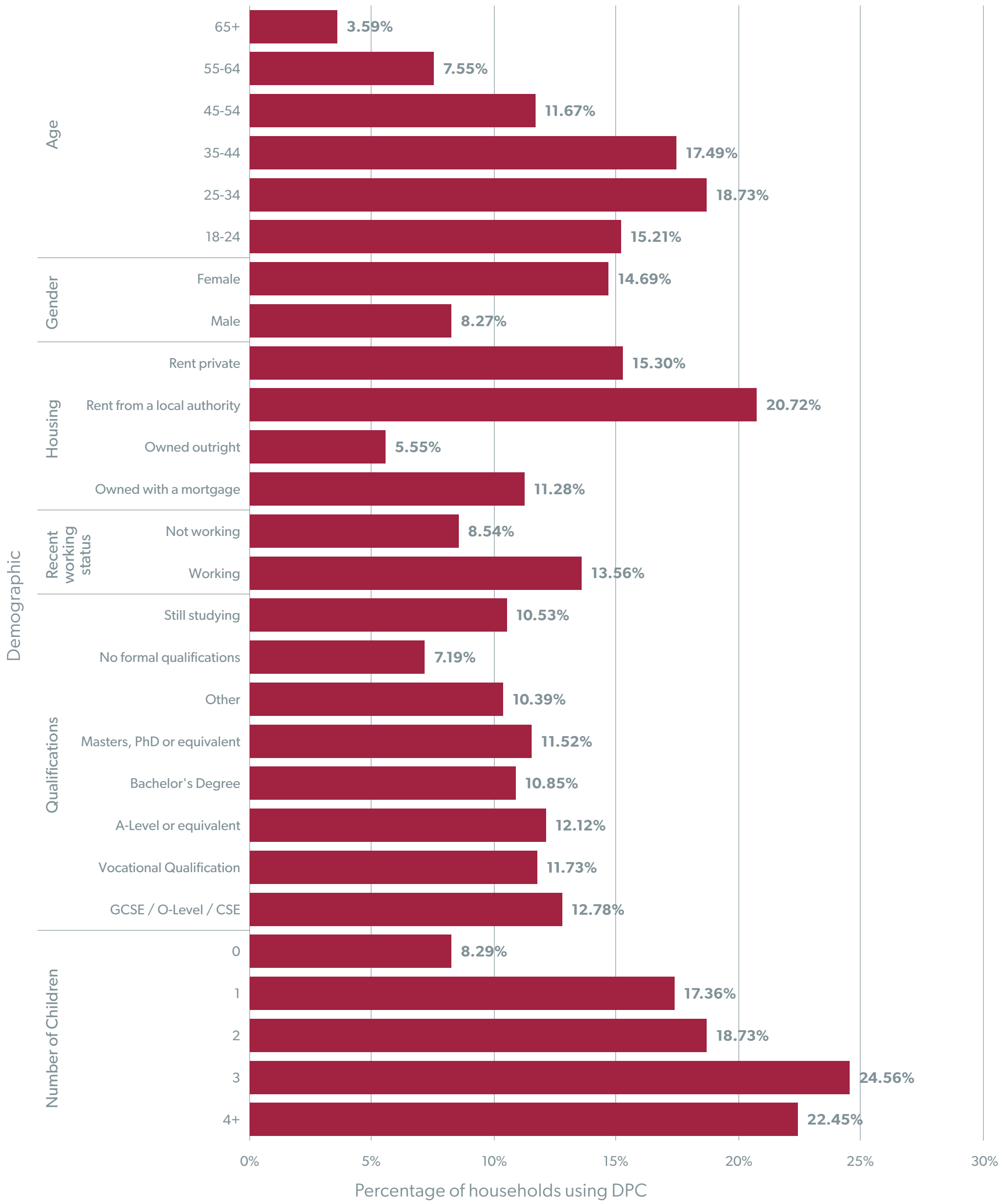
But who is borrowing? Below we present the rates of borrowing amongst different demographic groups. As has been described in literature elsewhere, Deferred Payment Credit appears to have a broad-based cut through with households across the country but is more commonly found amongst the young.[39]

In our analysis, those aged 25-34 are most likely to use DPC, with 18.73% of respondents using the product. Interestingly, however, the prominence of 25-34 year olds suggests that DPC usage is higher amongst a slightly older demographic than those previously presumed to be primary users (18-24 year olds). This accords with similar research in the United States.[40]

39 BBC News, *Payment firm Klarna messed up my credit score, says student;* BBC News, *Buy now, pay later: People using service for food, warn charities*.

40 Consumer Financial Protection Bureau, *Buy Now, Pay Later: Market trends and consumer impacts*.

Figure 3: Use of Deferred Payment Credit by demographic category



Source: Analysis of the Bank of England's NMG Survey 2024.

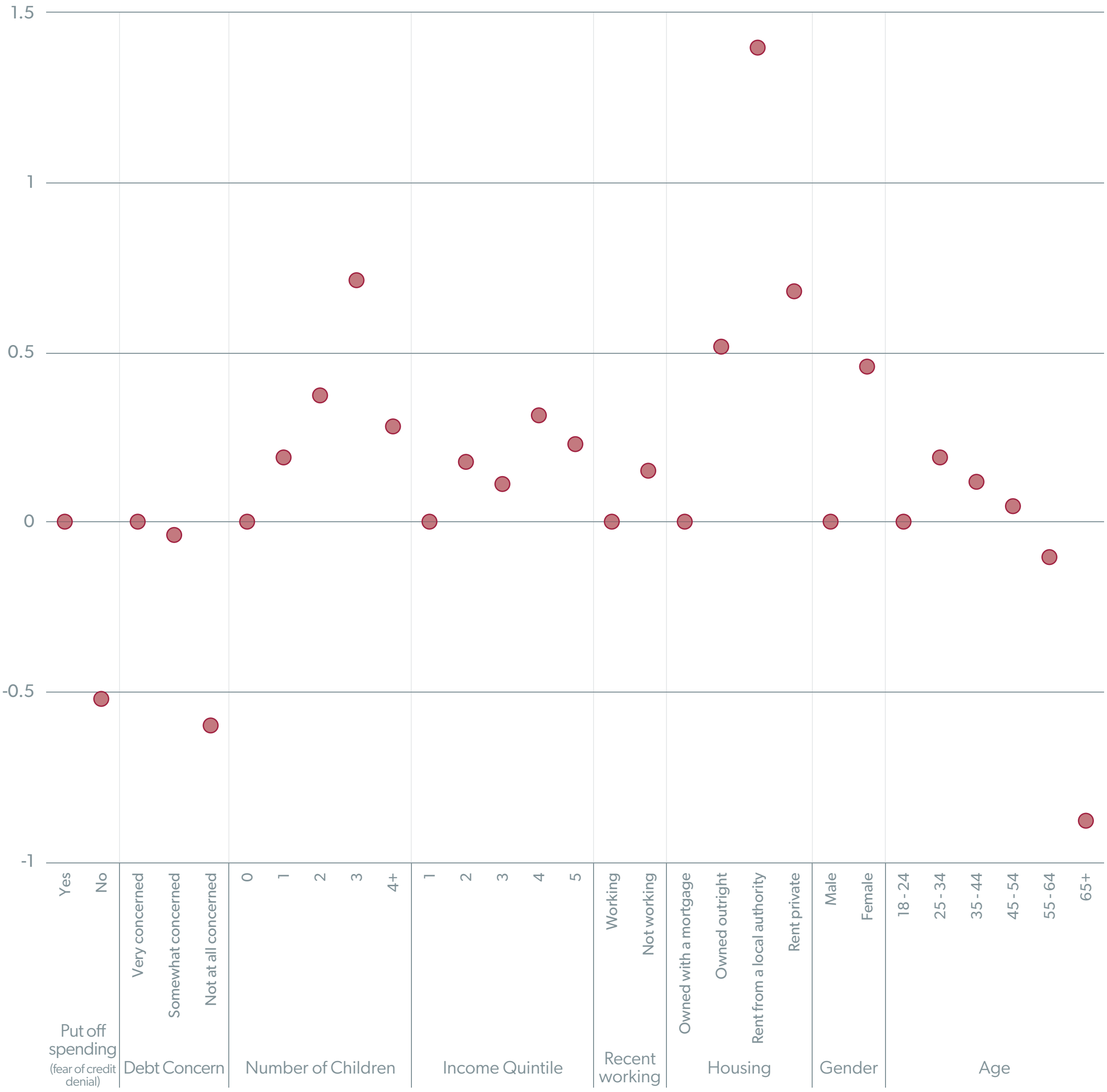
Similar to other work conducted by the Financial Conduct Authority and Which?, respectively, we find that Deferred Payment Credit use is more common amongst those with dependent children. 23 per cent of respondents with 4 or more children said that they had used this form of credit compared to 17 per cent of those who only had one.[41]

41 Financial Conduct Authority, *Dear Chief Executive Officer: FCA Strategy for Consumer Lending*; Which?, *Under Pressure: Who uses BNPL?*

To dig deeper, we ran a binary logistic regression model with some of the demographic variables we present above – as well as a variable detailing financial concern - to ascertain which variables held predictive power. We present the rules below in figure 4.[42] We find a clear age gradient, whereby older respondents are less likely to say that they borrow Deferred Payment Credit. For example, our model suggests that a 25-34 year old has a 12 per cent chance of borrowing DPC compared to just 4 per cent for a 65 year old.

Interestingly, we also find that households who are concerned about their amount of borrowing are more likely to have borrowed money using Deferred Payment Credit. This can be seen on the left panel of figure 4, where the log odds ratio declines for households who are somewhat and not at all concerned about their borrowing compared to the baseline of those who are "very concerned". We shall return to this later.

Figure 4: Logistic regression of the statistical drivers of Deferred Payment Credit use.



Source: Analysis of the Bank of England's NMG Survey

Methodology Note: We have fitted a binary logistic regression model to the data. Sample size = 5,980. McFadden's R2 = 0.26. Accuracy rating = 73%.

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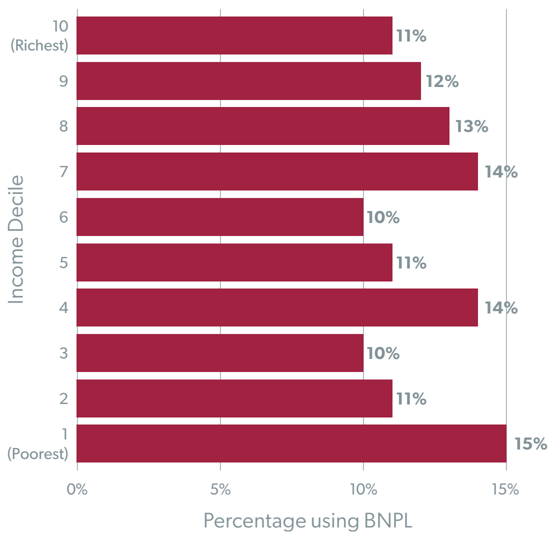
Next, we turn to the use of Deferred Payment Credit by income. To understand a household's income, we calculate equivalised household income using the square root method.[43] This helps us to compare households by taking into account their size and how much they need to maintain a similar standard of living. Intuitively, we might reason that lower income households are more likely to use Deferred Payment Credit because they can use it to cover short-term cashflow problems that other households might not face.

However, external evidence suggests a more broad-based coverage, with slightly higher usage amongst the middle part of the income distribution. The Financial Lives Survey – a large individual level survey run by the Financial Conduct Authority - suggests that just 14 per cent of individuals with a household income below £15,000 used Deferred Payment credit compared to 24 per cent and 26 per cent between £15,000-£30,000 and £30,000-£50,000 respectively.[44]

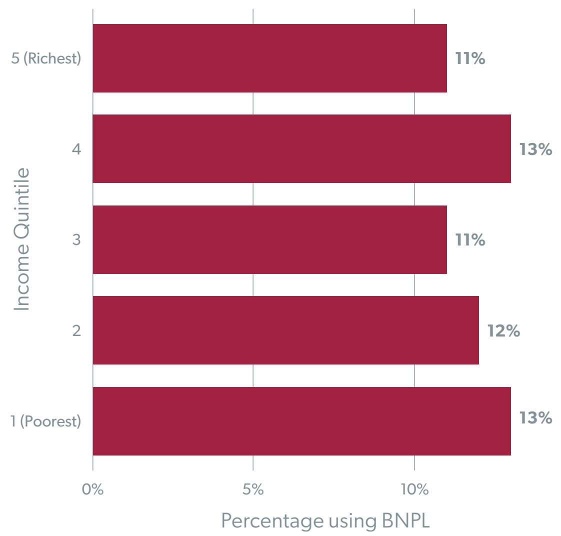
Our analysis of the Bank of England's NMG survey suggests something similar but coverage is more even. In figure 5 below, we show that the use of Deferred Payment Credit is broadly similar across income deciles. We seek to clarify this in figure 6 and also find it to be broadly similar by income quintile.[45]

Figure 5: Use of Deferred Payment Credit by income decile



Source: Analysis of the Bank of England's NMG Survey (n= x)

Figure 6: Use of Deferred Payment Credit by income quintile



Source: Analysis of the Bank of England's NMG Survey (n= x)

Methodology Note: Income deciles and quintiles are computed using the equivalised household income. Equivalised household income is computed using the square root method applied to the total number of adults in the household. Each respondent is asked the income of themselves, their partner, and all other adults in the house. Respondents are prompted to offer a band that indicates the range of their borrowing if they don't know or prefer not to answer the free text answer. Where respondents provide a band but not a free text answer, we impute the mid point of the band as their income.

There are disparities in the amount of money households in different income quintiles use Deferred Payment Credit, though. While a majority of all income quintiles borrow small amounts relative to typical spend on other credit products – the average credit card spend in the UK is over £1,000 – the poorest and richest income quintiles appear to borrow slightly more in the early portion of the distribution.[46]

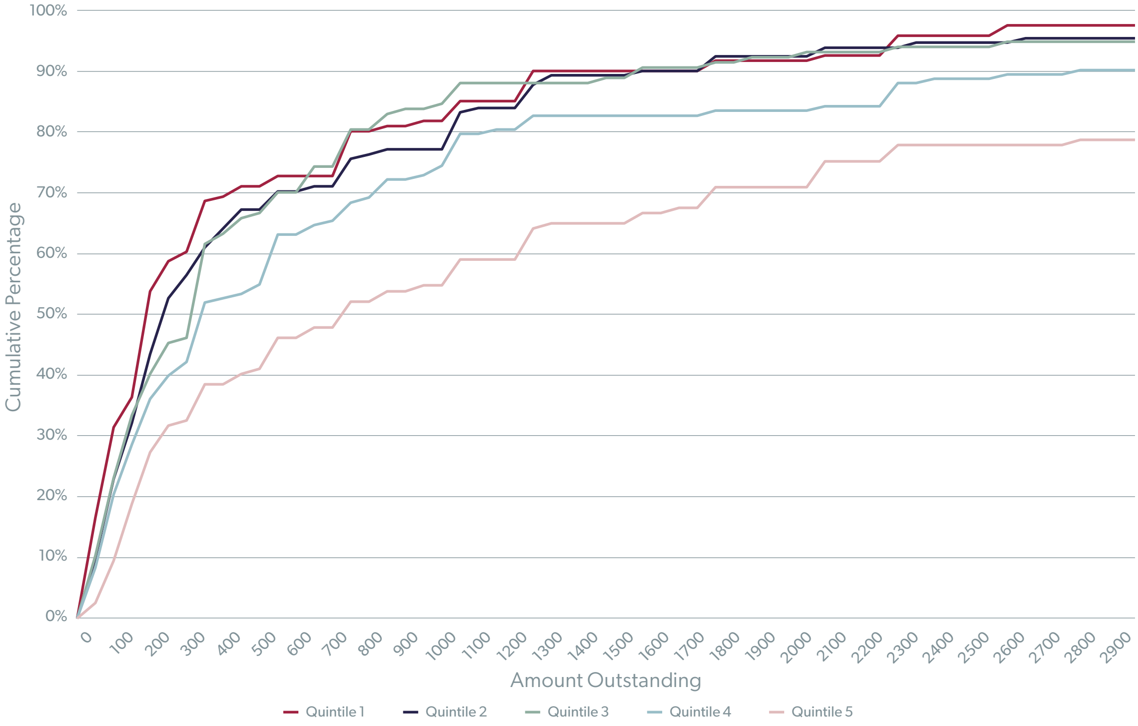
43 Different equivalisation methods can produce different outcomes. We use the square root method because the prerequisite data is available in the NMG survey. This is not the case for the modified OECD scale that we have used elsewhere. For further information, see: Social Metrics Commission, *Equivalisation in Poverty Measures: Can we do better?*; OECD, *What are Equivalence Scales?*; Centre for Social Justice, *Left Out: How to Tackle Digital Exclusion and Reduce the Poverty Premium*.

44 Financial Conduct Authority, *Financial Lives Survey 2022 Library*. Note, the FCA's survey operates on an individual level whereas the NMG survey is a household survey, meaning they are not directly comparable.

45 Larger sample sizes allow for narrower confidence intervals.

46 We avoid using the amount borrowed by credit card in the NMG survey because recent changes to the survey design led to large increases in purported borrowing compared to previous years. FICO Blog, *UK Credit Cards: Average Spending and Balances Reach New High*.

Figure 7: Cumulative percentage of the amount borrowed on Deferred Payment Credit



Source: Analysis of the Bank of England's NMG Survey (n= 619)

In quintile 1, 48 per cent of households borrowed £250 or less compared to over 50 per cent in quintile 2 and 4 and over 60 per cent in quintile 3. Quintile 5 is further behind, with just 43 per cent of households borrowing this much. We cannot make like for like comparisons with research produced by the Financial Conduct Authority because their evidence operates on an individual level, but parts of its overall message accords with our own findings; those on higher incomes generally borrow more when using Deferred Payment Credit.[47]

As can be seen in figure 7, a different story emerges towards the end of the distribution where the income quintiles form groups. For example, quintile 2 and quintile 4, about 10 per cent of households say they owe more than £2,000 on Deferred Payment Credit. By contrast, quintile 5 lags the other groups, with some households in this group borrowing significant amounts on Deferred Payment Credit.

While the amount borrowed on Deferred Payment Credit is a useful indicator of take-up – and to some extent an indicator of how many DPC providers households may be using – it's ability to inform our view of the debt's sustainability is limited. A household may borrow significant sums using Deferred Payment Credit, but if their use of other credit products is limited then repayments may not pose a burden for them. Equally, if repayments across their credit use make up a small proportion of overall income, then households may be able to manage their costs appropriately. [48]

Fortunately, the NMG survey allows us to dig slightly deeper into this by calculating a household's debt to income ratio before and after the inclusion of BNPL. Below, we chart DPC using households' debt to income ratios before and after the addition of Deferred Payment Credit, and we colour our observations by income quintile. This allows us to see how the use of DPC effects the ratios of different households on the income distribution.

47 Financial Conduct Authority, *Deferred Payment Credit: findings from the Financial Lives Survey*, October 2023.

48 Bank of International Settlements, *Household Over-Indebtedness, Definition and Measurement with Italian Data*.

Figure 8: Household debt to income ratio before and after the use of DPC by income quintile

Source: *Analysis of the Bank of England's NMG Survey (n= 647)*

Figure 9: Household debt to income ratio before and after the use of DPC by income quintile

Source: Analysis of the Bank of England's NMG Survey (n= 647)

There are a few key messages that emerge from the figures above. We explore three of them below.

Most debt-to-income ratios are broadly unchanged: The most obvious message to be drawn out of the figures above is that most households' debt to income ratios fall on the diagonal line and are broadly unchanged as a result of adding their use of Deferred Payment Credit into their debt-to-income calculations. In our analysis, 68 per cent of households' ratios change by 2 per cent or less. Given the figures above only show households that use Deferred Payment Credit, this suggests that many households who use DPC don't retain significant borrowing on it. This aligns with the evidence we have presented above.

A cluster of households who don't use or have limited credit burdens use DPC: On the left-hand side of each figure, there are a number of observations that rise in a vertical line –these are observations for whom debt to income ratios were zero before adding in DPC, which subsequently raises them. This can be seen in the greater detail in figure 9, where we zoom into the households with ratios below 20 per cent. This suggests that there are some households for whom Deferred Payment Credit may be their first foray into the credit market.

Secondly, there appears to be a cluster of DPC using households who had debt to income ratios between 0 and 6 per cent whose use of DPC boosts their DTI slightly. This may represent a group of households who do not typically use credit and are experimenting with Deferred Payment Credit, but it is difficult to tell at this stage.

Some low-income households' DPC use is significant: The final message worth taking from our analysis is that some households debt to income ratio significantly increase after adding their use of Deferred Payment Credit. This is true for all income quintiles, but is more pronounced in income quintile 1, which includes households on the lowest income. This may be because they are more easily able to access DPC than other forms of credit in the market and is worthy of further investigation.

To illustrate overall debt to income ratios, we plot this in figure 10 below. It is noticeable that debt to income ratios for DPC using households are significantly higher in income quintile 1. 35 per cent of DPC using households in income quintile 1 have a debt-to-income ratio of over 40 per cent compared to 19 per cent for all households across income quintile 1.

Case study: Sarah

Sarah, a 45-year-old mum of three from High Wycombe, discovered Buy Now Pay Later (BNPL) through a friend. Like many others, she was drawn to ability to spread payments interest-free.

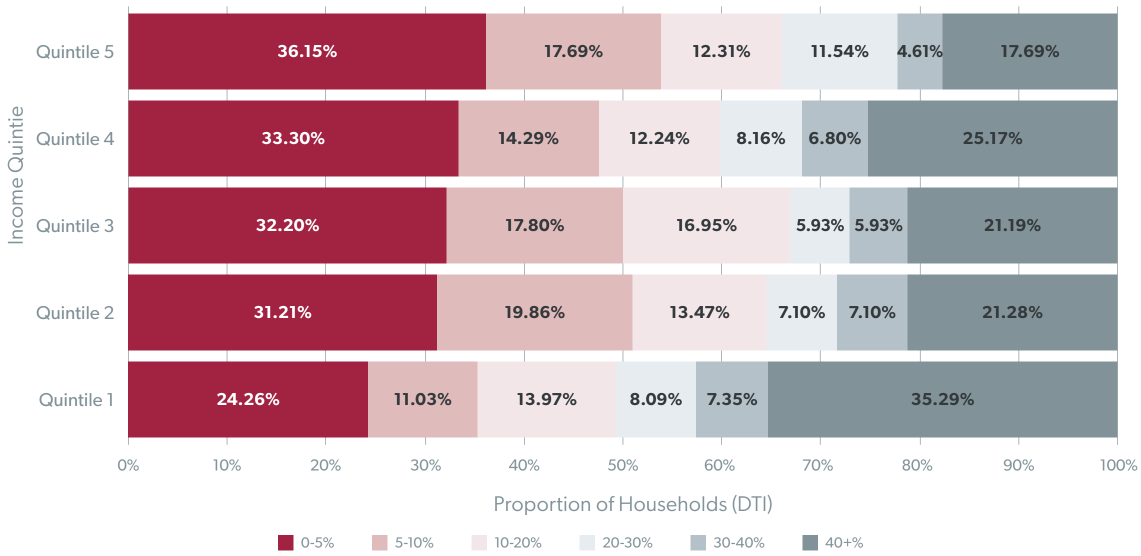
Already battling debt, Sarah's situation became worse after she was forced to give up work due to mental health struggles. The rising cost of living only added to her stress, making it harder to keep up with household bills and provide for her 13-year-old daughter. Being out of work and on universal credit, Sarah became more reliant on BNPL for everyday essentials like food, clothes and basic household items. That's when her financial situation started to spiral out of control and she found herself missing priority bills to try and keep up with her BNPL repayments.

However, she soon fell behind with her BNPL repayments too and this led to increasing anxiety. She made cutbacks wherever she could and started visiting a local social supermarket where she could get a basket of groceries for £3. But she still couldn't get on top of her debt.

By the time she approached Money Wellness, Sarah was £10,000 in debt and owed a total of £1,200 to BNPL companies. She also had universal credit advancements to repay and credit card debt. Money Wellness supported Sarah to create a sustainable budget and maximise her income and she is now feeling much more positive about the future.

**some personal details have been changed to protect individuals' identities*

Figure 10: Debt to income ratios of BNPL using households.

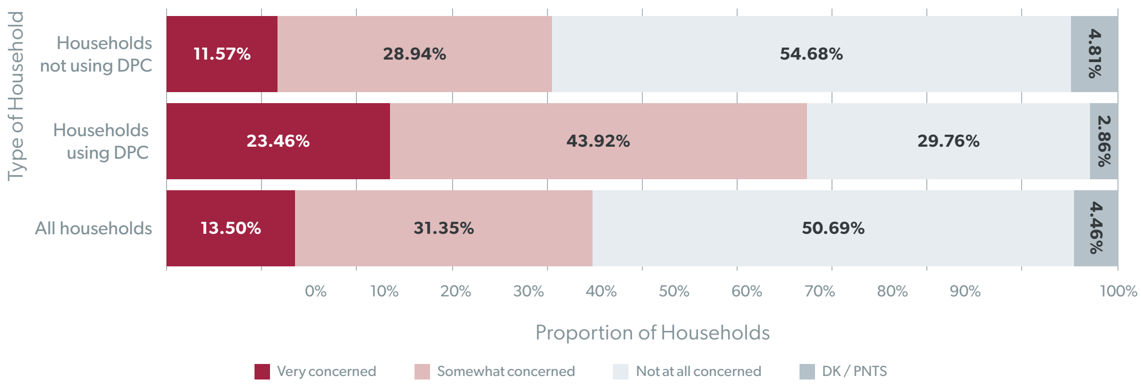


Source: Analysis of the Bank of England's NMG Survey (n= 672)

In addition to reviewing debt to income ratios, we also look at how respondents assess their subjective debt sustainability. Figure 11 overleaf shows that households using DPC are significantly more likely to be worried about their current level of debt. This is particularly true amongst those in income quintile 1. 32.59 per cent of DPC using households in income quintile 1 say they are very concerned about their current level of debt, significantly above both the national average and the average for DPC using households.

This is likely connected to evidence presented in figure 12 below, which shows DPC using households are much more likely to say they've been put off spending because they're concerned they may not be able to access further credit when they need it. Those households who are cutting back are also likely to have higher debt to income ratios, pointing to a group of households using DPC that show signs of financial distress.

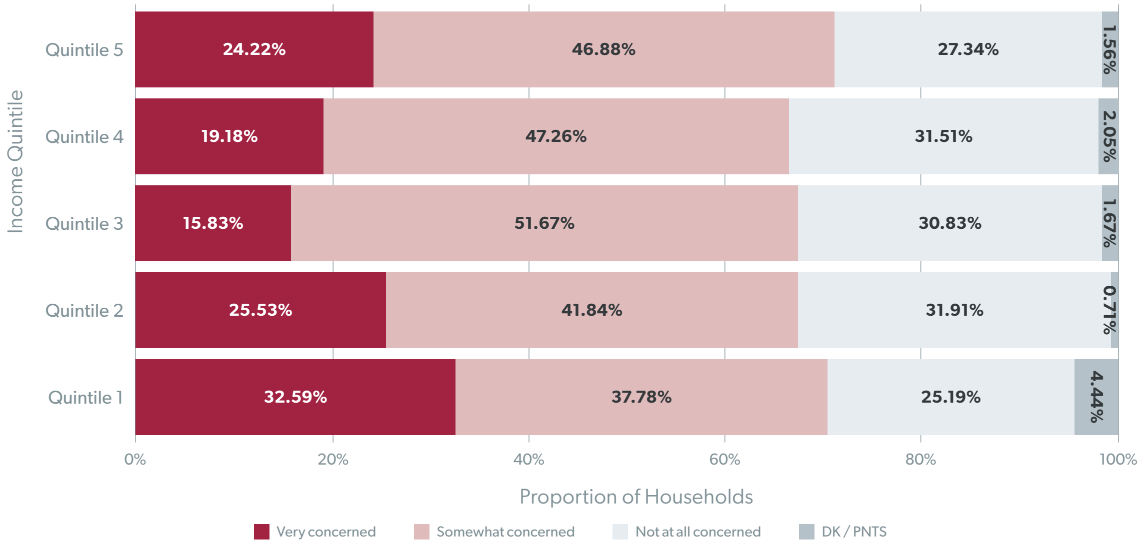
Figure 11: Debt concern for users of Deferred Payment Credit



Source: Analysis of Bank of England NMG Survey (n= 4354)

Note: All households excludes households who say they do not owe money on a product, don't know, or prefer not to say.

Figure 12: Debt concern for users of Deferred Payment Credit by income quintile



Source: Analysis of Bank of England NMG Survey (n = 670)

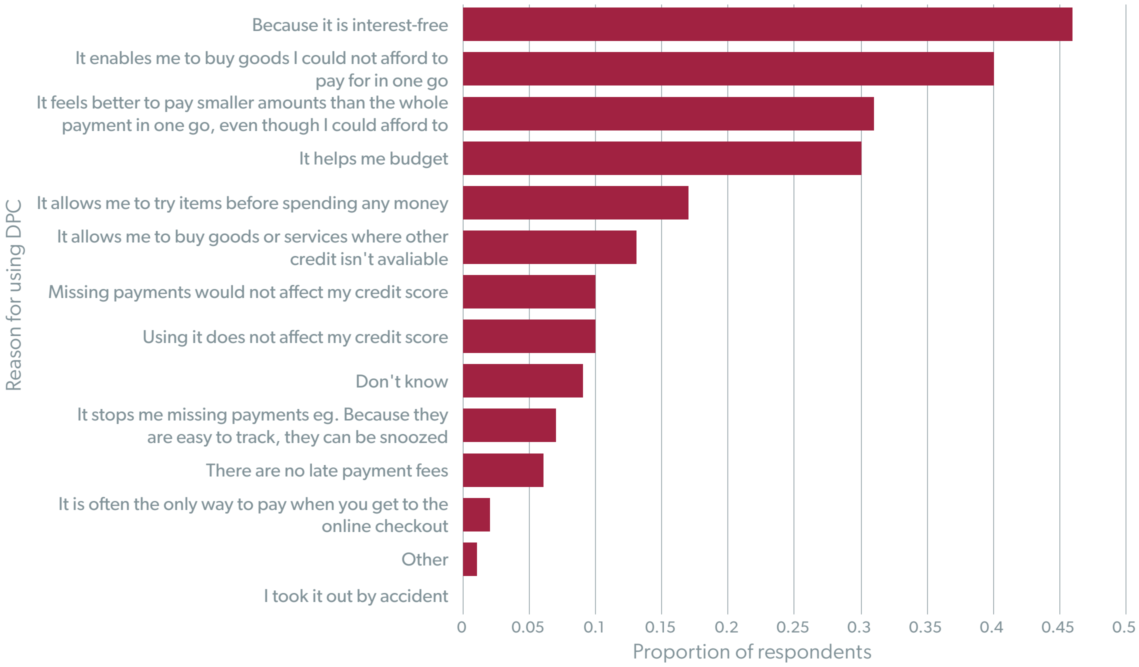
Why do people use Deferred Payment Credit?

The recent explosion in the use of Deferred Payment Credit begs the question, why has it suddenly become so popular? Unfortunately, the NMG survey does not provide us insight into the motives behind consumer use, so this chapter will make use of external data sources, including the CSJ's own proprietary polling.

Significant amounts have already been written on why consumers choose to use Deferred Payment Credit, including key research papers from the Financial Conduct Authority, the Behavioural Insights Team working in partnership with the Money and Pensions Service, and other bodies.[49] We will not recount all of the external research here, but draw on parts of it to discuss why consumers use DPC and how this differs across consumer segments.

The most common reason consumers cite for using Deferred Payment Credit is that it is interest free. In short, the ability to borrow without additional cost is enticing to consumers. The interest free nature of BNPL is the answer most cited in the Financial Conduct Authority's Financial Lives Survey 2022, with 46% of DPC users saying this.

Figure 13: Reasons for using DPC (2022).



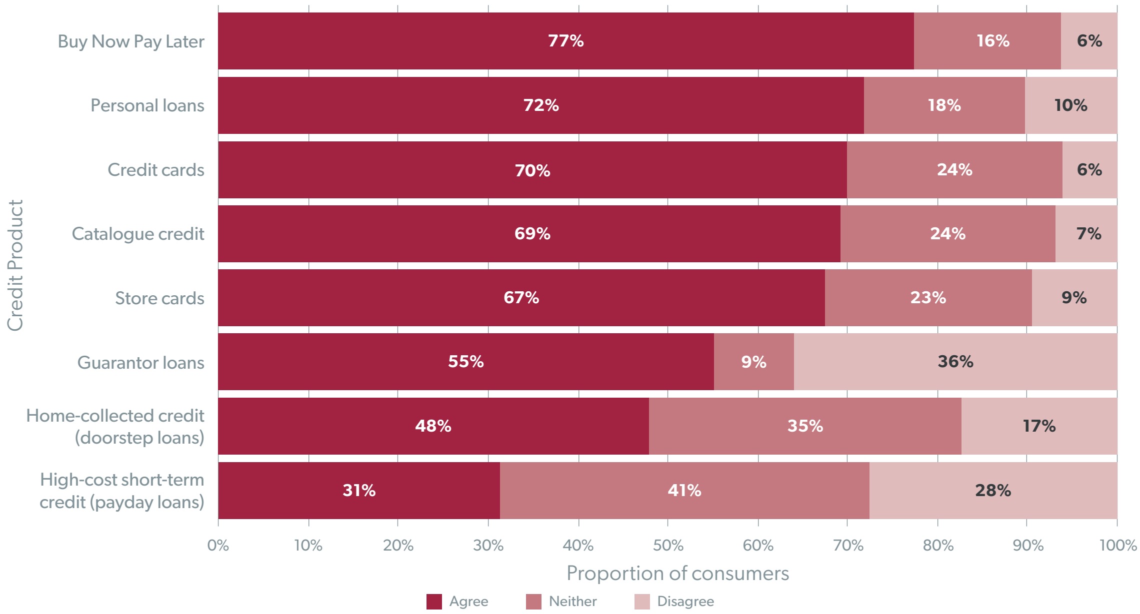
Source: Financial Lives Survey 2022 (N = 1,232)

49 Financial Conduct Authority, *Deferred Payment Credit: findings from the Financial Lives Survey*, October 2023; Behavioural Insights Team and Money and Pensions Service, *Buy Now Pay Later: a review of the market, risks and trends, consumer understanding, impact and outcomes*, June 2023.

The next three most popular reasons noted by respondents are also worth noting; that DPC enables them to purchase goods they could not afford to pay in one go, it feels better to pay smaller amounts even when they can pay the full amount, and it helps them budget. At first glance, most of these seem to be ordinary features of most credit products, but they take on a different tone in the framework created by Deferred Payment Credit. The lack of interest charged on the product differentiates the product from other products in the market and seems to be fundamental for consumers who choose to use the product.

Another reason consumers are likely to use DPC products is because they have a good experience using the product. When we asked respondents to what extent they agreed that they had a good experience using their respective credit products, Deferred Payment Credit emerged favourably. 77 per cent of respondents who had used DPC said they either strongly agreed or agreed that they had a good experience, compared to 70 per cent for respondents who had used a credit card and far lower scores for users of high-cost products. This is likely to reflect the ease of use, including embedded finance on retailer's websites and the increasing use of apps by third party providers.

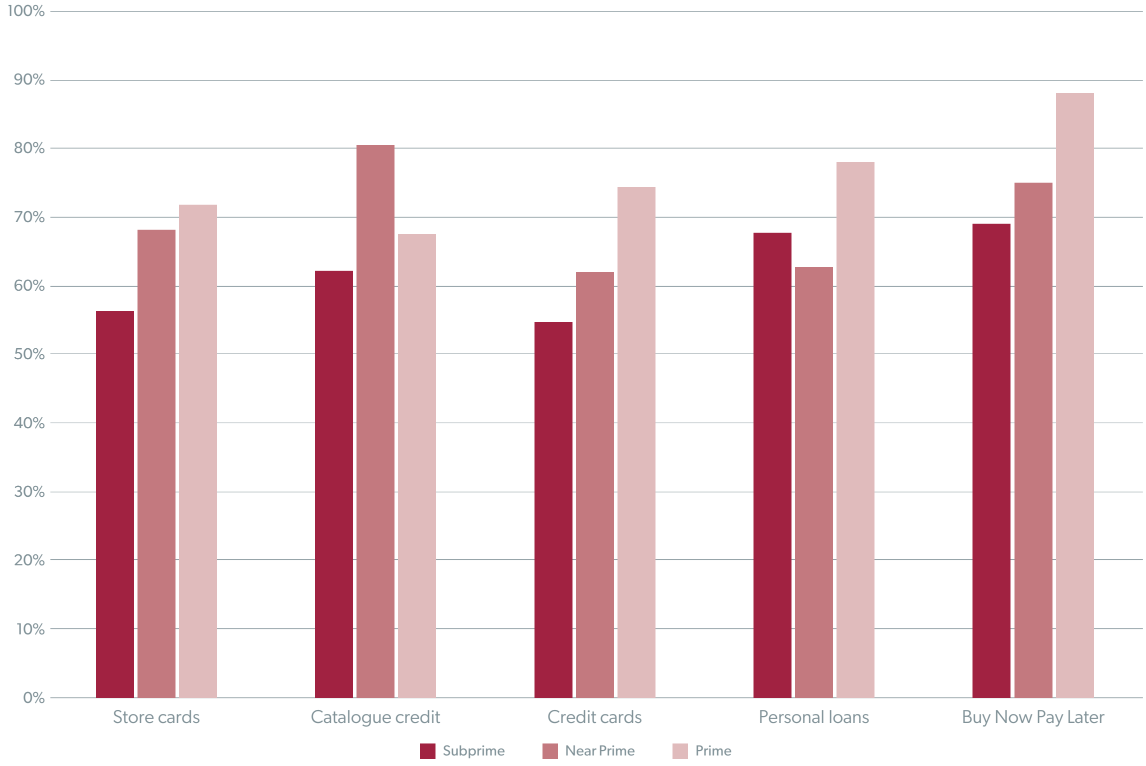
Figure 14: Percentage of product users who agree with the statement "I have had a positive experience with my lender"



Source: Analysis of commissioned polling from Opinium.

Interestingly, Deferred Payment Credit also leads other credit products across all of our credit segments. As might be expected, prime users are more likely to agree that they had a positive experience – with 88 per cent saying so – but subprime users also experience higher satisfaction than they do with other credit products.

Figure 15: Percentage of product users who agree with the statement "I have had a positive experience with my lender"



Source: Analysis of commissioned polling from Opinium.

A force for financial inclusion?

In addition to discussion about the potential for DPC to cause consumer harm – more on which shall be discussed later – there has been some debate about its potential to promote financial inclusion by allowing consumers with low credit scores previously on the cusp of the regulated credit market to access small sums.

For example, research by the Federal Reserve Bank of New York, has shown that consumers with relatively low credit scores – defined as below 620 – are more likely to use Deferred Payment Credit as well as those with recent credit delinquency.[50] They note that DPC appears attractive to those with unmet credit needs and limited access because it expands their access. A further recent study by the Consumer Financial Protection Bureau, which found 45 per cent of originations were from consumers with 'deep subprime scores'.[51] This supports our recent work reviewing the state of the UK High Cost Credit sector. In *Beyond the Tipping Point* we showed evidence to suggest that reasonable proportions of consumers on the fringe of the credit market – in this case consumers who have used high-cost credit – were using Deferred Payment Credit. In our analysis, we found that 33 per cent of consumers who were using high-cost credit in 2017/18 were using DPC in 2022/23.[52]

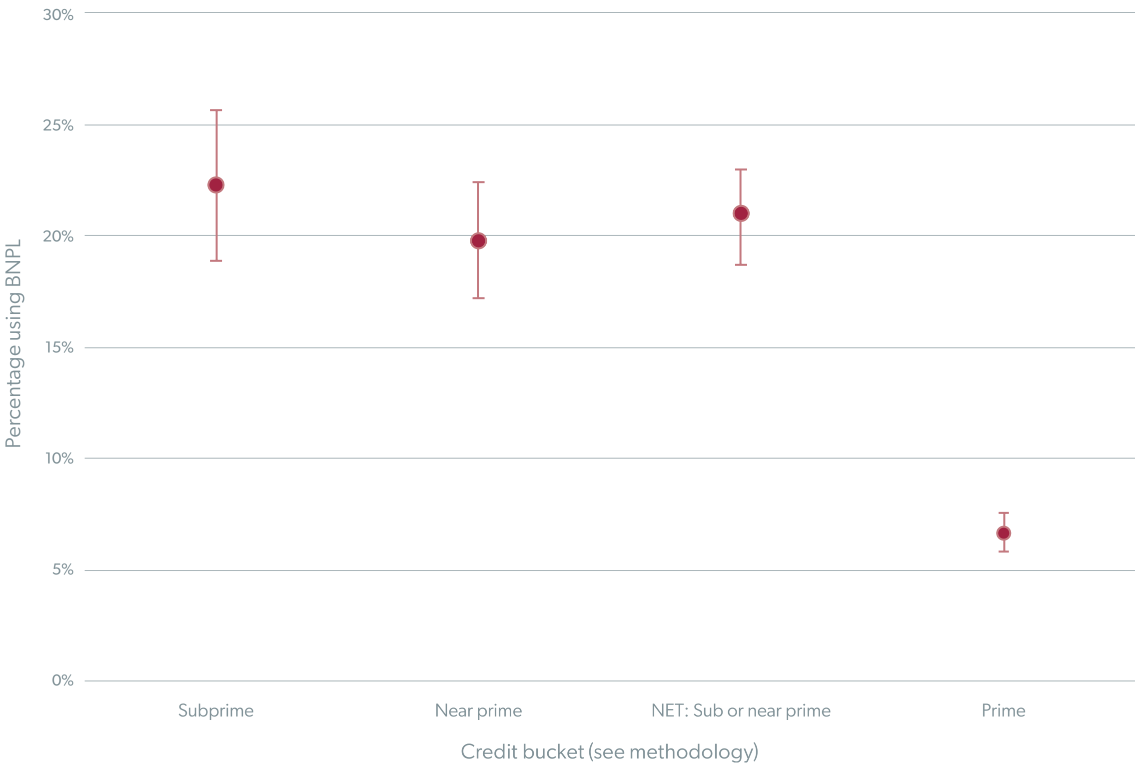
50 Federal Reserve Bank of New York, *Liberty Street Economics: Who Uses "Buy Now, Pay Later?"*.
51 Consumer Financial Protection Bureau, *Consumer Use of Buy Now, Pay Later and Other Unsecured Debt*.
52 Centre for Social Justice, *Beyond the Tipping Point: What happened to High Cost Credit*.

For our part, we put this to the test in our data. Using the Bank of England's NMG survey, we see that consumers who report having missed a payment – a sign of delinquency – are much more likely to use Deferred Payment Credit than those who don't. 24 per cent of consumers who say they have found themselves behind on more than two or more unsecured credit payments say they use DPC compared to just 9 per cent who say they have not.

In addition to the Bank of England's NMG survey, we commissioned polling of 4,000 individuals from Opinium – which we also use above - to further understand the types of consumers that use Deferred Payment Credit.[53] In our survey, we attempt to understand the type of credit profile that consumers present to lenders by asking them a series of screening questions (see appendix 1) and we use the results to bucket them into credit profile groups.

We find that consumers we bucket into the subprime and near prime bucket are much more likely to say they currently hold Deferred Payment Credit than prime consumers and all UK adults. 22 per cent of Subprime adults tell us they hold this type of credit compared to just 6 per cent of prime adults.

Figure 16: Use of Deferred Payment Credit by credit bucket



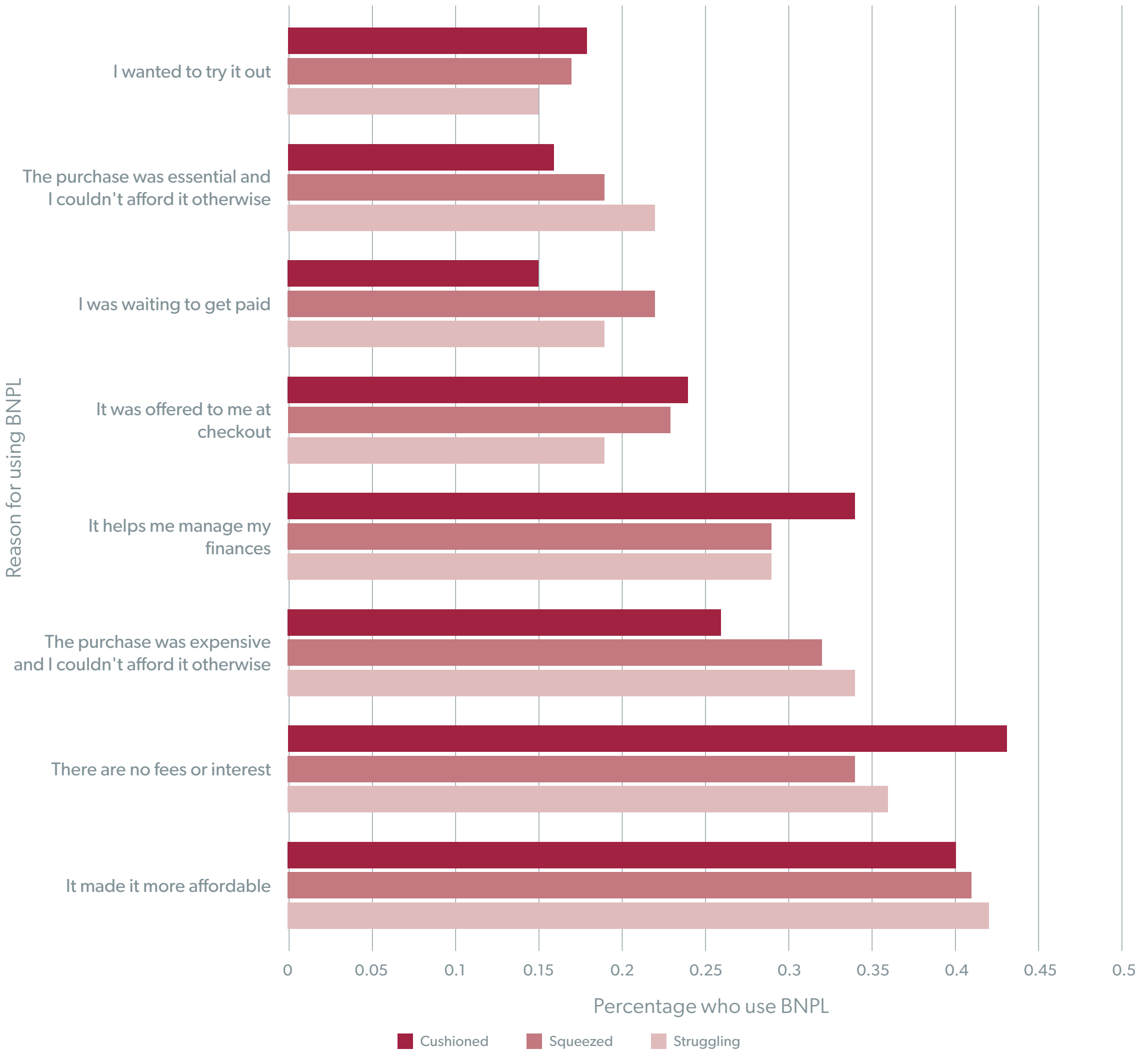
Source: Analysis of commissioned polling from Opinium

However, this possibility ought not to pass without qualification. In this first instance, existing evidence suggests that Deferred Payment Credit suggests it is consumers with unmet credit demand that are more likely to use DPC with little to say about if it enables consumers currently entirely excluded from the credit market – for example because they are credit invisible - to access credit.

53 We commissioned Opinium to conduct a survey of 4,022 UK adults between 12th and 15th September 2023. The results are weighted to be nationally and politically representative. The survey data is now relatively old.

Secondly, just because DPC is available to consumers on lower incomes does not mean it is inherently a good thing. Subprime users of credit often show more signs of financial stress and may be at greater risk of overleveraging themselves. The Behavioural Insights Team and Money and Pensions Service show that struggling and squeezed consumers are more likely to say they use DPC because they couldn't otherwise afford something or were waiting to get paid than cushioned consumers.[54] Further to this, research from the University of Frankfurt shows causal evidence that customers spend 20 percent more when DPC is available and that less creditworthy consumers are most responsive to DPC offers.[55]

Figure 17: Reason for using BNPL by MaPs segment



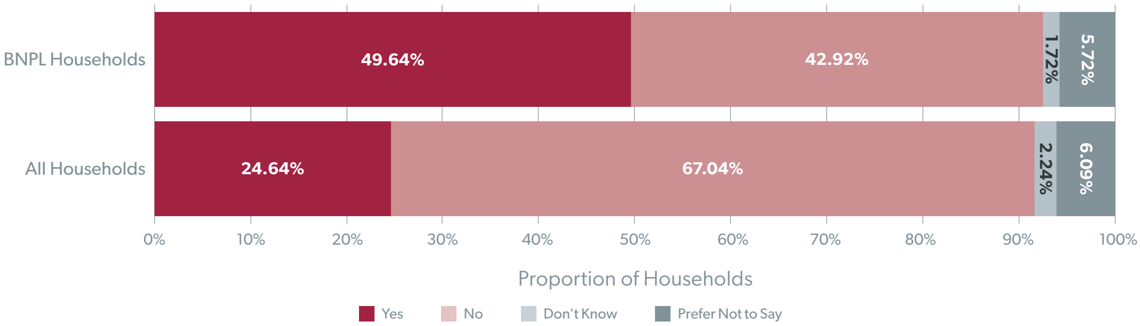
Source: Behavioural Insights Team and Money and Pensions Service (N = 2,507)

Returning to the NMG Survey, our analysis provides further support that some households who use BNPL feel financially squeezed. The survey suggests that almost 50 per cent of households who owe money on DPC products have cut back on spending because they are concerned they will not get further access to credit when they need it.

54 Behavioural Insights Team and Money and Pensions Service, *Buy Now Pay Later: a review of the market, risks and trends, consumer understanding, impact and outcomes*, June 2023.

55 Berg et al, *The Economics of "Buy Now, Pay Later": A Merchant's Perspective*.

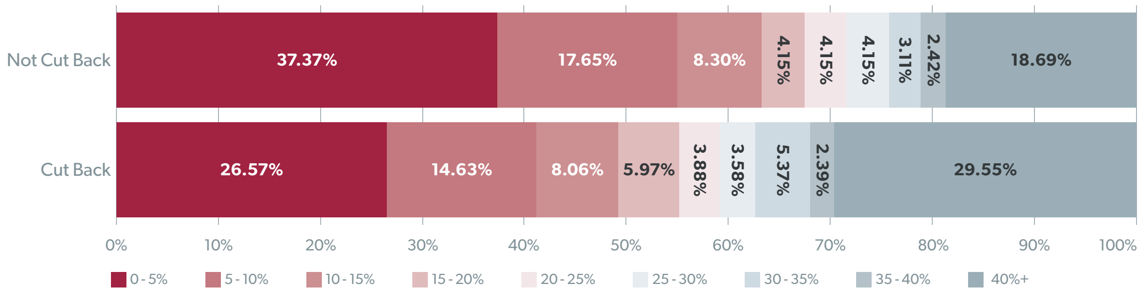
Figure 18: Proportion of households reporting cutting back on spending due to concerns about access to credit



Source: Analysis of the Bank of England's NMG Survey (n= 6,041)

Delving deeper, we find that the households who cut back are significantly more likely to have higher debt to income ratios than those who have not cut back. Almost 30 per cent of households using BNPL who say they are cutting back have a debt-to-income ratio of over 40%, compared to 19 per cent of those who have not cut back. This highlights a subset of consumers who firms may need to focus on to ensure consumer harm is avoided.

Figure 19: Debt to income ratios of BNPL using households.



Source: Analysis of the Bank of England's NMG Survey (n= 624)

Case study: Sid

Sid, a 54-year-old dad of five from Hull, was a regular Buy Now Pay Later (BNPL) user. At first, he was able to manage his repayments but started to struggle after suffering a seizure and being diagnosed with epilepsy. From that point on, Sid started having regular seizures meaning, not only did he have to give up his job as an HGV driver, but he couldn't work at all. He was now reliant on universal credit and disability benefits to get by.

Not being able to work affected Sid's mental health and he turned to online shopping as a form of comfort. Sid says he found it easy to make numerous BNPL purchases in a single day and admitted he bought things he didn't need, describing himself as a "shopaholic". Sid soon found the BNPL repayments unmanageable and his debt started to spiral. Desperate to get a grip on his finances, he turned his heating off and started skipping meals, but he still couldn't scrape together enough money to repay what he owed.He avoided the phone calls he was getting from lenders and was scared to answer the door. By the time he approached Money Wellness for help, Sid had accumulated £21,000 of debt, £3,000 of which he owed to BNPL companies, and was feeling desperate. Money Wellness recommended a debt relief order, which is now in place, and Sid feels like he's been given a fresh financial start and a weight has been lifted from his shoulders.

**some personal details have been changed to protect individuals' identities*

Deferred Payment Credit: Striking the right balance.

Given its rapidly increasing popularity, there have been many calls for Deferred Payment Credit to be regulated. This is both to provide a level playing field by requiring DPC firms to follow the same regulation as other consumer credit firms are required to and to ensure consumers are protected when they interact with the market. In 2021, the Woolard Review of change in the unsecured credit market urged the government to regulate DPC and was published on the same day the government pledged to introduce regulation.[56]

Where provided and used appropriately, Buy Now Pay Later Regulation offers the potential to spread financial inclusion via making small sums of interest free credit to consumers who previously had limited ability to access credit or whose credit options were high cost. However, there are obvious challenges. Limited consumer understanding and the potential for consumers to overburden themselves – as evidence from the US shows – means it is important to strike the right balance.[57]

In October 2021, the government consulted on potential regulation and subsequently published its response and draft regulation on 14th February 2023.[58] In March 2024, the then Conservative government confirmed that BNPL regulation would take longer than expected.[59] In October 2024, the new Labour government brought forward a further consultation, which set out to achieve their pledge of regulating the sector. The consultation will create a number of benefits for consumers including:

- Greater protection from irresponsible lending via mandatory affordability checks;
- The ability to build their credit profiles via reporting to credit reference agencies;
- Access to the Financial Ombudsman Service where things go wrong;
- Access to section 75 of the Consumer Credit Act where the single item cash price of a purchase is at least £100.

These changes will improve protections for consumers while continuing to allow providers to offer a genuinely innovative product to consumers. Below, we discuss several aspects of the consultation and areas for future focus by HM Treasury and the Financial Conduct Authority.

Scope of Regulation: In its consultation, the government confirmed its intention to only bring Deferred Payment Credit offered by third-party lenders into regulation. Credit provided by merchants themselves will remain subject to the exemption in article 60F(2) of the Financial Services and Markets Act (Regulated Activities) Order 2001.

56 Financial Conduct Authority, *The Woolard Review – A review of change and innovation in the unsecured credit market*; Clearscore and EY, *Building a non-prime lending market that delivers for UK consumers*.

57 Consumer Financial Protection Bureau, *Consumer Use of Buy Now, Pay Later and Other Unsecured Debt*.

58 Gov.UK, *Regulation of Buy-Now Pay-Later: consultation on draft legislation*.

59 Politico, *Morning Financial Services UK Buy now, regulate later;* Financial Times, *Labour's Siddiq rebukes Hunt over delay to regulating 'buy now, pay later' lenders;* Labour Party, *Financing Growth: Labour's Plan for Financial Services*.

It was noted in the consultation that this could create competition issues if larger merchants and/or others were to develop and offer their own unregulated agreements. Not only would this mean larger merchants could offer otherwise regulated credit outside the FCA's regulatory perimeter, it could also mean smaller merchants are reliant on regulated credit providers to their disadvantage.

Closely related to this, attention will need to be paid to how such products are structured. The Consumer Credit Act defines products as either fixed or running account products and most DPC lenders currently rely on an exemption for fixed sum credit agreements where: the number of repayments is not more than 12, the repayments are made over no more than 12 months, and there is no interest or fees.

It was noted in previous consultation responses that products benefiting from the exemption might be structured in such a way as to benefit from the advantages of the fixed sum credit exemption and features of running account products.[60] For example, a series of fixed sum credit agreements might be documented as individual transactions but the overall amount borrowable is determined by a 'shadow balance' that limits how much can be drawn at any one time. This approach would appear to operate an affordability assessment similar to that required by the FCA for running account credit, where the lender assumes the whole balance is drawn down on day one and repayments are made by equal instalments over time.[61] Even if this were not appropriate – which it is unlikely to be – it may take some time before it were noticed without FCA supervision. This is therefore something the government should keep under review to ensure consumer harm does not occur in the gap left by new regulation.

Disapplication of the Consumer Credit Act: During the consultation phase, the government decided to disapply specific sections of the Consumer Credit Act 1974 (CCA), such as those relating to pre-disclosure. Pre disclosure requirements define the information that consumers must be given before they agree to a loan.[62] In its consultation, the government advances the view that the FCA's rules-based regime for pre-contractual disclosure requirements would provide a more proportionate regime than the prescriptive and outdated rules governing other regulated credit agreements in the Consumer Credit Act 1974. This reflects its view that DPC is a low-risk product.[63]

This decision is welcome. As the Government noted in its 2023 consultation on reforming the CCA, 'the world has been transformed since 1974' and many aspects of the CCA are no longer fit for purpose.[64] Giving the Financial Conduct Authority the responsibility for setting new rules tailored to the sector provides an opportunity to reflect DPC's low risk profile compared to other products.

A tailored regime offers an opportunity to genuinely innovate pre-disclosure requirements and understand what information consumers can readily read, understand, and make a decision with. We are hopeful that this will not be used as an opportunity to perpetuate the status quo.

However, it remains important to ensure consumers understand that they are using a credit product. Many analyses have noted that consumers do not view BNPL as a credit product and do not always realise the product carries late fees.[65] Nor are all BNPL transactions small. While our analysis suggests most users hold only small amounts of DPC debt, some users hold high aggregate balances, indicating the potential for larger purchases using the product.

60 Definitions for fixed sum credit and running account credit can be found by following the hyperlinks attached. UK Finance, *UK Finance response to the HMT Treasury consultation – Regulation of Buy-Now Pay Later*.

61 Financial Conduct Authority, *Policy State PS18/19: Assessing creditworthiness in consumer credit: Feedback on CP17/27 and final rules and guidance*.

62 Legislation.gov.uk, *The Consumer Credit (Disclosure of Information) Regulations 2010*.

63 HM Treasury, *Regulation of Buy-Now Pay-Later: Consultation on draft legislation*.

64 HM Treasury, *Reforming the Consumer Credit Act 1974*

65 Credit Strategy, *Most UK BNPL users don't think they can lead to debt*; BobsGuide, *Half of BNPL users unaware of late payment fees*.

An area to address may be the potential need for different pre-disclosure requirements depending on the channel by which credit is accessed. The intensification of app use amongst consumers is a genuine innovation but it reduces friction between consumers and purchasing decisions. The gamification of spending has the potential to encourage consumers to spend more than they should and evidence suggests it is households on the lowest incomes that are likely to spend more using the product.[66] We would encourage the FCA to investigate the potential for channel-dependent disclosure requirements that reflect the credit's ease of access.

RECOMMENDATION 1: THE FINANCIAL CONDUCT AUTHORITY SHOULD INVESTIGATE THE POTENTIAL FOR CHANNEL-DEPENDENT DISCLOSURE REQUIREMENTS.

We welcome the decision to disapply specific provisions of the Consumer Credit Act 1974 to reflect the reduced risk of DPC products. The decision provides an opportunity to genuinely innovate pre-disclosure requirements and understand what information consumers can readily read, understand, and make a decision with.

However, it remains important to ensure consumers understand that they are using a credit product. The intensification of app use and gamification of spending amongst consumers has the potential to drive increased spending amongst consumers, particularly low income consumers. We encourage the FCA to investigate the potential for channel-dependent disclosure requirements to reflect the credit's ease of access and incorporate an appropriate level of friction.

Disapplying elements of the Consumer Credit Act inevitably creates competition concerns as DPC benefits from different rules than other credit products. While we support a tailored regime, it should swiftly be followed by progress in the reform of the Consumer Credit Act 1974 to ensure an FCA-led regime across products. This does not suggest that all products should be subject to the same regime, but failure to make significant progress on the reform of the Consumer Credit Act risks creating an unlevel playing field between different products whose risk merit the same regulatory burden.

RECOMMENDATION 2: THE GOVERNMENT SHOULD BRING FORWARD ITS PLANS TO REFORM THE CONSUMER CREDIT ACT AS SOON AS POSSIBLE.

It has long been agreed that the Consumer Credit Act 1974 is out of date and in need of reform to ensure that regulation remains fit for the 21st century. The current state of play where consumer credit regulation is split between the regimes set out by Consumer Credit Act and the Financial Services and Markets Act remains unpalatable. The negative effects of the failure to deliver this reform is beginning to show and the decision to exempt DPC providers from pre-contract disclosure requirements is a case in point. HM Treasury should bring forward its plans to reform the Consumer Credit Act as soon as possible to ensure credit providers are subject to a single credit regime.

66 Berg et al, *The Economics of "Buy Now, Pay Later": A Merchant's Perspective*. The British Psychological Society, *The New Rules of Credit*.

Credit Broking: Under existing regulatory controls, where a business introduces a customer to a lender with a view to the customer entering into a regulated credit agreement, the business will be undertaking credit broking, which is a regulated activity.[67] In its consultation, the government decided to exempt merchants who offer newly regulated agreements from third-party lenders from credit broking regulations unless the activity takes place in the home of the customer. This is because it is concerned that regulating these merchants would represent a significant cost to retailers and reduce the use of BNPL.[68]

However, there is little evidence to suggest that merchants introducing consumers to BNPL products carries less of a risk to consumers than other products, perhaps with the exception of BNPL's lower value. However, there is evidence to suggest that the use of BNPL carries benefits for merchants. Academic evidence from the University of Frankfurt shows causal evidence that customers spend 20 per cent more when DPC is available and that less creditworthy consumers are most responsive to DPC offers.[69] This suggests there is potential for consumer harm to emerge.

There is clearly a need to balance the competing requirements of consumer protection and the costs imposed on retailers and firms by regulation. Too stringent restrictions on credit broking would diminish the use of BNPL products and likely shift providers towards operating other products. The decision to mitigate this risk by requiring unauthorised merchants to obtain approval for financial promotions may be sufficient, but this should be closely monitored.

Access to the Financial Ombudsman and Section 75: Two further protections bestowed upon consumers as a result of the regulation of Deferred Payment Credit is access to Section 75 of the Consumer Credit Act and the ability to bring complaints before the Financial Ombudsman Service.

Section 75 is a well-known consumer protection that entitles consumers to compensation from both their creditor - in this case the DPC firm - and retailer in the event of breach of contract or misrepresentation. In order to qualify, a single item purchase must cost between £100 and £30,001.[70] For example, if a consumer purchased an item worth £200 on a credit card and it did not arrive, they could reclaim £200 from their credit provider under specific circumstances. This is the case even where only part of the cost has been paid with credit. This is a welcome development.

The Financial Ombudsman Service (FOS) is a statutory body established by Parliament that exists to adjudicate on disputes between financial companies and their customers. Bringing DPC into regulation will allow the FOS to begun adjudicating on consumer complaints and ensure redress is given where appropriate. But the existing framework for the FOS does not fit neatly with the DPC market particularly where case fees are concerned. The FOS provides 3 free cases before charging £650 per case fee. Given the analysis presented earlier which suggests that total DPC balances are often considerably below this – indicating that individual purchases are even lower – firms may be encouraged to repay consumers directly rather than being subject to the Ombudsman's scrutiny. This has the effect of potentially hiding poor practice should it occur and placing greater import on the FCA's supervision.

The recent treatment of fees for professional representatives has demonstrated the ability to be flexible with case fees.[71] This may be a further area of flexibility, although it would need to be considered in the context of fees charged to other credit providers.

67 HM Treasury, *Regulation of Buy-Now Pay-Later: Consultation on draft legislation*.

68 Hogan Lovells, *Buy-Now-Pay-Later reform: UK government publishes updated proposals – now over to the FCA*.

69 Berg et al, *The Economics of "Buy Now, Pay Later": A Merchant's Perspective*.

70 Legislation.gov.uk, *Consumer Credit Act 1974*.

71 FT Adviser, *FOS to charge CMCs to refer cases from April*.

RECOMMENDATION 3: THE FINANCIAL OMBUDSMAN SHOULD REVIEW THE FEES FOR DPC PROVIDERS TO REFLECT THE LIMITED AVERAGE VALUE OF DPC PURCHASES.

Bringing DPC into regulation will allow the FOS to begun adjudicating on consumer complaints and ensure redress is given where appropriate. But the existing framework for the FOS does not fit neatly with the DPC market - particularly where case fees are concerned. The FOS charges £650 per case fee, but this has the potential to encourage firms to hide poor practice by dealing with customers themselves. We therefore recommend that the FOS reviews its case fee model in light of the introduction of Deferred Payment Credit to its remit.

Credit Stacking:

In the context of Deferred Payment Credit, credit stacking is where a consumer repays a DPC product using other credit, usually a credit card.[72] Research by Citizens Advice suggests that 26 per cent of consumers who have used Deferred Payment Credit said they used a credit card to repay it in the 12 months prior to the survey and this is supported by other research.[73]

Evidence produced by academics at the University of Chicago and Nottingham suggest this is a significant problem in the UK. Their research using administrative data of approximately 1 million credit cards held by UK consumers between December 2018 and September 2022 found that 19.5% of active UK credit cards in December 2021 had a BNPL transaction charged during 2021.[74] It also found that this is more common in more deprived local authorities.

Loan stacking is a risk to consumers because it has the effect of shifting the location of debt rather than repaying it. In addition, moving the debt to an interest-bearing product may result in the consumer paying more than they otherwise would have. One of the benefits of Deferred Payment Credit is its zero interest and the use of credit stacking therefore erodes the primary benefit which appears to drive consumer use.[75]

Most importantly, consumers who opt to pay with their credit card are likely to be in a greater degree of financial stress and the effect of credit stacking is to allow them to increase their overall borrowing by moving their borrowing to a credit card and taking out more DPC. Where consumers hold DPC and are distressed, it is better they seek debt advice with a lower balance than an inflated one. In light of this, we recommend that DPC providers support consumers to retain control over their lending by refusing to accept credit card payments.

72 Zilch, *Can HM Treasury go further still to regulate and protect consumers using BNPL credit?*

73 Citizens Advice, *Two fifths borrowed to pay off Buy Now Pay Later*.

74 Guttman-Kenny, Firth, Gathergood, *'Buy now, pay later (BNPL)... on your credit card'*, *Journal of Behavioural and Experimental Finance*, Volume 37, March 2023.

75 Financial Conduct Authority, *Deferred Payment Credit: findings from the Financial Lives Survey*, October 2023.

RECOMMENDATION 4: FIRMS SHOULD REFUSE TO ACCEPT CREDIT CARDS FOR DPC TRANSACTIONS.

Research suggests that some consumers are using credit cards to repay their Deferred Payment Credit borrowing, a process known as credit stacking. Credit stacking has negative repercussions for both firms and consumers because it allows consumers to grow their total debt burden by moving debt around rather than paying it off. In turn, it hurts firms because their consumers can end up with greater amounts of bad debt. We believe firms should seek to avoid enabling consumers to stack their credit by refusing to accept credit card payments.

FCA Implementation:

The legislation provided by HM Treasury will place Deferred Payment Credit into the Financial Conduct Authority's regulatory remit and grant the regulator the responsibility for supervising and enforcing its rules.

Prior to supervising, the FCA will need to design a proportionate regulatory environment for deferred payment credit. During the course of creating its rules, the FCA will be obliged to consult on the rules it proposes, and it is likely to expect considerable interest from firms and consumer groups.

Given its discretion, the onus will be on the FCA to prove that its rules are proportionate to the reality of the DPC market. In light of this, we recommend the FCA use its powers to request information from firms to inform a market study that is published alongside its consultation. [76] This will help ensure the regulator puts forward robust proposals that meet the expectations of consumers and firms and dispel much of the knowledge gap that currently exists surrounding the use of DPC.

RECOMMENDATION 5: ALONGSIDE A CONSULTATION PAPER PROVIDING THE FIRST RULES FOR DEFERRED PAYMENT CREDIT FIRMS, THE FCA SHOULD PUBLISH A MARKET STUDY.

The rapid growth of Deferred Payment Credit has understandably prompted considerable interest from all corners of the stakeholder market. Yet for all of the research, there is still much about the market and how it engages with consumers that remains unknown. The FCA's consultation on new rules for the sector will therefore be met with much expectation.

The onus will therefore be on the FCA to prove that its rules are proportionate to the reality of the DPC market. We recommend it uses its powers to request information from firms to inform a market study that should be published alongside its consultation.

76 Legislation.gov.uk, *Financial Services and Markets Act 2000*; Financial Conduct Authority, *EG 3.2 Information Requests(section165)*. Financial Conduct Authority, *MS19/1.2 - Credit Information Market Study: Interim Report and Discussion paper;* Financial Conduct Authority, *FCA requests information from firms about delivery of their ongoing advice services and the Consumer Duty*.

Conclusion

Over the last few years, Deferred Payment Credit has taken the market by storm and it clearly has a significant role in the credit market going forward. Our analysis suggests that the market continues to develop and that most DPC usage does not appear to significantly change consumers' aggregate outstanding debt. Where used appropriately, DPC can be a genuine substitute to higher cost products.

However, there is evidence to suggest DPC can pose risks to some consumers. Our analysis suggests a subsection of DPC users say they are cutting back because they are worried about accessing credit and those consumers generally have higher debt to income ratios, suggesting heighted vulnerability.

We suggest a number of steps that could be taken to expand our understanding of the DPC market and increase friction between consumers and credit use.

List of Recommendations

Recommendation 1: The Financial Conduct Authority should investigate the potential for channel-dependent disclosure requirements.

Recommendation 2: The government should bring forward its plans to reform the Consumer Credit Act as soon as possible.

Recommendation 3: The Financial Ombudsman should review the fees for DPC providers to reflect the limited average value of DPC purchases.

Recommendation 4: Firms should refuse to accept credit cards for DPC transactions.

Recommendation 5: Alongside a consultation paper providing the first rules for Deferred Payment Credit firms, the FCA should publish a market study.

Annex 1: Segmenting the UK Population

As part of our analysis of the UK credit market, we have segmented consumers into broad groups that help us to understand their ability to access credit and the price they are likely to pay for it. We define these groups as "Prime", "Near Prime" and "Sub Prime" and these terms are widely used in the UK and international lending market.

To achieve this segmentation, we asked two screening questions to respondents that were used to segment them into the aforementioned groups. These were the following:

Sub Prime consumers were defined as those who told us:

- Bankruptcy imposed
- County Court Judgement (CCJ) for credit related matters
- A decree for credit related matters
- Debt Relief Order
- Minimal asset process
- Individual Voluntary Arrangement (IVA) (i.e. an agreement made with your creditors to pay off your debt over a set period of time)
- Protected Trust Deed (i.e. an agreement made with your creditors to pay off your debt over a set period of time)
- Voluntary arrangement plan with a credit lender

Near Prime consumers were defined as those who told us:

- I am a new borrower to the credit market i.e. I have never borrowed / had credit before and therefore don't have a credit foot print in the UK
- I am new to the UK credit market i.e. I have only recently moved to the UK so don't have a credit foot print in the UK
- I have had issues with my borrowing in the past i.e. I have missed one or more payments e.g. credit card bills, loans repayments etc.
- I am currently taking steps to re-build my credit score having had problems in the past
- I have an inconsistent income e.g. No set working hours/ Zero-hour contract

Prime consumers were defined as consumers who did not mention any of the above.

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