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Where Buy Now Pay Later is going in Europe – the latest regulatory trends

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In 2022, Buy Now Pay Later (BNPL) products continue to gain interest among consumers and merchants. Along with their growing popularity, they have attracted the attention of regulators who oversee consumer safety on the financial markets.

BNPL market players - FinTechs, Lendtechs, Paytechs, as well as merchants - in the face of regulatory challenges on the one hand and consumer expectations on the other - are trying to cooperate to provide the most innovative BNPL solutions. Banks are attempting to join this group, who have the most barriers and challenges in the implementation of financial products, but also the greatest experience and possibility to scale them.

BNPL as a consumer loan

The BNPL service allows the consumer to complete a transaction (for example, an e-commerce purchase of goods) with a simultaneous postponement of the payment date – for instance for 30 days from purchasing the product online. The BNPL provider pays the merchant for the product, while the consumer in turn pays the BNPL provider within 30 days. Generally, this is a fee-free finance arrangement for the consumer and does not involve additional fees or interests for borrowing the money if the consumer repays the borrowed amount within the agreed period. In practice, this means that the consumer pays only for the goods purchased on the Internet only when the goods are received, verified, and not returned – and if the full amount due is settled on time, no interest will be charged for the deferral period. . This resonates with the needs of consumers who often declare that the ability to examine the product before making a payment is an important factor in encouraging them to make a purchase. The customer obtains financing online as part of one purchasing process, which significantly affects the quality of customer experience related to online shopping. Since online merchants are often willing to participate in the cost of financing – which ultimately increases their sales (conversion) – BNPL is often a financially more beneficial product for the consumer than other forms of financing.

Deloitte Legal's BNPL 2022 study (*BNPL products - selected legal regulations in 24 European jurisdictions*) indicated that the consumer credit model is the most typical BNPL model and is usually based on the provisions of the Consumer Credit Agreements Directive[1] (Consumer Credit Directive), the purpose of which is, in particular, to protect the consumer, aims to ensure that the consumer has sufficient knowledge of financing, and attempts to prevent excessive financial burden placed on the consumer.

BNPL products differ from typical credit products (online loans, credit cards) in that they offer a simple and easy activation process which does not require providing extensive personal data, and it is firmly nested in the purchasing process with merchants. Meeting the detailed requirements resulting from the Consumer Credit Directive is the main pillar of consumer protection mechanisms, but at the same time it may make the purchasing process different from BNPL products (in terms of user-friendliness, simplicity, integration with the e-commerce process). This is one of the reasons why some BNPL products are offered as non-consumer credit products – this is only possible in certain situations (e.g., low-value or free credit).

Risks associated with BNPL products granted outside the consumer credit regime

The regulations of individual European Union countries provide for exceptions to the application of consumer credit regulations, in particular for free loans, insignificant amounts of loans or loans granted for short periods (e.g., Poland, Austria, Cyprus, Luxembourg, Italy, and United Kingdom). In practice, however, they are used by those players who seemingly prefer a better customer experience and product innovation above formal mechanisms to protect the consumer from over-indebtedness.
The planned amendment to the Consumer Credit Directive provides that free loans will no longer be exempt from the regime of consumer credit regulations. This means that, from approximately 2024, when the changes are expected to come into force, many BNPL products that have not yet had to comply with regulations aimed at protecting the consumer from over-indebtedness will have to be fundamentally rebuilt and it is possible that we will no longer see them in their current form.

A particular example is the BNPL market in the UK, where loans are granted based on an exception to the application of consumer credit rules and therefore are not subject to supervision and licensing. Perhaps for this reason, sales of BNPL products in the UK led to a significant level of accumulating consumer debt between 2020 and 2021 (this is very similar to situation on BNPL markets in Australia and the United States) [2].
This, in turn, initiated a proposal for changes in the provisions of UK law aimed at eliminating this exception and including such entities in both licensing and supervision by the FCA (Financial Conduct Authority). At the time of writing, the proposals have not yet been accepted, but FCA succeeded in amending the most controversial consumer provisions in the model contracts of four major BNPL providers in the UK (Clearpay, Klarna, Laybuy and Openpay[3]). This shows that supervisory influence on the part of regulators can take many forms.

Supervision of BNLP

As already mentioned, BNPL products are usually regulated by consumer credit regulations. Provision of BNPL services rely on supervision by the authorities supervising the financial market, authorities tasked with consumer protection (particularly in the financial markets), and authorities responsible for compliance with personal data protection regulations. The BNPL 2022 study in this regard provided the following conclusions:

- Even though BNPL products may be offered in many countries both as regulated and as nonregulated (based on various exceptions) in 19 (of 24) surveyed countries, providers of regulated BNPL products are subject to institutional supervision over consumer credit lending activities.
- In 16 EU countries, the authorization of the supervisory body is required to start a consumer credit business to offer BNPL; in 5 countries, only an entry in a special register is required; and in 3 countries, neither authorization nor entry in a special register (except for entries in registers for doing business in general) are required.

Alternative BNPL models

In the consumer e-commerce market, there are other models that provide similar customer experiences as BNPL credit products. They are based on financing the merchant's activity through factoring. Simply put, they involve deferring payment to the consumer for the product while the merchant assigns the claim against the consumer for payment of the sale price of the product. The BNPL 2022 study indicated that such models are present at least in 8 EU countries.

They usually take one of two forms: the first is the purchase of receivables from the merchant by an external factor (most often an entity from the Fintech industry, e.g., Klarna, Afterpay, etc.), and the second is the purchase of receivables by an entity from the merchant's capital group (this is how Zalando works, for example).

Factoring activities are generally not subject to special regulations other than the typical provisions on the sale of receivables. Particularly, consumer credit regulations do not apply (unless additional financing fees are charged), which may make such BNPL products easy to implement. However, as indicated by the BNPL 2022 study, BNPL products based on factoring would be supervised in 11 EU countries and would require an authorization in 8 EU countries.

What is particularly noteworthy in the case of BNPL products based on factoring, the assessment of the consumer's ability to repay the purchases is often based on different data than in the case of BNPL in the form of consumer credit – merchant estimates the credit risk based to a large extent on historical transaction data of a given consumer, rather than on data on the consumer's income and expenses.

It is difficult to unequivocally decide whether such a risk assessment model, based mainly on transaction data, can ensure an adequate level of non-performing loans and, ultimately, the good financial position of the BNPL product provider.

As a side note, the model with functionality similar to BNPL, which may become popular in the near future is the subscription model, where similar to BNPL products, the payment is deferred or spread over instalments. In such a subscription model e.g., the manufacturer of smartphones, provides the user with the possibility of always using, for a specified period, the latest device for a fixed monthly fee. This is how the sale of Apple smartphones in the subscription model may work soon [4]. More about the business potential of the subscription model and customer preferences is in Deloitte report from 2022 "Demystifying the hype of subscription."

Banks on the BNPL market

The BNPL 2022 study shows a significant increase in the number of countries where banks offer BNPL products. Such products are currently present in at least 12 jurisdictions; however market penetration and popularity of such products may differ from country to country. The relatively small involvement of banks is not a result from the statutory exclusion of the possibility of offering such products – in most countries there are no top-down restrictions for banks to engage in the loan sector through subsidiaries of banks, or financing lending activities by banks (few limitations, however, may be found in European Banking Authority guidelines)[5].

Rather, the reason why banks in Europe do not offer BNPL widely is that banks have the biggest barriers to the implementation of financial products (including non-regulatory ones), and they already offer similar products, although not giving a similar consumer experience to BNPL.

We should, however, expect a further increase in the presence of banks in this market soon, which have the greatest possibility to scale these products.

The most interesting change in the position of banks on the BNPL market may take place in Poland, where a bill is being processed which will tighten the requirements for entities offering consumer loans, including BNPL products (the so-called "anti-usury act"). This project provides for the supervision of the Polish Financial Supervision Authority ('PFSA') over entities granting consumer credit, an even greater reduction of fees that may be charged to borrowers, requirements relating to the legal form, and sources of financing of such entities. The most important change in the context of BNPL seems to be the tightening of requirements related to the assessment of creditworthiness. Until now, it has been difficult for the banking sector to compete with BNPL players due to regulatory requirements. The PFSA, through Recommendation T, imposes detailed requirements on banks regarding assessing the borrower's creditworthiness. These requirements do not apply to loan companies that are subject only to the provisions of the Consumer Credit Act. If the draft enters into force as proposed, Fintechs and Lendtechs may lose the main competitive advantage they have – the creditworthiness assessment requirements for these entities will be tightened and will be just as, if not more, stringent than those for banks (the new requirements for assessing creditworthiness indicated in the draft anti-usury law do not apply to banks). Consequently, it will be more difficult to build lightweight BNPL products that are well-integrated into the purchasing process, which until now have been the main tool of Fintechs and Lendtechs. In the changing legislative environment in Poland, the questions whether banks should participate in increasingly competitive BNPL market and in what business model remain valid.

Banks and BNPL: new approaches

One of the possible approaches is to form a partnership with payment entities. This approach has been chosen by Polish Bank Pekao which, in cooperation with the payment operator TPay, has been working on extending its offer with new payment options including BNPL, cash loans for online shopping, and instalments[6].

Another potentially interesting way of involvement of banks is to provide the BNPL through the physical or virtual card that customers could use both online and offline. Interest in such solutions has been declared recently by pure BNPL players such as Klarna. The Swedish fintech launched the "Klarna Card" in the UK, allowing customers to use BNPL at physical stores[7].

Considering that credit cards are traditional banking products, banks have an advantage over Fintechs in developing similar solutions. It may result in fulfilling the need of existing customers towards BNPL and appeal to younger generations who usually do not own credit cards but look for credit solutions as user-friendly as offered by the majority of BNPL solutions providers now.

Banks can also develop the BNPL service individually. This path gives them the opportunity to build customized offers for customers, as well as leverage their own capabilities and data. Such an approach is being followed by Santander, which since thelaunch of its own BNPL "Zinia" last year has acquired more than two million customers in Germany and has already announced the roll-out of the service across its other European markets[8].

Regardless of the way banks choose to engage within the BNPL market, it is crucial they offer products that are easily accessible and user-friendly enough in terms of the offered customer experience.

[1] Directive 2008/48/EC of the European Parliament and of the Council of 23 April 2008 on credit agreements for consumers

[2] Incidentally, in Australia and the United States, BNPL products are also, in principle, offered outside the consumer credit rules, which also has a broad response from consumer interest organisations. https://consumeraction.org.au/wp-content/uploads/2022/03/230322-US_CFPB-BNLP-Final_230322-1-1.pdf.)

[3] https://www.fca.org.uk/news/statements/fca-drives-changes-buy-now-pay-later-bnpl-firms-contract-terms

[4] https://www.fca.org.uk/news/statements/fca-drives-changes-buy-now-pay-later-bnpl-firms-contract-terms

[5] Limits on exposures to shadow banking entities which carry out banking activities outside a regulated framework under Article 395(2) of Regulation (EU) No 575/2013; European Banking Authority Guidelines on loan origination and monitoring, EBA/GL/2020/06, 29 May 2020

[6] https://tpay.com/o-tpay/blog/tpay-i-pekao-nadaja-kierunek-dalszemu-rozwojowi-cyfrowych-platnoscii

[7] Klarna to launch BNPL credit chttps://www.paymentscardsandmobile.com/klarna-to-launch-bnpl-credit-card-for-physical-pos-purchases

[8] https://www.santander.com/en/press-room/press-releases/2022/01/santander-launches-zinia-its-new-buy-now-pay-later-service

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