

UK Government Issues Draft Legislation To Regulate the Buy-Now-Pay-Later Market

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The UK government has issued [draft legislation](#) to regulate buy-now-pay-later (BNPL) providers. It has also settled its position on a number of other key aspects of its policy on both BNPL providers and providers of short-term interest-free credit (STIFC) products, following a consultation process in 2022. (See our client alerts of 5 July 2022, “[UK Government Confirms Approach to Regulation of Buy-Now-Pay-Later Market](#)”, and 29 October 2021, “[UK Treasury Launches Consultation on Regulation of ‘Buy-Now-Pay-Later’ Financing](#)”.)

In certain areas, the draft legislation resiles from extending regulation to the degree indicated in the consultation paper, acknowledging concerns that some of those proposals would have resulted in unduly burdensome regulation.

Key aspects of proposed legislation are summarised below:

BNPL Providers Will Be Subject to FCA Authorisation

- The UK regime generally requires businesses lending to consumers to be authorised to do so by the UK Financial Conduct Authority (FCA). However, at present, there is an exemption from FCA authorisation for consumer credit-related activities where credit is provided on an interest-free basis and on terms of repayment in 12 or fewer instalments and within 12 months or less.¹ BNPL providers currently rely on this exemption.
- The draft legislation substantially curtails that exemption, with the effect that BNPL agreements offered by third-party lenders will be regulated credit agreements and such lenders will therefore be required to be FCA-authorised.
- Specifically, “borrower-lender-supplier agreements” for fixed-sum credit to individuals or relevant recipients of credit (which would include some small businesses) will become regulated where they are: (i) interest-free and repayable in 12 or fewer instalments within 12 months or less; (ii) provided by a person who is not the provider of goods or services that the agreement finances (*i.e.*, a third party and not the merchant); and (iii) is not otherwise exempt.
- In the draft legislation, the UK government is careful to avoid impacting certain established types of credit which currently fall outside of regulation where it believes the risk of consumer detriment in the absence of regulation has not been made out. Accordingly, the draft legislation includes specific exemptions for credit arrangements such as interest-free agreements to finance contracts of insurance and employer-employee lending.
- BNPL agreements that are outstanding at the time the legislation comes into effect or previously entered into and performed will not be captured by the new legislation; *i.e.*, the legislation will not have retroactive effect.

Broking a BNPL Agreement Will Be Exempt From FCA Authorisation Requirements

- The existing regulatory framework requires brokers of regulated (and some unregulated) consumer credit agreements to be FCA-authorised for ‘credit-broking’.²
- Accordingly, unless made exempt, a merchant introducing a customer to a (newly regulated) BNPL provider would need to be FCA-authorised. The government’s position is that requiring such merchants to obtain FCA authorization would be

¹ Article 60(F)(2), Financial Services and Markets Act 2000 (Regulated Activities) Order 2001.

² Article 36A, RAO 2001.

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disproportionate to the risk of potential consumer detriment. The government considers this to be overly burdensome in cost and could lead to retail merchants ceasing to offer interest-free credit options to customers.

- The draft legislation, therefore, provides for a new exemption from FCA authorisation for credit broking activity in respect of newly regulated agreements, which will benefit merchants who offer BNPL payment options.

Merchant-Provided STIFC Will Be Carved Out From Regulation

- The 2022 consultation set out the government's initial view that merchants offering short-term interest-free credit (STIFC) could present meaningful risk of consumer detriment similar to the BNPL sector. Although in-person STIFC carries greater friction, online STIFC presents less friction and a greater level of risk and regulation was therefore considered for the latter type of STIFC.
- Having considered consultation feedback, the government concluded that the risks of online, merchant-provided STIFC are not of the same degree as those presented by BNPL agreements. These merchants may not be in the business of providing financial services, and many have been providing credit to consumers in one form or another for decades without excessive consumer detriment — for example, by allowing payment for domestic goods purchases in instalments on an interest-free basis. Further, compliance for merchants providing STIFC would be overly burdensome.
- However, the government is keen to prevent efforts by BNPL providers to skirt the regulatory regime by assuming the role of merchant in a transaction to avoid FCA authorisation. Consequently, the draft legislation includes a provision capturing situations where a supplier has an arrangement with the third-party lender under which the supplier sells the goods to the lender when the agreement is taken out. This provision will prevent third-party lenders from technically becoming the supplier (having purchased the goods) in order to remain unregulated. This is a useful, protective provision, given that consumers may be unaware of such arrangements between BNPL providers and merchants.

Restrictions on the Promotion of BNPL Options Are Clarified

- Existing restrictions on marketing financial products apply to both lenders and merchants advertising currently exempt agreements. Merchants who are not FCA-authorized are prevented from “communicat[ing] an invitation or inducement”

to enter into investment activity.³ The FCA issued a “Dear CEO Letter” to affected firms in August 2022 explaining that this includes “posters in shop windows, paid for Google ads, and posts made by influencers on social media”.

- The marketing restrictions do not apply if the firm is: (i) authorised; (ii) an unauthorised merchant or lender but where the content is approved by an authorised person; or (iii) a merchant authorised for credit-broking or another regulated activity. At present, unauthorised merchants must obtain approval before promoting BNPL agreements and the rules governing the marketing of newly regulated BNPL agreements would be the same.
- Acknowledging the impracticalities of this for merchants offering BNPL options, the UK government proposes that newly regulated third-party BNPL lenders should supply pre-approved marketing material to unauthorised merchants as part of the overarching commercial arrangement between them.

Pre-contractual Information Requirements Subject to FCA Rules

- Typically, lenders must provide specific information to prospective borrowers before a regulated credit agreement is entered into by the parties.⁴ Respondents to the 2022 consultation considered those requirements to be overly onerous for BNPL agreements, and the government concurred.
- The government has now made clear that a flexible approach would be the most appropriate and proportionate. BNPL providers would therefore have to comply with FCA rules on pre-contractual information, which are expected to be tailored for the BNPL sector. Failure to do so will result in the FCA taking action using its existing supervisory and enforcement toolkit. Customers would also be able to make a claim for damages and a complaint to the Financial Ombudsman Service⁵

Creditors Will Be Liable for Merchants' Breaches and Misrepresentations

- A well-known statutory consumer protection mechanism provides that the lender is jointly and severally liable for any breach of contract or misrepresentation by a merchant.⁶ The government has confirmed that this will apply to newly regulated BNPL agreements with the same thresholds applying (*i.e.*, to purchases between £100 and £30,000).
- This is one of the main benefits to the consumer of using a credit card, so its application to newly regulated agreements is significant.

³ Section 21(1) FSMA 2000.

⁴ Section 55 Consumer Credit Act 1974.

⁵ Section 138D FSMA 2000.

⁶ Section 75 CCA 1974.

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Temporary Permissions Will Be Granted While New Authorisations Are Pending

- The draft legislation provides for transitional arrangements in the form of a temporary permissions regime (TPR). This would allow BNPL providers to continue to operate until fully authorised. Without such relief, they would have to suspend operations prior to being authorised.
- Under the TPR, providers awaiting authorisation would be deemed FCA-authorized and therefore permitted to undertake activities as if they were authorised to enter into newly regulated agreements. This temporary authorisation would be replaced by the grant of authorisation by the FCA or the withdrawal or rejection of an application for authorisation.
- Providers deemed authorised would need to comply with the full suite of FCA rules, and the FCA would be able to supervise or take enforcement action against them if necessary.

Next Steps

- The current consultation period for the draft legislation expires in on 11 April 2023.
- Once the UK government has considered stakeholder responses and made any necessary changes, it aims to lay the legislation before Parliament when time allows. The expectation is that this will be during 2023, so legislation may come into force later this year or in 2024.