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'Buy Now, Pay Later' (BNPL) Payment Services

Opportunities and Legal Challenges for EU Consumers and Businesses

The digital revolution is rapidly advancing in a society in which payment and credit services are becoming increasingly indispensable to foster the transition from more traditional services. The payment and credit sectors are expanding swiftly and the range of services they provide attempts to meet a wider spectrum of demands from consumers increasingly shopping online and merchants that are looking to optimise their transactions while attracting more clients. In this context, 'buy now, pay later' (BNPL) represents the hottest novelty in the payment and (short-term) credit market. In this respect, we provide, on the one hand, an analysis of opportunities and risks for consumers, merchants and competitors engaging with BNPL services. On the other hand, through a complete and timely analysis of the relevant European Union (EU) legislation concerning payments and credit systems, we aim to identify whether BNPL firms are subject to an appropriate regulatory perimeter by using the experience of other jurisdictions, such as the United Kingdom, as a reference framework. In this respect, we will assess the extent to which the EU legislator should regulate BNPL services, especially concerning their scope, and how BNPL can fit whithin the existing regulatory perimeter concerning consumer credit and payment services.

I. Introduction: The Market for Unsecured Credit[1]

In recent years, the financial sector experienced a rapid digitalisation driven by innovation and evolving consumers' preferences who are increasingly shopping on-line and that are seeking new alternatives to traditional lending and payment services. In digital platforms, consumers seek smoother and faster processes for obtaining credit, frequently of small amounts, with non-stop access. The COVID-19 pandemic accelerated this trend as e-commerce sales grew steadily in line with a significant digital transformation in the banking and financial industries.[2] This is corroborated by statistics showing that the largest increase in the use of e-commerce in Europe was registered in 2020,[3] thus matching the start of the pandemic. Rapidly evolving markets and new trends have fostered the surfacing of new payment solutions, services and technologies that resulted in the emergence of new market players. The rise of digital (fractional) lending is an example of the deviation of the market towards digital solutions.

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1 The cut-off date for the information included in this paper is 10 July 2023.

2 For instance, in the US, e-commerce increased in 2021 by 14.2 % comparing to the previous year and 50.5 % comparing to 2019. See J Goldberg, 'E-Commerce Sales Grew 50 % to $870 Billion During The Pandemic', (*Forbes*, 18 February 2022) <https://www.forbes.com/sites/jasongoldberg/2022/02/18/e-commerce-sales-grew-50-to-870-billion-during-the-pandemic/>.

3 On the matter, see S Lone et al., 'European E-commerce Report' (2021) <https://ecommerce-europe.eu/wp-content/uploads/2021/09/2021-European-E-commerce-Report-LIGHT-VERSION.pdf>.

In this context, we identified 'Buy now, pay later' (BNPL) as a cutting-edge innovation in the payment and credit services industry that is still outside of the main debates in academia. We can define BNPL as a split-payment service that allows consumers to defer payments for a product or service directly at the 'checkout' phase, meaning when authorising an online purchase directly from the webstore of a merchant, a characteristic that indicates its digital focus. We argue that consumers are increasingly attracted by BNPL services mainly because of their (initial) interest-free nature as BNPL services do not charge any interest fees when the customer meets the deadlines for each interim payment.[4] Customers turned towards BNPL also for other reasons, such as the willingness to keep cash in case of emergency or because of a sudden loss of income, dynamics fuelled by the pandemic.[5] By virtue of these reasons, this service experienced an explosive growth and it is currently considered by traditional players of the banking and payments industry as 'the fastest-growing payment method globally'.[6] For instance, BNPL grew significantly from the 8 % to the 19 % of the total online purchases made in Germany between 2017 and 2020.[7]

II. The Emergence of a New and Increasingly Popular 'Purchase/Pay-Over-Time' Payment Option

1. What Is 'BNPL'?

Unlike other digital and financial innovations, the BNPL acronym embodies the exact meaning of its service, a purchase/pay-over-time service. Typically, it allows customers to buy a product while paying for it later, in instalments. The mechanism of BNPL foresees two main types of services. The first, that is considered as the most common type, focuses on instalments returned over a very short period of time with no interest charges (usually 3 to 7 instalments).[8] The second model provides the possibility to make payments divided over the course of several months. Overall, this mechanism can be compared to small consumer credit provided by the conventional credit industry through credit cards. Even though in the United Kingdom (UK), the Financial Conduct Authority (FCA), included PayPal among the 'providers of BNPL credit agreements',[9] we argue that BNPL services cannot be compared with other open-banking digital players like PayPal or Satispay because they do not provide payments in instalments as a form of short-term credit line, since they are specialised in issuing electronic money (i. e., e-money)[10] and providing payment services by means of e-money. Moreover, PayPal is a credit institution having been granted a banking licence in

4 See J Tijssen and R Garner, 'Buy Now, Pay Later in the UK. Consumers' Delight, Regulators' Challenge' (2021) *Bain* & *Company* <https://www.bain.com/globalassets/noindex/2021/bain_report_buy_now_pay_later-in-the-uk.pdf>.

5 M Backman and J Caporal, 'Buy Now, Pay Later Services Continue Explosive Growth' (*Fool*, 18 July 2022) <https://www.fool.com/the-ascent/research/buy-now-pay-later-statistics/>.

6 See *'Buy Now, Pay Later': Banking on Global Financial Innovation* (*Morgan Stanley*, 11 November 2021) <https://www.morganstanley.com/ideas/buy-now-pay-later-apps-credit-card-alternative, last accessed 10 May 2022>.

7 *Ibid*. The data has been extracted from Worldpay from FIS, 'The Global Payments Report' (2021) < https://worldpay.globalpaymentsreport.com/en>, last accessed 10 May 2022.

8 See N Megaw, 'Will Covid and Klarna kill the credit card?' (*Financial Times*, 17 September 2021) <https://www.ft.com/content/22c81ad9-91d9-4f00-8b66-1fa77468690d>.

9 See Financial Conduct Authority, 'The Woolard Review – A review of change and innovation in the unsecured credit market', Report to the FCA Board, 2 February 2021, 45.

10 For an overview of e-money institutions with an EU regulatory perspective, see P Athanassiou and N Mas-Guix, 'Electronic Money Institutions – Current Trends, Regulatory Issues and Future Prospects' (2008) European Central Bank Legal Working Paper No. 7.

Luxembourg back in 2007 despite no plans to provide banking services in the EU, whereas Satispay is an 'e-money' institution. Both are based in Luxembourg and are authorised and regulated by the Luxembourg's National Competent Authority (NCA), the *Commission de Surveillance du Secteur Financier*. Based on the above, we argue that the proper comparison among payment mechanisms can be undertaken between BNPL and credit cards.

The key distinction between BNPL and credit cards is the lack of interest charges on postponed payments. Furthermore, the credit scores of BNPL customers located in the United States (US) or the UK will not be impacted in case of missed payments.[11] In these jurisdictions, credit card companies provide Credit Rating Agencies (CRAs)[12] with regular reports on purchases and other financial operations of each customer registered within the respective tax authorities. The credit score that results from the reports managed by the CRAs serves for banks, credit card companies and other financial institutions to decide on whether to grant a loan (even if short-term) and under what conditions as, for example, the interest to be applied.

Due to their peculiar business model, BNPL firms do not conduct credit checks with CRAs before authorising their short-term loans. In fact, BNPL firms manage their credit risk by letting the user earn the privilege to use the platform to a larger extent rather than performing formal credit checks. In particular, a consumer is first issued a limited credit authorisation that may be increased over time upon successful repayments within the foreseen deadlines. From a regulatory perspective, this model raises several concerns in terms of sustainability, profitability and risk exposure. In this respect, we can preliminary argue that the approach to credit checks is the direct consequence of the lax regulatory regime that is currently applicable to this modern industry.

Since the BNPL business model looks quite ambiguously from a profitability point of view, we wanted to understand how this industry is able to make big gains and register exponential growth. The answer lies again in the business model. In fact, to accept the BNPL payment option at checkout, that is the merchants' point of sale, online retailers have to pay a direct charge to the BNPL firm. These charges (or fees) account for 70-85 % of the revenues of BNPL firms, while the rest is mostly resulting from the interests over the customers' missed payments. What could seem as a novelty at a first glance, in reality is another example of the similarity between the credit card business and the BNPL. Traditional card payment firms apply a fee to merchants for each transaction made by customers. As for what concerns BNPL, the fee ranges between 2 % and 6 %, representing a much higher fee compared to that of credit/debit card payments that are usually below 2 %, although fees differ among countries. Having clarified the main source of revenue for BNPL firms, another doubt arises on the success of BNPL among merchants despite the increased costs compared to traditional payment services. We argue that besides high costs, BNPL remains an appealing offer for merchants because, among other reasons explored in section 3.2, customers who use

11 For an analysis on the shopping behaviour of US consumers with regard to the use of credit cards and the subsequent impact on their credit scores, see V Stango and J Zinman, 'Borrowing High versus Borrowing Higher: Price Dispersion and Shopping Behavior in the U. S. Credit Card Market' (2015) 29 The Review of Financial Studies 4; A Kara et al., 'An empirical investigation of US credit card users: Card choice and usage behavior' (1996) 5 International Business Review 2.

12 On this matter, see S. Finlay, *Consumer Credit Fundamentals* (Palgrave Macmillan 2005), 117-141.

BNPL as their checkout option prefer to purchase larger baskets that translate into higher revenues for those merchants.

Similarly to BNPL, credit cards allow consumers to defer a payment for a product or service at the time of purchase. The outstanding amount can be settled either entirely by the end of a specified date or partially with the extension of the remaining balance as a credit subject to interest rates.[13] However, receiving a credit card depends on a customer's creditworthiness, meaning that usually a bank is involved in collecting data and assessing the history of the operations of a customer, such as transactions or loans. The outcome of this assessment results in a score on which depend many elements as, for example, the monthly limit for purchases or the interest rates. Purchases made by customers during a calendar month are usually settled by credit card companies at the beginning of the subsequent month by withdrawing funds from the client's bank account linked to the credit card or by means of an invoice to be settled by the client.

As we mentioned above, the main difference between BNPL services and credit card is that BNPL do not charge interest rates on their deferred (on time) payments whereas credit cards are one the most costly types of credit in terms of interest rates.[14] In the UK, the average annual percentage rate for credit-card purchases reached 24,7 % in September 2019 and about 27 % in September 2021 – that is the highest level in 13 years.[15] Also in the US it was possible to observe an aggressive increase in interest rates,[16] meaning that, in 2021, US consumers had to pay an average interest rate on credit cards of 16,45 %.[17] However, customers with poor credit scores may be faced with interests rates as high as 25 to 30 % considering that they imply higher risk for the provider of credit. Unsurprisingly, although credit cards commonly account to only 5 to 10 % of financial institutions' lending, interest rates charged on credit cards bring 13 to 31 % of revenues.[18] As a consequence, we argue that the emergence of services, such as BNPL, will most probably force banks and other start ups to ramp up, digitalise, ease or refine their offerings as it could be observed by the recent plans of several big players of the UK financial services industry.[19] Hence, the onset of the BNPL services may possibly boost competition and thus the emergence of new payment options provided by banks with lower interest rates and clearer terms.

2. BNPL *versus* Traditional Payment Methods

We found that BNPL shares similarities also with traditional point-of-sale financing offered by stores, the so called 'layaway'. Layaway is a pay-over-time option that became a part of retailers' business offer in the 1940 s and 1950 s[20] allowing

13 See T Kokkola, 'The Payment System' (2010), European Central Bank, 31.

14 OO Cherednychenko and JM Meinderstma, 'Mis-selling of Financial Products: Consumer Credit' (2018) Study for the European Parliament Committee on Economic and Monetary Affairs (ECON), Directorate-General for Internal Policies, PE 618.997, 14.

15 See L Warwick-Ching, 'Credit card interest rates rise to highest levels in 13 years' (*Financial Times*, 17 September 2019) <https://www.ft.com/content/bc471b1c-d932-11e9-8f9b-77216ebe1f17>; Megaw (n 8).

16 In 2019, interest rates on credit card balances in the US reached its record and amounted to 17,87 %. See R Armstrong, 'US credit card interest rates hit 25-year high' (*Financial Times*, 6 August 2019) <https://www.ft.com/content/47fa19fe-b56e-11e9-bec9-fdcab53d6959>.

17 M Black and R Saks Frankel, 'What Is The Average Credit Card Interest Rate?' (*Forbes Advisor*, 2 September 2022) <https://www.forbes.com/advisor/credit-cards/average-credit-card-interest-rate>.

18 See Megaw (n 8).

19 *Ibid*.

20 See, for example, J Birchall, 'Toys R Us launches a 'layaway' service' customers to reserve an item by making a down payment.[21] This means that a merchant would hold a product for a customer until the payment would be completed in regular interest-free instalments. Similarly to BNPL, layaway works for those consumers who have limited expendable income or who may have bad or no credit. Assuming that a consumer would not pay in full for a reserved product, the item would be put on sale again and the customer would be reimbursed either partially or in full after the deduction of the cancellation fee. However, a customer might be also forfeited entirely. Although still available, the popularity of this point-of-sale financing service faded when credit cards became commonly available and with the fast-growing BNPL industry, even more retailers are closing their layaway programmes.[22] With respect to the comparison between BNPL and layways, we agree with the opinion of Rohit Chopra, Director of the US Consumer Financial Protection Bureau, who sees BNPL services as the new version of traditional layaway with 'modern, faster twists where the consumer gets the product immediately'.[23] In fact, in contrast to purchases with the use of credit cards or BNPL, the layaway option does not allow the customer to take immediate possession of the purchased item until the payment is made in full.

III. Opportunities and Risks of BNPL Services

1. For Consumers

As shown by Siemens, consumers are keen for a credit product that is short-term and interest free.[24] Howver, consumer credit may be necessary not only to enable consumers to finance large purchases but also to balance the budget and cover essential needs. In this respect, while the FCA warned that 'the harms which can arise in sub-prime credit markets must be balanced against the harm of not accessing credit at all',[25] a recent study conducted by Finance Watch[26] revealed that consumers seeking BNPL are typically those without financial reserves nor planning ability and/or those who are unable to borrow via regular channels.[27] This is corroborated by a recent study that showed that 36.92 % of consumers choose BNPL services to avoid paying credit card interest, while 24.73 % choose the BNPL payment option to borrow money without a credit check and 14.16 % use BNPL because of the inability to be approved for a credit card.[28] The fact that certain consumers do not have access to the mainstream credit means that they have to look for other options and this means that the regulator should balance the objec-

(*Financial Times*, 20 October 2009) <https://www.ft.com/content/a5167a80-bce3-11de-a7ec-00144feab49a>.

21 See D Wang et al., 'Optimal inventory decisions for a risk-averse retailer when offering layaway' (2020) 284(1) European Journal of Operational Research.

22 J Alcazar and T Bradford, 'The Appeal and Proliferation of Buy Now, Pay Later: Consumer and Merchant Perspectives', Federal Reserve Bank of Kansas City Payments System Research Briefing, 10 November 2021, < https://www.kansascityfed.org/documents/8504/psrb21alcazarbradford1110.pdf>.

23 See 'Consumer Financial Protection Bureau Opens Inquiry into 'Buy Now, Pay Later' Credit' (*Consumer Financial Protection Bureau*, 16 December 2021) <https://www.consumerfinance.gov/about-us/newsroom/consumer-financial-protection-bureau-opens-inquiry-into-buy-now-pay-later-credit/>.

24 See J C Siemens, 'When consumption benefits precede costs: towards an understanding of 'buy now, pay later' transactions' (2007) 20(5) Journal of Behavioral Decision Making 5.

25 See Financial Conduct Authority (n 9) at 16.

26 See Finance Watch, 'Tackling causes of over-indebtedness in the EU consumer credit market' (2022) Finance Watch Policy Brief.

27 *Ibid*. at 9.

28 See Backman and Caporal (n 5).

tives of the protection of consumers with those of ensuring financial inclusion, especially via Fintechs.[29]

Clients with unstable or low income often turn to short-term high-cost credit products such as payday loans.[30] Although payday loans may provide benefit to customers in temporary financial distress, in many circumstances they can cause consumer harm. The annual percentage rate for payday loans is typically of the order of 1447 % but it can be as high as 5632 %.[31] Because of high interest rates and other exorbitant costs for arrears and default, payday loans are frequently portrayed as being 'extortionate'. In our opinion, what makes the situation even worse is that high-cost loans are often granted to consumers who often have multiple loans and that are taking new ones to repay existing loans or to finance late payment fees in relation to existing debt that may lead to debt spirals and eventually engender over-indebtedness. In contrast to payday loans, BNPL payments foresee the establishment of caps on late fees. This, together with the lack of interests, induces providers rather to propel widespread use with timely payment instead of accepting rolled-over debts. In this context, BNPL is considered as 'a more cost-effective method of borrowing than traditional alternatives'[32] and it can be seen as improving financial and social inclusion, especially for those who face obstacles in accessing traditional financing products and services. In addition, we consider that such innovative financial products and new non-traditional operators may increase competition in the market fostering other companies to provide services that embed similar values.

BNPL is often advertised as a zero-cost product, a marketing strategy that can be misleading considering that a part of BNPL providers' income comes from high late-payment fees and other hidden costs. For instance, in case of non-payment of the instalment by the due date, a BNPL provider active in the UK market, Clearpay, charges a late fee of 6 pound sterling (GBP) for purchases of less than 24 GBP.[33] For purchases equal to or more than 24 GBP, the total late fees may amount to 25 % of the order price or 36 GBP, whichever is less.[34] Similarly, Klarna, one of the most-known and widespread BNPL providers in the US and the EU, charges late fees of similar amonts but that cannot be more than 25 % of the instalment payment amount, except when limited or prohibited by the applicable law.[35] Evidence suggests that customers are not adequately informed about these costs,[36] showing that in 65 % of the cases, pre-contractual information on the costs of BNPL schemes was not clear.[37] Even more strikingly, information on the consequences in case of default and late payments was unclear or very unclear in 90 % of the cases.[38] Yet, more than a third of BNPL users declares that they have made a late payment or were charged a late fee.[39] This was one of the reasons that has drawn increasing regula-

29 T Philippon, 'On Fintech and Financial Inclusion' (2019) NBER Working Paper No. 26330.
30 See N Bhutta, 'Payday loans and consumer financial health' (2014) 47 Journal of Banking & Finance.
31 Finance Watch (n 26) at 13.
32 Tijssen and Garner (n 4) at 30.
33 See Clearpay, *Terms of service* (last updated 25 July 2022) <https://www.clearpay.co.uk/en-GB/terms-of-service>.
34 *Ibid.*
35 See, for example, Klarna's French terms and conditions, *Les conditions générales d'utilisation de l'Expérience Shopping Klarna* (last updated 9 June 2022) <https://cdn.klarna.com/1.0/shared/content/legal/terms/0/fr_fr/user>.
36 Finance Watch (n 26) at 9.
37 *Ibid.* at 11.
38 *Ibid.*
39 Backman and Caporal (n 5).

tory scrutiny for this type of hybrid payment and credit solution, shifting the balance towards the protection of consumers.

BNPL providers lure customers by creating an illusory feeling of increased purchasing power. Services are promoted with explicit references to freedom and safety. Some of the slogans advertise BNPL as 'the smoothest & safest way to get what you want today, and pay overtime. No catch.'[40] Others refer to empowering customers 'with features designed to provide freedom and flexibility'.[41] Whereas, one of the most recent BNPL firms claims '*[f]aites-vous plaisir et payez en 3 fois sans frais*'[42] (treat yourself and pay in 3 instalments free of charge), highlighting the strength of this business model compared to BNPL's main competitor, the credit card companies. This concentration of advertising with variable content triggered the reaction of the authorities. In December 2020, the UK Advertising Standards Authority (ASA) banned several advertisements of a BNPL provider for irresponsibly encouraging the use of deferred payment services to improve people's mood during the lockdown enforced due to the pandemic.[43] BNPL advertising is often designed to take advantage of consumer biases with the aim to drive sales. The delusion of buying desired lifestyle at times takes over the due consideration of the actual commitment made by the consumer. Interestingly, consumers using BNPL services tend to purchase larger baskets. When choosing BNPL as checkout option consumers' purchases can be 20 %-30 % larger than when paying with credit card.[44] In this respect, Ah Fook and McNeill analysed the impact of BNPL on consumers' impulse buying tendency of the online fashion shopping, providing evidence that consumers paying by means of BNPL have shown a greater impulse buying tendency than those purchasing via other means of payment.[45]

Another concern regarding BNPL is that some consumers do not perceive it as credit and frequently associate it rather with other payment technologies or e-money solutions, such as Google Pay[46] or ApplePay, even tough Apple is also engaged in the BNPL industry,[47] which adds further confusion for consumers. Although, as analysed above, the two payment methods have a number of similarities, consumers also frequently perceive BNPL as an alternative to a credit card rather than a (short-term) credit product because on the websites of merchants, BNPL appears on the checkout page together with the other means of payment and it is often marketed as a zero-cost 'new way to pay'.[48] Moreover, the FCA observed that some consumers erroneously assume that BNPL services come with the protections of other regulated services.[49] In view of this lack of understanding, there is a risk that consumers may not have the same level of scrutiny as the

40 See Klarna's webpage <www.klarna.com/us/what-is-klarna/>, last accessed 12 June 2023.
41 See Clearpay's webpage <www.clearpay.co.uk/en-GB/responsible-spending>, last accessed 12 June 2023.
42 See Scalapay's webpage <https://www.scalapay.com/fr>, last accessed 12 June 2023.
43 See Advertising Standards Authority, *ASA Ruling on Klarna Bank AB*, 23 December 2020 <https://www.asa.org.uk/rulings/klarna-bank-ab-a20-1081031-klarna-bank-ab.html>.
44 Tijssen and Garner (n 4) at 2.
45 See L Ah Fook and L McNeill, 'Click to buy: The impact of retail credit on over-consumption in the online environment?' (2020) 12(18) Sustainability.
46 [48] See Financial Conduct Authority (n 9) at 46.
47 J De Avila, 'Apple Rolls Out Buy Now, Pay Later Plan' (*Wall Street Journal*, 28 March 2023) <https://www.wsj.com/article/apple-rolls-out-buy-now-pay-later-plan-640ae583>.
48 Financial Conduct Authority (n 9) at 46.
49 *Ibid.* at 47.

one that they would have when deciding on other credit products. Using BNPL may also hinder consumers' ability to control their expenditures and keep the track of their debt and repayments. This might be the case for those who use several credit facilities at the same time. BNPL providers typically conduct a very superficial credit assessment. In many cases, providers manage their risk by applying initial limits to the extended credit and, in the event of missed payments, consumers are suspended or restricted from using the rest of the credit.[50] Furthermore, unlike credit card firms, BNPL providers are not obliged to share information with CRAs. Considering that many consumers declared that they look for another provider if they reach their limit with one credit provider or if they are rejected, the risk of creating widespread and significant indebtedness is most likely. In fact, the European Banking Authority (EBA) warned that 'fast credit granting decision-making process may nudge customers into loans that may not be in line with their affordability and risk profile.'[51]

Nonetheless, it needs to be noted that, as mentioned earlier, BNPL providers try to make efforts to show that responsible lending is an integral feature of their business model. Most providers, next to checkout options in the merchant's website, also provide apps, which help customers to follow repayments, including notifications reminding of the coming payments. This is important to keep track of the various expenditures and the amount of each instalment, in order to contain over-spending trends. It is also worth noting that several BNPL providers started recently to report to CRAs late payments as well as unpaid purchases. In this way, they are able to make use of 'credit agency data to help assess customers' suitability for loans.'[52] This is an important step towards enabling BNPL providers to assess affordability for the consumer taking into account credit history rather than focusing solely on credit risk. Additionally, most BNPL providers cap late payment fees at a specified percentage of the initial transaction and will not continue lending to those customers who have outstanding payments with them. We argue that these solutions are going into the right direction for ensuring a stronger consumer protection. However, in a framework of a lax regulatory environment for BNPL services, there is still a handful of issues to be addressed. In this sense, the legislator should apply a proportionality approach by weighting the needs for consumers, merchants and financial stability. This can be achieved by ensuring a level playing field through harmonised rules.

2. For Merchants

In section 2.1 we identified merchants as an active part in the BNPL business model. This is due to their active promotion of BNPL services and to the regular payment of fees to BNPL firms. Merchants who cooperate with BNPL providers are often required to actively promote those arrangements to customers ensuring their visibility online. This kind of BNPL advertising triggers impulsive shopping in which consumers in the heat of the moment decide to spend more money than

50 *Ibid.* at 48.

51 See European Banking Authority, 'Final Report on response to the nonbank lending request from the CfA on digital finance', EBA/Rep/2022, 8 April 2022.

52 See S Venkataramakrishnan, 'Klarna to report 'buy now, pay later' use to UK credit agencies' (*Financial Times*, 4 May 2022) <https://www.ft.com/content/6ed86c58-7367-4da1-b4bd-9c7cac145a45>; 'All you need to know about Klarna sharing BNPL payments with credit reference agencies' (*Klarna*, 4 May 2022) <https://www.klarna.com/uk/blog/all-you-need-to-know-about-klarna-reporting-bnpl-payments-to-credit-reference-agencies/>.

intended or purchase things that otherwise would not consider buying. At present, certain BNPL firms claim to be committed to encourage 'responsible spending', a clear sign that this payment mechanism is likely to be overused by consumers with poor management skills with regards to their own personal finances. BNPL firms are engaging with consumers promoting a more responsible behaviour with tools, such as notifications about upcoming repayments or enabling consumers to keep track of specific repayment dealines through online accounts and mobile applications. In this way, consumers are able to stay in control of their finances and make informed decisions about their purchases and repayments.

As for what concerns the payment of fees by merchants to BNPL firms, being the extent of those fees higher than those paid to traditional credit card providers, it should in theory discourage merchants from engaging with this innovative payment and credit system. However, from the merchants' point of view, this still represents a profitable business due to an increase in consumer basket sizes. In other words, unlike conventional online purchases, since the average customer does not have to disburse the whole amount in one single payment at checkout, it would self-persuade to buy more items, thus increasing sales and profitability for merchants. In line with this argument, we argue that customer loyalty also increases because customers will be engaged for several weeks (or months) with the merchant as they will have to be paying the instalments through the BNPL services.

BNPL offers to merchants frictionless and well-integrated checkout systems in which consumers do not have to insert all their data several times but can purchase at checkout with a 'single click', or through the BNPL app, as all the necessary clients' data is already present in the BNPL platform that will process the payment and that will take care of the collection of the successive instalments. Easing the process definitely helps merchants engaging with BNPL services compared to their competitors that adopt more traditional means of payment. The relationship between BNPL firms and online merchants is much broader. We observed that BNPL firms use quite a few incentives to expand their commercial network. For example, BNPL firms want to make sure that such commercial network is not permanent, as they reserve the right to revoke their agreement in any moment. In this way, they use a sort of exclusivity strategy to foster merchants to compete to be able to embed BNPL services among the vaiours payments systems that they include in their platforms or websites, thus offering a broader range of means of payment to consumers and showing to be at the digital state-of-the-art, a marketing strategy that is particularly effective with younger generations that are more prone to online shopping and digital payment services.

The use of BNPL services for merchants does not only come with opportunities. From the point of view of the liability concerning every single purchase, BNPL firms are very keen in stressing that all the responsibility lies within the merchant. Since these firms claim to be exclusively responsible for the finalisation of the payment, all matters related to the adequate receipt and quality of the purchased product or service have to be attributed exclusively to the merchant. Inevitably, this represents a potential source of issues for both consumers and merchants. By introducing BNPL as the 'middleman'[53] for the execution of online payments, it is possible to observe

53 Judge discussed about the issues concerning the presence and the rise of 'middlemen' in financial services, including payment systems. See K Judge, *Direct* (Harper Collins 2022), 199-205.

an increase in the number of interlocutors with whom the customer must liaise in case of issues. In the same way as for the problems related to the lack of financial knowledge and those related to 'misleading advertisements', the customer is not able to make an exhaustive judgment on the attribution of the responsibility between the BNPL service and the merchant in the event of concerns, such as the non-delivery of the product. For example, the customer would not know whether this is due to the non-acknowledgment of the merchant's payment (or its notification) by the BNPL service, or to a simple error or omission of the merchant that is not attributable to the conduct or the service of the BNPL firm. Failing to address the concern to the correct party in this multi-party transaction could compromise the success of the customers' query or complaint.

Another risk for merchants collaborating with BNPL companies is that linked to credit. Online merchants who are affiliated to BNPL companies are directly exposed to counterparty risk and default of the latter companies. In the case of financial difficulties or default of BNPL firms, merchants could suddenly fall short on the gains coming from purchases correctly made by consumers on BNPL platforms but not completed towards the merchant because of the sudden default or the lack of adequante funding of the BNPL firm. In the current uncertain regulatory framework in the EU, it would be highly complicated to retrieve the amounts due as it would occur for a customary insolvency procedure. In this sense, the type of company providing BNPL services, such as a bank, a 'pure' payment services provider or an hybrid, can make a considerable difference.

3. For Competitors

Commonly, innovation is received more warmly by its users than by those who will become the competitors and the same fate occurred to BNPL firms. While consumers happily and quickly embraced this new smooth payment method, the traditional financial sector turned up its nose. BNPL companies have been labelled by some traditional lenders as 'extortion schemes',[54] while scholars observed a new trend consisting of a relationship between banks and Fintech companies.[55] In this framework, instead of resisting or fighting against innovation, banks put at the service of Fintechs and similar companies their knowledge and experience concerning regulatory compliance, risk management and other types of critical operational support. On the other side, traditional banks receive benefits that go beyond competition in the digital financial markets, because they keep up the pace of new technologies, consolidate their network and learn how to approach a new generation of consumers that are attracted by different, faster and more intuitive types of financial products.

Nevertheless, the initial enthusiasm towards BNPL encountered the first decline when they registered the first losses,[56] as several investors were concerned about the future of these companies and the sustainability of their business model. This follows a similar trend experienced in general by Fintechs and other start-ups. For example, the current inflationary pressures and the subsequent raise of interest rates by the

54 See Megaw (n 8).
55 See L Enriques and WG Ringe, 'Bank–fintech partnerships, outsourcing arrangements and the case for a mentorship regime' (2020) 15(4) Capital Markets Law Journal.
56 See K Hur, 'There's more pain coming for investors who own buy now, pay later plays, Jim Cramer says' (*CNBC*, 6 July 2022) <https://www.cnbc.com/amp/2022/07/06/theres-more-pain-coming-for-investors-who-own-buy-now-pay-later-plays-jim-cramer-says.html>.

European Central Bank (ECB) and other central banks can slow the demand which can affect the profitability of BNPL firms. Unlike other types of credit and financial companies, BNPL firms are more exposed to liquidity and funding risks as their business model make them more exposed to short-term funding. In any case, the market for BNPL services appears very dynamic and open not only for global or pan-European solution but also for domestic markets.[57]

IV. Regulatory Challenges

1. The Regulatory Response to BNPL in the UK

In a similar vein to other financial and, especially, digital innovations, once the trend of a service is consolidated then also the regulators step in. As for what concerns the UK, the government has recently issued draft legislation to regulate BNPL providers. In the UK, the expansion of the BNPL was driven by a decline in the use of the traditional credit card lending in favour of more simple and innovative online solutions that can count on widespread consumer satisfaction.[58] According to a recent study, only 8 % of UK consumers declared that they would prefer to use a traditional option, such as a credit card, when there is a possibility to proceed with a payment via BNPL.[59] In addition, the FCA declared that UK consumers spent 'at least £2.7 bn through BNPL in 2020'.[60] As such, this amount might sound not significant considering the whole market for payment services. However, it must be considered that just over a year, the amount spent through BNPL services was four times higher than in the previous year. To properly identify these services, the FCA provided in a report a definition of BNPL services, labelling them as 'deferred payment credit'[61] and initially positioning them outside of the regulatory perimeter of the UK consumer credit regulation, the Consumer Credit Act (CCA),[62] by virtue of Article 60F(2) of the Financial Services and Markets Act due to their 'short-term and interest-free nature'.[63]

The unsecured credit market has become a constant presence in the daily life of most UK consumers since, sooner or later, all 'rely on a credit card, loan or overdraft'.[64] In this respect, the FCA warned that there is a range of issues that may cause detriment to consumers in the currently unregulated interest-free BNPL market and concluded that bringing these products within the scope of regulation is a 'matter of urgency.'[65] Thus, the FCA envisaged to work with the UK Treasury to modify the legislation in order to include BNPL within the regulatory perimeter. As a result, in February 2021, the UK government declared its intention to bring currently exempt BNPL products into regulation.[66] The first step was the opening of a consultation[67] for the amendment of the CCA that

57 For example, in the Netherlands, there is a BNPL service called Tinka that is available only for local consumers. See Tinka's website <https://www.tinka.nl/over-ons>, last accessed 8 July 2023.
58 J Tijssen and R Garner (n 4) at 30.
59 *Ibid*.
60 Megaw (n 8).
61 Financial Conduct Authority (n 9).
62 See the UK Consumer Credit Act 1974 and B Guttman-Kenney et al., 'Buy now, pay later (BNPL) …on your credit card' (2023) 37 Journal of Behavioral and Experimental Finance.
63 Financial Services and Markets Act 2000 (Regulated Activities) Order 2001.
64 Financial Conduct Authority (n 9) at 5.
65 Financial Conduct Authority (n 9) at 52.
66 *Ibid*.
67 HM Treasury, 'Regulation of Buy-Now PayLater. Consultation on draft legislation', February 2023, <https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/1136257/BNPL_consultation_on_draft_legislation.pdf>.

accompanied by a proposal (i. e., the draft oder) of the UK government.[68] The package was published on 14 February 2023.

The main objective of the draft order is that of bringing BNPL companies within the scope of the FCA, meaning that the latter authority should be responsible of authorising BNPL firms and to impose on them a series of statutory and regulatory obligations, such as creditworthiness assessments and relevant information upon the occurrence of arrears or default, all issues that we have highlighted in previous sections. As for the scope of the application of this proposal, it is imperative to mention that merchants are extempt from this regime and that there are certain threshold for a company to be identified as a BNPL falling within the scope of the authorisation and supervision by the FCA. Even though these thresholds might change due to the draft nature of the amendment to the CCA, they mostly refer to payments made via interest-free instalments of a fixed amount that is granted by a third party that is not the merchant.

As for consumer protection, the current draft should extend the possibility for consumers to raise claims under Section 55 of the CCA also to payments made through BNPL, although with limitations concerning the value of the purchase that should fall within a pre-defined range. The proposed amendments envisage the possibility for consumers to raise those claims to be addressed to BNPL firms by resorting to the Financial Ombudsman Service (FOS).[69] The FOS is a public body established with Financial Services and Markets Act that preserves its own independence from the UK regulator (i. e., the FCA) while following its guidelines. Moreover, BNPL firms would most probably be obliged to comply with the Distance Marketing Regulations[70] that should prevent these companies from promoting BNPL through misleading claims.

2. The EU Legal Framework

In 2020, with the purpose of embracing the digital transformation of finance and appropriately address associated risks and challenges, the European Commission (EC) announced its digital finance strategy.[71] In February 2021, the EC requested the three European Supervisory Authorities (ESAs), namely the EBA, the European Insurance and Occupational Pensions Authority and the European Securities and Markets Authority, for technical advice on digital finance and related issues.[72] The ESAs replied jointly by advising the EC on a number of issues to address in the digital finance framework, such as financial inclusion, data protection and handling of complaints, all elements that concern also BNPL firms.[73] Furthermore, the EC asked the advice of the EBA on whether there is a need to adjust the EU regulatory framework in relation to 'non-banking lending sector, i. e. lending provided by financial intermediaries outside the EU financial services

68 The Financial Services and Markets Act 2000 (Regulated Activities etc.) (Amendment) Order 2023.
69 W Merricks, 'The Financial Ombudsman Service: not just an alternative to court' (2007) 15(2) Journal of Financial Regulation and Compliance.
70 Financial Services (Distance Marketing) Regulations 2004.
71 See European Commission, 'Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions on a Digital Finance Strategy for the EU', COM(2020) 591 final, 24 September 2020.
72 See European Commission, 'Request to EBA, EIOPA and ESMA for Technical Advice on Digital Finance and related issues', 2 February 2021.
73 For the related recommendations from the ESAs, see European Supervisory Authorities, 'Joint European Supervisory Authority response', ESA 2022 01, 31 January 2022.

regulatory perimeter.'[74] In its report, the EBA included various business models such as peer-to-peer lending platforms, microcredit, pawnshops, financial leasing along with BNPL services. The report indicated that regulatory regimes adopted for non-bank lending differ between EU Member States (MS) and remain largely unharmonised across the EU.[75] An aspect that, in general, endangers the EU Single Market as it increases the unlevel playing field among EU MS. According to the EBA, 'in some jurisdictions non-bank lenders are not subject to any specific entity-based prudential regime, while in some instances they must comply only with activity-based requirements as set out in the CDD (Consumer Credit Directive),[76] and in other cases they are left unregulated.'[77]

The report of the EBA also provided several recommendations to adjust the current regulatory framework applicable to non-bank lending. Amongst other things, these included widening the scope of the CCD,[78] enhancing provisions regarding disclosure of information, credit advertising, complaint handling and ensuring that new provisions are adapted for lending via digital means. Taking into consideration that, for the time being, BNPL services are not explicitly regulated by the existing EU legislative framework for consumer credit and payment services, the recommendations put forward by the EBA are essential to ensure consumer protection also with regards to the new players in the credit market. In this respect, we considered it necessary to analyse the regulation of consumer credit and payment services in the EU with the aim to understand how this regulatory framework covers payment services provided by BNPL firms.

3. Consumer Credit Rules

For what regards consumer credit, the scope of the CCD includes various agreements in which the total amount of credit ranges between EUR 200 and 75.000. In other words, all agreements below or above this range should be considered outside of the CCD's perimeter. Further, the CCD does not apply to agreements in which the credit is granted free of interest and without any other charges and credit agreements that are to be repaid within three months and only insignificant charges are payable.[79] Form this preliminary considerations, we argue that BNPL arrangements do not fall under the current scope of the CCD due to possible lower amounts and BNPL's interest-free nature. This translates into higher risks for consumers who are deprived from the protections enshrined in this Directive.

However, due to the changing digital and financial environment, on 30 June 2021, the EC proposed to revise the CCD.[80] Such revision aimed at addressing new technological and market developments and ensuring a consistently high level of protection for consumers. One of the suggested amendments would be to extend the scope of application of the CCD. In the Recital (15) of the current draft, the EC

74 European Banking Authority (n 51).
75 *Ibid.* at 58.
76 Directive 2008/48/EC of 23 April 2008 on credit agreements for consumers and repealing Council Directive 87/102/EEC [2008] OJ L133/66.
77 European Banking Authority (n 51) at 58.
78 Directive 2008/48/EC.
79 See Article 2(2)(c) and (f) of the CDD.
80 See European Commission, 'Consumer protection: Commission revises EU rules on product safety and consumer credit', 30 June 2021 <https://ec.europa.eu/commission/presscorner/detail/en/ip_21_3242>; European Commission, 'Proposal for a Directive of the European Parliament and of the Council on consumer credits', COM(2021) 347 final, 30 June 2021.

Satzspiegelhöhe: 257.5mm
Höhe der ges. Fahne 4599mm

explicitly indicated that the CCD should cover BNPL solutions. In detail, the proposed text stated that 'credit agreements in the form of an overdraft facility and where the credit has to be repaid within one month, and credit agreements where the credit is granted free of interest and without any other charges, including Buy Now Pay Later schemes, i. e. new digital financial tools that let consumers make purchases and pay them off over time, and credit agreements under the terms of which the credit has to be repaid within three months and only insignificant charges are payable should not be excluded from the scope of application of this Directive.'[81] By analysing this Recital, we consider the definition of BNPL services provided by the EC as comprehensive and sufficiently flexible as it does not provide for a too detailed definition. Moreover, this definition is in line with the true scope of BNPL activities. Therefore, should BNPL come within the scope of the CCD, it will imply that BNPL providers will have to comply with specific consumer protection rules, such as those related to marketing practices, pre-contractual information, obligation to assess the creditworthiness of the consumer, right of withdrawal and right of early repayment. This could represent a major step forward in the protection of EU consumers using BNPL services. The assessment of creditworthiness alone symbolises the shielding of those consumers with poor financial literacy and management of their own finances.

To ensure that customers using products such as BNPL are provided with the necessary protection, the reviewed CCD should also ensure that provisions regarding advertising and information disclosure are 'fit for the digital age'.[82] For the EBA, the Standard European Consumer Credit Information[83] that needs to be provided to the consumer prior to the conclusion of credit agreement, might be difficult to read on mobile devices.[84] Those devices represent the major instruments for making purchases using BNPL, both through *ad-hoc* apps or websites. Moreover, the EBA recently issued an opinion regarding the Distance Marketing of Consumer Financial Services Directive (DMFSD),[85] suggesting that the latter should also be revised to ensure a maximum level of consumer protection in face of financial innovations.[86] According to the EBA, the disclosure rules in the DMFSD 'should be revised to focus much more on the presentational aspects of disclosure for those [digital] channels. This should include rules regarding the form, prominence and timing of disclosure, which should be adapted to the specific product or service, the digital channel(s), and the consumer's device.'[87] We consider this changes as imperative since many BNPL customers are not even aware that they are taking credit.

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81 See Recital (15) of the European Commission Proposal for a Directive on consumer credits.

82 On this point, see European Commission, 'A Europe fit for the digital age' <https://ec.europa.eu/info/strategy/priorities-2019-2024/europe-fit-digital-age_en>.

83 See European Commission, 'Standard European Consumer Credit Information' <https://ec.europa.eu/info/sites/default/files/standard_european_consumer_credit_information_en.pdf>.

84 European Banking Authority (n 51) at 60.

85 Directive 2002/65/EC of the European Parliament and of the Council of 23 September 2002 concerning the distance marketing of consumer financial services and amending Council Directive 90/619/EEC and Directives 97/7/EC and 98/27/EC [2002] OJ L271/16.

86 European Banking Authority, 'Opinion of the European Banking Authority on disclosure to consumers of banking services through digital means under Directive 2002/65/EC', EBA-Op-2019-12, 23 October 2019.

87 *Ibid*. at 3.

Another concern raised in respect to BNPL services is the lack of transparency about the real cost. In this respect, the EBA proposed, among other things, that information on charges and fees 'should be I to be highlighted, framed and contextualised effectively within the display screen, and presented upfront.'[88] The EBA also emphasised that the display of the information about the risks of the product or service should have the same prominence as the information on its benefits. Another widely debated risk in relation to BNPL services is poor creditworthiness assessment of borrowers. We argue that a robust check is crucial to protect consumers from entering into credit agreements because they cannot afford to repay or resort to multiple credit facilities as it risks to lead them to over-indebtedness. Since BNPL is currently excluded from the scope of the CCD, its Article 8 on the creditworthiness assessment does not apply. Therefore, the proposed extension of the scope of the CCD will force BNPL providers to evaluate properly creditworthiness of a borrower. This might have repercussions on BNPL's business model as these firms base a significant portion of their 'fortune' on consumer's impulsive shopping tendencies not always matching an adequate financial planning or management. Furthermore, widening the scope of the CCD will also broaden the application of the EBA Guidelines on loan origination and monitoring[89] which, for the time being, are applicable to entities and loans falling under the scope of the CCD and to all credit institutions under the Capital Requirements Directive (CRD).[90] These guidelines complement Article 8 of the CCD and specify how to assess the creditworthiness of consumers.

4. Payment Services Regulation

In September 2020, the EC announced its renewed strategy for the modern, safe and efficient retail payments market in which various stakeholders could benefit from the opportunities that come with digitalisation.[91] One of the announced objectives was to ensure that the legal framework covers all major players in the payments market including technology companies. In this context, in May 2022, the EC launched a public consultation[92] to gather information regarding open finance and the revision of the Payment Services Directive (PSD2).[93] The objective of this consultation is to evaluate whether PSD2 met its purposes, such as an integrated and efficient EU payment market, a level-playing field for all payment services providers, better consumers' protection

88 *Ibid.* at 7.
89 See European Banking Authority, 'Final Report on Guidelines on loan origination and monitoring', EBA/GL/2020/06, 29 May 2020.
90 Directive 2013/36/EU of the European Parliament and of the Council of 26 June 2013 on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms, amending Directive 2002/87/EC and repealing Directives 2006/48/EC and 2006/49/EC [2013] OJ L176/338.
91 See European Commission, Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions on a Retail Payments Strategy for the EU, COM(2020) 592 final, 24 September 2020.
92 See European Commission, 'Public Consultation on the Review of the Revised Payments Systems Directive (PSD2) and on Open Finance, Consultation Document' <https://ec.europa.eu/info/sites/default/files/business_economy_euro/banking_and_finance/documents/2022-psd2-review-open-finance-consultation-document_en.pdf>. The outcome of the consultation, opened from the 10 May to the 2 August 2022, can be found here: European Commission, 'Payment services – review of EU rules, Public consultation' <https://ec.europa.eu/info/law/better-regulation/have-your-say/initiatives/13331-Payment-services-review-of-EU-rules/F_en>.
93 Directive (EU) 2015/2366 of the European Parliament and of the Council of 25 November 2015 on payment services in the internal market, amending Directives 2002/65/EC, 2009/110/EC and 2013/36/EU and Regulation (EU) No 1093/2010, and repealing Directive 2007/64/EC [2015] OJ L337/35.

against fraud and abuse and a more open market with an enhanced competition. Even though the EC consultation does not constitute a formal legislative proposal, it provides an important indication to understand the background of proposals and related concerns. The consultation document aims, among other things, to show 'whether newcomers and traditional players are treated equally, based on the principle of 'same business, same risks, same rules'.'[94] The consultation inquired, *inter alia*, whether payment transactions using crypto-currencies, digital wallet services, payment-processing services and BNPL services should be included in the PSD2 list of services.[95] If so, those contributing to the consultation shall state what modifications are needed to the supervisory provisions.

While the wording of the EC could be perceived as an indication that BNPL services would be part of the PSD2 revision (i. e., the PSD3), the EBA published an opinion on the consultation about the proposal for the PSD3. In its opinion, the EBA argued that 'the scope and requirements of PSD2 are sufficient to assess the payment services used in more common BNPL business models and do not require any additional regulatory approach',[96] thus ruling out the need of an *ad-hoc* regulation of BNPL as foreseen in the recent draft regulatory amendments in the UK and as we advocated in this article. However, the EBA acknowledged that 'it is not clear whether BNPL services can be treated as ancillary credit'[97] thus being under the scope of Article 18(4) of the PSD2. In other words, we argue that the EBA opinion does not take into consideration the full range of services applicable to the operations of BNPL firms and, therefore, it cannot completely rule out the need of tailored rules to cover BNPL services in the proposed PSD3. Similarly to the EBA, the traditional banking sector argued that BNPL services should be covered by the CCD, since 'the payments part of BNPL [is] covered by PSD2'.[98] The EC seems to have followed this approach as it literally excluded BNPL services from what it considers as a payment services and indeed restricting its scope to the CCD. In fact, Recital (35) of the draft PSD3 states that in light of BNPL's 'principally lending nature, [BNPL] services should not constitute a payment service. Those services are covered by the [revised CCD]'.[99] In other words, for the EC, BNPL services are closer to credit institutions due to their lending activities than to providers of payment systems. While it is true that BNPL provide a form of short-term loans, we argue that the failure to acknowledge their nature as a payment system or, better, an hybrid system embedding payment and credit services excludes all the various protections for consumers and rights for the BNPL firms that are stemming from the PSD2 and its subsequent revision.

94 See European Commission, 'Targeted consultation on the review of the revised payment services Directive (PSD2)', 2.

95 *Ibid.* at 18.

96 European Banking Authority, Opinion of the European Banking Authority on its technical advice on the review of Directive (EU) 2015/2366 on payments services in the internal market (PSD2), EBA/Op/2022/06, 23 June 2022, 26.

97 *Ibid.*

98 See European Banking Federation, 'EBF response to European Commission Consultation on the review of the revised payment services Directive (PSD2)', 15 July 2022, 38.

99 See Recital (35) at European Commission, 'Proposal for a Directive of the European Parliament and of the Council on payment services and electronic money services in the Internal Market and amending Directive 98/26/EC and repealing Directives 2015/2366/EU and 2009/110/EC', COM(2023) 366 final, 28 June 2023.

V. Concluding Remarks

Modern financial innovation has produced a multitude of new solutions that are gaining important market shares, especially with regard to payment systems. Given that young digital businesses tend to suffer from growing competition in an open but highly volatile market, one wonders if BNPL is there to stay. In fact, as in the experience of some Fintechs specialised in food delivery, the mitigation of the pandemic has led to a drastic reduction in the number of customers, in a period characterised by an exponential increase in costs due to the ongoing inflationary pressures and the related responses from central banks. Others are wondering whether BNPL are going to replace credit cards and, according to the Global Payments Report analysed in this article,[100] we observed how BNPL services are still occupying a small fraction of the global payments market. Nevertheless, as the US, the UK and some EU MS, BNPL market share is sharply increasing within a short period of time at the expenses of traditional payment methods. Therefore, we argue that from a global perspective BNPL services are definitely not a threat. However, concerning the EU market, their sharp increase is not followed in the same way by a solidity in terms of capital and corporate structure, such as to be able to withstand the current pressures due to the exponential increase in costs compared to more established companies. This is also due to the fact that digital companies, especially those active in the banking and financial markets, usually do not have risk assessment and management systems in place compared to their more traditional and better integrated counterparts from a regulatory point of view. This latter aspect certainly offers a certain long-term stability.

For example, Klarna is registered as a bank in Sweden, where it has its legal *siège*. This means that while Klarna Bank AB (publ) is authorised by the Swedish Financial Supervisory Authority (*Finansinspektionen*). From the perspective of this company as a credit institution, it is outside of the supervision of the ECB's Single Supervisory Mechanism (SSM). In fact, Klarna provides services within the EU also by means of branches in euro area MS, such as Germany or France, thus being under the supervision of the respective NCAs (i. e., the *Bundesanstalt Für Finanzdienstleistungsaufsich* and the *Autorité de Contrôle Prudentiel et de Résolution*). For example, in Germany, by virtue of the passporting of credit institutions under the CRD,[101] Klarna provides also savings accounts that are outside of the scope of a pure payment system,[102] showing the hybridity of the business model of BNPL firms. This could be a point in favor of the proposed PSD3 that considers BNPL services as credit services.

Even though the *Finansinspektionen* informed in 2021 that Klarna was the twelfth biggest Swedish financial entity and that, according to the EBA Guidelines on the assessment of other systemically important institutions (O-SIIs),[103] it was not considered as an O-SII,[104] its exponential growth is making it gaining places in this 'ranking', meaning that now it is

100 See (n 9).
101 See Articles 33 to 48 of the CRD.
102 See Klarna, Klarna Bank AB (publ) Annual Report 2022 <https://www.klarna.com/assets/sites/5/2023/02/27204212/2022-Klarna-Bank-AB_Annual-Report_EN.pdf>.
103 European Banking Authority, Guidelines on the criteria to determine the conditions of application of Article 131(3) of Directive 2013/36/EU (CRD) in relation to the assessment of other systemically important institutions (O-SIIs), EBA/GL/2014/10, 16 December 2014.
104 See Finansinspektionen, 'Identifiering av kapitalbuffertpåslag för övriga systemviktiga företag (O-SII)', FI Dnr 20-10792, 5 July 2021, <https://finansinspektionen.se/contentassets/f8e4c164e64c4c9482c8bfce-de46e0b7/o-sii-pm_2021.pdf>.

among the top ten Swedish banks. The growth in size of this company comes with additional risks not only to consumers and merchants but also to the financial system and, in this respect, we argue that a tailored regulatory approach is necessary to protect all the relevant stakeholders as, for example, through the ring fencing of activities for BNPL firms or an *ad-hoc* regulatory framework to be embedded in the proposed PSD3. As a result, this company is currently outside of the scope of the consolidated supervision of the ECB/SSM being supervised by NCAs and, thus, being subject to home-host supervisory issues that, for example, do not ensure a level playing field or uniformity of treatment and coordination among the various authorities at different levels, such as intra EU, within the euro area or with third countries, since BNPL firms are very active in the US and/or the UK market.

Despite these reservations, the BNPL has evolved into a must-have online checkout option, bringing an intriguing and revolutionary strategy to the short-term consumer credit industry. Furthermore, for the time being, such companies collaborate with a large network of merchants and acquirers with the aim of broadening their market, making them a completely addressable opportunity rather than a danger. However, looking from a regulatory perspective, we argue that the BNPL should be brought within a suitable regulatory perimeter not only to protect consumers but also to ensure a level playing field between regulated financial institutions and unregulated BNPL providers. In this respect, there are many similarities between the proposed amendments to the legislation of the EU and the UK. Such similarities are the result of shared concerns over the impact of BNPL services on consumers. For example, the proposal of the UK government will require BNPL firms to undertake affordability checks to its customers. Furthermore, concerning marketing, the amended regulation will make sure that advertisements 'are fair, clear, and not misleading'.[105] Companies that provide BNPL services will need to receive the approval of the FCA which implies a unique base for supervision since, at the moment, different BNPL firms enjoy different types of company structure and, thus, registrations in the jurisdictions in which they operate.

However, we argue that the UK regulation has adopted a more comprehensive approach compared to the EU. In the UK, BNPL services are defined taking into account both the payment and the credit elements, thus reflecting the hybridity of their business model, while the EU adopted a more restrictive approach by excluding these companies from the definition of payment services providers, placing them close to credit institutions and, thus, limiting their scope. Since the emergence of digital lending created new challenges and new risks, we argue that it is important for the EU legislator to find a right balance between a flexible regulatory approach, so not to create excessive regulatory barriers for innovation, and a prudent risk-based attitude, to ensure the safety and soundness of the financial sector and appropriate safegurds for consumers. Digital lending is not an option for everyone. Therefore, traditional alternatives should be accessible for those who cannot or do not want to use online lending to ensure inclusion of all who are in need of financing. ■

105 HM Treasury, 'Regulation of Buy-Now-Pay-Later set to protect millions of people, 20 June 2022' <https://www.gov.uk/government/news/regulation-of-buy-now-pay-later-set-to-protect-millions-of-people>.