Policy Note number 10

May 2017

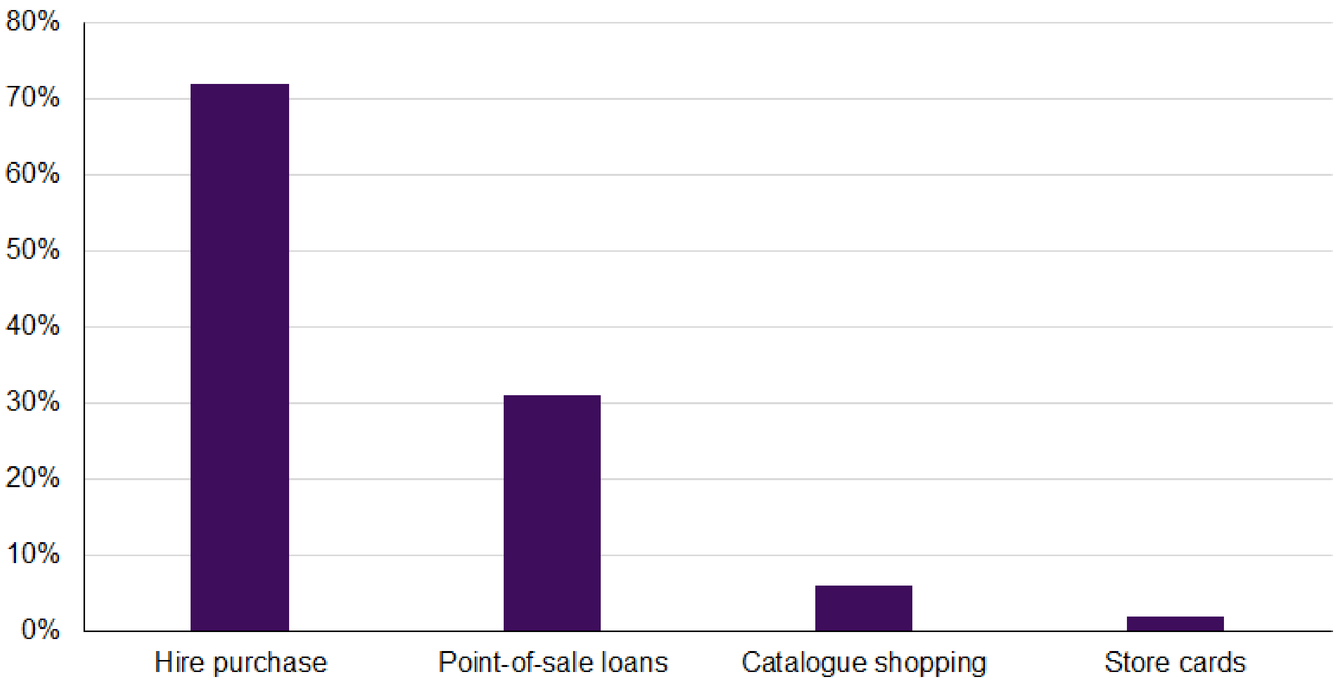
Author: Katie Evans

Buy now, pay later: Problems in the point sale credit market

Introduction

'Point of sale' credit encompasses a number of quite different credit products, and serves a wide range of customer segments. From store cards to hire-purchase, rent-to-buy and buy-now-pay-later models, many consumers make purchases using credit offered by retailers. However with the cost of credit bundled with the cost of the good or service being bought, and sometimes tied to time-limited discounts or loyalty offers, the opportunities for consumer detriment are many and varied. With complaints to the ombudsman about these types of credit increasing, as illustrated in Figure 1, it is time the FCA turned attention to this market.

Figure 1: Year-on-year increase in complaints about point of sale credit products to the Financial Ombudsman Service, 2015/16



Source: Financial Ombudsman Service, Annual review of consumer complaints about... insurance, credit, banking, savings, investments, Financial year 2015/16.

Offering credit at the point of sale is well-recognised by retailers as a way to increase sales, raising volumes by up to 30%.[1] As such, a growing number of retailers are offering credit to customers, including major online retailers like PayPal[2] and Amazon.[3] Over £6.7 billion of consumer credit was provided through retailers in 2016, an increase of 2% over the previous year.[4]

Problems at the point of sale

For many consumers, point of sale credit is a convenient way to spread the cost of purchases, large or small, to receive a bonus on a planned purchase, or a way to access discounts and loyalty offers from retailers. However, if mis-sold or unaffordable, point of sale credit has the potential to harm consumers, just like more conventional forms such as credit cards and loans.

Some specific features of point of sale credit, however, mean that there may be even greater risk of consumer harm in this market. Credit offered at the point of sale is often less competitive than credit offered elsewhere. Consumers are less likely to shop around for credit once the item they want is in front of them, and so retailers are likely to be at an advantage in determining the cost and terms of credit. In some cases, point of sale credit may also be the last resort of those who are unable to find credit to purchase an item elsewhere, forcing them to rely on rent-to-own providers.[5] Catalogue debts are recognised as a significant problem by the UK's main providers of consumer debt advice: a third (35%) of StepChange clients in 2015 had catalogue debts,[6] and in 2013 catalogue debt was the fifth most common problem among people using Money Advice Trust's National Debtline, ahead of rent, payday loans and water.[7]

Who pays the price?

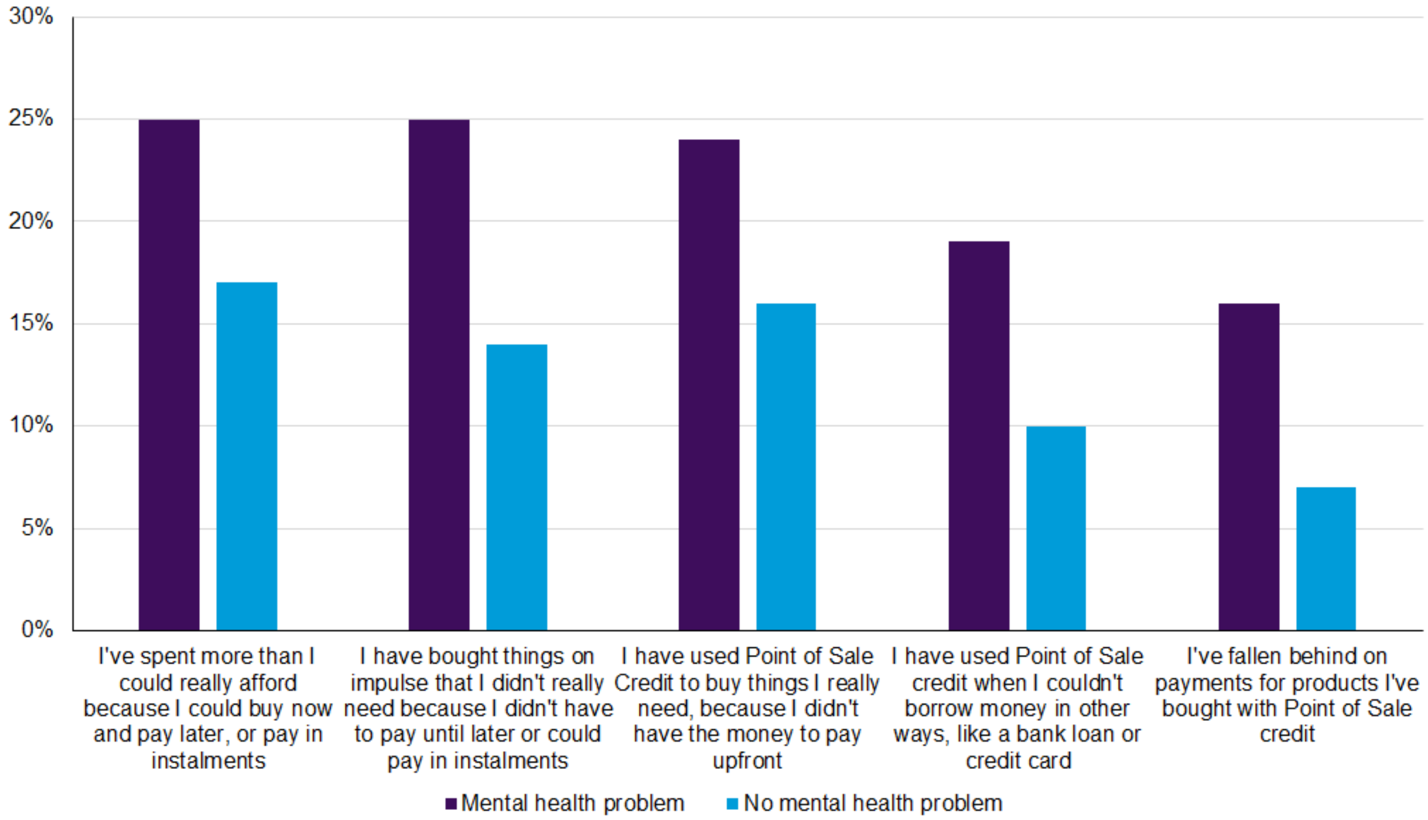
In many cases, people with mental health problems are particularly vulnerable to these risks, and more likely to find themselves in financial difficulty as a result of point of sale credit products.

"Looking through catalogues, the internet, the shops, all Aladdin's caves...no one ever asked about any health problems or ability to pay back the money."

New UK-wide polling of 2,051 people carried out by Money and Mental Health in partnership with Populus, demonstrates that people experiencing mental health problems are substantially more likely to both use and fall into difficulty with point of sale credit products.[8] Consumers with mental health problems are significantly more likely to use point of sale credit; 39% of people who have experienced a mental health problem have bought something using point of sale credit, compared to just under a third (32%) of people who have not experienced a mental health problem.

Digging into the nature of people's experiences with point of sale credit, we find further evidence that people with mental health problems are experiencing specific harm from these products, illustrated in Figure 2.

Figure 2: Experiences of point of sale credit - people with and without mental health problems



Source: Money and Mental Health analysis of online survey of 2.051 people, carried out by Populus 9-11 December 2016. Data is weighted to be nationally representative.

Three themes emerge from this data. We find that people with mental health problems are:

1. Substantially more likely to spend more than they can really afford and to buy things on impulse when point of sale credit is available.

A quarter of people with mental health problems say they have spent more than they can really afford because they could get point of sale credit (25%), compared to 17% of people without mental health problems. The same proportion have bought products on impulse that they didn't really need because they could pay later (25%) compared to (14%) of those without mental health problems.

2. More likely to use point of sale credit to buy things they really need or when they are unable to access other forms of credit.

One in four people (24%) with a mental health problem have used point of sale credit to buy things they really needed, because they didn't have money to pay upfront. This contrasts to just 16% of people without mental health problems. One in five people with mental health problems (19%) report that they have used point of sale credit when they were unable to borrow money in other ways, compared to just 10% of people without mental health problems.

3. Twice as likely to fall behind on payments for products bought with point of sale credit.

16% of people with mental health problems report going into arrears on point of sale products compared to just 7% of those without mental health problems. Older data (from 2007) suggests that people experiencing mental health problems are five times more likely to be in arrears on mail-order payments, and nearly three times as likely to fall behind on goods on hire purchase.[9] This may be explained by the fact that people with mental health problems are less likely to be in work,[10] more likely to be on a low income and more likely to use point of sale credit - but also suggests that these products are causing specific harm to this customer group.

Why are people with mental health problems more likely to experience difficulties with point of sale credit?

Recent Money and Mental Health research has explored how experiencing a mental health problem can affect a person's financial capability.[11] Reflection on these findings and the point of sale credit market has allowed us to identify two reasons why consumers with mental health problems might be more likely to come to harm when using point of sale credit. Our polling data confirms these concerns.

1. Facilitating impulsiveness

A quarter of people with mental health problems report spending more than they could really afford because they could buy-now and pay later, or pay in installments, and the same proportion (25%) say they have bought things on impulse that they didn't really need because point of sale credit was available.

Recent Money and Mental Health research has identified reduced ability to resist impulses as a common experience among people with mental health problems. The availability of credit at the point of sale may make it harder for some people with mental health problems to resist spending more than they can afford, and make it easier to get into problem debt. 'Buy now pay later' offers, and the common practice of offering discounts in store to customers taking out a storecard, could create difficulties for customers experiencing a mental health problem which reduces their ability to manage impulses. Many people with mental health problems also experience difficulties planning ahead, which may make it difficult to anticipate the cost of a credit agreement over its full term. This, combined with heightened impulsiveness, could lead a person to focus on attaining a product today without properly assessing the future cost of the credit agreement.

2. Complex pricing

Mental health problems can affect our working memory and ability to process complex information. This means some people experiencing mental health problems might find it more difficult to understand the implicit price of credit provided at the point of sale. Sales models used by retailers like Bright House, which bundle the cost of credit with the cost of the item and compulsory insurance make understanding the price competitiveness of each component very difficult, and make it more likely that consumers pay over the odds. In other cases, credit which is initially marketed as 'free' becomes very expensive if a customer misses a payment.[12] This is particularly worrying when many people experiencing mental health problems will also be on low incomes,[13] and may at least partially explain why so many people with mental health problems end up struggling to pay back point of sale credit.

Together, these problems create a market which is heavily weighed in the creditors' favour. Taking out credit on the spur of a moment, when the pricing is complex means consumers are much less likely to shop around - allowing creditors to charge extortionate fees in some cases, and causing serious detriment to consumers, particularly those with mental health problems.

"I have a [store] account and have been paying regularly and had a £450 limit. Upon checking my balance a week or two ago they increased it to £2,000 so I've gone mental in spending on the clearance section. As I'm not able to feel / see the items before purchase I'm constantly ordering and returning. Sadly it seems I've lost complete control."

Recommendations

1. Ban discounts on purchases where point of sale credit is taken out.

A credit contract taken out to purchase a product or service may well last longer than the purchase itself. It is critical that customers are able to understand the credit agreements they make, and are not unduly influenced to use credit products. In particular, consumers experiencing mental health problems should be protected from taking out credit they cannot afford for purchases they do not need when they are more vulnerable to impulsivity.

Regulators would be unlikely to tolerate the notion of discounted prices for credit or 'bonuses' for taking out credit agreements on the spot in other settings. A simple first step, therefore, would be to ban the practice of offering customers a discount on goods or services when they take out a store card or other credit product at the point of sale. This may also help to avoid potential confusion among customers about the distinction between storecards (a credit product) and loyalty or reward card schemes.

2. Clarify pricing and sales procedures for credit agreements made at the point of sale

Creditors have an obligation to ensure that customers understand and are able to remember and weigh up information on the terms of credit agreements.[14] How often, however, are consumers really given chance to reflect on the complex terms of point of sale credit agreements when these are sold alongside goods at a till, when they are often at the front of a long queue? This is particularly problematic as the pricing of credit at the point of sale is often opaque, with the cost of credit bundled alongside the item itself, and sometimes insurances or extended warranties. The FCA should, as part of its ongoing investigation into high cost credit, investigate sales procedures for point of sale credit and if necessary revise guidance to ensure consumers are provided with:

a) A clear and comparable pricing structure, which separates out the cost of credit in currency, rather than as a percentage.

b) adequate opportunity to question the terms of credit contracts, and understand their rights and obligations.

With more online retailers introducing point of sale credit services, the FCA must also consider how rules under section 2.10 of CONC, regarding mental capacity, can be effectively implemented online.

3. Consider extending measures from the high-cost short-term credit market to point of sale credit products

Substantial regulatory interventions were put in place in the high-cost short-term (payday) credit market in January 2015 in response to very weak competitive pressures in this market, which were leading to significant consumer harm. We believe that the market for some point of sale credit products exhibits equivalent demand-side constraints on competition which mean measures such as a price cap should be considered. Consumers taking out credit at the point of sale do so having already decided on the item they wish to purchase. As such, their decision regarding credit is tied to the item, and not subject to strong competitive pressures. This is particularly problematic for people experiencing mental health problems who may experience both increased impulsivity, making purchases funded by point of sale credit more tempting, and limited problem-solving abilities, which can make understanding and comparing complex credit products difficult. A cap on the cost of this credit, even temporarily while alternative long-term solutions, like helping consumers source affordable credit, would help avoid the harm currently felt by the most vulnerable consumers, including those with mental health problems.

References

[1] Close Brothers Retail Finance analysis of existing retailers, https://www.closeretailfinance.co.uk/?utm_source=Close%20Brothers%20Group&utm_medium=Website&utm_content=Customer%20Finance

[2] https://www.paypal.com/uk/webapps/mpp/paypal-virtual-credit

[3] https://www.amazon.co.uk/gp/cobrandcard/marketing.html/ref=footer_monthly?ie=UTF8&inc=giluk14&pr=giluk

[4] Finance and Leasing Association, Consumer Finance Figures 2016 http://www.fla.org.uk/index.php/research/consumer/

[5] Financial Conduct Authority, Consumer credit and consumers in vulnerable circumstances, April 2014.

[6] StepChange Yearbook Statistics on Personal Debt 2015, March 2016.

[7] Money Advice Trust, Changing household budgets, June 2014

[8] Populus interviewed 2,051 Britons online between 9 and 11 December 2016. Data was weighted to be nationally representative. Populus is a member of the British Polling Council and abides by its rules; for more information www.populus.co.uk.

[9] Jenkins R et al. Debt, income and mental disorder in the general population. Psychological Medicine 2008; 38: 1485-1493.

[10] Independent Mental Health Taskforce, The Five Year Forward View for Mental Health, NHS England, 2016.

[11] Holkar, M . Seeing through the fog: How mental health problems affect financial capability, Money and Mental Health Policy Institute, 2017.

[12] Citizens Advice, "Catalogue customers hit hard for missing interest free deadlines", December 2016 .

[13] McManus S, Meltzer H, Brugha T, Bebbington P, Jenkins R. (eds) (2009). Adult Psychiatric Morbidity in England 2007: results of a household survey. NHS Information Centre for Health and Social Care

[14] Financial Conduct Authority, CONC 2.10 Mental capacity guidance