Play it forward

The cost-of-living crisis and growing regulatory scrutiny are set to shape the evolution of the BNPL securitisation sector. **Angela Sharda** reports.

The cost-of-living crisis may stall the securitisation of buy now, pay later (BNPL) assets before the sector has had chance to take off, given concerns around borrower affordability and the limited operating history of many lenders. Indeed, with growing regulatory scrutiny of the market, its evolution is likely to be dictated by how the next 12 months play out.

"The market is essentially an alternative to using a credit card and we have seen the increase in BNPL as an alternative to credit card usage. It's a product that retailers like; it is popular and it is here to stay," observes Salim Nathoo, partner at Allen & Overy.

BNPL is a form of consumer credit, whereby goods and services are paid for in instalments over a period typically less than 12 months, instead of being paid for in full at the time of purchase. This borrowing – which is utilised in many shops on the high street and online – is generally interest free, if the customer pays instalments on time. Crucially, a lender isn't required to be regulated for consumer credit origination if they extend credit for less than three months.

Doug Paterson, primary credit analyst at S&P, says that his firm assesses BNPL lenders on a case-by-case basis, as they don't have a homogenous approach in terms of how they originate and underwrite loans. At one extreme, it is possible to have a standardised lender that applies all of the characteristics of mainstream lending with stringent underwriting. However, at the other extreme, some BNPL lenders have a limited operating history, take a light touch approach to affordability assessments and don't report to the credit bureaus. ▶

Salim Nathoo, Allen & Overy

Against this backdrop, the cost-of-living crisis is a growing concern in the context of securitisation. Across the ABS asset class, Paterson believes that the non-prime and unsecured sectors – which generally includes BNPL – are most vulnerable to this crisis.

Rising interest rates pose a current challenge, although how this will affect individual BNPL businesses depends on how they are funded. Another challenge remains the lack of regulation of the sector *(SCI 25 March)*.

Paterson observes: "BNPL providers haven't been subject to as stringent regulations as mainstream consumer lending platforms. However, this is set to change – with growing attention on the sector from the FCA in the UK, in particular."

Indeed, regulatory scrutiny is expected to increase going forward. Entities such as the FCA have raised concerns about BNPL and there will be further regulation crystalising, particularly if delinquencies and defaults increase in the current market conditions. Advertising, origination, underwriting and affordability checks are likely to be placed under further scrutiny by the regulators.

Another concern is that many BNPL providers have a limited operating history, which reduces the data they can draw on to show how consumers behave in a downturn. In contrast, many credit card providers have over 15 years of data, dating back to before the 2008 recession. The implications of these issues are difficult to assess and are highly dependent on the individual BNPL model, but it is likely that delinquencies and defaults will increase for many lenders.

Nathoo explains: "It hasn't gone through an economic cycle and therefore there is a great deal of anxiety around it for rated securitisation transactions. Additionally, regulators in Europe have indicated that this is something that they would want to be looking at regulating more closely – for example, as to whether it is disclosed to customers that this is credit and whether customers are given full disclosure on what happens if they can't pay."

He adds: "The cost-of-living crisis may affect this and people may fall over in terms of their payments. The next 12 months will be crucial as to who survives and who thrives in this environment."

The pandemic played a significant role in boosting the popularity of the BNPL sector: with shops closed due to various restrictions, consumers were attracted to the ease of online shopping. Paterson notes: "This was beneficial to the BNPL sector – which often targeted the younger generation, who went online to buy goods, often using BNPL."

However, he agrees that the picture that he is now presented with is a reversal of those trends, specifically with regards to disposable income. "Savings rates are dropping, while generally speaking consumer debt is quite high and household budgets are increasingly stretched. Covid-19 was not a negative for BNPL, but the current economic circumstances and the cost-of-living crisis that we have moved into now has placed stress on the BNPL sector."

Nathoo believes that the BNPL sector will continue to evolve, with interest emerging from private equity funds to finance the assets, for example. But the growth of the market is highly dependent on how regulation manifests itself, how the economic environment develops, how much fees increase and how credit card issuers compete within this space.

Paterson concludes: "It's difficult to assess or predict what will happen in the future. It is likely that there will be more consolidation, as well as BNPL lenders entering into partnerships with existing banks and incumbent banks launching their own products."

"SAVINGS RATES ARE DROPPING, WHILE GENERALLY SPEAKING CONSUMER DEBT IS QUITE HIGH AND HOUSEHOLD BUDGETS ARE INCREASINGLY STRETCHED"

*SCI's Premium Content offers regular in-depth analysis of trends and developments across the securitisation market, in addition to our usual news output. To upgrade your subscription to access all Premium Content for a year or for further information, email **ta@structuredcreditinvestor.com**.*