Buy Now, Pay Later

Hidden and not so hidden risks

Buy now, pay later (BNPL) services provide customers with the option to purchase in installments — sometimes without paying anything up front at all.

BNPL options are also sometimes called “instant financing” or “interest-free installments”.

You’ll often find these services, like Clearpay, Klarna, Laybuy, Openpay, and Zip at the checkout page of your favourite online retailer.
How does it work?

1. At the checkout page of your online store, you select your payment option to be BNPL

2. You will be taken to the BNPL site to sign up for an account

3. You will need to pass a “soft” credit check (doesn’t affect your credit score) to complete the transaction

4. Once that’s done, you’re in. You can make your purchase without paying the full price up front

The BNPL provider you use, will determine how many instalments you will need to pay and how often you’ll need to pay them. Generally, this ‘contract’ is set up when making your purchase and there are often different options for you to choose from – for example, you may be able to choose whether to spread your repayments over 3, 6 or 12 months.

Instalments are a little like standing orders; payment is automatically taken from your card or BNPL provider. So you don’t need to worry about manually making payments on specific dates, but you do need to make sure you have enough money in your account to cover the payment.
How do BNPL providers make money?

1. Providers charge a transaction fee to the retailer for every purchase made using BNPL. Some sneaky psychology: shoppers are more likely to buy more if they don't need to pay the full price upfront. So more stuff is bought when retailers use BNPL, resulting in better business for the retailer and more transaction fees for the BNPL provider.

2. Late fees and interest. Depending on the service provider the real cost of using BNPL will vary. If you miss a payment, for example, you can expect to pay a late fee that generally ranges between $25 to $50. Some providers don't charge interest under any circumstances, while some offer an interest-free period and others charge interest rates between 0% and 29.95% APR.

Advantages

- No interest charges: Most BNPL providers are normally interest and fee free – unless you are late on your repayments.
- Use your purchase immediately: You can pay off the debt in installments while enjoying your purchase immediately.

Risks

- Damage to your credit score: If you are late with a payment or missed one, BNPL providers might send your details onto a debt collector and credit agency, which could affect your credit score.
  - Applying for lots of BNPL deals can also be a red flag for credit agencies
  - If you get charged a payment when you don’t have enough money in your account, you’ll likely get hit with overdraft fees from your bank — see our info on Overdrafts for more.

- High interest and late fee charges: if you don't pay what you owe on time, you could face a build up of interest and late fee charges that you'll need to pay in addition to your installments.

- Temptation (and ability) to overspend: Spreading costs can be helpful, especially with bigger ticket items, but the ability to spread the cost can also tempt you to overspend.

- BNPL is an unregulated industry: there is no Ombudsman service for BNPL like there is with other credit facilities, so if something goes wrong you have no other avenues to ask for help than the supplier themselves.

Update (02.02.21) The Financial Conduct Authority (FCA) has completed a review of BNPL companies and is recommending regulation in order to better protect consumers. Measures will include affordability checks and processes to ensure vulnerable customers are treated fairly.

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What to think about before using “Buy Now, Pay Later” services

“Buy Now, Pay Later” is really just another name for debt, since you still have to pay the full price eventually. If you are going to use a “Buy Now, Pay Later” service, make sure you:

- Understand what you’re agreeing to
- Can afford what you’re paying for
- Know how and when you’re going to pay it back
- Keep track of what you owe by setting reminders
- Stay on top of your repayments.

As a general rule, we would suggest only using BNPL services when you could also afford to buy the purchase in question in cash and the full amount upfront.

There’s nothing wrong with doing some shopping and buying yourself something nice, but there’s a big difference between spending your money to treat yourself and spending money you don’t have.

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References


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