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INSIGHT

Rapidly Growing "Buy Now, Pay Later" (BNPL) Financing: Market Developments and Policy Issues

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"Buy now, pay later" (BNPL) is a form of point-of-sales financing. It allows a consumer to purchase and take possession of an item immediately, then pay for it over a certain period of time or with a specified number of payments. BNPL financing is often offered online and has generally been developed by technology-focused, nonbank financial companies, often characterized as "fintech" companies.

BNPL financing has been growing rapidly in recent years. Reports suggest that BNPL financing may have tripled in 2020 compared to the prior year. A consulting firm estimates that BNPL balances grew by 24% from 2016 to 2019 and are expected to grow around 20% annually for the next three years.

This Insight discusses the BNPL financing market and potential policy issues in this market.

"Buy Now, Pay Later" (BNPL) Financing Market

BNPL financing allows consumers to spread the cost of a purchase over a set number of payments or period of time without accruing interest. For example, some BNPL financing services may require four installment payments ("Pay in 4") in two-week intervals; other services may have regular intervals over a six-week period.

BNPL financing aims to help consumers manage their personal cash flow, often at a lower cost and with greater flexibility relative to traditional financial products. BNPL financing may be attractive to thin credit file and younger consumers who may not qualify for traditional credit cards. Consumers may use BNPL financing through a merchant that embeds it as a payment option in the checkout process or directly on BNPL companies' platforms. BNPL companies determine consumer terms through a soft credit check and a consumer's past performance on the platform.

While BNPL companies generally do not charge interest or fees at time of purchase, they charge a late fee if a customer does not make payment on time. BNPL companies generate most of their revenue by charging merchants for the service, who are willing to pay to attract new consumers to their merchandise. While some companies that offer BNPL financing operate independently, others work with banks to originate a majority of their loans. In such instances, a company may buy the loans back or sell them to third parties.

Companies operating in the BNPL space include Klarna, Afterpay, Affirm, Splitit, and Sezzle. Some of these companies have high market values, despite often operating at a loss. Such valuations may reflect expected value from sources other than the companies' BNPL financing business, such as access to consumer data and spending patterns and the ability to cross-sell traditional banking services.

Policy Issues

Generally, many BNPL financing services are provided by nonbank financial companies rather than traditional banks. While these companies are not regulated as banks for safety and soundness, they generally must comply with federal consumer protection and data security laws. At the federal level, the Consumer Financial Protection Bureau (CFPB) has the authority in nonbank consumer financial markets to write regulations, enforce laws, and supervise companies in certain cases.

While BNPL financing can provide access to credit or cash-flow flexibility to consumers who might not be able to obtain traditional bank credit at better terms, this financing may also introduce consumer protection risks to consumers that the CFPB is currently monitoring. This trade-off may be particularly acute for younger or subprime consumers. Policy issues relating to BNPL financing include:

- **Unsustainable Debt Risks:** Although many BNPL financing services have no initial interest or fees, some consumers may still face negative consequences due to the use of these financing services, such as accruing charges when repayment is late. For example, some studies suggest a high number of consumers miss BNPL payments; one study found that 38% of consumers have missed BNPL payments. For consumers who have unpaid BNPL payments, they could be blocked from future purchases or have their debts sent to debt collectors.
- **Consumer Disclosure Risks:** BNPL financing may not be subject to similar disclosure requirements as other consumer credit markets. The Truth in Lending Act (TILA; 15 U.S.C. §§1601 et seq.) requires disclosure of credit terms in many consumer credit markets; however, TILA disclosure requirements apply only to consumer credit that is subject to a finance charge or payable in more than four installments. Therefore, these requirements may not apply to many BNPL financing services. There is a risk that consumers may not understand the terms of BNPL financing, such as late payment fees, before they use them. In addition, BNPL financing might not have consumer protections similar to more traditional financial products. For example, BNPL financing generally does not offer the same dispute protections as credit cards if merchandise is faulty or a scam, and a BNPL consumer may still be responsible for paying the merchandise cost in these cases.
- **Consumer Credit Reporting:** Many BNPL financing services do not report information regularly to consumer credit bureaus. While some consumers may prefer to exclude BNPL financing from their credit reports, others might miss out on the opportunity to build a credit history, particularly those who pay their BNPL financing on time and have limited credit histories. By contrast, consumers who become delinquent using BNPL financing are likely to damage their credit scores because debts in collection can be reported to consumer credit bureaus. For example, one study suggests that almost three-quarters of consumers who have missed BNPL payments have seen their credit scores drop due to the missed payments.

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- **Consumer Data Privacy, Control, and Security:** BNPL financing services often access sensitive consumer data, such as consumer shopping behavior, which may introduce privacy and cybersecurity concerns. This information is valuable to companies that want to understand consumer behavior and market new products and services. Consumers may not understand how their data is being used by a company and may have a limited ability to control or correct it, which can make it difficult to protect their privacy, obtain redress for data breaches, or avoid other negative consequences from a company's use of their data.

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