Buy Now, Pay Later: Market trends and consumer impacts

Office of Markets | November 2022

Consumer Financial Protection Bureau

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CFPB's BNPL Actions

- December 2021: Issued market monitoring orders for 2019-21 data on BNPL loans to Affirm, Afterpay, Klarna, PayPal, and Zip.
- January 2022: Issued Request for Comments on BNPL
- June 2022: Blog post on "BNPL and Credit Reporting"
- **September 2022: published report "Buy Now Pay Later: Market trends and consumer impacts"**
  - Focuses on pay-in-four products: typically, 4 interest-free installments, including a down payment; remaining installments paid in two-week intervals by auto-pay from debit/credit card; some assess late fees; revenue primarily from merchant fees
  - Does not include longer term point of sale loans
  - Does not include bank/credit card post-purchase options
- **September 2022: CFPB Director issued remarks, including next steps**

What is Buy Now, Pay Later?

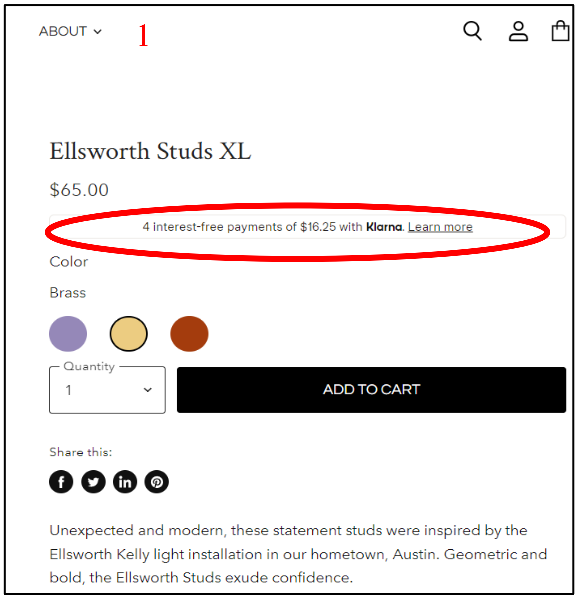
- There is no single agreed-upon definition of "Buy Now, Pay Later" (BNPL) across the consumer finance ecosystem
- The CFPB refers to BNPL as the **"pay-in-four"** product, in which consumers split a retail purchase (typically $50 to $1,000) into 4 equal interest-free installments, with the first installment (down payment) due at checkout and remaining installments due in two-week intervals
- The CFPB does not refer to the following products as BNPL:
  - **Point-of-Sale (POS) loans**: 3-48 month installments, issued at the point of checkout, often bearing interest; intended for $500-$5,000 infrequent purchases; down payment usually not required
  - **Post-purchase credit card installment plans**: fixed installments run through a user's existing credit card issuer, often bearing interest or fixed finance charges; typically issued *after* the point of purchase

BNPL Business Models

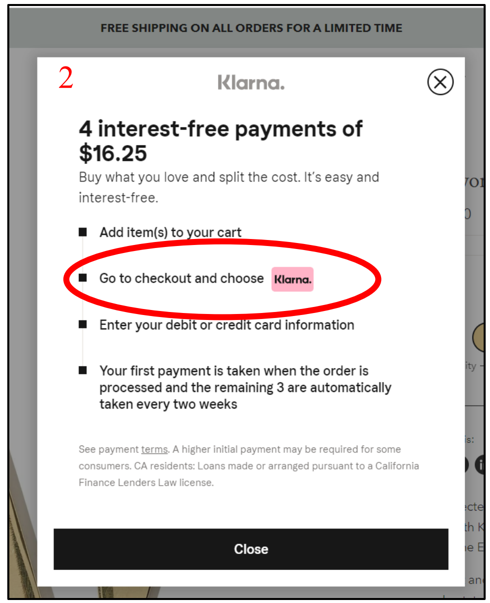
	Merchant Partner	App-Driven
Description	BNPL provider partners with merchants to offer its services on the merchant's website/app/in-store portal alongside other legacy checkout options.	Consumer shops on BNPL provider's app, receives a virtual card with its own account number and a preset credit limit.
Consumer acquisition point	Merchant's website/app/store	BNPL provider's app
BNPL revenue sources	Merchant discount fees	Lead generation/referral, portion of virtual card interchange
Merchant benefits	Increases in cart conversion, average order value, and repeat customer visits	Cost-effective method of lead generation, no tech build required

Merchant-Driven Model – Sample Screenshots

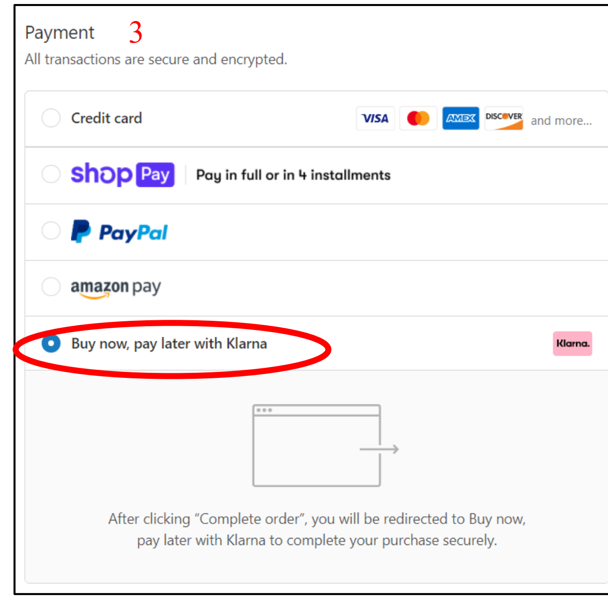
1: Link to BNPL teaser modal at product detail page



2: BNPL teaser modal instructs user to select BNPL at checkout



3: BNPL featured on checkout page with credit cards and other payment options



4: BNPL embedded checkout page detailing repayment schedule; users who click "Place Order" are asked for their debit/credit card information and are underwritten and give an instantaneous credit decision.

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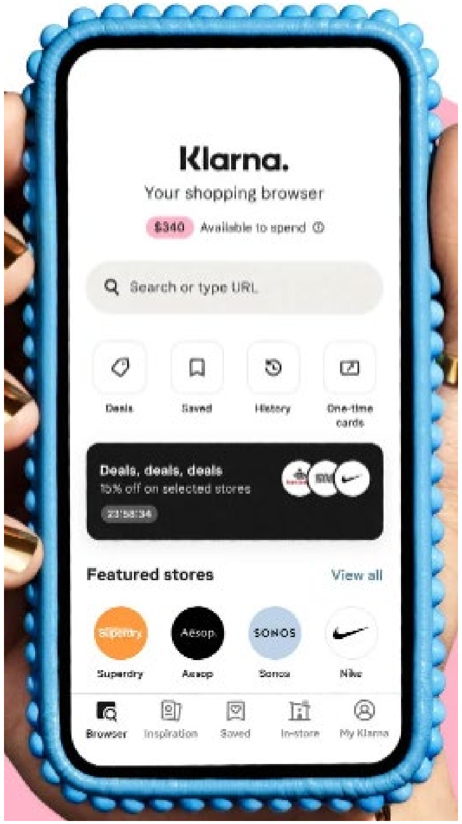
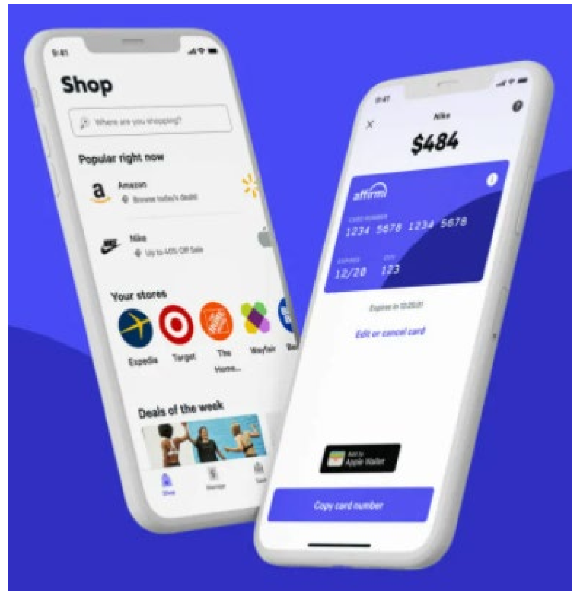
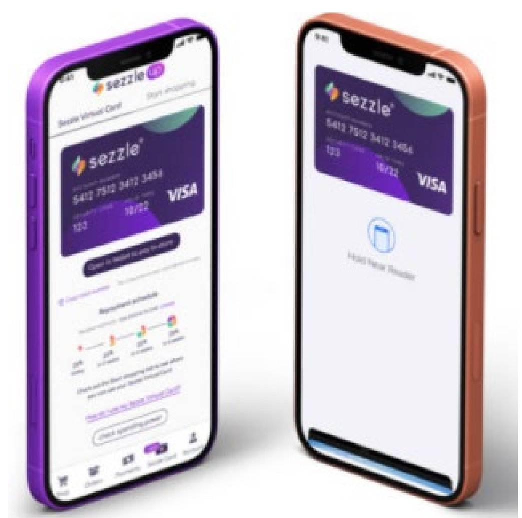
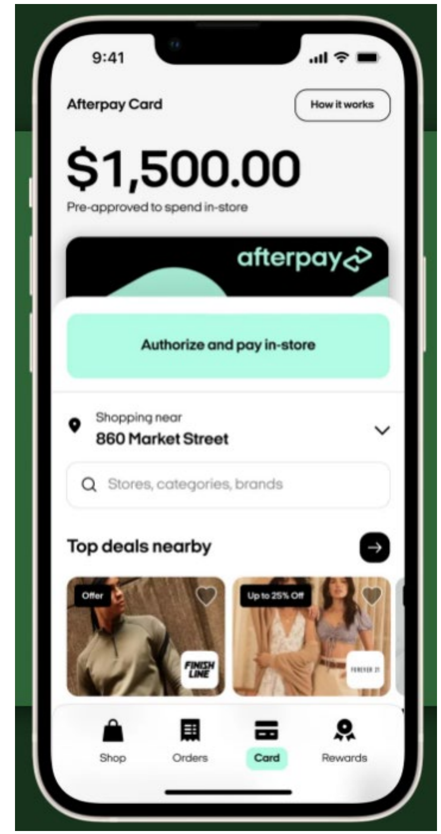
Sources: Raven & Lily, Klarna

App-Driven Model – Sample Screenshots









Sources: Klarna, Affirm, Afterpay, Sezzle

BNPL Report Background

CFPB's activities in the BNPL market:

- December 2021: Issued market monitoring orders for 2019-21 data to five BNPL lenders (Affirm, Afterpay, Klarna, PayPal, Zip).
- January 2022: Issued Request for Comments (RFC) on BNPL
- Consumer blog posts and Ask CFPB consumer education topics
- June 2022: Blog post on “BNPL and Credit Reporting”
- September 2022: Published report “Buy Now Pay Later: Market trends and consumer impacts”

Why review BNPL?

- BNPL industry has been experiencing rapid growth
- Relatively little direct regulatory oversight
- Relatively little high-quality, publicly available data

BNPL Report Background

What does the report accomplish?

- Provides a definitive overview and analysis of the BNPL industry in the US
- Incorporates information from consumer complaint submissions to the CFPB, comments to RFC, and publicly available data

What is *not* included in the report?

- Legally-binding rulemaking
- Detailed survey of the existing regulatory landscape
- Opining on long-term business viability of individual BNPL lenders or predictions on market "winners" and "losers"
- Overall market sizing (volume data only based on five lenders surveyed)
- Data on non-BNPL products in the US or BNPL products outside of the US
- Loan-level analysis

Report Findings: Summary

- 73 percent of applicants were approved for credit in 2021, up from 69 percent in 2020.
- 89 percent of loan repayments were made on a debit card in 2021, virtually unchanged from each of the previous two years.
- 10.5 percent of borrowers were charged at least one late fee in 2021, up from 7.9 percent in 2020.
- 13.7 percent of individual loans in 2021 involved a purchase that was returned or disputed, up from 12.2 percent in 2020.
- 3.8 percent of borrowers had a loan that was charged off in 2021, up from 2.9 percent in 2020.

Report Findings: Volume

BNPL loan volume from the five lenders surveyed has increased by more than 200% per year

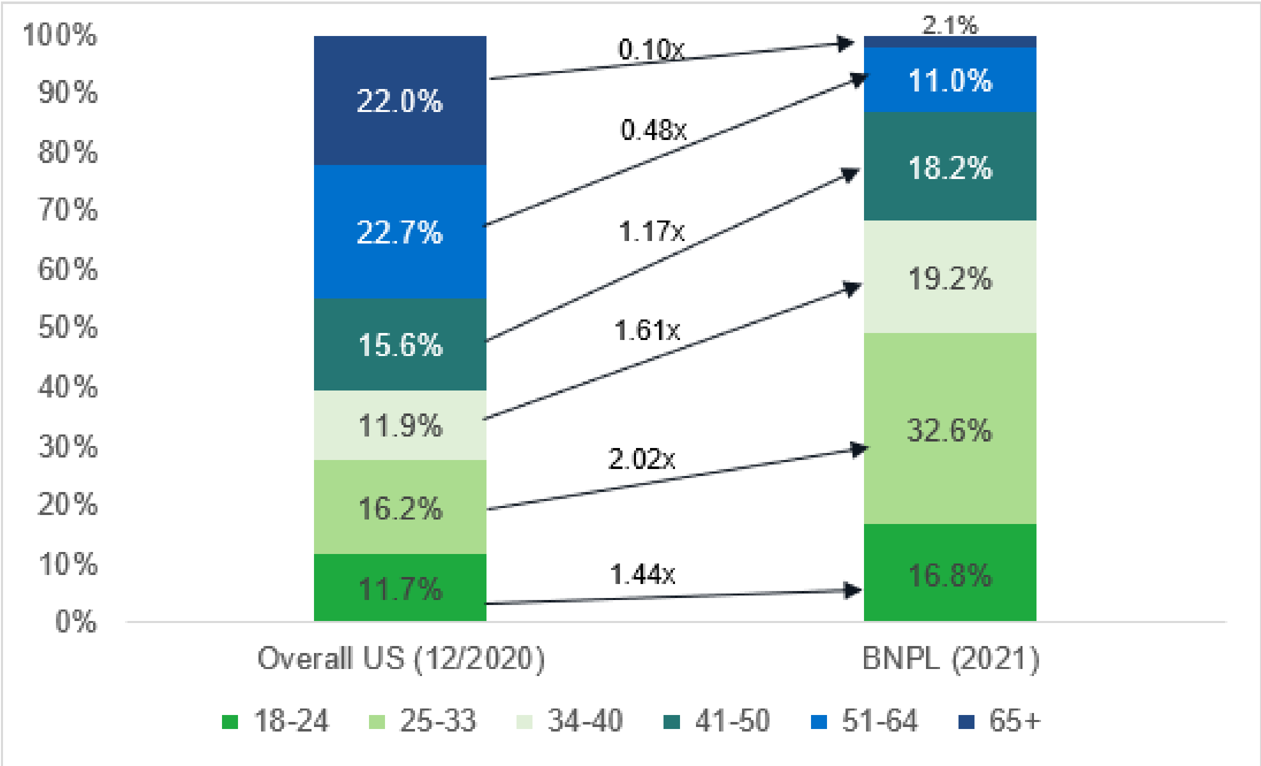
	2019	2020	2021	19-21 CAGR*
Loan Originations (Millions)	16.8	68.4	180.0	227%
Dollar Originations ($ Billions)	2.0	8.3	24.2	245%
Average Loan Size	$121	$121	$135	5.5%

*CAGR (compound annualized growth rate) can be thought of as the average year-over-year rate of growth for a given metric. For example, the 245 percent CAGR for unit originations means that, over the two year-over-year periods studied (2019 to 2020 and 2020 to 2021), unit originations grew by an average of 245 percent per year. Its main analytical benefit is to create a standardized figure that can compare growth over different lengths of time.

Report Findings: Borrower Base by Age

BNPL skews young, but youngest cohort is not the most over-represented

Share of unique BNPL borrowers by age cohort vs. overall 18+ U.S. resident population

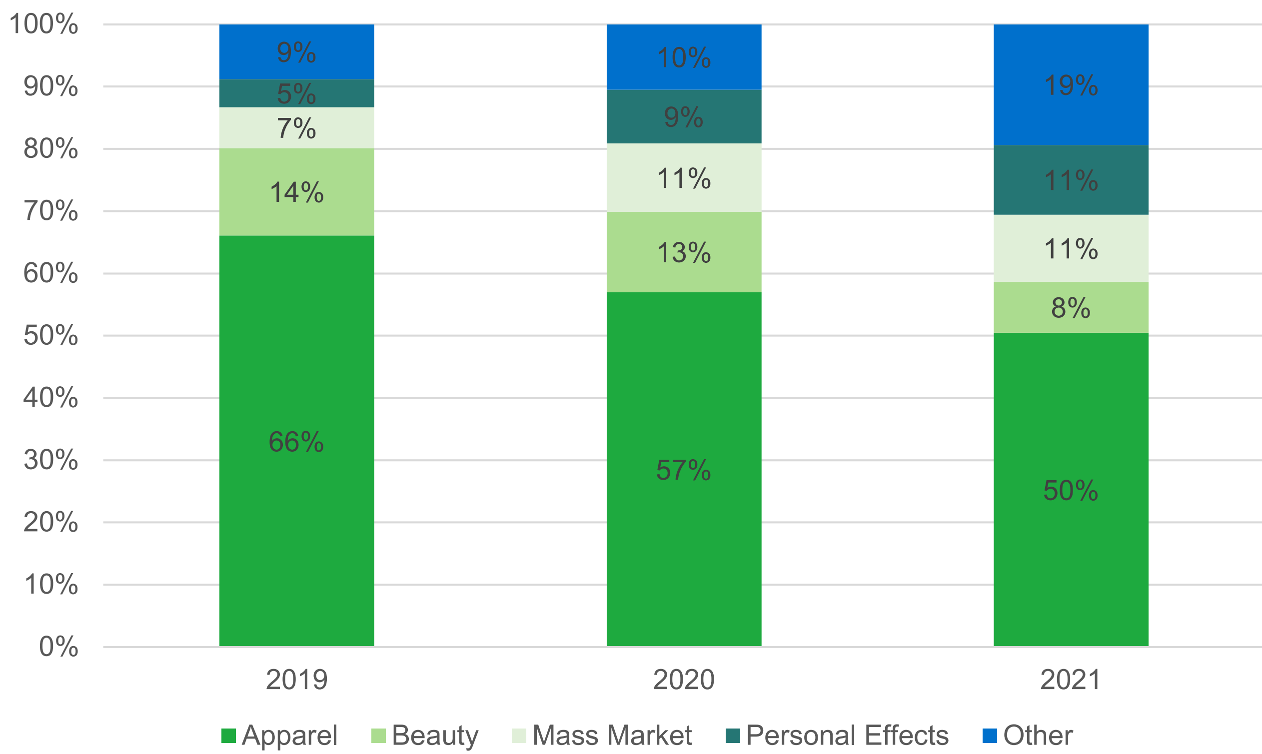


Overall US Source: US Census Bureau

Report Findings: Merchant Mix

BNPL merchant mix has diversified significantly since 2019

Share of annual BNPL dollar originations by merchant vertical



Report Findings: Shrinking Unit Margins

A combination of idiosyncratic and macroeconomic factors are contributing to shrinking unit margins (net income earned for every $100 of BNPL loans originated):

- **Declining merchant discount fees**: Increasing competition driving down the rates lenders can charge merchants to process BNPL transactions
- **Increasing credit losses**: In line with other lending sectors, the end of Covid-19 stimulus payments has coincided with an increase in BNPL losses
- **Increasing funding costs**: Rising interest rates in 2022, combined with more general market concerns about unprofitable tech companies, have led to a sharp increase in BNPL lenders' borrowing costs

Report Findings: Business Model Shifts

Many BNPL lenders are responding to shrinking unit margins with a combination of the following business model shifts

- **Tightening underwriting standards**: Approval rates and credit limits will likely decline as lenders look to stem rising credit losses
- **Increasing consumer fees**: Consumer fees are growing as a share of revenue for 2 of the 5 lenders surveyed
- **Shifting toward the app-driven customer acquisition model**: Potential to significantly broaden and deepen the lender-consumer relationship (aided by harvested user behavioral data), thereby increasing the frequency with which users take out BNPL loans

Report Findings: Financial Benefits

- The CFPB's 2021 report on the consumer credit card market found that the total cost of credit was 17.7 percent for revolving cardholders on general purpose cards. A CFPB analysis from January 2022 also estimated that Americans pay roughly $120 billion per year in credit card interest and fees.
- By contrast, BNPL is typically a no-interest product. Borrowers who miss BNPL payments may be prohibited from future use until they repay or face late fees, but those fees are relatively low in absolute terms and do not compound as does credit card interest. Consequently, BNPL can be a low-cost alternative to other credit products.

Report Findings: Operational Benefits

BNPL offers several operational benefits surrounding its ease of use, including:

- Minimal required user inputs
- An instantaneous credit decision
- A high credit approval rate
- A straightforward repayment structure
- In the merchant-driven model: a checkout process embedded in a merchant's website that does not require exiting to a third-party page
- In the app-driven model: a discovery engine that allows users to instantly browse from dozens of products and brands

Report Findings: Risks – Discrete Consumer Harms

- Some BNPL products appear to be structured to evade certain federal consumer lending requirements
- These requirements are designed to protect consumers and create a level playing field that fosters competition and consumer choice
- Conversely, the absence of these requirements may lead to a competitive imbalance both within the BNPL industry and against similar products, as well as cause harm to consumers
- Discrete consumer harms in the context of BNPL loans may be occurring in the contexts discussed in the ensuing slides

Report Findings: Risks – Discrete Consumer Harms

- **Lack of standardized disclosures:** For both open-end and closed-end credit, disclosures provide a standardized, meaningful visual aid about the terms of credit and allow consumers to make informed decisions across a variety of credit products. However, most BNPL lenders do not currently provide the standard cost-of-credit disclosures required by Regulation Z or periodic statements.

- **Dispute resolution challenges:** Dispute resolution is the top-ranking BNPL-related complaint category in the CFPB's Consumer Complaint Database. The lack of uniform billing dispute rights leads to operational hurdles (requirements that consumers first, or exclusively, contact the merchant for dispute resolution) and financial harm (as consumers are required to pay remaining installments by continued withdrawal of funds from the consumer's debit card while resolution of the return or dispute is pending).

Report Findings: Risks – Discrete Consumer Harms

- **Compulsory use of autopay:** Most BNPL lenders require that borrowers use autopay, and some make removing autopay challenging or impossible. This policy may adversely limit consumer choice and flexibility to elect or change payment methods, or to skip a BNPL payment to satisfy other financial obligations.
- **Multiple payment re-presentments:** All five BNPL lenders re-present (i.e., attempt to reauthorize) failed payments, in some instances up to eight times for a single installment. Consumers may experience harm in the form of fees charged by the consumer's bank associated with the failed payment method, along with downstream impacts when those funds are unavailable to pay other obligations.
- **Late fees:** At least BNPL one lender's policy permitted it to impose multiple late fees on the same missed payment. As industry-specific and broader macroeconomic factors continue to put pressure on BNPL unit margins, lenders might impose more aggressive late fee strategies.

Report Findings: Risks – Data Harvesting

- The practice of harvesting and monetizing consumer data across the payments and lending ecosystems may threaten consumers' privacy, security, and autonomy. It also may lead to a consolidation of market power in the hands of a few large tech platforms who own the largest volume of consumer data, reduce long-term innovation, choice, and price competition.
- The BNPL industry provides an example of the data harvesting that is occurring at the intersections of digital commerce, content, and lending. BNPL lenders often collect a consumer's data—and deploy models, product features, and marketing campaigns based on that data—to increase the likelihood of incremental sales and maximize the lifetime value they can extract from the consumer.

Report Findings: Risks – Data Harvesting

- The availability and effectiveness of consumer data may increase as lenders' customer acquisition models shift from merchant partnerships to BNPL-branded apps
- Additionally, the value of that proprietary real estate (i.e., "first-party" data usage) to advertisers may increase as mobile operating system providers reduce tech platforms and retailers' ability to track customer usage across apps and websites (i.e., "third-party" data usage)
- BNPL lenders' use of consumer data also has the potential to increase overextension risks by engendering repeat usage and contribute to market concentration by rewarding a small number of firms who achieve the largest quantity of consumer data

Report Findings: Risks – Overextension

BNPL presents two discrete potential overextension risks to the consumer:

- **Loan Stacking**: The risk that a consumer takes out two or more concurrent BNPL loans at different lenders and is unable to repay some or all of them
- **Sustained Usage:** The risk that frequent BNPL usage threatens consumers' ability to meet *non-BNPL* financial obligations
  - Borne by those who *do* repay (and use repeatedly), not by defaulters
  - Core product features such as mandatory autopay, low size of installments may contribute to consumers placing BNPL at the top of their "payment hierarchy" (prioritization of different financial obligations)
  - The risk is potentially enhanced as lenders focus on the app-driven customer acquisition model, which leverages a user-friendly, behavioral-data-driven interface to propel repeat usage

Director's Remarks: Next Steps

- Identify potential interpretive guidance or rules with goal of ensuring BNPL adheres to credit card baseline protections
- Identify data surveillance practices that may need to be curtailed and coordinate with Federal Trade Commission on commercial surveillance rulemaking
- Suggest options on appropriate credit reporting
- Ensure appropriate supervisory examinations
- Reflect BNPL in Federal Reserve's household debt estimates