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National Association of Federally-Insured Credit Unions

March 25, 2022

Comment Intake—Statement into BNPL Providers
Bureau of Consumer Financial Protection
1700 G Street NW
Washington, DC 20552

RE: Request for Comment regarding Inquiry into Buy-Now-Pay-Later Providers (Docket No.: CFPB-2022-0002)

Dear Sir or Madam:

On behalf of the National Association of Federally-Insured Credit Unions (NAFCU) I am writing in response to the request for comment (RFC) issued by the Consumer Financial Protection Bureau (CFPB or Bureau) regarding its inquiry into providers of buy-now-pay-later (BNPL) products. NAFCU advocates for all federally-insured not-for-profit credit unions that, in turn, serve over 127 million consumers with personal and small business financial service products. NAFCU appreciates the Bureau's efforts to better understand the nature of the BNPL market and any risks to consumers that exist therein. Although NAFCU is not opposed to point-of-sale installment loans in general, our members have serious concerns regarding the utilization of "Pay in 4" loans by unsupervised fintech companies.

NAFCU requests that the Bureau release a comprehensive report regarding its findings from the December market monitoring orders and this RFC. Furthermore, to the extent that these findings reflect a deliberate intent on the part of "Pay in 4" BNPL providers to circumvent regulation and target financially vulnerable consumers, NAFCU urges the Bureau to take steps to ensure that these unregulated lenders institute adequate consumer protection practices. NAFCU also asks that the Bureau engage in consumer education regarding the potential risks associated with Pay in 4 products and encourage BNPL providers to do the same. Finally, to increase the availability of consumer credit while maintaining consumer protections, NAFCU suggests the Bureau consider several updates to Regulation Z that would level the playing field in the BNPL market.

General Comments

On December 16, 2021, the Bureau opened market monitoring orders requiring five providers of BNPL products in the United States, Affirm, Afterpay, Klarna, PayPal, and Zip (hereinafter "the five companies"), to provide information about their size, scope, and business practices. The Bureau has specifically targeted in its inquiry split-pay companies that offer installments of four or less and has excluded longer-term point-of-sale installment loans. BNPL's use has spiked during the COVID-19 pandemic and over the most recent holiday shopping season.[1] According to a recent

[1] *See* American Banker, "Consumer protections should apply to buy now/pay later firms, too" *available at* https://www.americanbanker.com/opinion/buy-now-pay-later-firms-have-an-unfair-advantage-over-banks.

survey, 39 percent of Americans say they have tried BNPL at least once and of those, 55 percent tend to spend more ($312 average spend) compared to other payment methods.[2]

The BNPL-generated increase in the price tag of purchases has endeared the product to merchants, resulting in an explosion of merchants offering BNPL at checkout. Specifically, retailers are willing to pay fees to BNPL providers that are more expensive than average credit and debit interchange rates and fees, because offering BNPL is estimated to increase conversion rates by 20 to 30 percent and lift average purchase prices by 30 to 50 percent.[3] Retailers are willing to lose 3 to 6 percent of the purchase price of a transaction to BNPL companies because the average BNPL consumer is willing to buy more frequently and buy more expensive items than they otherwise might. Whether these consumers can afford to make the payments associated with these more expensive purchases does not seem to concern retailers or BNPL providers.

Although NAFCU supports increased access to credit, it must be done so in a manner that is safe and cognizant of differences in financial health and ability to repay. NAFCU and its member credit unions have significant concerns regarding BNPL providers' apparent targeting of low-income or paycheck-to-paycheck consumers as well as the insufficient underwriting that accompanies each loan. NAFCU is also deeply concerned about the absence of a level playing field in the BNPL market, which incentivizes providers to craft their products to avoid regulation and adequate consumer protections. Finally, while the scope of data harvesting by BNPL consumers remains opaque, NAFCU asks for strong protections to safeguard consumer information from unauthorized access, use, and disclosure.

Accumulating Debt

In its RFC, the Bureau expresses concern surrounding the impacts from consumers becoming regular users of BNPL for everyday discretionary buying. Specifically, the Bureau notes that to the extent that a consumer has multiple purchases on multiple schedules with multiple companies, it may be hard to keep track of when payments are scheduled and when there is not enough money in a consumer's bank account, which can potentially result in charges by both the consumer's bank and the BNPL provider. Independent studies and data from NAFCU's member credit unions have shown that this concern is well-founded and that the "Pay in 4" model of BNPL offered by fintechs overwhelmingly caters to individuals in poor financial health and is generally unconcerned with the risk posed to these consumers. Although efforts to extend new forms of credit to consumers with low account balances or low credit scores is generally commendable, the fact that these consumers represent such a significant proportion of BNPL users warrants enhanced disclosures and significant consumer education to offset the risks.

In general, credit union members who are in poor financial health, younger, and debit-favoring are more likely to use and be interested in using BNPL products. One NAFCU member credit union found that BNPL usage is significantly higher among those who are in poor financial health (39

[2] *See* The Straw Group, "Buy Now, Pay Later – Boom or Bust?" *available at* https://thestrawgroup.com/buy-now-pay-later-boom-or-bust/.
[3] *See* CNBC "Retailers bid farewell to layaway, as shoppers embrace buy now, pay later options" *available at* https://www.cnbc.com/2021/09/25/why-retailers-are-embracing-buy-now-pay-later-financing-services.html.

percent). Average BNPL consumers have low account balances of less than $1,000 or $500 and are often living paycheck-to-paycheck. In a recent study of consumers in general, 61 percent of those who live paycheck-to-paycheck had either used BNPL or were familiar with BNPL but have not used it.[4] These findings point toward two conclusions: first, consumers in poor financial health are more likely to be attracted by the spending power that BNPL offers and, second, they are least able to afford the consequences of a missed payment.

BNPL products are extremely attractive to low-income consumers for several reasons. They have a high degree of ease of experience, they provide access to debt management through the ability to spread payments, and they provide consumers who have no or low access to credit with more purchasing power than they might otherwise have. BNPL providers appear to be aware that their products are significantly more attractive to low-income consumers and are marketing directly toward them with a great deal of success. Among consumers who have blemishes on their credit profiles, 72 percent are aware of BNPL.[5] Among consumers who are unable to access conventional sources of credit, 64 percent are familiar with BNPL. In contrast, 54 percent of "worry-free" consumers who have no barriers to approval for a traditional credit card or loan are familiar with BNPL. A NAFCU member credit union also found that interest in future BNPL usage is significantly higher among those who are in bad financial health (33 percent), aged 18-34 (30 percent), and have a debit card only (27 percent).

The fact that BNPL consumers are purchasing items that are more expensive than they would otherwise purchase, and they are purchasing them more frequently, indicates that these consumers may not fully understand the obligations they are undertaking when they use the product. According to the Barclays study, 36 percent of adults who have used BNPL did not fully understand the consequences of not making payments on time.[6] Another 39 percent of users admitted that they did not fully understand how the payment product actually works. Even more alarming, in a January 2022 survey of one NAFCU member credit union's members, only 49 percent of those who had used BNPL were familiar with it, implying that over half of these members are using BNPL without understanding how it really works and how it can impact their financial wellbeing.

BNPL's reliance on consumers in bad financial health is further evidenced by BNPL providers' behavior in terms of credit checks and credit reporting. Ordinarily, consumers who apply for loans or other forms of credit are subject to a hard credit inquiry, which allows lenders to view the consumer's credit reports before making a decision about whether to extend credit. Importantly, section 1026.51 and the implementation of the ability-to-pay provisions of the *Credit Card Accountability, Responsibility, and Disclosure* (CARD) *Act*, requires credit card issuers to determine a consumer's ability to make required minimum periodic payment based on the consumer's income or assets and obligations prior to opening a credit card account or increasing a

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[4] *See* PYMNTS, "The New Credit Model: Why Financially Worry-Free Consumers Still Want Alternatives To Traditional Credit" *available at* https://www.pymnts.com/wp-content/uploads/2021/12/PYMNTS-The-New-Credit-Model-December-2021.pdf.
[5] *Id*.
[6] *Id*.

credit limit.[7] BNPL providers, conversely, have no similar obligation to ensure that their users are able to repay their loans. Each hard credit inquiry can impact a consumer's credit score, but also provides a greater level of certainty regarding the consumer's ability to repay. Soft credit checks, on the other hand, have no impact on a consumer's credit score, and can be done repeatedly, as in the case of BNPL providers, without harming a credit score. The five companies exclusively use soft credit checks in their Pay in 4 BNPL products.[8]

Credit bureaus factor hard inquiries into a consumer's credit score for good reason; they assume that if a consumer is applying for additional credit, they might be at greater risk of not paying back existing debts. BNPL providers are able to circumvent this consideration by only engaging in soft credit checks, leaving the potential for repeated use of BNPL to result in the accumulation of considerable debt.[9] The lack of hard inquiries inflicts an added harm to credit union members by obscuring their financial activity outside of the credit union. If credit unions cannot accurately understand the financial history of their members, it is very difficult for them to ascertain whether the member is a good credit risk or whether they could benefit from financial literacy resources or alternatives to BNPL products.

These same issues are compounded by the inconsistencies in BNPL credit reporting, which can damage credit scores and the ability of credit union members to qualify for the safe and affordable lending products offered by their credit union. BNPL providers frequently decline to report on-time payments from consumers, thereby depriving them of the benefit associated with building creditworthiness. Conversely, consumers that do miss payments are often reported to the credit bureaus, damaging their credit scores and reducing their ability to qualify for safe and affordable credit products with their credit unions. Although the three major credit bureaus have all recently announced plans to accept BNPL tradelines into consumer credit files, in practice this could further damage credit scores with the short-term nature of BNPL loans lowering the average age of accounts.[10]

The totality of these concerns paints a picture of Pay in 4 BNPL as a credit product that caters largely to consumers in poor financial health, who often do not understand the potential risks of the product and can accumulate ruinous debt. As it currently exists, Pay in 4 BNPL fails to build consumer credit and often harms it, and has a damaging effect on the ability of credit unions to understand their members and for credit union members to access safe and affordable credit.

[7] 12 CFR 1026.51.
[8] *See* Affirm, "How it Works" *available at* https://www.affirm.com/how-it-works; Afterpay, "Is using Afterpay bad for my credit score?" *available at* https://help.afterpay.com/hc/en-au/articles/900003970646-Is-using-Afterpay-bad-for-my-credit-score-; Klarna, "Does Klarna Perform a Credit Check" *available at* https://www.klarna.com/us/customer-service/klarna-perform-credit-check/; Zip, "How it Works" *available at* https://zip.co/us/how-it-works; Paypal, "Pay-in-4" *available at* https://www.paypal.com/us/for-you/pay-in-4.
[9] In a December 2021 study from Barclays, 25 percent of respondents said they struggle to keep track of spending after taking out loans through multiple BNPL providers, and another 24 percent said this has even caused them to miss a payment. *See* Barclays, "Barclays reveals pitfalls of unregulated BNPL agreements for Christmas shoppers" *available at* https://home.barclays/news/2021/11/-barclays-reveals-pitfalls-of-unregulated-bnpl-agreements-for-ch/.
[10] *See* CNBC "'Buy now, pay later' loans can decrease your credit score even if you pay on time—here's what you need to know" *available at* https://www.cnbc.com/select/how-buy-now-pay-later-loans-can-decrease-your-credit-score/.

NAFCU supports efforts to improve the BNPL market and ensure that consumers have access to credit in the short term that will help build their creditworthiness in the long term.

Regulatory Arbitrage

The Bureau has also raised concerns regarding BNPL companies' failure to adhere to consumer protection laws and credit industry norms. This includes a lack of disclosures and dispute resolution protections as well as late fees and policies that expose consumers to greater risk of financial harm. This is particularly troubling for NAFCU's member credit unions that must deal with the fallout from their members being harmed by the insufficient regulatory framework for BNPL providers.

Troublingly, some BNPL products, including those which are the subject of the market monitoring orders, appear to be intentionally designed to avoid application of certain federal and state laws.[11] Generally, credit that is repayable in more than four installments or includes a finance charge is subject to the federal *Truth in Lending Act's* rules on consumer lending terms and disclosures found in Regulation Z. These rules require disclosures to be provided prior to consummation of a closed-end loan, provide procedures for refinances and modifications, and include closed-end advertising requirements. Regulation Z also includes rules that apply to credit and charge card application and solicitation disclosures. By offering BNPL in a "Pay in 4" model, the five companies sidestep these rules and, as a result, disadvantage consumers using the products, who are, as previously discussed, often the most financially vulnerable. Worsening the issue, most BNPL consumers are unlikely to be aware of the absence of these protections and will view BNPL as an equally safe alternative to traditional forms of credit.

The absence of standardized disclosures creates concerning potential for hidden fees and expenses. Marketing through merchants' websites and mobile apps exacerbates this problem by advertising BNPL products as available at "no cost" or with "no interest." That can create a misperception that credit is truly free. Consumers are also exposed to risk of overdrafts or NSF fees because they typically repay BNPL credit through automatic withdrawals from bank accounts or payment via debit cards. Although financial institutions, such as credit unions, are required to disclose the fees that will be charged in association with NSF and overdraft, BNPL providers, through their absence of disclosures and misleading marketing, including prominent mention of introductory, zero interest rate financing, can misinform consumers and lead them to incorrectly believe that BNPL is somehow exempt from fees for the duration of the loan. This is clearly not the case as, for example, when using Afterpay a customer is assessed late fees that can eventually reach up to 25 percent of the purchase price.[12] Another model claims never to impose late fees or interest payments but will report charge-offs to credit bureaus and can make referrals to collection agencies.[13] This incongruity between BNPL marketing and reality has already led to private legal

[11] *See* Steptoe, "What's Old Is New Again: The Risks in RISCs (Retail Installment Sales Contracts)" *available at* https://www.steptoe.com/en/news-publications/whats-old-is-new-again-the-risks-in-riscs-retail-installment-sales-contracts.html.
[12] *See* Afterpay, "Purchase Payment Agreement" *available at* https://www.afterpay.com/purchase-payment-agreement.
[13] *See* Sezzle, "Sezzle User Agreement" *available at* https://legal.sezzle.com/user.

action, class actions, and regulatory enforcement and will continue to contribute to consumer harm if not addressed.[14]

Data Security Concerns

Any entity that has access to substantial amounts of consumer data should be held to a heightened standard of care in how it handles and uses that data. An estimated 45 million Americans are active users of BNPL loans, according to a September 2021 Accenture study commissioned by Afterpay.[15] That same report shows that BNPL users in the U.S. have shot up by more than 300 percent per year since 2018, and BNPL is expected to make up 10 percent of all e-commerce by 2024. With this dramatic growth, it is clear that BNPL lenders have access to the valuable payment histories of a significant portion of the American population. And while depository institutions are subject to their regulators' stringent implementation of the safeguard requirements of the *Gramm-Leach-Bliley Act* (GLBA) and the privacy rules in Regulation P, other entities that handle consumer financial data are not held to the same standards or level of supervision. NAFCU's members have serious and justifiable concerns with BNPL provider and merchant data security practices that can lead to unauthorized access to consumer data, which may ultimately cause a loss to the credit union.

Although BNPL has not yet shown itself to be particularly susceptible or attractive to fraudsters, consumer data should nevertheless be safeguarded. To the extent that entities are sharing or profiting from consumer data, consumers should be informed. This RFC seeks information about how BNPL companies collect and maintain data resulting from consumer use of a BNPL product and data about individual users of BNPL. Furthermore, the Bureau has asked the five companies how they use this data, whether they share it, and whether they use the data for targeted offers or to sell advertising.

It seems clear that at a minimum, some, if not all, of the five companies use collected data from consumers to create closed loop shopping apps with partner merchants, pushing specific brands and products. Some providers such as Afterpay even tout their access to this data as a selling point to merchants.[16] BNPL providers are the first to admit that they view consumer data as a valuable

[14] *See Vidaurre v. PayPal Inc.*, Case No. 5:22-cv-01283, justia.com, N.D. Cal., alleging that Paypal violated the Florida Deceptive and Unfair Trade Practices Act, California's Unfair Competition Law and California's False Advertising Law when it misrepresented the true nature, benefits, and risks of its service and then repeatedly re-processed payments that were not successful on the first attempt—causing multiple NSF fees totaling $348 on one repayment; *See also Shepard v. Affirm Holdings, Inc.,* Case No. 7:21-cv-05241, justia.com, S.D.N.Y., alleging that Affirm is unable to provide refunds, making it difficult for consumers to return defective items to the retailer; that consumers who return items are still required to make installment payment to Affirm; and that consumers do not have the option to dispute the transaction as they would with a credit card company. *See also Miller v. Afterpay US*, Case No. 3:21-cv-04032, justia.com, N.D. Cal.; *Edmundson vs. Klarna, Inc.*, Case No. 3:21-cv-00758-KAD; justia.com, D. Conn.

[15] *See* Afterpay, "The Economic Impact of Buy Now, Pay Later in the US" *available at* https://afterpay-corporate.yourcreative.com.au/wp-content/uploads/2021/10/Economic-Impact-of-BNPL-in-the-US-vF.pdf.

[16] "Equipped with valuable consumer data — from top selling categories to preferred channels and new versus returning shoppers — Afterpay establishes feedback loops with its partners to extrapolate key insights that can inform strategic planning and decision-making." *See* Business of Fashion, "At Afterpay, Partnership Beyond Payments" *available at* https://www.businessoffashion.com/articles/technology/at-afterpay-partnership-beyond-

resource, but it is unclear the extent to which consumers are being made aware that their shopping habits and payment histories are being sold. The Bureau has previously observed that companies "knowing what we spend our money on is a valuable source of data on consumer behavior" and suggested that the use of such data by companies with outsize market power could pose new risks and undermine fair competition.[17]

This risk of mismanagement of consumer financial data should prompt the Bureau to strongly consider exercising its "larger participant" authority to ensure that companies operating in the unsecured consumer lending market are adequately supervised, have adopted appropriate compliance systems, and are managing privacy and data security risks commensurate with the high expectations that apply to credit unions and other regulated financial institutions. Under the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act), the Bureau has authority to supervise nonbank entities considered to be "a larger participant of a market for other consumer financial products or services." In 2021, BNPL represented 4 percent of e-commerce payments in the U.S., doubling from the previous year, and it is expected to continue its explosive growth.[18] The use of this authority to supervise BNPL providers would allow the Bureau to develop a fuller understanding of harvesting by BNPL providers, while simultaneously providing the CFPB with valuable information related to nonbank compliance practices as it considers implementation of section 1033 of the Dodd-Frank Act.

Level Playing Field

To the extent that the Bureau is unwilling or unable to exercise its large participant authority over BNPL providers, it could seek to expand access to credit by allowing traditional financial institutions, subject to Bureau supervision, and with a track record of compliance to offer BNPL models. Many credit unions have considered, or are currently considering, offering a BNPL-like product, however the majority of these credit unions have avoided offering point-of-sale or post-purchase installment loans due to existing hurdles found within Regulation Z. In a February 2022 NAFCU Monitor Survey, 36 percent of respondents said that the lack of clarity in regulatory expectations was the main factor that influenced their decision not to offer BNPL. This has provided an opportunity for fintech companies to enter the BNPL marketplace by structuring their products to avoid card-specific rules governing dispute resolution and prioritize sales volume over consumer protection.

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payments/; Afterpay also recently announced that it will launch a new merchant analytics platform called Afterpay iQ to provide its partners with analytics and data-driven insights. *See* PYMNTS, "How Partnerships With BNPL Providers Can Help Merchants Elevate Their Marketing Strategies and Data Insights" *available at* https://www.pymnts.com/buy-now-pay-later/2021/partnerships-with-bnpl-providers-can-help-merchants-elevate-marketing-strategies-data-insights/.

[17] *See* CFPB, "Statement Regarding the CFPB's Inquiry into Big Tech Payment Platforms" *available at* https://www.consumerfinance.gov/about-us/newsroom/statement-regarding-the-cfpbs-inquiry-into-big-tech-payment-platforms/.

[18] *See* Statista, "Market share of buy now, pay later (BNPL) in domestic e-commerce payments in 41 countries worldwide from 2016 to 2021" *available at* https://www.statista.com/statistics/1233850/online-bnpl-penetration-country/.

To make the BNPL market safer, give consumers more control, and promote competition for these products, which hold the potential to help lower-income individuals gain access to credit and build credit history, the Bureau should consider providing updates to Regulation Z to make it easier for traditional card issuers to offer BNPL-like products to consumers who seek them. Specifically, the Bureau could revise the 6-month promotional rate minimum rule to allow shorter repayment terms for BNPL-like repayment plans.[19] Additionally, the Bureau could provide a BNPL-like repayment plan exception to the limitation on rate increases within the first year of account opening.[20] This would enable consumers with new credit card accounts to use their credit card's BNPL-like repayment feature to take advantage of special low rates.

The Bureau could also permit credit card issuers to reset consumers' BNPL-like plans to their card's standard credit terms, including applying the card's standard annual percentage rate (APR) and minimum payment amount. This would allow vulnerable consumers or those in poor financial health to cancel their installment repayment plan if they found the new payment too expensive. To do this, rules barring increases to rates and fees would need to be amended to include an exception for this situation.[21]

Finally, the Bureau could allow credit card issuers to allocate payments above the minimum payment amount first to low-rate installment repayment plans before applying them to higher-rate balances.[22] This would enable card issuers to retain the member's low required minimum payment, while giving consumers the option of paying additional amounts to take advantage of a low-rate short term repayment offer. Additionally, this change would be beneficial for other products such as secured credit cards, which also cater to consumers in poor financial health, but have the added benefit of helping build credit history. These recommendations would enable traditional financial institutions to compete more directly in the BNPL market and provide consumers with more, safer choices for credit. The addition of more credit unions, with their culture of compliance and consumer protection, to the BNPL market, can only serve to improve the standards and practices of BNPL as a whole.

Conclusion

NAFCU appreciates the opportunity to provide comments on this RFC. NAFCU requests that the Bureau take steps to ensure that unregulated lenders in the BNPL market institute consumer protection practices, potentially by exercising its larger participant authority over the unsecured lender market. NAFCU also asks that the Bureau engage in consumer education regarding the risks associated with these products and encourage BNPL providers to do the same. Finally, in order to increase the availability of credit, while maintaining consumer protections, NAFCU suggests the Bureau consider updates to Regulation Z that would level the playing field in the BNPL market.

[19] *See* 15 USC 1666i-2; 12 CFR 1026.55(b)(1).
[20] *See* 15 USC 1666i-2; 12 CFR 1026.55(b)(3)(iii).
[21] *See* 15 USC 1666i-1; 12 CFR 1026.55.
[22] *See* 15 USC 1666c; 12 CFR 1026.53.

If we can answer any questions or provide you with additional information, please do not hesitate to contact me at 703-615-5109 or jakin@nafcu.org.

Sincerely,

James Akin
Regulatory Affairs Counsel