

United States House of Representatives
Committee on Financial Services
2129 Rayburn House Office Building
Washington, D.C. 20515

October 28, 2021

Memorandum

To: Members, Committee on Financial Services
From: FSC Majority Staff
Subject: November 2, 2021, “Buy Now, Pay More Later? Investigating Risks and Benefits of BNPL and Other Emerging Fintech Cash Flow Products”

The Task Force on Financial Technology will hold a hybrid hearing entitled, “Buy Now, Pay More Later? Investigating Risks and Benefits of BNPL and Other Emerging Fintech Cash Flow Products” on November 2, 2021 at 10:00 a.m. ET in person in room 2128 of the Rayburn House Office Building, and on the virtual meeting platform Cisco Webex. This hearing will have one panel with the following witnesses.

- **Dr. Kristen Broady**, Fellow in the Brookings Metropolitan Policy Program, Brookings Institution
- **Penny Lee**, CEO, Financial Technology Association
- **Lauren Saunders**, Associate Director, National Consumer Law Center
- **Marisabel Torres**, Director of California Policy, Center for Responsible Lending
- **Brian Tate**, CEO and President, Innovative Payments Association

Overview

In the last few years, several consumer loan products offered by technology-focused, nonbank financial institutions (fintechs) have attracted attention for both their rapid growth and popularity, as well as potential consumer protection concerns. Some of these products have been designed to help individuals manage their personal cash flow, often at a lower cost and with greater flexibility relative to traditional financial products and services. Many of these consumer products and services, in particular Buy Now, Pay Later (BNPL), earned wage access (EWA), and overdraft avoidance products, have dramatically grown their customer base.¹ While these products may offer consumers new ways to purchase goods and services, consumer advocates have raised concerns over whether these products have the potential to create unsustainable levels of debt.² Lending disclosure requirements, such as the Truth in Lending Act (TILA), may not apply to a number of these products, which raises questions about consumers’ understanding of the risks. As many of these products do not report payments to the credit bureaus, questions have also been raised over whether consumers miss out on opportunities to build credit.³

¹ R. Shevlin, [Buy Now, Pay Later: The “New” Payments Trend Generating \\$100 Billion In Sales](#) (Sept. 7, 2021).

² *Id.*

³ This memo was prepared with assistance from Cheryl R. Cooper and Paul Tierno at Congressional Research Services (CRS). For more insight, see CRS, [Rapidly Growing “Buy Now, Pay Later” \(BNPL\) Financing: Market Developments and Policy Issues](#) (Nov. 1, 2021).

Buy Now, Pay Later

“Buy Now, Pay Later” or BNPL, is a point of sale financing product that allows a consumer to purchase and take possession of an item immediately and pay for it over a certain period of time or with a specified number of payments.⁴ BNPL products may target thin credit file individuals who may not qualify for traditional credit cards.⁵ Accordingly, younger consumers may be more likely to use BNPL.⁶ Generally, BNPL allows borrowers to spread the cost of a purchase over a fixed number of payments or period of time, usually without accruing interest.⁷ The market for BNPL has grown rapidly in recent years, with one report suggesting that BNPL use has increased 230% since early 2020.⁸ Among the more popular products are those that allow four installment payments in two-week intervals; or payment at regular intervals over a six-week period.⁹

Klarna, Afterpay, Affirm, Splitit and Sezzle are among the companies offering BNPL products. Some of these companies have high market values, despite often being loss-generating operations.¹⁰ Klarna, a pioneer in the BNPL industry, after its latest round of equity funding, has been estimated to be valued at over \$45 billion.¹¹ Square recently announced plans to acquire Afterpay at a value of \$29 billion.¹² Such valuations may reflect expected revenue from sources indirectly related to the companies’ BNPL business, such as access to customer data and spending patterns and the ability to potentially cross-sell traditional banking services.¹³

Consumers may use BNPL payment products directly through a merchant, with some BNPL companies establishing relationships with specific merchants that embed the BNPL financing as a payment option in the merchant’s check-out process.¹⁴ Alternatively, some BNPL companies may allow customers to use the company’s platform in the form of a browser extension to purchase from retailers.¹⁵ Applications for financing take place at check out, and companies determine financing terms based on a soft credit check and a consumer’s tenure and performance on the platform.¹⁶

BNPL companies may charge a late fee if customers do not make a payment after a grace period, and nonpayment may curtail future opportunities. Unlike credit card companies, BNPL companies typically do not report repayment to credit reporting agencies, but some may report delinquencies to credit reporting agencies.¹⁷ BNPL companies generate most of their revenue by charging merchants for the service.¹⁸ Merchants are willing to pay these fees because they are

⁴ Forbes, [Buy Now, Pay Later: Here’s What You Should Know About Offers From Affirm, Klarna, AfterPay And Other Installment Purchases](#) (Oct 11, 2021).

⁵ McKinsey & Company, [Buy Now, Pay Later: Five Business Models to Compete](#) (Jul. 29, 2021).

⁶ Pymnts, [BNPL Expands ‘Next Gen’ Label: Aims Across Demographics](#), (Apr. 9, 2021).

⁷ *Id.*

⁸ See Accenture for Afterpay, [The Economic Impact of Buy Now Pay Later in the US](#) (Sep. 2021).

⁹ Forbes, [Pay In 4, PayPal’s Buy-Now-Pay-Later Product, Resonates With Shoppers](#) (Jun. 8, 2021).

¹⁰ Financial Times, [Is “Buy Now Pay Later” a Viable Business Model?](#) (Oct. 7, 2021).

¹¹ Klarna, [Klarna Secures Additional Funding As Consumers Demand Smarter Alternatives to Shop, Bank, & Pay](#), (Jun. 10, 2021).

¹² Financial Post, [Square, Inc. Announces Plans to Acquire Afterpay, Strengthening and Enabling Further Integration Between its Seller and Cash App Ecosystems](#) (Aug. 1, 2021).

¹³ Financial Times, [Is “Buy Now Pay Later” a Viable Business Model?](#) (Oct. 7, 2021).

¹⁴ Protocol, [Invest now, win later: Inside the ‘buy now, pay later’ gold rush](#) (Oct. 4, 2021).

¹⁵ CNBC, [Everything you need to know about the most popular buy now, pay later apps](#) (Oct. 12, 2021).

¹⁶ See CRS, [Consumer Credit Reporting, Credit Bureaus, Credit Scoring, and Related Policy Issues](#) (Oct. 15, 2020).

¹⁷ CFPB, [Should you buy now and pay later?](#) (Jul. 6, 2021).

¹⁸ CNBC, [Fintech firm Upgrade is getting into buy now, pay later with short-term installment loans](#) (Oct. 1, 2021).

motivated by new customer acquisition. While some companies that offer BNPL products operate independently, others work with banks to originate a majority of their loans. In such instances, a company may buy the loans back and hold them on its balance sheet or sell them to third parties.¹⁹

Earned Wage Access

EWA products allow individuals to access part of their earned but not yet paid income before the end of the conventional pay period. Frequently, workers are paid at regularly scheduled intervals, typically weekly, every two weeks, twice a month, or monthly.²⁰ Companies that offer EWA products promote their tools as more attractive, lower-cost alternatives to other types of cash advances or short-term credit products, such as payday loans.²¹ EWA products may work directly with employers' human resources' time management and payroll software to determine the number of hours an employee worked, and allow individuals to access a portion of that earned income earlier than their employer's established payday.²² Companies providing EWA products include PayActiv, Branch, DailyPay, FlexWage, and Instant. Market studies estimate that millions of workers currently use EWA, with one estimate putting the addressable market of EWA users at approximately 45 million.²³ Companies such as Walmart, McDonald's, and Uber have agreements with EWA companies, with a focus on serving their "gig economy" workers.²⁴

Overdraft Avoidance Products

Overdraft avoidance products are tools intended to help individuals avoid the fees associated with overdrawing a bank account. Overdraft charges occur when a bank chooses to honor a payment initiated by an account holder even though the transaction exceeds the account holders' balance, and charges the account holder for doing so.²⁵ Overdraft avoidance products require access to customers' bank accounts to allow for monitoring of balances and transactions. Some overdraft products charge a fee for the benefit of having funds deposited automatically in customers' bank accounts to cover transactions that would otherwise exceed the balance, and thus avoid overdraft or other charges.²⁶ Other products require an account holder's approval before it transfers to their account up to \$100 to cover transactions. These products may be free on their face, but may encourage monetary tips from consumers to the vender. Some companies operating in this space include Brigit and Dave. Brigit has been used by one million people,²⁷ and Dave generated \$120 million in revenue in 2020.²⁸

Regulatory Framework, and Notable Enforcement Actions

As the use of fintech loan products becomes widespread, state and federal regulators are assessing to what extent these products and services are covered by existing consumer protection laws, including the Truth in Lending Act (TILA) and the Gramm-Leach-Bliley Act (GLBA).

¹⁹ See Finextra, [How Banks Can Ride the BNPL Trend](#) (Aug 24, 2021).

²⁰ U.S. Bureau of Labor, [Length of Pay Periods in the Current Employment Statistics Survey](#), (May 3, 2021).

²¹ Forbes, [Payday Loans vs. Cash Advance Loans: What To Know And How To Avoid Them](#) (Jul. 10, 2020).

²² Forbes, [How Earned Wage Access Can Upend Predatory Lending And Build Employee Financial Wellness](#) (Feb 5, 2021).

²³ Mercator Advisory, [On-Demand Earned Wage Access: U.S Vendor Comparison](#), (Apr. 17, 2020).

²⁴ KPMG, [Attention Payroll Leaders: COVID-19 Spurs Surge of Earned Wage Access Programs](#) (Dec. 2020).

²⁵ See CRS, [Overdraft: Payment Service or Small-Dollar Credit?](#) (Mar. 16, 2020).

²⁶ The New York Times, [Banks Slowly Offer Alternatives to Overdraft Fees, a Bane of Struggling Spenders](#) (Jun. 22, 2021).

²⁷ Brigit, [Brigit Announces \\$75M in Debt Financing from Social Impact Fund - CIM](#) (Apr. 28, 2021).

²⁸ SEC EDGAR Filing, [Transcript of the Discussion with Kyle Beilman, CFO of Dave, Inc.](#) (Sep. 10, 2021).

Enacted in 1968, TILA’s goal is to ensure that consumers are provided with meaningful disclosure of credit terms, among other things.²⁹ TILA is implemented by the CFPB through Regulation Z.³⁰ In general, TILA disclosure requirements apply to consumer credit that is subject to a finance charge or payable in more than four installments.³¹ Enacted in 1999, the GLBA provides a framework for regulating the privacy practices of financial institutions.³² This framework is built upon two pillars: (1) privacy standards that impose disclosure limitations on financial institutions concerning consumers’ information and (2) security standards that require institutions to implement certain practices to safeguard information from unauthorized access, use, and disclosure. GLBA applies to individuals who obtain financial products for personal, family, or household use from a financial institution. GLBA defines “financial institution” broadly as an institution that engages in financial activities.³³

In July 2021, the CFPB released a blog post that assessed risks of using BNPL products, and warned consumers not to overextend their finances.³⁴ Prior to that, in November 2020, the CFPB issued an advisory opinion that certain Earned Wage Access products that partner with an employer and do not charge consumers to use the product are not considered “credit” under TILA.³⁵ Following the advisory opinion, the CFPB provided PayActiv, an EWA company, a sandbox approval that allowed them to act in a safe harbor, shielding the company from liability relating to compliance with TILA, raising concerns from consumer protection advocates.³⁶

State regulators have also raised consumer protection concerns regarding these fintech products. In 2019, the New York Department of Financial Services led a multistate investigation into the EWA and Overdraft Avoidance space and whether these products should be subject to state lending laws, and whether fintechs offering these products engaged in illegal lending activities.³⁷ In 2021, the California Department of Financial Protection and Innovation (CA DFPI) issued memorandums of understanding with five EWA and overdraft avoidance companies.³⁸ The CA DFPI has also taken a number of actions against BNPL and released a legal opinion that BNPL products fall under the definition of loans and are required to be licensed as lenders.³⁹

Assessing Consumer Protection Concerns

While these emerging fintech lending products can provide access to credit or cash-flow flexibility to consumers who might not be able to obtain traditional bank credit at better terms,

²⁹ CFPB, [Annual Report on the Truth in Lending Act, the Electronic Fund Transfer Act, and the Credit Card Accountability Responsibility and Disclosure Act](#) (Dec. 18, 2019).

³⁰ 12 C.F.R. §1026; *see also* CFPB, [12 CFR Part 1026 – Truth in Lending \(Regulation Z\)](#).

³¹ *See* CFPB, [12 CFR Part 1026 – Truth in Lending \(Regulation Z\)](#), Comment 2(a)(10).

³² *See* CRS, [Big Data in Financial Services: Privacy and Security Regulation](#) (Nov. 15, 2019).

³³ GLBA relies on the Bank Holding Company Act of 1956 (12 U.S.C. §1843(k)) to define financial activities.

³⁴ CFPB, [Should you buy now and pay later?](#) (Jul. 6, 2021).

³⁵ CFPB, [Consumer Financial Protection Bureau Issues an Approval Order to Facilitate Employee Access to Earned but Unpaid Wages](#) (Dec. 30, 2020).

³⁶ Letter from 96 Consumer, Labor, Civil Rights, Legal Services, Faith Community and Financial Organizations and Academics to Rohit Chopra, CFPB Director, [Rescind Earned Wage Access Advisory Opinion and Sandbox Approval and Treat Fee-based Earned Wage Access Products as Credit](#) (Oct. 12, 2021).

³⁷ NYS Department of Financial Services, [Superintendent of Financial Services Linda A. Lacewell Leads Multistate Investigation of the Payroll Advance Industry](#) (Aug. 6, 2019).

³⁸ CA DFPI, [The DFPI Signs MOUs Believed to be Among the Nation’s First with Earned Wage Access Companies](#) (Jan. 27, 2021).

³⁹ CA DFPI, [DBO Denies Lending License Sought by Unregulated Point-of-Sale Financer and Issues Related Legal Opinion](#) (Dec. 30, 2019).

these products may also present risks to consumers. These risks can include (1) unsustainable debt; (2) lack of adequate consumer disclosure or notice; (3) consumer credit reporting; and (4) consumer data privacy, control, and security risks.

Although some cash flow products have low interest rates or fees, or only accrue charges when a consumer falls behind on repayment, consumers may face other negative consequences when using these fintech lending products. Often, a lender is not required to evaluate the consumer's ability to repay these products before issuing the financing.⁴⁰ Therefore, some consumers may accept the terms of an unsustainable debt without fully understanding the terms and consequences for late or nonpayment. For instance, although many BNPL companies do not charge interest or finance charges, BNPL product terms typically include late fees that can accrue over time.⁴¹ For earned wage access products, consumer advocates have shared concerns that, in addition to possibility that using these products can lead to unsustainable debt, they are not governed adequately under existing state usury laws, and do not need to comply with federal disclosure requirements that exist for other credit products.⁴² Similar concerns exist for overdraft avoidance products as well.⁴³

For some fintech cash flow products, TILA disclosure requirements may also not apply, depending on how the financial product is structured.⁴⁴ For those products with unclear disclosure regimes, there is a risk that consumers may not understand the terms of these products before they use them. In addition, some of these products might not have consumer protections similar to more traditional financial products. For example, BNPL products generally do not offer the same dispute protections as credit cards when the product that is purchased turns out to be faulty or part of a scam, with the consumer possibly still being held responsible for payment.⁴⁵

Since many of these fintech consumer products do not report consumers' payment information to the credit bureaus, consumers may miss out on the opportunity to build a credit history, particularly those who have a limited credit history and make their payments on time.⁴⁶ By contrast, consumers who fall behind on these cash flow product payments may see damage to their credit because debts in collection can be reported to consumer credit bureaus. For example, one study suggests that for consumers who have missed a BNPL payment, about three-quarters of those consumers have seen their credit score drop due to the missed payment.⁴⁷ And as these products may give companies access to sensitive consumer financial data, including shopping behavior, payroll information, or checking account information, such products also raise concerns about data privacy and consumer cybersecurity.⁴⁸

⁴⁰ World Bank, [Consumer Risks in Fintech New Manifestations of Consumer Risks and Emerging Regulatory Approaches](#) (Apr. 2021).

⁴¹ Consumer Reports, [The Hidden Risks of Buy-Now, Pay-Later Plans](#) (Feb. 14, 2021).

⁴² Letter from National Consumer Law Center and Center for Responsible Lending to California Department of Financial Protection and Innovation, [Proposed Rulemaking under the California Consumer Financial Protection Law: Earned Wage Access](#) (Mar. 15, 2021).

⁴³ *Id.*

⁴⁴ CFPB, [The Consumer Credit Card Market](#), at p. 165 (Sep. 2021).

⁴⁵ CFPB, [Should You Buy Now and Pay Later?](#) (Jul. 6, 2021).

⁴⁶ See CRS, [Consumer Credit Reporting, Credit Bureaus, Credit Scoring, and Related Policy Issues](#) (Oct. 15, 2020).

⁴⁷ Credit Karma, [72% of Americans saw their credit scores drop after missing a 'buy now, pay later' payment, survey finds](#) (Feb. 8, 2021).

⁴⁸ See Business Insider, [Why User Privacy Is Critical for Earned-Wage Access Adoption](#) (Nov. 19, 2020).

Appendix – Legislation

H.R. 4277, the Overdraft Protection Act of 2021 (Maloney) would strengthen protections and disclosures for consumers with respect to overdraft fees, under the Truth In Lending Act (TILA). It would limit the number of overdraft fees a bank may charge on a monthly and annual basis, prevent financial institutions from re-ordering transactions to increase overdraft fees, and codify Federal Reserve requiring financial institutions to provide consumers with the opportunity to opt-in to overdraft coverage for all transactions.