

# **Prepare Now or Pay Later: Heightened Regulatory Oversight for Buy-Now- Pay-Later Providers**



Buy-now-pay-later (BNPL), the latest point-of sale financing available to consumers, has experienced incredible new-user growth of 300% a year since 2018, as well as expanding market penetration.<sup>1</sup> The surge in usage of BNPL services has largely been driven by online shopping growth during the COVID-19 pandemic. Many online retailers are offering the BNPL payment option at checkout and new merchants are continuing to enter the market. This explosive growth in BNPL usage has the regulators' attention, and signs are pointing to increased regulatory oversight of BNPL providers.

## Background on BNPL

BNPL is a short-term line of credit offered to consumers at the point-of-sale, allowing consumers to make purchases with little to no money upfront and pay off the balance over a number of installments. BNPL credit is linked to a specific purchase rather than being a general line of credit.

According to a recent survey, consumers' most popular reason for using BNPL services is to avoid paying credit card interest, followed by the ability to make purchases that otherwise would not fit in their budget, and to borrow money without a credit check.<sup>2</sup>

There are different variations of BNPL, but one of the most common is a "Pay in 4" model, which divides a purchase into four equal installments with the first payment due immediately. In this situation, assuming installments are two weeks apart and payments are made on time, the consumer will have paid off the purchase in six weeks. Other variations of BNPL may have longer payment terms that stretch out as long as 60 months.

Given the variations available, as well as multiple potential due dates, managing BNPL purchases can be challenging for borrowers. If borrowers are not able to manage appropriately, this can potentially lead to additional late fees, rate increases, and credit reporting impacts.

The BNPL market is expected to grow **181% by 2024**, according to the 2021 Global Payments Report by Worldpay from FIS, a financial services technology group.<sup>3</sup> The same report found that BNPL accounted for **2.1% of global e-commerce transactions in 2020 (approximately \$97 billion)** and the figure is expected to double to **4.2% of global e-commerce sales by 2024**.



Merchants are interested in adopting BNPL programs and are willing to pay fees of 3% to 6% of the purchase price to the companies because consumers often buy more and spend more with BNPL. This is higher than the typical 2% transaction fees they pay to credit card companies, but the services likely enable them to attract new customers and close sales that otherwise might not happen.

1. Buy Now, Pay Later Puts a New Twist on Consumer Debt, January 13, 2022, <https://www.bloomberg.com/news/articles/2022-01-13/buy-now-pay-later-the-credit-card-alternative-to-put-a-twist-on-consumer-debt>.

2. Buy Now Pay Later Report: Market trends in the ecommerce financing, consumer credit, and BNPL industry; Insider Intelligence; November 09, 2021; <https://www.insiderintelligence.com/insights/buy-now-pay-later-ecommerce-financing-consumer-credit/>.

3. The Global Payments Report 2021, Worldpay from FIS, <https://worldpay.globalpaymentsreport.com/en/>.



## Rising Regulations

Until recently, the BNPL market was largely unregulated, aside from a few cases taken on by the California Department of Business Oversight (DBO). However, under the Biden administration and new Consumer Financial Protection Bureau (CFPB) Director Rohit Chopra, it is expected there will continue to be an increase in federal regulatory scrutiny and coordination with state regulators on fintech practices, including BNPL.

On December 16, 2021, the CFPB opened an inquiry into BNPL credit in a series of orders issued to five companies offering BNPL credit.<sup>4</sup> The CFPB plans to collect information on the benefits and risks of BNPL and report to the public about industry best practices and risks. The CFPB indicated it is concerned about accumulating debt, regulatory arbitrage, and data harvesting in a consumer credit market that is already quickly changing with technology.

The same day the CFPB issued those orders, they also posted a blog on their website titled, "Know Before You Buy (Now, Pay Later) This Holiday Season," which outlined the most common risks for consumers to be aware of before using a BNPL product.<sup>5</sup> The risks they outlined and discussed were as follows:

- BNPL products often carry fees
- Returning merchandise bought with BNPL products can be complicated
- BNPL products have fewer protections than credit cards
- Understand a BNPL product's impact on your credit scores
- Know before you buy (understand the risks and terms)

Prior to the CFPB's orders, some of the few other regulatory actions were from the California DBO, which had taken on a number of cases centering on BNPL services in early 2021. In one case involving an unidentified BNPL company, the DBO spoke specifically to the California Civil Code's definition of a loan, stating that it refers to "a contract by which one delivers a sum of money to another, and the latter agrees to return at a future time a sum equivalent to that which they borrowed." The definition is significant because if a BNPL company's services fit within this definition, they are regulated in the same way as a loan, and, thus, the company must have a California Financing Law license in order to legally carry out its operations. Due to most BNPL operations falling into this definition, many companies have started applying for the state license.

In another matter, the DBO reached a settlement with a provider in March 2021, accusing the BNPL leader of collecting fees from more than 640,000 Californians in so-called BNPL transactions that were actually "illegal loans." As a result of the settlement, the provider—which had 5.6 million active US users as of June 30—was required to refund \$900,000 to consumers and pay \$90,000 in administrative fees. A company spokeswoman stated in connection with the settlement that the provider "does not believe such an arrangement required a license from the DBO or was illegal, [but] has agreed to conduct its operations under the DBO license as a part of this settlement."<sup>6</sup>

Given the increased oversight and focus on technology companies, it will be prudent for BNPL service providers to understand the regulatory implications so they can be prepared for any potential regulatory inquiries, exams, or investigations.



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4. United States of America before the Consumer Financial Protection Bureau, December 16, 2021, [https://files.consumerfinance.gov/f/documents/cfpb\\_bnpl\\_sample-order\\_2021-12.pdf](https://files.consumerfinance.gov/f/documents/cfpb_bnpl_sample-order_2021-12.pdf).

5. Know Before You Buy (Now, Pay Later) This Holiday Season, Andrew Braden, CFPB; December 16, 2021, <https://www.consumerfinance.gov/about-us/blog/know-before-you-buy-now-pay-later-this-holiday-season/>.

6. As Buy Now, Pay Later Services Gain Steam, Regulators Are Paying Attention, The Fashion Law, December 20, 2020, <https://www.thefashionlaw.com/as-buy-now-pay-later-services-gain-steam-regulators-are-paying-attention/>.

## Considerations for BNPL Providers

Due to the nature of BNPL lending, there are several risk and compliance considerations that may or may not impact the product, depending on how the federal and state agencies label the transaction, i.e., credit facility, personal loan, payday loan. BNPL providers should consider the following areas of potential regulatory focus:

### Marketing and Communications

- Communications and disclosures should be clear about fees, interest, and return policies.
- Consumer consent may be necessary in certain situations (e.g., text messaging or electronic signatures).
- Adverse action notices should be considered.

### Originations

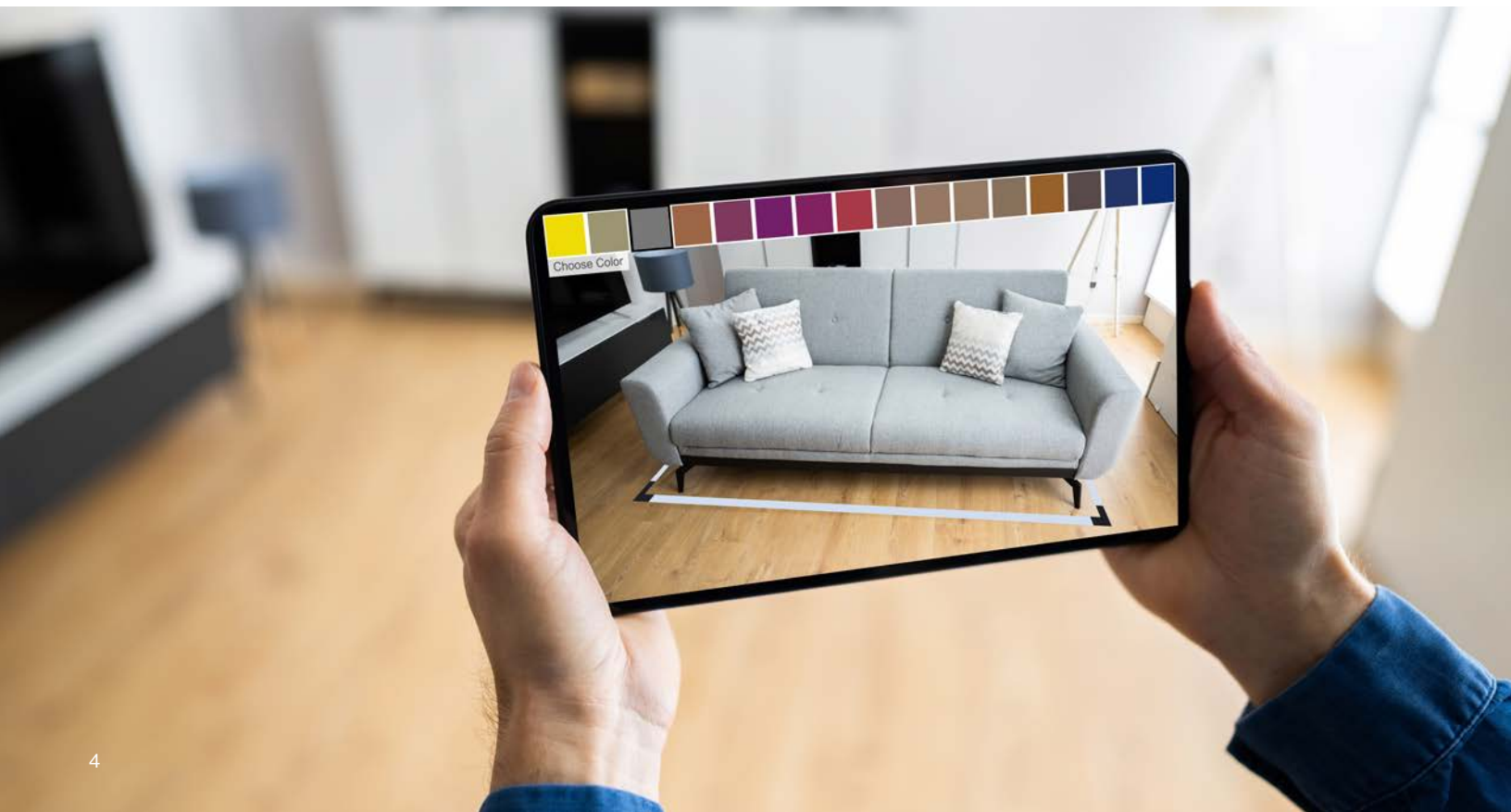
- Policies, as well as application screening and underwriting processes and procedures, should be reviewed, particularly in light of the heightened fair lending focus, including use of AI and machine learning.
- New provisions under the Payday Rule may be applicable to some products.

### Servicing

- Policies and procedures should also be reviewed from a fair servicing perspective.
- Privacy and security should be considered when sharing data with third parties.
- Credit reporting should be completed in line with any updated credit bureau reporting standards.

### Third-Party/Vendor Management

- Upfront due diligence on third parties will continue to be important (e.g., contact centers, data hosting, debt collections).
- Information provided to third parties should be closely monitored.
- Debt collection practices should be considered, including any implications of using third-party debt collectors.



## Recommendations in Preparation of Reviews

Guidehouse has valuable insight and perspective as BNPL providers begin or continue to update their Compliance Management Systems, including policies, procedures, systems, and processes to prepare for increased federal and state regulatory activity. We have significant experience advising financial institutions on the evolving regulatory landscape to help ensure that our clients are on the forefront of industry best practices and are prepared for potential investigations.

While this is not an all-encompassing list, we have identified a few areas for consideration and some of our related recommendations below.

Areas of Consideration	Recommendations
<b>Risk Management</b>	<ul style="list-style-type: none"> <li>✓ Conduct risk assessment to identify potential gaps</li> </ul>
<b>Legal Repository</b>	<ul style="list-style-type: none"> <li>✓ Identify and obtain relevant rules, and distill this information into distinct requirements</li> </ul>
<b>Policies and Procedures</b>	<ul style="list-style-type: none"> <li>✓ Update policies, procedures, job aids, checklists, templates, etc., based on requirements</li> </ul>
<b>Systems, Processes, and Controls</b>	<ul style="list-style-type: none"> <li>✓ Enhance systems and processes to account for the requirements</li> <li>✓ Implement new controls to monitor these updated systems and processes</li> </ul>
<b>Communications</b>	<ul style="list-style-type: none"> <li>✓ Update internal and external communications</li> </ul>
<b>Complaints Management</b>	<ul style="list-style-type: none"> <li>✓ Establish complaints review process, including root cause analysis; adjust communications to reflect trends as needed</li> </ul>
<b>Training</b>	<ul style="list-style-type: none"> <li>✓ Upgrade training materials in response to specific requirements</li> <li>✓ Conduct training to evidence business enhancement and subject matter expert qualification</li> </ul>
<b>Monitoring</b>	<ul style="list-style-type: none"> <li>✓ Expand first-, second-, and third-line-of-defense testing related to requirements</li> <li>✓ Establish a recurring reconciliation/verification process to review requirements, and update related policies, procedures, systems, and processes as necessary</li> </ul>

### How Guidehouse Can Help

Guidehouse is regularly engaged in working with clients that operate in the dynamic world of credit, to prepare for regulatory scrutiny and identify operations improvement opportunities.

We are here to help your team as you are preparing for the changing landscape and look to ensure your operations are in place to scale the business effectively and efficiently. Some of the ways our team is assisting clients in the current environment are:



- Conducting end-to-end risk assessments.
- Drafting/updating policies and procedures.
- Developing/enhancing processes and controls.
- Reviewing/improving compliance monitoring and testing programs.
- Compliance testing.
- System implementation support.
- Due diligence reviews, to include partnerships and third-party risk management.
- Regulatory preparation and response.
- Remediation support.



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### About Guidehouse

Guidehouse is a leading global provider of consulting services to the public sector and commercial markets, with broad capabilities in management, technology, and risk consulting. By combining our public and private sector expertise, we help clients address their most complex challenges and navigate significant regulatory pressures focusing on transformational change, business resiliency, and technology-driven innovation. Across a range of advisory, consulting, outsourcing, and digital services, we create scalable, innovative solutions that help our clients outwit complexity and position them for future growth and success. The company has more than 12,000 professionals in over 50 locations globally. Guidehouse is a Veritas Capital portfolio company, led by seasoned professionals with proven and diverse expertise in traditional and emerging technologies, markets, and agenda-setting issues driving national and global economies. For more information, please visit: [www.guidehouse.com](https://www.guidehouse.com).

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