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PAYMENTS

What card issuers can learn from CFPB's buy now/pay later inquiry

The Consumer Financial Protection Bureau's recently announced inquiry into the operations of buy now/pay later fintechs raises many questions about how the rapidly growing industry's policies affect overall consumer debt.

But the CFPB's probe could also end up spotlighting the very reasons consumers have flocked to simpler BNPL loans over the last few years, putting pressure on credit card issuers to modernize their own products.

"Shining a light on the BNPL industry's practices will show that in most cases the BNPL borrowing model is a precision instrument that's much safer for everyone than the open-ended credit card model," said Brian Shniderman, U.S. CEO and global chief strategy officer at Opy, the U.S.-based subsidiary of BNPL fintech Openpay Group, founded in Australia in 2013.

Opy, which launched in the U.S. in October, aimed to cover its bets with regulators by hiring longtime CFPB executive Gary Stein as Opy's chief product and compliance officer. Stein was at the CFPB for more than nine years, rising to deputy assistant director in the office of consumer credit, payment and deposit markets, before joining Opy in January 2021.

Marcial Tal of Tal Solutions LLC (left) and Brian Shniderman, U.S. CEO of Opy. "The BNPL borrowing model is a precision instrument," Shniderman said.

Stein predicts that despite the current “land grab” atmosphere right now in the BNPL industry — a rush of players into the market that's fueling innovation and growth — the CFPB’s inquiry will likely result in greater transparency for consumers and merchants about how the product can affect credit and debt. In the long run, such reforms could accelerate the loan category's growth, he said.

"The BNPL market is becoming increasingly competitive, forcing discipline on all our [partners and competitors]," Stein said.

Opy partners with Cross River Bank to originate loans, and offers a wide range of installment options of up to 24 months with fixed-fee pricing at merchants' online and in-store checkouts, versus many fintech-based BNPL loans that are interest-free with no fees if consumers repay installments on time.

The CFPB has asked BNPL giants Affirm, Afterpay, Klarna, PayPal and Zip to answer questions about whether individual BNPL borrowers’ transactions are limited by number or dollar amount; what happens when borrowers miss payments; when their payments are declined for lack of funds; and how BNPL providers use or monetize consumer data associated with the loans. The data is due to the CFPB on March 1, according to the order.

“The CFPB’s inquiry wasn’t unexpected, given the sudden rise of these financial products, and clearly they’re worried about how BNPL may affect consumers’ overall debt. When you run out of money, if you can’t pay a BNPL bill, you can’t pay your other bills,” said Kali Bracey, a partner in the Washington, D.C. office of Jenner & Block, who co-chairs the firm’s consumer law and state enforcement and regulation practices.

Beginning around the first quarter of 2021, consumer complaints to the CFPB about certain BNPL companies rose “like a hockey stick,” according to Marcia Tal, founder and CEO of Tal Solutions LLC, a New York-based firm that independently tracks trends within the CFPB’s consumer complaint database available online to the public.

"The CFPB doesn't have a category yet for tracking all BNPL loan complaints, but using keyword searches for BNPL companies, I started to notice a rise in complaints about these loans around fees people didn't understand, and complications around returning merchandise," Tal said.

But the overall magnitude of complaints is still relatively minor, given the rapid recent expansion of U.S. BNPL lending, according to Tal.

The dominant fintech BNPL lending model in the U.S. enables merchants to perform quick vetting before they offer customers interest-free installment loans at the point of sale. BNPL providers do a rapid survey of available credit information to qualify buyers for a closed-end loan with payments usually spread out over a few months. Merchants pay BNPL fintechs a fee for each loan resulting in a sale..

One thing the CFPB is likely to discover in its inquiry is a lack of consistency in how different BNPL firms handle delinquencies, with some providers charging late fees and others blocking further purchases if a customer misses a payment.

Consumer credit bureau Equifax said it plans to add surveillance of BNPL loan credit risk this year, but currently companies granting credit have little insight into how many consumers already have outstanding BNPL loans.

Several credit card issuers have responded to the evolution of the BNPL industry by adding installment loan options to consumers' existing credit card accounts.

American Express, Citigroup, JPMorgan Chase, Barclays and U.S. Bank each give consumers the opportunity to convert recent purchases into installment loans by clicking on the transaction within the credit card account online or via a mobile app.

One example is Barclays' Easy Pay plan introduced in September 2020, which invites customers to go online or through their card's mobile app and convert any individual credit card purchase over $100 into an installment loan, making an equal number of payments over six to 36 months at interest rates lower than the account's basic APR.

Citi, which introduced its Citi Flex Pay and Flex Loan installment option in 2019, saw demand for this type of loan rise 22% during the quarter ended Sept. 30, 2021 compared to a year earlier, a spokesperson said.

In a study Citi fielded with Harris Poll in August 2021 among 2,000 U.S. adults, one in four consumers said they would prefer to use a BNPL service from a traditional bank, the spokesperson said.

But restructuring finance terms for individual purchases requires several steps and takes place after the purchase, weakening the merchant's ability to directly promote deals at the point of sale, Opy's Stein said.

"Merchants like how BNPL loans influence the consumer's shopping behavior in the moment," he said.

To close that gap, many credit card issuers are moving instant credit offers directly to the point of sale and online checkout. Visa Installments, currently in pilot, aims to help banks accomplish this, along with Mastercard Installments, which is set to roll out this year.

In other developments, Discover teamed with Sezzle and Alliance Data Systems purchased Bread last year. Both payment companies plan to use those channels to significantly expand instant loans offered at the point of sale this year.

Amex last month announced a partnership with Opy that will add Amex as an instant financing option at the point of sale in the health care and automotive sectors. Stein said Opy is in discussions with "several major banks" looking to use Opy's application programming interfaces and other technology to bring instant financing options directly to merchants' checkouts.

“A big chunk of the U.S. population is happy with credit cards, and half of them revolve balances and the other half pay off their bills every month, but the fastest-growing group wants an option to finance purchases at the point of sale with BNPL loans, and credit card issuers are seeing that and responding to it,” Stein said.