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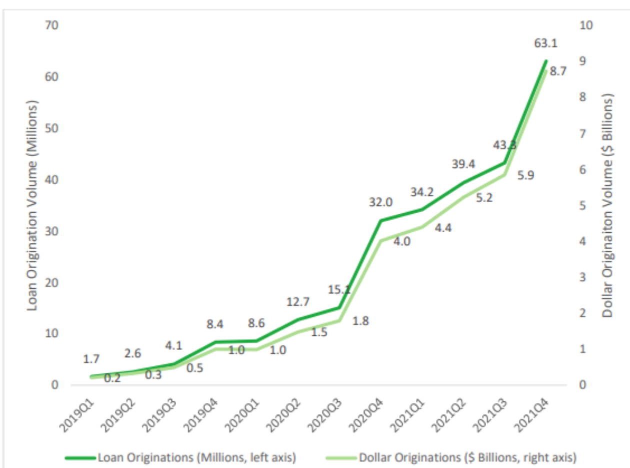
Rapidly Growing "Buy Now, Pay Later" (BNPL) Financing: Market Developments and Policy Issues

"Buy now, pay later" (BNPL) is a form of point-of-sales financing. With BNPL financing, a consumer can purchase an item now and pay for it later on a predetermined payment schedule. While retailers have offered BNPL financing for much of history in the form of installment plans, it is now often offered online. This modern form has generally been developed by technology-focused, nonbank financial companies, also known as financial technology (or "fintech") companies.

BNPL financing has been growing rapidly in recent years. The Consumer Financial Protection Bureau (CFPB) estimated that the number of BNPL originations (new financing offerings) by five major providers grew nearly tenfold from 2019 to 2021 with 180 million originations in 2021 totaling $24.2 billion (see **Figure 1**). Research by the CFPB found that 17% of consumers surveyed used BNPL between February 2021 and February 2022.

Figure 1. BNPL Originations by Quarter: 2019-2021



Source: CFPB.

This In Focus discusses the BNPL financing and potential policy issues in this market. The CFPB released an interpretive rule in May 2024—in effect as of July 30, 2024—that treats BNPL as equivalent in some ways to a credit card and mandates Truth in Lending Act (TILA; 15 U.S.C. §§1601 et seq.) disclosures and the right to dispute charges. Legislation introduced in the 118th Congress would overturn the rule using the Congressional Review Act (H.J.Res. 190 and H.J.Res. 195) or mandate further study before rule finalization (H.R. 8628).

The BNPL Financing Market

BNPL financing allows consumers to pay for purchases in payments over time, generally without accruing interest. For example, BNPL financing services typically offer "Pay in 4" programs, which require four installment payments in four two-week intervals. BNPL companies can also offer financing over various terms. These other options, particularly for more expensive products, require monthly payments. Monthly options, which can last up to 60 months depending on the provider, may also charge interest. These monthly options are generally already covered by TILA, as they typically require more than four installments and are more facially similar to a consumer loan.

BNPL financing may help consumers with their personal cash flow. Compared to other traditional financial products (e.g., credit cards), BNPL financing is often lower cost and arguably more flexible. BNPL financing may be attractive to younger consumers and those with thinner credit files who may not qualify for traditional credit cards. A consumer may use BNPL financing through a merchant that embeds it as a payment option in the checkout process or directly on BNPL companies' platforms. BNPL companies determine consumer terms through soft credit checks and consumers' past performances on those platforms.

While BNPL companies generally do not charge interest or fees at time of purchase for their Pay in 4 products, they generally charge late fees if customers do not make payment on time and other fees like processing BNPL payments by card. BNPL financing services earn much of their revenue by charging merchants, who are willing to pay to attract new consumers to their merchandise and may also be able to mark up the prices of their products to cover these costs. While some BNPL companies operate independently, others work with banks for origination.

Companies operating in the BNPL space are generally nonbank financial companies such as Klarna, Afterpay, Affirm, Splitit, and Sezzle. Some BNPL companies attained high market valuations in late 2021, but since then, the market experienced a significant drop in market capitalization, and various companies are significantly below their 2021 peaks. The COVID-19 pandemic provided a ripe environment for e-commerce facilitated by BNPL. Now, consumers face inflation and higher interest rates, and BNPL providers are experiencing greater regulatory scrutiny and competition from banks.

Selected Policy Issues

At the federal level, the CFPB has regulatory and supervisory authority in certain nonbank consumer financial markets. While BNPL financing can provide some payment flexibility to consumers, it may pose some consumer protection risks that the CFPB focused on in its recent rule.

Consumer Disclosure and Protections

There is debate over whether BNPL financing should be subject to disclosure and other requirements under TILA and its implementing regulation, Regulation Z. In May 2024, the CFPB issued an interpretative rule, which expanded "the term *credit cards* to include such digital credit devices [including BNPL] for purposes of TILA and Regulation Z." The CFPB justifies this decision by arguing that digital BNPL accounts "mimic conventional credit cards" when merchants offer them as single-use virtual cards or as a payment option on their websites. Therefore, BNPL providers must provide TILA disclosures of credit terms and must allow a consumer to dispute charges and to demand a refund after returning a product purchased with BNPL.

Some argue that BNPLs and credit cards are a mismatched comparison. They note, for example, that BNPL products are generally short-term, interest-free options and do not *revolve* (meaning, they are not lines of credit available for other purchases). BNPL is underwritten for each transaction, as opposed to credit cards, which are underwritten at the time of account opening. In previous research, the CFPB referenced BNPL as "a popular alternative to credit cards." Others argue that the additional TILA requirement was unnecessary because industry has already implemented many of these protections, including the ability to dispute charges and disclosures on the cost of credit. According to research by the Financial Health Network, 99% of users understood the terms and conditions associated with BNPL.

The CFPB had an expedited 60-day implementation timeline for its rule, which PayPal argued "does not provide BNPL lenders an adequate amount of time to come into compliance." In response to the CFPB rule, Representative Byron Donalds introduced H.R. 8628, which seeks to delay issuing new BNPL rules until the CFPB and the Comptroller General conduct further study. Representative Gary Palmer and Representative Donalds also introduced H.J.Res. 190 and H.J.Res. 195, respectively, which would use the Congressional Review Act to disapprove the rule.

Debt Risks

Although many BNPL financing services have no initial interest or fees, consumers could face accruing charges or interest when repayment is late. Some studies suggest that a high number of consumers miss BNPL payments. For example, a CFPB survey found that in 2021 more than 10% of BNPL consumers were charged late fees. Other research by Harvard Business School found that after starting BNPL, consumers had a higher likelihood of overdraft and lower checking account balances driven by BNPL-driven spending.

BNPL finance charges are still generally lower than those for credit cards and other products such as payday loans. According to the Financial Technology Association, BNPL products have lower delinquency rates (2%) than traditional credit cards (9%).

The CFPB argued that BNPL financing is closed-end credit such that the ability-to-repay regulation or other penalty fee requirements for credit cards under the Credit CARD Act of 2009 (P.L. 111-24) are not applicable. BNPL is not subject to these requirements, because it is considered closed-end, generally paid in four or fewer installments without interest or other finance charges. Part of H.R. 1188—a broader bill that would create a task force to protect members of the military, veterans, and their families from financial fraud—would also require the task force to study the financial risks of BNPL and other emerging financial technologies.

Consumer Credit Reporting

According to Harvard Business School research, of five major BNPL providers, two report positive payment information to credit bureaus, and four report negative payment information. Some consumers, therefore, might miss out on the opportunity to build credit histories, particularly those who pay their BNPL financing on time and have thinner credit histories. By contrast, consumers are more likely to damage their credit scores if they become delinquent on their BNPL payments, because debts in collection can be reported to consumer credit bureaus. One study by Credit Karma finds that almost three-quarters of consumers who have missed BNPL payments report credit score declines due to their late payments.

Consumer Data Privacy, Control, and Security

BNPL financing services often access sensitive consumer data, such as consumer shopping behavior, which may introduce privacy and cybersecurity concerns. Consumers may not understand how companies are using their data and may have little ability to control or correct it.

CRS Resources

CRS In Focus IF10513, *Financial Innovation: "Fintech"*, by David W. Perkins

CRS In Focus IF11460, *Overdraft: Payment Service or Small-Dollar Credit?*, by Andrew P. Scott

CRS In Focus IF12727, *Earned Wage Access Products*, by Paul Tierno and Karl E. Schneider

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