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Policy Brief

Buy Now Pay Later

Executive Summary:

- Buy Now Pay Later (BNPL) products have skyrocketed in use since the pandemic, in part due to marketing that brands BNPL as a safe and fee-free form of credit.
- Despite marketing promises, BNPL products do carry risks for consumers, as can be seen in the way they incentivize outsized spending, fail to protect consumers from fraud, and interact with existing financial products such as credit scores and overdraft fees in ways that are not explicitly communicated to consumers.
- Regulation at state or federal level, however, struggles to handle this new financial product that deftly skirts the legal definitions of "creditor" and that differs from existing lending products such as credit cards and layaway loans.
- Increasing state and federal regulations of this booming industry, particularly by requiring lending licenses of firms and closing legal loopholes to apply existing federal regulations such as Truth in Lending Act, would protect consumers from present harms.
- Ultimately, policymakers should refine existing legal structures to fully capture products like Buy Now Pay Later that are, in essence, loans, to both provide transparency and promote responsible lending and borrowing.

Introduction to Buy Now Pay Later

After widespread use during the pandemic, Buy Now Pay Later (BNPL) has become increasingly integrated into online markets, offering consumers a partial payment structure. Most commonly, payment plans follow a "four payments in six weeks" model, requiring a quarter of the purchase to be paid up front, followed by three subsequent installments two weeks apart.[1] Other than its payment timeline, what sets BNPL apart from traditional creditors is its accessibility: the majority of BNPL lenders say they only conduct "soft" credit checks, meaning that there is no impact on potential buyers if rejected for the credit line.[2] BNPL lenders partner with shopping apps, so that individuals can see as they shop whether or not they would be approved for a credit line.[3] The first opportunity for BNPL presents itself before purchase: when deciding to buy a certain good or not, websites have colorful and eye-catching stickers that inform users if the purchase is eligible for BNPL partnership.[4] The second moment when individuals can choose to pay with BNPL is at checkout, when consumers are reminded of how much credit they could access if they ran a soft credit check with a BNPL lender and made an account.[5] Accounts can then be used to shop directly through the lender on apps and web pages with a virtual wallet letting consumers know how much they can spend. This partnership allows BNPL lenders to draw as much as 61% of revenue from retailers for sales, and merchants to expand their markets by selling to consumers who might not otherwise have the capacity to pay upfront.[6]

The perceived lack of cost and risk has led to surging use of BNPL as a payment method: while Americans spent $2 billion through BNPL on purchases in 2019, they used BNPL for $24.2 billion of purchases in 2021, amounting to a 1,092 percent increase.[7] The industry grew even more in 2023, with a record $16.6 billion being spent by consumers through BNPL during the holiday season alone (a $2.2 billion increase from the 2022 holiday season).[8] While few can dispute the rapid propagation of BNPL, its rapid surge into the market raises ethical and logistical policy issues around intervention in this exploding market.[9]

Benefits of BNPL:

BNPL holds two key benefits for consumers: allowing for consumption-smoothing, and increasing credit access for those who might otherwise be excluded.[10] The former of these benefits is relatively straightforward and uncontested, as allowing individuals to make payments over time rather than instantly means that individuals with fluctuating liquidity levels can break larger purchases into smaller chunks.[11] To buy groceries, a refurbished cell phone, or any other purchase, paying with a debit card requires having the amount to cover the purchase in a bank account, while paying with a credit card requires having a credit card with enough credit. BNPL allows individuals without this liquidity to purchase the goods they need in the time they need them–with the understanding it will be repaid. Indeed, as Table 1 reflects, the first and second most popular reasons for using BNPL use pertain to its capacity to easily pay later, as 54 percent of consumers pay with BNPL to afford their purchase, and 88 percent cite the spread-out nature of payments as the attractive feature of this lending. This use of BNPL to afford larger payments that might not otherwise be feasible is also apparent in open-ended responses to questions about why individuals use BNPL, particularly for low-income individuals.[12]

Table 1: Reasons for Using BNPL By Individuals' Earnings

Reason for Usage	*Less than $25,000*	*$25,000 to $49,999*	*$50,000 to $99,999*	*$100,000 or more*	*Total Population*
Avoid Interest	51%	56%	62%	72%	59%
Spread Out Payments	81%	91%	93%	90%	88%
Fixed Payment Number	49%	50%	44%	42%	46%
Convenience	81%	86%	83%	81%	83%
Only Way to Afford	68%	63%	51%	30%	54%
Only Accepted Payment Available	32%	16%	15%	10%	20%
Didn't Want to Use Credit Card	46%	59%	59%	57%	54%

Source: Author's calculations from the New York Federal Reserve Board's 2022 Survey of Household Economics and Decision-making

The second reason for the popularity of BNPL pertains to the credit market, both in its exclusionary practices and penalties for usage. Unlike traditional credit cards, BNPL lenders do not run hard credit checks on consumers (a fact that they heavily advertise), meaning that consumers' credit scores won't be damaged in the process of applying. BNPL lenders often advertise their credit as a "safe" way to build up a credit score, even though most do not submit positive reports to credit bureaus.[13] The perceived safety of BNPL as a credit form is borne out in the data: Table 1 indicates 54 percent of BNPL users use this payment method explicitly to avoid credit card use. Despite being a factor in usage, however, credit access does not drive BNPL's popularity; Table 2, demonstrating financial and demographic characteristics of BNPL users when compared to non-BNPL users, indicates that both consumers and non-consumers of BNPL have roughly the same access to credit cards. Indeed, the average BNPL user uses credit cards at higher rates than individuals who don't use BNPL.

Table 2: Characteristics of BNPL Users and Non-Users

	Non-Users of BNPL	Users of BNPL	Difference
Individual Characteristics			
Age	52.76	45.51	-7.25
Gender	0.52	0.42	0.1
Educational Level	3.28	3.05	-0.23
Financial Characteristics			
Average Income Level	2.68	2.37	-0.31
Have At Least One Credit Card	0.86	0.85	-0.01
Able to Pay All Bills This Month	0.86	0.64	-0.22
Confidence in Credit Card Approval	3.45	2.87	-0.58
Have Emergency Savings	0.61	0.34	-0.27

Source: Author's calculations from the New York Federal Reserve Board's 2022 Survey of Household Economics and Decision-making
Note: Education level is represented on a scale of one (no high school diploma or GED) to five (Master's Degree or higher). Gender is represented as a binary where zero represents female and one represents male. Average income level is represented on a four-point scale (Less than $25,000; $25,000-$49,999; $50,000-$99,999; $100,000 or more). Confidence in the credit approval process has been reported on a four-point scale from one (not confident) to four (very confident) with individuals responding as not sure included with those not confident. Capacity to pay all bills in the month and ownership of a credit card are both binary with zero representing a negative answer and one representing a positive answer. BNPL-users are defined as those who have used the service within the past year.

While BNPL financing doesn't necessarily expand access to the credit market, it does differentiate who is offered access to credit. BNPL firms will offer payment options to individuals even if they have a poor credit history, allowing consumers with credit scores below 620–a threshold below which few credit cards will lend to–to access pay-later financing as a pseudo-credit.[14] The largest financial difference indicated within Table 2 between the populations appears to come from financial stability, as BNPL users have lower ability to pay their monthly bills, lower confidence in credit card approval processes, and typically do not have access to emergency savings. This suggests that instead of providing credit to those who would otherwise lack it, BNPL provides an alternative and potentially cheaper access to credit: the Consumer Financial Protection Bureau estimates that APR for BNPL borrowers' credit lines would have been approximately 22 to 24 percent.[15]

The choice to expand access to the credit market may not be as altruistic as it seems, however, with a notable increase in marketing offers specifically for individuals with low credit scores when compared to those with high credit scores. Individuals who had been rejected for credit or had missed a loan payment also reported being offered BNPL at a higher rate, suggesting an audience-targeting.[16] Part of the incentive for this extension of BNPL credit likely comes from the desire to increase consumption of a product by those who might not otherwise be able to afford it. As reported in Table 1, individuals earning less than $49,999 report using BNPL because it was the only way to afford something at twice the rate of those earning above $100,000.

Risks and the Underbelly of BNPL:

As with all financial products, the benefits do not come without risks. The largest issue with BNPL arises from its interactions with traditional credit and financial markets. Most BNPL lenders require autopay to be turned on for debit card payments, and missing a payment is costly. In addition to whatever late fee is charged by the BNPL provider (these vary by firm and can be as high as 25 percent of the purchase amount or a $7 flat rate),[17] banks charge overdraft fees on autopay bills (including BNPL), meaning that forgetting a payment date and spending the money elsewhere can lead to racking up bank fees.[18] The five largest BNPL providers all re-present bounced payments to the account, with some trying as many as eight times in a row to extract payment from the bank account despite insufficient funds.[19] This can lead to multiple overdraft or NSF charges from banks as the payment is tried and declined repeatedly. While it is difficult to tease out the causality of overdraft fees, multiple studies confirm that BNPL users are more likely than non-BNPL users to have overdraft fees.[20]

Beyond incurring unexpected overdraft and NSF fees from banks, BNPL also has the potential to trigger a decline in credit score that can be a surprise for users. While BNPL lenders market themselves as risk-free alternatives to credit, failure to repay a BNPL loan results in the debt being sent to collections, at which point it harms consumers' credit scores.[21] Missing a payment can harm customer's credit scores, with 72 percent of BNPL users who failed to make a payment reporting a subsequent decline in their credit score.[22] The intensive marketing around branding BNPL as a safe credit alternative, however, means that many users do not fully internalize the risk they take in signing up for the interest-free loans.[23]

Even in cases where late payments and overdraft fees aren't an issue (i.e. an individual has sufficient funds for their purchase), the autopay mandate for debit cards removes the element of choice from consumers when faced with unexpected costs.[24] If an individual purchased something and then disputed or tried to return it, which can be a long and arduous process, they are still responsible for maintaining autopay payments, which might prove problematic if they have competing simultaneous costs.[25] Paying for utilities, daily transit, and medical treatment would likely rank higher for individuals than a purchase that they have either tried to return or realized they can't afford, but autopay means that none of these categories can be prioritized over what could have been an impulsive purchase.

The use of autopay for future payments combined with the minimal upfront cost also exploits temporal discounting—an innate bias in humans' perception of time that prioritizes present pleasure over future potential pain.[26] Because payments seem far off and present loss (expenditure) is limited, consumers overspend. In a survey by Lending Tree, 70 percent of BNPL consumers report spending more than they would not have spent without access to a BNPL payment structure.[27] Additionally, as reflected in Table 1, 54 percent of users cite using BNPL because it was the only way they could afford something. The nature of this overspending results in a purchase amount increase of 20 percent, compared to individuals without the option of paying with BNPL.[28] Instead of being a one-time consumption boost, the consumption alteration sticks if BNPL remains an option for payment, creating a bubble of consumers within the future-oriented pattern of BNPL repayment. This constitutes irresponsible lending on the part of BNPL firms, who don't offer a centralized, tracked repayment system, and who refer loans to debt collectors after failure to repay.[29]

Because BNPL transactions can be done either through the merchants (i.e. when buying a specific product) or through the lender directly (i.e. shopping through a company such as Klarna), users quickly find themselves pulled into the world of data generation.[30] Unlike other financial products which might have access to information on how you spend money, BNPL providers also have a direct incentive and means to influence that, selling data and advertising slots on their shopping platforms.[31] Users' data, both on and off BNPL shopping websites, also impacts the amount of BNPL "credit" available to spend on purchases, with consumers complaining about spontaneous and unexplained changes to the amount of BNPL credit they were previously approved for.[32]

Exacerbating the economic underbelly of BNPL is this impending uncertainty derived from ignorance and confusion around its usage, laws, and capabilities. When surveyed, 73% of BNPL users equated BNPL to credit cards and installment loans, both of which are financial products subject to more regulation. Users of BNPL also scored an average of 0.29 out of five when answering true/false questions about the rights and capabilities of BNPL, indicating a low level of consumer awareness around BNPL.[33] Table 3, reflecting the top five reasons people complained to the Consumer Financial Protection Bureau about five BNPL firms (Sezzle, Afterpay, Affirm, Klarna, and Quadpay) by issue, product, and sub-product reflects an organized chaos as consumers struggle to categorize BNPL. When filing complaints about BNPL, the fourth highest subproduct individuals reported difficulties with was "I don't know" (7.73 percent), indicating confusion as to what exactly these services are categorized as. Product categorization of BNPL was equally confusing for consumers, as responses ranged from "Payday loan, title loan, personal loan, or advance loan" (23.78 percent) to "Credit Card or Prepaid Card" (8.93 percent), indicating the lack of consensus or clarity around what BNPL is considered.

Table 3: Top Five Issues, Products, Sub-Products Associated with BNPL Firm Complaints Reported to the CFPB for Sezzle, Afterpay, Affirm, Klarna, and Quadpay		
	Frequency Reported	*Percent of Reports*
Issue Reported:		
Credit Report	1712	40.0%
Debt Collection and Related Practices	723	16.9%
Repayment Practices	339	7.9%
BNPL Credit Denial/Reduction	253	5.9%
Identity Theft/Fraud	238	5.6%
Product (of Issue)		
Credit reporting or other personal consumer reports	1755	41.0%
Payday loan, title loan, personal loan, or advance loan	1017	23.8%
Debt collection	918	21.5%
Credit Card or Prepaid Card	382	8.9%
Money transfer, virtual currency, or money service	120	2.8%
Sub-Product		
Credit Reporting	1725	40.3%
Installment Loan	764	17.9%
Other Debt	379	8.9%
"I Do Not Know"	331	7.7%
General-purpose credit card or charge card	256	6.0%

Source: Author's calculations from Consumer Financial Protection Bureau complaints portal data.

Beyond confusion about what the product itself is, consumers lack awareness around its potential impacts. Nearly one in three (30%) of BNPL users reported being unaware of the fee and penalty structure held by their BNPL firm, and one in four (25%) reported being unsure of the impact that BNPL would have on their credit score.[34] Table 3 shows around 40 percent in each category of complaint (issue, product, and subproduct) is about BNPL credit report issues. This confusion is not the fault of consumers: BNPL marketing in many ways perpetuates confusing narratives. Concepts of sustainability, fairness, and equitability are used by BNPL lenders to position themselves as healthy and consumer-empowering alternatives to traditional credit.[35]

Regulation of Buy Now Pay Later

Current Federal Oversight of BNPL:

As the BNPL market blossoms, several gaps in oversight rise to the fore, including within one of America's largest consumer protections laws. The Truth in Lending Act (TILA), established in 1968, mandates that lenders (including credit card companies) clearly disclose the terms of lending, specifically to prevent the exploitation of consumers in a jargon-heavy industry and to allow them to compare different financial products. Crucially, lenders with repayment plans involving less than or equal to four installments are exempted from the TILA, as are lenders who do not charge repayment fees (such as interest or service charges). Because of the short time frame of BNPL and its lack of additional upfront cost, lenders can avoid falling under this regulation.[36]

While BNPL lenders can dodge regulation from the TILA, they still fall under the jurisdiction of the Unfair, Deceptive or Abusive Acts or Practices (UDAAP) clause of the Dodd Frank Act. This legislation was designed following the stock market crash of 2008 to prevent financial lenders from engaging in manipulative behaviors to trick consumers into signing up for financial products that were really against their best interests. Though this applies to BNPL lenders, it is up to the Consumer Financial Protection Bureau (CFPB) to enforce this and to outline what actions would constitute violations of UDAAP.

Like consumer confusion, the largest issue with the federal enforcement and regulation of BNPL lies in the chaotic misunderstanding, misinterpretation, and mis-equation of BNPL that creates a patchwork frame of legal oversight rather than a unified front. Because BNPL providers can set their own rules and policies, it becomes hard to regulate an industry norm when there isn't one. Misinterpretation arises when entities like the CFPB seek to understand and potentially regulate BNPL according to the same rules as credit cards, a mismatch as the BNPL market integrates with consumption habits in ways that credit cards don't.[37]

Current Indiana Oversight of BNPL:

Even though 321 websites integrate Klarna, one of the most-used BNPL firms, as a payment method within Indiana,[38] and that data on the Indianapolis users of BNPL can be purchased online,[39] the state legislature has yet to enact any BNPL-specific legislation. This contrasts with the 14 states (as of 2023) that enacted installment lender license requirements for BNPL firms,[40] the beginnings of much-needed regulation in an industry that otherwise faces little accountability.

Policy Recommendations:

State Level:

Installment Lending Licenses: Already, 14 states across the country and across partisan lines (California, Georgia, Hawaii, Illinois, Louisiana, Maryland, Missouri, Nevada, North Dakota, New Mexico, Ohio, Rhode Island, South Dakota, Washington) require small loan licenses for BNPL providers,[41] and Indiana should join that list. Licensing should be the bare minimum for BNPL regulation, not the endpoint, as there is no consistent level of scrutiny or consumer protection guaranteed by licensing. Instead, licensing serves to ensure that the state has oversight in investigating and remedying any wrongdoing by non-bank financial entities conducting business within the state, as well as ensuring lender compliance with state financial codes. State oversight would also provide frustrated and lost consumers with a more immediate recourse to rectify BNPL complaints and issues, likely through the Attorney General's Office of Consumer Protections or the Department of Financial Institutions. Additional state protections could come from requiring adherence to federal laws such as the Truth In Lending Act to receive lending licenses. Given that federal oversight of BNPL has been struggling to take shape and is likely to face opposition, states (including Indiana) owe it to their residents to legislate the local BNPL industries.

Data Protections: Consumer data on BNPL platforms are tracked, provided to merchants, and used for internal analytics and rewards. The extent of data-selling beyond this is relatively unknown, making two out of three BNPL consumers "extremely" or "very" concerned about the usage of their data.[42] Indeed, a website called Start.io listed data for sale of BNPL users in Indianapolis including demographic information, frequently visited places, and mobile carriers indicates that whether through lack of safekeeping or through desire for profit, third parties are indeed benefiting from consumer tracking in this way.[43] To address this, more states should increase consumer data protections, including clauses that require the informed consent of individuals regarding their data policies, and provide the right to opt-out from data collection or delete information. While this legislation would most likely come at a state level, federal intervention would be welcomed as well.

Federal Level:

Redefining Creditors: Currently, lenders nationwide - including earned wage access lenders and BNPL lenders - skirt lending laws through arbitrary loopholes such as the installments specifications. This needs to change by tightening the federal legislation to provide greater clarity without arbitrary exemptions for how the act of providing someone financial resources in advance and expecting repayment does indeed count as a loan. This would also help the government regulate other new and unregulated financial products such as advance wage withdrawals.

Transparent BNPL Lending Models: The principle of BNPL as a form of alternative credit has meant that BNPL firms effectively develop their own credit market, one which has less transparency than is mandated for regulated credit products. The Truth In Lending Act (TILA), a key regulator of the credit market, requires transparency in informing consumers of their terms for accessing credit, as well as how much they can access. While BNPL currently skirts these regulations by evading the definition of creditor established in the legislation, the absence of TILA increases consumer confusion around how much BNPL credit they can access without a clear amount available, the hidden potential fees that they could trigger, and what the true cost of participating in this lending practice is with those considered.

Revoke "Risk-Free" Marketing: Fintech BNPL firms continue to market themselves as risk-free and wholesome alternatives to the credit market, capitalizing on individuals' lack of understanding about what possible product drawbacks are. This is a violation of UDAAP and should be treated as such, as no credit is risk free, particularly not one that will report to credit bureaus if it is not repaid (resulting in a subsequent drop in credit score). Even on FAQ sections, BNPL firms will note that there is no credit checking or reporting of financial data to credit bureaus; however, if debt is sent to collections, that is reported to bureaus and harms unsuspecting consumers.

Late Fees: Given the CFPB crackdown on credit card and overdraft fees under UDAAP,[44] late fees charged by BNPL providers should also be restricted, with firms undergoing the same burden of proof and scrutiny that credit card providers and debit card providers must do in order to charge users fees, since there is currently no proof that the late fee actually just covers the cost of the late payment for the firm, rather than being another money-making opportunity. Additionally, BNPL providers should be required to ensure consumers understand the terms of the loan, including the late fees, and that firms' repeated attempts to withdraw money from an overdrafted bank will lead to consumers facing fees from both institutions.

Responsible Lending Restrictions: Exposing buyers to BNPL at checkout induces an artificial pressure to accept the financial product and contributes to increases in consumer spending. Under UDAAP, such pressure should be regulated and applying for BNPL credit should be entirely divorced from the process of shopping to ensure that consumers are not rushed into risky financial products or purchases they cannot afford.

Conclusion:

As the intersection between financial markets and technology proliferates, it is a critical time for legislators to remain engaged in concerns around responsible lending, ethical lending practices, and ways in which consumers may be more vulnerable to misleading products. Buy Now Pay Later (BNPL) is one such industry that, after its ballooning use, has also harmed low-income consumers with misleading marketing and questionable lending practices. BNPL will hardly be the last of such products, however, which is why it is important on a federal and state level to increase protections for financial consumers, making regulations proactive rather than reactive to ensure the wellbeing of households nationwide.

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