

**Testimony of Marisabel Torres
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Center for Responsible Lending**

**Before the U.S. House Committee on Financial Services – Task Force on Financial Technology
“Buy Now, Pay More Later? Investigating Risks and Benefits of BNPL and Other Emerging Fintech Cash
Flow Products”**

November 2, 2021

I. Introduction and Overview

Good morning Chairman Lynch, Ranking Member Davidson, Chairwoman Waters, Ranking Member McHenry, members of the Task Force, and members of the Committee. I am Marisabel Torres, Director of California Policy for the Center for Responsible Lending (CRL). Thank you for the opportunity to testify today.

CRL is a nonprofit, non-partisan research and policy organization dedicated to protecting homeownership and family wealth by working to eliminate abusive financial practices. CRL is an affiliate of Self-Help, one of the nation’s largest nonprofit community development financial institutions. For 40 years, Self-Help has created asset-building opportunities for low-income individuals, rural communities, women, and families of color. In total, Self-Help has provided over \$9 billion in financing to 172,000 homebuyers, small businesses, and nonprofit organizations and serves more than 160,000 mostly low-income families through 72 credit union branches in North Carolina, California, Florida, Illinois, South Carolina, Virginia, Washington, and Wisconsin.

We appreciate the Task Force’s focus on emerging, rapidly growing products marketed as solutions to managing cash flows or access to affordable credit. Like many fintech platforms, these providers offer consumers something that appears new, inviting, even altruistic. But often, “innovation” in the financial space is more about shiny packaging than fundamental changes to age-old financial products. And often, those age-old financial products have long been, and thus remain, predatory. We are particularly concerned that without vigilant monitoring and appropriate regulation, products that promise to promote financial inclusion may exacerbate financial exclusion. This risk is especially high where fintechs rent a bank charter in an effort to evade state law.

Buy now, pay later may indeed be a preferred way for some to purchase goods. But there are clear concerns about the affordability of loans in this market. **Earned wage access** loans – those actually integrated with the employer and repaid only via deduction from future pay, without providing the lender access to the checking account – are far preferable to payday loans but still pose risks and should not be given a regulatory free pass to evolve outside of the regulation of credit. **Faux earned wage access** loans – where the lender repays itself from the borrower’s checking account – are, for all intents and purposes, payday loans and should be regulated as such. **“Overdraft avoidance”** products also pose risks by accessing the borrower’s checking account and should be regulated as credit.

Our top-line recommendations are as follows:

- **Buy Now, Pay Later (BNPL):**
 - CFPB should use its market monitoring authority to collect, analyze, and publish data from the largest providers (anonymized) to better identify risks within the market.
 - CFPB should also issue a larger participant rule to define the market and then actively supervise large BNPL lenders to ensure, at a minimum, that they are not engaged in unfair, deceptive, or abusive acts or practices or unlawful discrimination.
 - CFPB should ultimately ensure that BNPL lenders make loans only after determining the borrower’s ability to repay, considering both income and expenses or obligations, and that these lenders are not charging unfair fees.
 - States should require BNPL lenders to obtain state licenses and consider collecting data to better illuminate the risks involved in these programs.
- **Earned Wage Access (EWA):**
 - CFPB should repeal or significantly amend its actions concluding that certain EWAs are not credit (see October 2021 letter from the National Consumer Law Center (NCLC) and CRL);¹
 - States should generally regulate EWA programs under their state credit laws.
- **Faux EWA and “overdraft avoidance” apps:**
 - CFPB should supervise these lenders pursuant to its authority under Dodd-Frank to supervise payday lenders regardless of their size;
 - States should regulate these lenders under their state credit laws;
 - CFPB and states should affirm that “tips” on extensions of credit are evasive attempts to disguise interest charges;
 - CFPB and states should monitor use of “participation fees” to ensure they are not being used to evade regulation as credit.

II. Buy Now, Pay Later

Buy Now, Pay Later (BNPL) loans are typically designed in a way that may precisely avoid coverage under the Truth in Lending Act (TILA).² That law excludes from the definition of “creditor” one who extends credit that doesn’t require a finance charge and is repayable in four or fewer installments. BNPL products are typically structured with no finance charge and as repayable in no more than four installments. The fact that this appears to be a “free credit” product raises the question: What’s the catch?

It turns out there are a number of catches – some demonstrable, some potential – which require regulatory attention and response. We address these in subsection B. below.

Our discussion of concerns is not to disregard that – for borrowers who have the ability to repay – BNPL may be preferable to a credit card or other forms of borrowing. U.S. consumers with revolving credit

¹ See Letter from National Consumer Law Center & Center for Responsible Lending to CFPB (Oct. 12, 2021), <https://www.responsiblelending.org/sites/default/files/nodes/files/research-publication/crl-nclc-ewa-letter-to-cfpb-oct2021.pdf>.

² BNPL loans could fall under TILA if they are structured to hide a finance charge or if they are deemed analogous to charge cards.

card debt pay over \$100 billion annually in related interest and fees.³ These consumers tend to be those without the means to pay off their entire balance each month and find themselves in debt month after month for years on end. To the extent no- or low-cost installment loans could offer responsible closed-end credit that consumers pay off within a reasonable time period, consumers may indeed benefit substantially. But it is imperative that these loans be responsible and the payments affordable – and not just the interest rate, which may be zero percent, but the principal. Otherwise, these loans will often simply pile unsustainable debt onto debt burdens consumers are already struggling to manage. And without at least regulatory oversight, we can only hope for responsible, affordable lending.

A final introductory note: We are wearied by the now-familiar claim, particularly among many occupying the “fintech” space, that extending credit, without any accompanying requirement that it be affordable, promotes financial inclusion. **Unaffordable credit may provide a quick inflow of cash, but it exacerbates financial exclusion over the longer term which, in the case of BNPL, can be just a few weeks or months down the road.** And a number of incentives in the BNPL space make it particularly susceptible to unaffordable lending.

A. BNPL is exploding, so risks present on a large and growing scale.

As has been widely reported, the BNPL market has exploded over the last year or two, with data suggesting it has increased anywhere from 200% to 350% over the last year.⁴ Afterpay’s November 2021 sales were more than double those a year earlier.⁵ One survey found that 42% of American consumers have used BNPL.⁶ The valuations of the major BNPL firms are in the tens of billions of dollars. Projections show BNPL reaching 10% of all e-commerce dollar volume by 2024:

³ Financial Health Network, The FinHealth Spend Report 2021, at 27, https://s3.amazonaws.com/cfsi-innovation-files-2018/wp-content/uploads/2021/04/19180204/FinHealth_Spend_Report_2021.pdf.

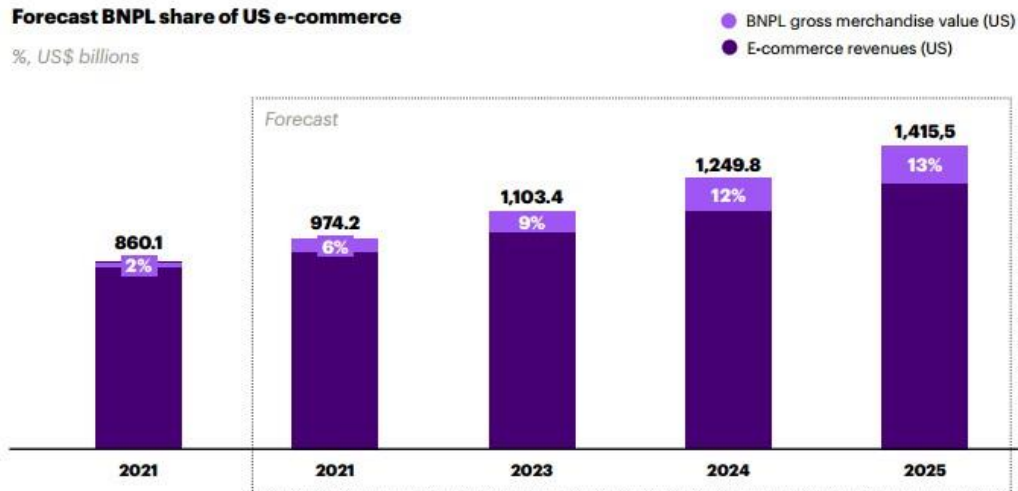
⁴ Cardify, Covid-19 and the surge of “buy now, pay later” (July 29, 2020), <https://www.cardify.ai/reports/buy-now-pay-later>; Kate Fitzgerald, *Missed payments don’t faze new buy now/pay later lenders*, American Banker, Sept. 17, 2021, https://www.americanbanker.com/news/missed-payments-dont-faze-new-buy-now-pay-later-lenders?position=editorial_2&campaignname=AB%20Daily%20Briefing-09202021&utm_source=newsletter&utm_medium=email&utm_campaign=V2_AB_Daily_2021%2B%27-%27%2B09202021&bt_ee=nGfLaLr2vIJND2KI3HAiDNOjCYfFNKMqHuorZKCJNBjX8N7b5T9YololuV%2FB6GO&bt_ts=1632142941186.

⁵ Penelope Wang, *The Hidden Risks of Buy-Now, Pay-Later Plans*, Consumer Reports, Feb. 14, 2021, <https://www.consumerreports.org/shopping-retail/hidden-risks-of-buy-now-pay-later-plans-a7495893275/> (“Consumer Reports, 2021”).

⁶ Nelson Akeredolu, Andrew Braden, Joshua Friedman, and Laura Udis, CFPB, *Should you buy now and pay later?* (July 6, 2021), <https://www.consumerfinance.gov/about-us/blog/should-you-buy-now-and-pay-later/> (citing Credit Karma/Qualtrics survey, <https://www.creditkarma.com/insights/i/buy-now-pay-later-missed-payments>) (“CFPB, BNPL 2021”).

Figure 1:

BNPL transactions are expected to reach 10% of all e-commerce by 2024 as the US catches up to more mature markets



Note: E-commerce revenue growth assumed at same rate as 2020-2021.
Source: Credit Suisse (2021), AFRM Q3 Results; US Census Bureau (2021), Estimated Quarterly U.S. Retail Sales (Adjusted¹); Total and E-commerce: Research and Markets (2021), United States Buy Now Pay Later Business and Investment Opportunities (2019-2028) Databook; Accenture analysis. Worldpay (2021), Global Payments Report; Payments Journal (2021), In Australia, BNPL is Big, but PayPal is Bigger.

SOURCE: Accenture (Commissioned by Afterpay), The Economic Impact of Buy Now, Pay Later in the U.S. (Sept. 2021)⁷

California regulatory data released earlier this month – which the state has collected after wisely determining that BNPL lenders are making “loans” within the state and requiring them to be licensed as consumer finance lenders (discussed further below) – show a “surge” in BNPL lending.⁸ The top six BNPL lenders in California accounted for 10.9 million, or 91%, of the 12 million total consumer loans originated in the state in 2020.⁹

Thus, it is clear that to the extent there are risks within the BNPL market, they exist on a wide and growing scale.

⁷ Accenture (Commissioned by Afterpay), The Economic Impact of Buy Now, Pay Later in the US, at 13 (Sept. 2021), <https://afterpay-corporate.yourcreative.com.au/wp-content/uploads/2021/10/Economic-Impact-of-BNPL-in-the-US-vF.pdf> (“Accenture (Commissioned by Afterpay)”).

⁸ Ca. Dept. of Financial Protection and Innovation, Annual Report of Finance Lenders, Brokers, and PACE Administrators Licensed Under the California Financing Law, at 2 (2020), <https://dfpi.ca.gov/2021/10/07/dfpi-report-shows-changes-in-consumer-lending-decrease-in-pace-program/>.

⁹ *Id.*

B. Causes for concern with BNPL

1. Unaffordable loans

BNPL lenders do not engage in traditional underwriting.¹⁰ They generally verify identity and require a debit card or credit card to make payments and run a “soft” credit check but not a hard credit inquiry.¹¹ Lenders often also check the consumer’s performance history with that particular lender. Several factors suggest that BNPL loans are not meaningfully underwritten for ability-to-repay, resulting in unaffordable loans:

- Rates of bad debts: Data out of Australia (which has the same largest BNPL market provider as the U.S.) found that, among its eight largest BNPL lenders, bad debts amounted to 30% of revenues.¹²
- Rates of delinquency: According to a Reuters-commissioned survey released in September, more than a third of BNPL borrowers had fallen behind on one or more payments.¹³ A 2020 study found that 43% had fallen behind, although two-thirds said the reason was having lost track of payments (another risk with BNPL loans) rather than lack of funds.¹⁴
- Provider access to payment devices reduces incentives to underwrite: BNPL lenders typically require a debit card or credit card to be linked to the borrower’s account, against which the lender applies payments. They likely encourage large portions of customers to enroll in auto-pay to avoid missing payments. Reliance on autopay reduces incentives to underwrite since the lender can expect to debit the account even when the borrower may not have sufficient funds.

Notably, some BNPL providers also permit repayment via credit card. For those with revolving credit outstanding on their cards, these charges will begin to accrue interest from the day they post, and the so-called “free” BNPL loan will not, in fact, be free. This practice – essentially using a credit card to pay off other debt – is one that credit card issuers often don’t permit with traditional credit card debt. For example, Visa and Mastercard do not permit a credit card to be paid off with a different credit card. The practice is prohibited for certain debts like federal student loans.¹⁵ This BNPL practice prompted one major credit card issuer to stop processing

¹⁰ CFPB reports that BNPL providers only require that the borrower be at least 18 years old, have a mobile phone number, and have a debit or credit card to make payments, and ensure they can validate the borrower’s identity, CFPB, BNPL 2021.

¹¹ *Id.*

¹² McLean Roche Consulting Group, Global Payments 2020-30, A seismic shift in the next ten years, Submission to Treasury Inquiry, at 37, https://treasury.gov.au/sites/default/files/2021-02/147719_mclean-roche_0.pdf.

¹³ Anna Irrera, *As ‘buy now, pay later’ surges, a third of U.S. users fall behind on payments*, Reuters, Sept. 9, 2021, <https://www.reuters.com/technology/buy-now-pay-later-surges-third-us-users-fall-behind-payments-2021-09-09/> (reporting on an August 2021 Qualtrics survey of 1,044 adults on behalf of Credit Karma).

¹⁴ Consumer Reports, 2021.

¹⁵ See, e.g., <https://www.chase.com/personal/credit-cards/education/basics/can-you-pay-off-a-loan-with-a-credit-card>.

credit card payments to BNPL lenders, noting that BNPL loans can be risky for the consumer and the bank.¹⁶

- Multiple BNPL loans, potentially across BNPL lenders: One survey found that Quadpay and Sezzle borrowers average four-to-five transactions per month; Afterpay and Klarna borrowers four per month; Affirm borrowers two per month.¹⁷ Without credit reporting (discussed further below), the borrower's BNPL debts across lenders are not aggregated anywhere and, even with credit checking, lenders (BNPL or other lenders) have no lens into how much BNPL debt borrowers are carrying. There are reports in the U.K. of retailers offering five different BNPL deals for the same purchase, which the consumer could use cumulatively to amass the amount of credit needed to make the single purchase.¹⁸
- Buying more with BNPL than without: One survey found that nearly half of BNPL borrowers spent 10-40+ percent more using BNPL than with a credit card.¹⁹ Indeed, as discussed further in the following section, the BNPL business model relies on merchant payments which presumably merchants are willing to make because they see more or larger purchases resulting.
- Lending to those who may lack capacity for more credit: Those who cannot qualify for other credit – whom some BNPL lenders claim to be helping especially – often do not qualify for other credit because they have been overburdened by credit already and cannot afford to repay more credit.²⁰

Of note, earlier this year, the U.K. Financial Conduct Authority (FCA) announced plans to supervise BNPL providers, and reforms contemplated included requiring hard credit checks and affordability assessments.²¹ Just this month, major BNPL lender Klarna announced it will give consumers the option

¹⁶ Byron Kaye, *Capital One stops 'risky' buy-now-pay-later credit card transactions*, Reuters, Dec. 7, 2020, <https://www.reuters.com/article/us-capital-one-fin-payments/capital-one-stops-risky-buy-now-pay-later-credit-card-transactions-idUSKBN28H0OR?il=0>. Capital One has since announced it will test its own BNPL product but has not changed its practice of not permitting BNPL lenders to charge against its credit card.

¹⁷ Cardify, *Convenience, Debt, and Novelty: Analyzing BNPL Consumer Data* (Sept. 8, 2021), <https://www.cardify.ai/reports/bnpl-trend-report>.

¹⁸ Matthew Vincent, *FCA calls for full regulation of 'buy now, pay later' credit: UK financial watchdog finds 'significant potential' for consumer harm*, Financial Times, Feb. 2, 2021, <https://www.ft.com/content/2c9bd737-80a6-45d7-a7f3-bf672850b3bd>.

¹⁹ Consumer Reports, 2021 (citing Cardify.ai survey).

²⁰ See, e.g., Which?, *Under Pressure: Who uses BNPL*, Policy Report, at 24 (May 2021) (explaining why some BNPL borrowers may use BNPL because they believe they cannot access other forms of credit: "It may also be that BNPL brands make credit available to people for whom other forms of credit are not affordable.").

²¹ Matthew Vincent, *FCA calls for full regulation of 'buy now, pay later' credit: UK financial watchdog finds 'significant potential' for consumer harm*, Financial Times, Feb. 2, 2021, <https://www.ft.com/content/2c9bd737-80a6-45d7-a7f3-bf672850b3bd>.

to share bank account transactional data that Klarna will use to determine their ability to repay.²² While we are skeptical that establishing this policy as optional is likely to lead to the dramatic change needed in assessing affordability in the BNPL space, the policy illustrates the feasibility of BNPL lenders' conducting meaningful underwriting.²³

The consequences of unaffordable BNPL loans can be severe. When the borrower's BNPL loan is linked to a bank account that lacks sufficient funds for payment, the BNPL lender's payment attempts will typically trigger highly punitive non-sufficient funds (NSF) and/or overdraft fees. These fees in turn are highly associated with closed bank accounts and exclusion from the financial system. Or, the borrower may have sufficient funds for the BNPL payment but then be left without sufficient funds for other essential living expenses or debts.²⁴ And many BNPL providers charge their own late or returned payment fees on top of the fees charged by banks.

2. Merchant subsidy-driven business model, today and as competition increases

The BNPL business model is driven by BNPL lenders' relationships with merchants. Afterpay, for example, reportedly earns 3-6% of the purchase price plus a \$0.30 fee per transaction²⁵ (significantly more than credit card interchange fees).²⁶ BNPL lenders market themselves to the merchant on the basis that their partnership will drive increased sales volume. A report commissioned by the U.K. FRA reports that, anecdotally, some BNPL providers claim they will increase sales by 30%.²⁷ It notes that Klarna refers to "increased conversion" rates to describe shoppers who complete purchases.²⁸ Afterpay boasts estimates that it drove \$8.2 billion in new sales revenue for merchants in 2021 (representing an 11% increase in profit margin); that the average Afterpay merchant obtains almost 13% more new customers; and that "basket sizes [i.e., shopping carts] are 17% higher in value" than before Afterpay.²⁹

²² Ryan Browne, *Klarna strengthens credit checks in the UK as regulators crack down on 'buy now, pay later'*, CNBC, Oct. 18, 2021, <https://www.cnbc.com/2021/10/17/klarna-tightens-credit-checks-in-uk-ahead-of-buy-now-pay-later-rules.html>.

²³ *Id.*

²⁴ One major U.K. bank reported that, in November 2020, 10% of its customers who had made a payment to two large BNPL providers had exceeded their overdraft allowance in the same period. Financial Conduct Authority, *The Woolard Review – A review of change and innovation in the unsecured credit market*, at 49 (Feb. 2, 2021), <https://www.fca.org.uk/publication/corporate/woolard-review-report.pdf> ("Woolard Review").

²⁵ Tristan Rose, *How Does Afterpay Make Money (Business and Revenue Model)* (Oct. 7, 2021), <https://entrepreneur-360.com/how-does-afterpay-make-money-13180>.

²⁶ Brian Riley, *The Buy Now Pay Later Merchant Proposition: Credit Card Interchange Is Cheaper*, Mar. 26, 2021, <https://www.mercatoradvisorygroup.com/Templates/BlogPost.aspx?id=9029&blogid=25506>.

²⁷ Woolard Review at 47.

²⁸ *Id.*

²⁹ Accenture (Commissioned by Afterpay) (data and graphic on following page).



Thus, there is concern that the entire business model rests on driving borrowers to purchase items they would not otherwise buy, which is concerning in and of itself and even more so when coupled with lack of underwriting for affordability.

Another risk is that merchants may seek to recoup the charges they pay BNPL lenders through hidden charges in the form of inflated prices and/or extra fees on BNPL purchases.

Moreover, as this market continues to grow, increased competition may create downward pressure on the merchant subsidy. This raises questions about whether lenders will seek to compensate for lower merchant subsidies, either through the interest rate, or through additional fees, or by more aggressively pushing purchase volume without affordability assessments.

3. Reliance on late fees, for some providers

Some BNPL lenders charge late fees.³⁰ For example, Afterpay charges late fees of the lesser of \$8 or 25% of the purchase.³¹ A report out of Australia found that Afterpay's total late fees were "very high," amounting to up to 68% APR.³²

One U.K. survey found that about 20% of respondents had missed a payment,³³ and substantial portions of those borrowers, as reflected in the chart below, reported having been charged a late fee, as well as receiving a letter from a debt collection agency or being visited by debt collectors:

³⁰ CFPB, BNPL 2021.

³¹ Trina Paul, *Afterpay review: Everything you need to know about this short-term 'buy-now, pay later' option*, CNBC, Oct. 31, 2021, <https://www.cnbc.com/select/afterpay-review/>.

³² McLean Roche Consulting Group, *Global Payments 2020-30, A seismic shift in the next ten years*, Submission to Treasury Inquiry, at 39, https://treasury.gov.au/sites/default/files/2021-02/147719_mclean-roche_0.pdf.

³³ See, e.g., Which?, *Under Pressure: Who uses BNPL*, Policy Report, at 21 (May 2021).

Figure 2:

Table 2: Breakdown of consequences BNPL users who had missed a payment claimed to have experienced, by brand

	Klarna	ClearPay	Laybuy	OpenPay	Payl8r	Flava
Base	138	100	74	86	64	65
I have had my account blocked and/or suspended	37%	39%	47%	51%	48%	49%
I was charged a late fee	Not applicable	54%	57%	58%	53%	Not applicable
I received a letter from a debt collection agency	51%	39%	51%	49%	64%	Not applicable
I was visited by debt collectors	39%	34%	43%	55%*	55%	Not applicable
My credit rating was damaged	Not applicable	42%	54%	Not applicable	55%	Not applicable

SOURCE: Which?, Under Pressure: Who Uses BNPL, Policy Report (May 2021)³⁴

4. Evasion of state credit laws

Though BNPL loans may skirt TILA regulation, many state laws define credit more broadly. The California Department of Business Oversight (DBO) brought enforcement actions against three BNPL lenders for making loans within the state without obtaining the required license. The agency found that the lenders’ practice of purchasing purported credit sales contracts from merchants (rather than registering as consumer finance lenders and explicitly lending themselves) was “structured to evade otherwise applicable consumer protections.”³⁵ Settlements with these lenders collectively resulted in refunds of fees of approximately \$1.9 million.³⁶

DBO also issued a legal opinion concluding that BNPL products are indeed “loans” under the California Financing Law, since the Civil Code defines a loan as “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

³⁴ *Id.* at 23.

³⁵ <https://dfpi.ca.gov/2020/03/16/point-of-sale-lender-afterpay-agrees-to-cess-illegal-loans-pay-refunds-in-settlement-with-the-department-of-business-oversight/>; <https://dfpi.ca.gov/2020/01/16/point-of-sale-lender-sezzle-agrees-to-cess-illegal-loans-pay-refunds-in-settlement-with-the-california-department-of-business-oversight/>.

³⁶ <https://dfpi.ca.gov/2020/04/22/point-of-sale-lender-quadpay-agrees-to-cess-illegal-loans-pay-refunds-in-settlement-with-the-california-department-of-business-oversight/>.

borrowed.”³⁷ BNPL lenders then typically obtained consumer finance licenses in California during 2020 and, as a result, the California Department of Financial Protection and Innovation was able to begin gathering data.

5. Dispute protections

Unlike a credit card, BNPL does not provide dispute protections, and product returns can be complicated. Even if a borrower returns an item financed through a BNPL loan, the borrower may have to keep paying the BNPL lender at least until the merchant and lender sort out the return.

6. Interaction with credit reporting

Most BNPL lenders do not report repayment to credit reporting agencies.³⁸ As a result, BNPL does not typically enable people to build or improve credit scores. When BNPL lenders do report to credit bureaus, late payments may negatively affect credit history.³⁹ One survey found that of the 38% of BNPL borrowers who responded that they had missed a payment, 72% saw their credit scores decline thereafter.⁴⁰

Another effect of lack of reporting is that regulated providers that do check credit reports will not see a BNPL borrower’s full credit picture, complicating the ability of other credit providers to make informed credit assessments. Indeed, those BNPL lenders that check a credit report before making a loan typically do a so-called “soft pull,” which means that other creditors will not even see that there was an application for credit.

7. Targeting youth market

A number of studies show that BNPL is much more prevalent among younger consumers than older consumers. One study found that of those who participated in a BNPL program last year, 27% were aged 19 to 25, while 48% were 26 to 34.⁴¹ Another study found that nearly half of Gen Z consumers (roughly

³⁷ <https://dfpi.ca.gov/2019/12/30/dbo-denies-lending-license-sought-by-unregulated-point-of-sale-financer-and-issues-related-legal-opinion/>. The opinion acknowledges that BNPL contracts bear similarities to retail installment sales contracts, which are not loans, but concludes based on its analysis of a range of factors that the substance of the BNPL transaction is a loan. These factors include the intent of the parties, whether the merchant and third party are closely related or have a preexisting relationship, whether the third party assumes the contract at the point of sale or later, whether the third party determines eligibility for the contract, and whether the transaction would be regulated under another law.

³⁸ CFPB, BNPL 2021.

³⁹ *Id.*

⁴⁰ Gaby Lapera, *72% of Americans saw their credit scores drop after missing a ‘buy now, pay later’ payment, survey finds*, Feb. 8, 2021, <https://www.creditkarma.com/insights/i/buy-now-pay-later-missed-payments>.

⁴¹ Consumer Reports, 2021 (citing Cardify.ai).

age 18-24) had used BNPL to pay for purchases of \$100 or less.⁴² It also found that more than half of Gen Z or millennials (roughly 18-30 years old) had missed at least one payment.⁴³

BNPL could be saddling young people with unaffordable debt, with long-term consequences. A UK case study concluded that BNPL marketing “overwhelmingly draw[s] on images of young people, and typically young women.”⁴⁴ The CA DBO found that Afterpay, “[l]ike other point-of-sale financiers, targets young consumers who are unable to qualify for traditional financing options like credit cards.”⁴⁵

8. Fair lending concerns

To the extent BNPL loans are underwritten, the process is largely if not exclusively algorithmically driven. It is thus subject to algorithmic bias, which reinforces the need for data and oversight to identify and address any fair lending concerns.

C. Recommendations addressing BNPL

Whether or not BNPL is subject to TILA, CFPB has broad authority to identify and address risks it poses to consumers. The CFPB should engage in active oversight of BNPL lenders. In the near term, it should use its market monitoring authority to collect, analyze, and publish data from the largest providers (anonymized) to better identify risks within the market. It should subsequently issue a larger participant rule to define the market and draw a line to identify larger participants; it should then actively supervise those larger BNPL lenders to ensure, at a minimum, that they are not engaged in any unfair, deceptive, or abusive acts or practices or unlawful discrimination. CFPB could also study checking account data, which it should be collecting in any event in order to monitor bank overdraft practices, to study the interaction between BNPL products and borrowers’ checking accounts, in particular NSF and overdraft fees. The Bureau should ultimately ensure that BNPL lenders are making loans only after determining the borrower’s ability to repay, considering both income and expenses or obligations, and that the lenders are not charging unfair fees. BNPL borrowers should also be given rights to dispute transactions and obtain refunds analogous to those credit card users have. And the Bureau should ensure that providers are not violating the Electronic Fund Transfer Act’s prohibition of conditioning the extension of credit on preauthorized electronic transfers.

We also strongly encourage states to require BNPL lenders to obtain state licenses and to consider collecting data to better illuminate the risks involved in these programs.

III. Earned Wage Access

Note: The written testimony for today’s hearing of Lauren Saunders of the National Consumer Law Center (on behalf of its low income clients) (NCLC) will cover earned wage access and faux earned wage

⁴² Anna Irrera, *As ‘buy now, pay later’ surges, a third of U.S. users fall behind on payments*, Reuters, Sept. 9, 2021, <https://www.reuters.com/technology/buy-now-pay-later-surges-third-us-users-fall-behind-payments-2021-09-09/> (reporting on an August 2021 Qualtrics survey of 1,044 adults on behalf of Credit Karma).

⁴³ *Id.*

⁴⁴ *See, e.g.,* Which?, *Under Pressure: Who uses BNPL*, Policy Report, at 4 (May 2021).

⁴⁵ <https://dfpi.ca.gov/2020/03/16/point-of-sale-lender-afterpay-agrees-to-cess-illegal-loans-pay-refunds-in-settlement-with-the-department-of-business-oversight/>.

access products in more detail than our sections III and IV do here. We generally share the concerns discussed in her testimony.

We begin by being clear about what we mean by “earned wage access” (EWA) programs. EWA programs, at a minimum, are (1) integrated with the employer, (2) extended based on earned wages verified via the employer or its payroll provider, (3) repaid solely via deduction from the borrower’s pay, without permitting the provider to access the borrower’s checking account or other payment mechanism, and (4) without debt collection efforts when the borrower’s pay is insufficient to repay to the advance.

A “fintech” provider that attempts to position itself as an EWA provider, but is not employer-integrated and takes authorization to debit the borrower’s checking account to repay the loan, is not in fact an EWA provider and poses heightened risks to consumers. We discuss faux EWA products in Section IV below.

EWA products have soared in use in recent years, with estimated volume nearly tripling from 2018 (\$3.2 billion) to 2020 (\$9.5 billion). Three of the four largest employers are reported to be offering EWA to their employees. Particularly given this exploding growth, we appreciate the Task Force’s the attention to this market.

Figure 4: EWA Market Growth



Source: Aite Group

SOURCE: Leslie Parrish, Making Ends Meet: On-Demand Pay and Employer-Based Loans, Aite Group LLC (Feb. 2021)⁴⁶

EWA programs offer consumers an advance on wages at typically a fraction of the cost of typical payday loans and without the severe risks involved when lenders take access to a borrower’s checking account. Users of one EWA provider responded in a survey that their use of the product was decreasing their

⁴⁶ Leslie Parrish, Making Ends Meet: On-Demand Pay and Employer-Based Loans, Aite Group LLC, at 17 (Feb. 2021), <https://aite-novarica.com/report/making-ends-meet-demand-pay-and-employer-based-loans>.

usage of payday loans and overdraft fees.⁴⁷ This is welcome news, and we should continue to monitor the extent to which these products replace rather than pile on to higher-cost credit. But even a clearly better option should not get a free regulatory pass.

The CFPB, under prior leadership in 2020, determined that EWAs in certain circumstances do not constitute a “debt” and thus cannot be considered “credit” under the Truth In Lending Act. We disagree with this conclusion and much of the rationale the Bureau applied to reach it; these concerns are detailed in a letter CRL and the National Consumer Law Center (on behalf of its low income clients) submitted jointly to CFPB last month⁴⁸ and are shared by the nearly 100 consumer, labor, civil rights, legal services, faith, community and financial organizations that also weighed in with the Bureau.⁴⁹

In short, an advance of wages by a third party, even if earned and even if repaid via payroll deduction, is a debt that the borrower must repay. And exempting EWA from “credit” at the federal level could have broad ramifications and pose risks to consumers, including at the state level. In state legislatures earlier this year, we saw a significant uptick in the efforts of EWA providers to earn explicit exclusions from state credit laws. The proposed legislation that would create such exclusions typically does not include limits on pricing, meaning that EWA providers could operate outside of credit laws that would otherwise prevent predatory pricing. Moreover, these efforts often involve excluding from credit laws not only EWA providers but also faux EWA providers; see further discussion in Section IV. below.

In other state activity, the California Department of Financial Protection and Innovation (DFPI) has entered into memoranda of understanding with a few EWA providers (Even, Payactiv and Branch) (as well as a faux EWA provider (Activehours, which does business under the name Earnin) and an “overdraft avoidance” product (Brigit)), as it collects data on these programs. The DFPI was clear that the MOUs do not reflect DFPI’s approval of any business model or conclusion that they comply with the law. We have urged DFPI to regulate all of these products as credit under state law.⁵⁰

EWAs are not without risks to consumers, and users of EWA may be particularly susceptible to harm. EWA borrowers are typically hourly, relatively low-wage workers. Research suggests that Hispanic adults and younger workers are more likely to use EWA than the population as a whole. Indeed, one study found the adoption rate among the general population was 14%; among Hispanics, it was 25%.⁵¹

⁴⁷ <https://www.dailypay.com/blog/our-survey-says-dailypay-saves-employees/>.

⁴⁸ See Letter from National Consumer Law Center & Center for Responsible Lending to CFPB (Oct. 12, 2021), <https://www.responsiblelending.org/sites/default/files/nodes/files/research-publication/crl-nclc-ewa-letter-to-cfpb-oct2021.pdf>.

⁴⁹ Letter from 96 consumer, labor, civil rights, legal services, faith, community and financial organizations and academics to CFPB (Oct. 12, 2021), <https://www.responsiblelending.org/research-publication/96-organizations-and-academics-urge-cfpb-regulate-fee-based-earned-wage-access>.

⁵⁰ See Letter from National Consumer Law Center & Center for Responsible Lending to CA Department of Financial Protection and Innovation (Mar. 15, 2021), <https://www.responsiblelending.org/sites/default/files/nodes/files/research-publication/group-comment-dfpi-ewa-15mar2021.pdf>.

⁵¹ Michael Moeser, Earned Wage Access: Faster wage payments disrupt the traditional payday, Original research from American Banker and Employee Benefit News (ebn), at 7 (June 2021), <https://www.americanbanker.com/research-report/faster-wage-payments-disrupt-the-traditional-payday>.

Data show that consumers who use these advances tend to use them frequently,⁵² which means costs can add up, particularly for the low-wage workers who tend to use the product. Where one advance is taken out simply to cover the gap left by repayment of a prior advance, consumers are essentially getting the benefit of only the initial advance but continuing to pay for each subsequent advance. Moreover, and critically, whatever EWA programs look like today may not be what they look like in the future if they are given a free regulatory pass: In a world where EWA is not considered credit at the state or federal level, a payday lender that manages to integrate itself with an employer could charge as high a rate it can get away with.

Top-line recommendations on EWAs:

- CFPB should repeal or significantly amend its actions concluding that certain EWAs are not credit (see October 2021 letter from NCLC and CRL);⁵³
- States should generally regulate EWA programs under their state credit laws.

IV. Faux Earned Wage Access, “Overdraft Avoidance” Products, and Others That Routinely Access the Borrower’s Checking Account/Payment Device

A product that purports to lend against earned wages but is not employer-integrated and takes access to the borrower’s checking account is, for all intents and purposes, a payday loan. Indeed, the wages payday lenders lend against typically are earned to some degree, too. Though some newer products may be lower cost, even significantly, there is simply no reason these products should be regulated as something other than credit – subject to all applicable federal and state credit laws, including applicable interest rate limits.

These products can inflict severe financial harm on a borrower through their access to the borrower’s checking account. When the borrower’s account lacks sufficient funds for repayment, the borrower typically incurs non-sufficient fund (NSF) and/or overdraft fees triggered by the attempted repayment. Litigation against Earnin resulting in a \$3 million settlement described how when a borrower took out multiple Earnin advances within the same pay period, each individual repayment attempt for each individual advance triggered an NSF fee or an overdraft fee; a borrower was charged four \$29 fees within three days, totaling \$116, all directly triggered by Earnin’s repayment attempts.⁵⁴

⁵² See Devina Khanna and Arjun Kaushal, Earned Wage Access and Direct-to-Consumer Advance Usage Trends, Financial Health Network, at 9-10 (April 2021), https://s3.amazonaws.com/cfsi-innovation-files-2018/wp-content/uploads/2021/04/26190749/EWA_D2C_Advance-sage_Trends_FINAL.pdf (finding more than 70% of users took advances in consecutive semi-monthly periods over one year; 10% took advances consecutively for at least 10 semi-monthly periods; and 30% took advances in every semi-monthly period between their first and last advance during the period covered by the data -- on average, 6.5 monthly periods); Leslie Parrish, Employer-Based Loans and Early Pay: Disruption Reaching Scale, Aite, at 13-14 (April 2019), <https://aite-novarica.com/employer-based-loans-and-early-pay-disruption-reaching-scale>.

⁵³ See Letter from National Consumer Law Center & Center for Responsible Lending to CFPB (Oct. 12, 2021), <https://www.responsiblelending.org/sites/default/files/nodes/files/research-publication/crl-nclc-ewa-letter-to-cfpb-oct2021.pdf>.

⁵⁴ *Perks, et al. v. Activehours, Inc.. d/b/a, Earnin*, Case No. 5:19-cv-05543-BLF (N.D. Ca.), Complaint at 6-7, http://www.perksearninsettlement.com/media/3125364/aup_class_action_complaint.pdf.

Even where funds are sufficient to repay the advance – which will often be the case since the lenders generally monitor checking accounts and time repayments to coincide with the next direct deposit – repayment may leave the borrower without funds for essential expenses and/or lead to the incurrence of NSF fees and overdraft fees later in the pay period unless the borrower takes out a new advance.

Therefore, faux EWA providers should not be given the carveouts from credit laws they seek. Not only do current faux EWA providers pose risks, but if they are given a carveout from state laws, we should expect payday lenders – even in states whose usury limits currently keep payday lenders out – to begin attempting to operate within those carveouts.

In addition, NCLC’s testimony discusses concerns, which we share, about the evasive “tip model” in the faux EWA space.

“Overdraft avoidance” programs extend advances typically repaid via access to the borrower’s checking account, to consumers whose accounts are running low and risk incurring overdraft fees. These products also can reduce costs, especially given the outrageously high level of overdraft fees. But these products obtain repayment by debiting borrowers’ checking accounts and also pose risks via NSF fees, overdraft fees, and not leaving enough funds for other essential expenses. These programs should also be regulated as credit and, to the extent they rely on “tips,” those tips should be treated as finance charges.

Top-line recommendations on faux EWA and “overdraft avoidance” apps:

- CFPB should supervise these lenders pursuant to its authority under Dodd-Frank to supervise payday lenders regardless of their size;
- States should regulate these lenders under their state credit laws;
- CFPB and states should affirm that “tips” on extensions of credit are evasive attempts to disguise interest charges;
- CFPB and states should monitor the use of “participation fees” to ensure they are not being used to evade regulation as credit.

V. Conclusion

Thank you again for holding this hearing and for the opportunity to provide input on these critical issues. I look forward to addressing any questions you may have.