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CFPB's Probe of Buy Now, Pay Later: What's the Risk to Consumers?

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Morgan Lewis banking and financial industry attorneys Eamonn Moran and Robin Nunn look at the regulatory spotlight on point-of-sale buy now, pay later financing. Among items to watch, they say, are how and whether the CFPB decides to address BNPL consumer disclosure and dispute, data privacy, and fee accumulation issues.

Due to the pandemic-fueled shift toward online and mobile app shopping, the "buy now, pay later" (BNPL) market has experienced sharp growth. BNPL is a type of short-term financing that allows consumers to make purchases and pay off the balance in small installments, often interest-free.

In 2021, consumers spent nearly $100 billion in purchases using BNPL programs, up from $24 billion in 2020—a 316% increase. This past holiday season, usage spiked, especially among the younger generation, and it appears the industry's popularity is only beginning, with retailers and payment firms jumping into the arena.

BNPL's rise is drawing scrutiny from financial services regulators, who are concerned with the lack of specific rules for point-of-sale credit and potential risks to consumers. Federal regulators have taken a largely hands-off approach, but recent noteworthy shifts signal that regulatory headwinds may be on the horizon.

In November 2021, the House Financial Services Committee, Task Force on Financial Technology, held a hearing on the state of the BNPL industry. A month later, some Democratic members of the Senate Banking Committee sent a letter to Rohit Chopra, the newly installed bureau director of the Consumer Financial Protection Bureau (CFPB), urging him to take action to ensure transparency and oversight of BNPL products and providers.

The next day, the CFPB launched a probe into five major BNPL providers over concerns about risks to consumers associated with accumulating debt, regulatory arbitrage, credit reporting, and data harvesting.

On Jan. 12, the CFPB opened up public comments regarding the industry. With final responses due by the BNPL companies by March 1, and from the public shortly afterwards, it appears the CFPB has placed this project on an expedited timeline.

Regulations Governing the BNPL Industry

BNPL providers are already subject to certain federal and state laws that address fair lending, credit reporting, consumer privacy and information security, and the prevention of money laundering. The CFPB can bring cases against BNPL providers under the Equal Credit Opportunity Act, Truth in Lending Act (TILA), E-SIGN Act, Fair Credit Reporting Act, Gramm-

Leach-Bliley Act, Bank Secrecy Act, Fair Debt Collection Practices Act, Telephone Consumer Protection Act, and Electronic Fund Transfer Act, and it has broad authority to bring enforcement actions against unfair, deceptive, and abusive acts and practices in the industry.

Far more limited in its authority, the Federal Trade Commission (FTC) also has jurisdiction over BNPL firms. These two regulatory agencies could target, among other aspects, deceptive advertising practices.

BNPL providers, depending on their products' structure, could be subjected to the CFPB's pending Payday Lending Rule. States also have regulatory power, with several already requiring providers to be licensed as lenders and possibly subjecting them to state-level fair lending and other laws.

Potential Areas of Regulation

While the CFPB's plans for the BNPL industry remain unclear at this early stage, many industry players are expecting additional guardrails and protections.

The first areas for increased oversight may include:

- **Fees and dispute resolution.** While many BNPL products do not assess interest or finance charges, product terms typically include late fees that can accrue. These products also lack certain consumer protections applicable to credit cards, including dispute-resolution procedures.
- **Consumer education and information access. While** a TILA-like disclosure regime may not be appropriate, regulators could propose certain more limited disclosure standards for BNPL products.
- **Evaluation of a purchaser's creditworthiness.** Unlike credit cards and other more traditional consumer credit products, providers have no obligation to conduct customer credit assessments. Concerns have been raised about BNPL providers' inconsistent use, and unclear provision, of credit-reporting information.
- **Cybersecurity and data harvesting.** Since these products give companies access to sensitive consumer financial data (shopping behavior, payroll information, or checking account information), concerns over data privacy, consumer cybersecurity, and data harvesting are likely to be triggered.

Looking longer term, the CFPB's potential adoption of a larger-participant rule for the unsecured consumer installment lending market could implicate certain BNPL providers and subject them to CFPB supervision.

While CFPB Director Chopra has promised vigorous enforcement of federal consumer financial services laws, the CFPB's stacked agenda, which remains focused on providing relief for consumers facing hardship due to Covid-19 and the related economic crisis, and promoting racial equity, may prove challenging in squeezing BNPL into new regulations.

If so, the CFPB could use guidance and other tools to address some of the above concerns, such as making fee disclosures more standardized.

Impact on the Greater Payments Industry

The CFPB continues to monitor the developing market for new forms of point-of-sale financing to ensure that consumers are adequately informed about financial offerings and protected from risky practices. The CFPB's increased attention comes as the FTC expands its use of the Restore Online Shoppers' Confidence Act.

With any fast-growing industry, the interplay between technology, transformation, and regulation is a delicate balancing act. New market entrants into an already crowded BNPL space will create competition and, potentially, more consumer-friendly safeguards and terms of service. However, it also creates concerns around "high-cost debt traps" that perpetuate inequality.

Even without additional federal regulation, the digital-payments industry should expect increased scrutiny and oversight. The CFPB has encouraged consumers to submit regulatory complaints about specific BNPL companies. The CFPB also explicitly notes that it reserves the right to use information collected through an inquiry for any purpose permitted by law, including enforcement, to the extent that it finds violations of consumer financial-services laws.

Whether this inquiry leads to enforcement, it sends a strong signal to all fintech firms and retail partners that regulators are questioning the degree to which consumers could face risk.

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