

## CFPB's 1st Try At BNPL Regulation Could Set Stage For More

By Jon Hill

*Law360 (May 23, 2024, 11:55 PM EDT)* -- The Consumer Financial Protection Bureau's new guidance that treats buy-now, pay-later firms more like credit card companies is drawing industry grumbles about "apples to oranges" comparisons, but consumer advocates say that applying additional credit card-esque rules would be the cherry on top.

Released Wednesday, the CFPB's guidance explains that providers of buy-now, pay-later, or BNPL, financing — a type of no-interest loan increasingly taken out through apps and retailers for everyday purchases — can legally qualify as credit card companies and must follow some of the same rules.

Those rules, which flow from the decades-old Truth in Lending Act, establish certain dispute and refund rights for consumers, as well as requirements for billing statements and other disclosures. The CFPB has said the guidance will help to ensure "consistency" in the protections available to consumers, regardless of whether they are paying via old-fashioned credit card or newfangled BNPL loan.

Since the guidance came out, the fast-growing BNPL sector has stressed that it does believe in offering strong protections for consumers and that many firms are already doing so. At the biggest BNPL firms, for example, it's standard for consumers to be able to dispute purchases and receive refunds.

But the CFPB's guidance is also encountering pushback over what some in the industry characterize as its ill-tailored approach. Klarna, one of the biggest BNPL firms, argued Wednesday that rules written for credit cards may not make sense for BNPL products that "operate in fundamentally different ways."

"It is baffling that the CFPB fails to acknowledge the fundamental differences between BNPL and credit cards in their guidance," Klarna said in a statement. "Trying to regulate BNPL like a credit card is like comparing apples with oranges."

Consumer advocates disagree, arguing that the two types of credit have become close substitutes for millions of Americans. Indeed, BNPL loans have exploded in popularity — across five major lenders, their total originations soared from \$2 billion in 2019 to more than \$24 billion just two years later.

Given that surging growth, advocates say it's critical for the CFPB to make sure this financing comes with protections like those that consumers have come to expect and depend on when using credit cards. If anything, advocates believe Wednesday's guidance should only be a starting point for BNPL regulation.

The guidance "is an important step towards extending basic rights to BNPL users, but the Bureau should

take further action to fully protect consumers," Jennifer Chien, a senior policy counsel for financial fairness at Consumer Reports, said in a statement.

"The CFPB should establish new rules for this largely unregulated market so consumers are treated fairly and enjoy more of the same rights and benefits they get when using other forms of credit," Chien added.

### **"A Big Change"**

The CFPB's guidance relies on the flexibility of definitions built into the Truth in Lending Act and its implementing rules, known collectively as Regulation Z.

Under this framework, a credit card isn't just plastic stamped with numbers — it can also be "any single credit device that may be used from time to time to obtain credit," a description that the CFPB said matches the "digital user accounts" that consumers usually have with a BNPL provider for taking out and managing loans.

Meanwhile, the disclosure requirements, dispute rights and refund protections covered in the guidance are found in Regulation Z's so-called Subpart B, a section that applies generally to "open-end credit."

Although BNPL loans aren't open-end, an exception in Regulation Z's definitions allows Subpart B to still apply when the credit in question "is not subject to a finance charge and is not payable ... in more than four installments." The typical BNPL loan is repaid in four payments and carries no interest.

"Essentially, any mechanism, tool or procedure that consumers can use from time to time to buy goods or services on credit gets the protections that consumers have come to know and expect with credit cards," CFPB Director Rohit Chopra said earlier this week.

In taking this position, the CFPB has said it is merely interpreting and applying standards that are already on the books, not creating new ones. But financial services attorneys told Law360 that this position — that Subpart B covers BNPL firms — is nevertheless one they've not seen any other regulator take before.

"This is the most significant regulatory response to BNPL to date," Erin Bryan, co-chair of the consumer financial services group at Dorsey & Whitney LLP, said in an email.

And it could have significant implications for how BNPL providers run their business, attorneys said; even if a BNPL firm already offers some version of the protections addressed in the guidance, it might not be doing so in exactly the manner Subpart B would require.

"This is a big change," said Allen Denson, a Morgan Lewis & Bockius LLP partner who represents consumer financial services clients in regulatory and enforcement matters. "They're going to have to issue monthly statements along the lines of what is required under TILA, and they may have to develop some pretty specific dispute resolution and right of return processes."

Joann Needleman, leader of the financial services regulatory and compliance practice at Clark Hill PLC, said it could accordingly prove "very expensive" for BNPL firms to comply with those standards, not to mention challenging, due to differences in how the average pay-in-four BNPL loan and credit cards work.

The lifespan of the BNPL loan, for example, can generally be measured in weeks, whereas a consumer may use a credit card open-endedly over many years. Requirements like monthly statements and potentially lengthy dispute investigations may make sense for the latter but might be an awkward fit for the former, Needleman argued.

"If you're the lender, you can absorb those [compliance] costs over a longer period of time, but it's going to be difficult to do that on a shorter term," Needleman said. "This is an industry that has been operating under the assumption that they are not credit cards."

The guidance could also create other complications for the industry, attorneys told Law360. For one, it could open up opportunity for private lawsuits against BNPL firms for alleged truth-in-lending violations.

"To the extent the Bureau was saying, 'This is just an explanation of what existing law was,' that creates a window for plaintiffs' counsel to make an argument that this was always the standard," Morgan Lewis' Denson said.

There are also questions about whether the CFPB might seek to apply the guidance beyond BNPL loans to include other types of fintech-enabled financing. After all, the agency framed the guidance broadly as addressing standards for "lenders that issue digital user accounts used to access credit."

If a product involves a digital "account, has no finance charge and is payable in four installments or less, it could potentially be covered," Denson said. That means "some of the more novel fintech products that are not strictly BNPL, like earned wage access or tip-model loans, could potentially be included there."

### **"Just the Beginning"?**

The CFPB will be accepting public comment on Wednesday's guidance until Aug. 1, and has said it is willing to consider adjustments. But the guidance, which was issued as an interpretive rule, is set to take effect 60 days after its formal publication, leaving BNPL firms with little time to prepare.

The industry's reaction so far suggests that while some firms may have misgivings, there is not the kind of broad-based opposition that would be likely to animate a preemptive legal challenge along the lines of what the CFPB has faced with other recent policymaking.

That could change, of course, if the U.S. Supreme Court curtails or jettisons the so-called Chevron doctrine of judicial deference to agencies' statutory interpretations, as Dorsey & Whitney's Bryan noted; the high court is reviewing this doctrine as part of two cases it is poised to rule on in the coming weeks.

"Because this interpretive rule pushes the envelope past existing law into pure agency interpretation, it will be an attractive target for industry challenge, should Chevron be overturned," Bryan said.

For now, at least, industry representatives like the Financial Technology Association, which includes several leading BNPL firms among its members, are indicating that they plan to engage with the CFPB during the upcoming comment period.

"BNPL products are fundamentally different from credit cards: these products have zero interest on outstanding balances, no ability to revolve a balance, and a profit model centered on user success," FTA President and CEO Penny Lee said in a Wednesday statement. "We look forward to providing additional

comments to the CFPB and distinguishing BNPL from products whose business models rely on revolving debt and high consumer fees."

At least one trade organization outright welcomed the guidance. The head of the American Fintech Council, which also has members in the BNPL space, said Wednesday that the CFPB had provided "vital clarity for companies" with its interpretive rule.

"The rule recognizes the benefits that responsible BNPL providers offer but more importantly provides consistent industry standards to promote greater choice and transparency for consumers utilizing responsible BNPL products," AFC CEO Phil Goldfeder said in a statement.

What else the CFPB might have up its sleeve is unclear. Speaking with reporters, agency officials said that while they are not "actively proposing" any new rules for BNPL firms, they would decide whether to do so once the comment period is over.

Bryan put it a different way: "This is just the beginning of the CFPB's regulation of the BNPL industry."

### **Taking the "Next Step"**

Consumer advocates certainly hope there's more to come.

Groups like Consumer Reports, the Center for Responsible Lending and the National Consumer Law Center applauded the CFPB's guidance Wednesday as much-needed progress for consumers, saying it takes aim at real problems encountered all too often by BNPL borrowers.

"Consumers who use BNPL loans often get the runaround when they are unhappy with a purchase and can face weeks of hassle trying to get a refund," Consumer Reports' Chien said. "The CFPB's new rule will help ensure consumers can dispute charges and get their money back promptly just as they are guaranteed by law when they make a purchase with a credit card."

The CFPB previously cataloged these problems in a 2022 report that it published following a months-long inquiry into the BNPL market. Although BNPL loans can have "real and sizeable" benefits as compared to traditional credit options, BNPL consumers do face certain risks of harm and other challenges, the agency said.

Among its concerns, the CFPB cited a lack of uniform consumer disclosures, refund and return difficulties, and other gaps in protections for BNPL borrowers — issues that Wednesday's guidance is intended to help address.

But the CFPB also pointed to serious concerns about some fee practices and how easy it can be for consumers to become financially "overextended" with too many BNPL loans at once. The new guidance doesn't touch those, but consumer advocates say that tackling them should be the agency's "next step."

"With many financially stressed consumers, including young people new to credit, using BNPL to buy groceries and make ends meet, we also need to make sure that consumers can afford to repay these loans and that late fees are not used as disguised interest," National Consumer Law Center associate director Lauren Saunders said in a Wednesday statement.

"The next step should be to extend the protections of the 2009 Credit CARD Act to BNPL products, which

would require providers to assess a borrower's ability to repay the loan and to charge only reasonable late fees," Saunders added.

Those protections are also written into Regulation Z, though in a different place — a section known as Subpart G. If BNPL firms can qualify as credit card companies for some parts of Regulation Z, it would seem only logical that other parts would apply too, but the CFPB specifically disclaimed that in Wednesday's guidance.

BNPL firms covered under Subpart B "are generally not subject to the credit card regulations appearing in Subpart G," the agency said.

Chi Chi Wu, senior staff attorney with National Consumer Law Center, explained that when those regulations were originally written more than a decade ago by the Federal Reserve, they used narrower terminology that refers more specifically to traditional credit cards and doesn't have the built-in flexibility of Subpart B.

That likely limited how far the CFPB felt it could go with its guidance, but Wu argued that the agency could use rulemaking to revisit Subpart G and expand the reach of its fee limitations and ability-to-repay underwriting requirements to the BNPL market.

"We would love to see the CFPB apply those protections to BNPL," Wu said. Affordability "is a real issue for BNPL borrowers," she added, and ability-to-repay underwriting "should actually be the touchstone for all lending."

"There are also some [BNPL] products, but not all, that have high late fees, so it would be good to apply the penalty fee limits as well," Wu said. But as a starting point, the CFPB's guidance "is certainly more than defensible."

Although critics may question whether it's fair or sensible to treat BNPL providers like credit card companies for regulatory purposes, Wu said the reality is that consumers are already treating them as functional equivalents when going shopping online and in stores. They accordingly "deserve the same dispute rights and refund rights," she said.

Strong consumer protections can also be good for business, according to Wu. That's what happened with the credit card industry, she said — card use became ubiquitous in part because consumers knew federal rules would, for example, give them recourse if a merchant stiffed them on a purchase.

Those rules "give people the confidence to use their credit cards online, to use them everywhere," Wu said. "They should have that same confidence with BNPL."

--Editing by Alanna Weissman and Michael Watanabe.