



Testimony of Professor Todd Zywicki Presented to  
United States Senate Committee on Banking, Housing and Urban  
Affairs

“New Consumer Financial Products and the Impacts to Workers”

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Chairman Brown, Ranking Member Toomey, and Members of the Committee:

I am Todd Zywicki and it is a pleasure to appear before you today to testify regarding “New Consumer Financial Products and the Impacts to Workers.” I am George Mason University Foundation Professor at Antonin Scalia Law School and Research Fellow of the Law & Economics Center. From 2020-2021 I served as the Chair of the CFPB’s Taskforce on Consumer Financial Law and from 2003-2004 I served as the Director of the Office of Policy Planning at the Federal Trade Commission. I am also co-author of *Consumer Credit and the American Economy* (Oxford 2014) and have written and spoken extensively on the impact to consumers from financial innovation, innovation, competition, and inclusion in consumer financial services products. I appear voluntarily today in my personal capacity and do not speak on behalf or represent any other party.

My testimony addresses three points:

First, the general welfare consequences to consumers from financial innovation and competition, especially with respect to traditionally underserved and excluded consumers, including both the economic benefits as well as potential consumer protection risks;

Second, the potential benefits and risks to consumers from the emergence and growth of Earned Wage Access products; and,

Third, the potential benefits and risks to consumers from the emergence and growth of “Buy Now, Pay Later” products

As will be seen, history and economic analysis demonstrate that innovation has been proven repeatedly to be a powerful mechanism to empower consumers, democratize

access to financial services on a fair and competitive basis, and, most important, to promote financial inclusion for traditionally underserved consumers, and to reduce demographic disparities in pricing and access to consumer financial services. Innovation is driving force behind greater competition, consumer choice, and empowering Americans to build a more prosperous and stable financial future. Moreover, as the recent experience of responding to the Covid pandemic made clear, innovation in consumer payments and finance is essential to resiliency in the economy to enable consumers and merchants' flexibility in responding to unexpected economic shocks.

The rapid growth in popularity of both EWA and BNPL testifies to their value in the evolving consumer financial ecosystem. Any regulatory initiatives should take great care to avoid stifling the continued growth and evolution of these products. Early in the evolution of a consumer financial product it is common for providers to experiment with different pricing, underwriting, and other business models.<sup>1</sup> History shows that over time as uptake of new products increases, they tend to gravitate toward more standardized terms and greater consumer value. I hasten add—this is not to say that regulators should be passive about new risks to consumers or opportunities to promote competition and innovation. It does suggest, however, that while regulators should be aggressive to prevent consumer harm, they should also be cautious about issuing premature and wide-ranging regulations that could freeze the market or entrench incumbent interests, either in these product industries or competitors, especially incumbent providers of financial services such as large banks.

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<sup>1</sup> See Todd Zywicki, *The Economics and Regulation of Network Branded Prepaid Cards*, 65 FLA. L. REV. 1477 (2013) (describing evolution of general purpose prepaid cards toward simpler, low-fee models as a result of market forces).

## The Role of Innovation in Consumer Financial Markets

Access to consumer financial products traditionally was limited to an elite group of Americans.<sup>2</sup> Bank accounts were limited to upper-income individuals and ancillary products that could provide liquidity between paychecks, such as overdraft protection, were also limited to high-income, high-status individuals.<sup>3</sup> Similarly, access to credit cards and bank personal loans were limited to established, low-risk customers, in substantial part because unreasonably low usury ceilings made it impossible to lend to all but the most credit-worthy, higher-income customers.

Working class Americans, by contrast, relied primarily on personal finance companies, pawnbrokers, and wage access loans (essentially proto-payday loans) to obtain liquidity between paychecks and retail store credit, layaway plans, and personal finance companies to acquire consumer durables and other goods.<sup>4</sup> The balkanized and segmented nature of these markets resulted from the presence of usury ceilings and other regulations that erected barriers that prevented competition across product categories, thereby dampening competition and consumer choice and increasing market power by providers.<sup>5</sup> The dominant position of retail store credit and layaway in the consumer credit ecosystem in the post-War decades was primarily a reflection of the fact that residents in states with restrictive usury ceilings were unable to obtain credit cards from banks and credit unions at prevailing usury ceiling rates, whereas department stores and

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<sup>2</sup> BUREAU OF CONSUMER FINANCIAL PROTECTION, TASKFORCE ON FEDERAL CONSUMER FINANCIAL LAW REPORT CHAPTER 10 (JAN. 2021)

<sup>3</sup> See Todd J. Zywicki, *The Economics and Regulation of Bank Overdraft Protection*, 69 WASH. & LEE L. REV. 1141 (2012).

<sup>4</sup> THOMAS DURKIN, GREGORY ELLIEHAUSEN, MICHAEL STATEN, AND TODD J. ZYWICKI, CONSUMER CREDIT AND THE AMERICAN ECONOMY CHAPTER 11 (2014).

<sup>5</sup> *Id.*

other retailers could circumvent usury ceilings by increasing the price of the goods they sold, thereby offsetting their losses on their credit programs.<sup>6</sup>

More generally, this experience illustrates the “perennial problem of... enabling rationed consumers to gain access to needed credit at what is considered by [third-parties] to be a ‘reasonable’ price instead of the price established through the free interplay of supply and demand.”<sup>7</sup> Ironically, providing widespread access at low prices has proven especially challenging for many consumers who are most in need of access to credit, such as young workers, immigrants, and wage-earners, who have unproven credit records, limited assets, or modest or unpredictable income flows.

Consumer credit use follows a lifecycle model. At the beginning of adulthood, consumers simultaneously have their highest demand for credit and lowest supply, aside from student loans. Consider an individual recently graduated from college. She likely needs to relocate to a new city, obtain housing, a work wardrobe, and furniture and appliances for outfitting a house or apartment, and perhaps reliable transportation (such as a car). At the same time, she is likely to have effectively no assets, savings, or other sources of liquid funds. In addition, her credit record and work history are limited and her income is the lowest it will be until she retires. As a result, she has her highest demand for credit at the same time she has her lowest supply.

As she matures and gets married, moves to a home and has children, her demand for credit increases. Children bring not only budget pressures but also budgetary unpredictability due to unexpected emergencies and the like. It is only until middle age that most Americans transition from being borrowers to being lenders (i.e., “saving”) and

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<sup>6</sup> Todd J. Zywicki, *The Economics of Credit Cards*, 3 CHAPMAN L. REV. 79 (2000).

<sup>7</sup> CFPB TASKFORCE REPORT, *supra* at 176.

accumulate assets. At this stage of life, income and assets are highest and one's credit record is well-established at the same time that demand for credit falls as consumers begin to downsize and children begin their own lives.

Credit usage, therefore, tends to skew toward earlier in one's financial lifecycle, especially with respect to non-prime products. Access to prime credit products (such as credit cards and home equity loans) are especially limited early in adulthood. Because of the high demand for credit to acquire needed goods and services, combined with the rationed access to prime credit products, those who use non-traditional credit products tend to be younger than those who predominantly use credit cards.<sup>8</sup> Moreover, most consumer durables (such as televisions, appliances, and furniture) are capital goods, thus there is great value to consumers from being able to accelerate the timing of purchases to acquire those goods and their use value rather than delaying purchase and being forced to use expensive and inconvenient alternatives instead (such as having to use a Laundromat rather than purchasing a washing machine).

History has shown the potential for innovation and competition to increase access and consumer choice for traditionally underserved consumers. Most notable, the development of national credit bureaus and particularly algorithmic-based credit scoring systems (such as FICO scores) not only increased financial inclusion and competition in consumer credit markets but also dramatically reduced disparities and discrimination in consumer lending markets by replacing archaic subjective assessments by lending officers with more objective measures of credit-worthiness.<sup>9</sup> Similarly, the Supreme Court's decision in *Marquette Nat. Bank v. First Omaha Svc. Corp.* that facilitated

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<sup>8</sup> CONSUMER CREDIT AND THE AMERICAN ECONOMY, *supra* at Chapter 8.

<sup>9</sup> CFPB TASKFORCE REPORT, *supra* at Chapter 10.

greater competition in credit card markets by enabling offerings across state lines was essential to the democratization of access of ordinary consumers to credit cards.<sup>10</sup> In turn, by unbundling credit offering from retail purchases, *Marquette* reduced the market power of large department stores and other retailers in both retailing and credit issuance, thereby benefiting consumers through enhanced competition in both markets.<sup>11</sup>

The emergence of Internet and app-based fintech products is creating an ongoing transformation in consumer financial markets today.<sup>12</sup> By drawing on “big data” and algorithmic underwriting models, entry by fintech providers has been shown to increase competition, increase access, reduce prices, and reduce demographic disparities in pricing in consumer credit markets.<sup>13</sup> By automating underwriting and issuance functions, the fintech nature of these products allows funds to be extended at very low cost, making even very small advances (a few hundred dollars or less) economically feasible if losses can be controlled.

Against this backdrop, it is clear that EWA and BNPL products have tremendous potential to disrupt traditional consumer finance markets. Any steps toward regulation or limitation of these products should be careful to avoid inadvertent costs that might dramatically reduce the value or increase the costs to consumers.

### **Earned Wage Access (EWA)**

Life does not happen on a two week cycle. Although many expenses are recurrent and predictable in timing and amount, such as rent or mortgages, many household

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<sup>10</sup> 439 U.S. 299 (1978).

<sup>11</sup> See Zywicki, *Economics of Credit Cards*, *supra*.

<sup>12</sup> See the extended discussion in CFPB TASKFORCE REPORT, *supra* at Chapters 9 and 10.

<sup>13</sup> *Id.* at Chapter 10.

expenses are less predictable. Yet wages are typically paid on biweekly, semimonthly, or monthly pay periods which creates a lag between the time that workers earn wages and the time they are actually received. This timing lag can be exacerbated by any delay in the clearance of a paycheck once deposited. If a consumer needs cash during this latency period between the time wages are earned and paid, they may often be forced to turn to expensive alternatives such as payday loans or bank overdraft protection, or be unable to make desired and potentially necessary purchases because of lack of liquid funds.

EAW programs have emerged as a fintech-based solution to this problem of accessing liquidity during the lag between the time wages are earned and actually paid.<sup>14</sup> This delay can be especially burdensome for new hires when the length of time between the first day of employment and first paycheck may be especially long.<sup>15</sup> This delay can lead some consumers to turn to short-term small-dollar products such as payday loans to meet short-term liquidity needs between paychecks.<sup>16</sup> EWA programs that allow consumers early and convenient access to their wages that have been earned but not yet disbursed.

Although it is possible that employers could pay wages on a more frequent basis, such as daily, it appears there remain certain technological, economic, and financial challenges to doing so, especially for smaller businesses. As a result, employers have typically partnered with third-parties to provide this service to employees. To date it is estimated that about 10 percent of companies have adopted EWA programs, especially larger employers with hourly or gig-economy workers such as Walmart, McDonald's,

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<sup>14</sup> See Bureau of Consumer Financial Protection, Advisory Opinion: Truth in Lending (Regulation Z); Earned Wage Access programs (Nov. 30, 2020).

<sup>15</sup> *Id.* at 2.

<sup>16</sup> *Id.* 2-3 (citing research by Financial Health Network).



and Uber.<sup>17</sup> That fraction is expected to continue to grow rapidly in the short run. Some surveys report that as much as 80 percent of employees would prefer more frequent payments, whether weekly or even daily as doing so enables them to budget better and reduces financial anxiety.<sup>18</sup>

Early EWA programs featured a variety of business models and fee structures.<sup>19</sup> Most of them were funded by some combination of fees assessed on employers and employees. Sometimes employers would cover employee fees in part or whole. Today, however, EWA programs are moving toward a pricing model of free employee access to wages with an ACH bank transfer or bank direct deposit, with a modest fee for acquiring funds by some alternative means.<sup>20</sup> Many EWA programs involve transfer of funds to a debit card issued by a partner bank (such as a Visa or MasterCard-branded card) and for which the EWA provider earns revenues through interchange fees when the consumer spends the money on the card which supports the program. The program itself is primarily funded by the interchange fee revenue when the consumer uses the card.<sup>21</sup>

Risk of loss is low on these programs due to the fact that providers are advancing against funds already earned but not yet paid. While it is possible that an employer could have a later claim for recoupment against these funds, recoupment efforts are rare and even more rare are efforts by the provider to try to recoup those losses against employees.

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<sup>17</sup> See Elena Whisler, *How Earned Wage Access Will Help Employers Through the Big Quit*, THE CLEARING HOUSE (Aug. 5, 2022), available in [https://www.theclearinghouse.org/payment-systems/articles/2022/08/insights\\_08-2022#:~:text=Today%2C%2010%20percent%20of%20companies,adopt%20earned%20wage%20access%20programs](https://www.theclearinghouse.org/payment-systems/articles/2022/08/insights_08-2022#:~:text=Today%2C%2010%20percent%20of%20companies,adopt%20earned%20wage%20access%20programs).

<sup>18</sup> *Id.*

<sup>19</sup> *Id.* at 3.

<sup>20</sup> See, e.g., PAYACTIV.COM, <https://www.payactiv.com/program-pricing/> (listing EWA Disbursement Type Fees).

<sup>21</sup> See Devina Khanna, and Arjun Kaushal, *Earned Wage Access and Direct-to—Consumer Advance Usage Trends* at Appendix, FINANCIAL HEALTH NETWORK (Apr. 2021) (listing fee structure for consumers from various EWA programs).

Moreover, most programs only allow the employee to draw only a portion of the funds earned but not yet paid (typically 50%), with the remainder paid at the end of the pay cycle. This holdback of wages reduces the risk of loss or need for subsequent recoupment. Still, this practice of limiting the amount of funds available appears to be rationalized primarily as a paternalistic limit on the ability of workers to gain access to their money, not to protect the financial solvency of the program, and I hope that eventually these limits will be reconsidered in the future consistent with responsible management of risk.

A study by the Financial Health Network this spring estimated that advances were successfully recouped at least 97% of the time.<sup>22</sup> Advances are relatively small in amount—according to one study the average was around \$120.<sup>23</sup>

A mismatch in the timing between when wages are received and when bills are due is generally recognized as a contributing factor to consumer use of bank overdraft protection or high-cost small-dollar loans, such as payday loans. Although some consumers use these products as short-term credit products, a significant number also appear to use them for liquidity to bridge timing gaps between the receipt of wages and when financial obligations are due.<sup>24</sup> EWA can serve as much lower cost and more convenient means for accessing liquidity than traditional payday loans. According to a survey by the Mercator Group conducted for one company, more than half of its customers previously used a payday lender but after they started using EWA, 69% of that group no longer used payday lenders and another 23% used payday loans less frequently

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<sup>22</sup> See Devina Khanna, and Arjun Kaushal, *Earned Wage Access and Direct-to—Consumer Advance Usage Trends* 11 FINANCIAL HEALTH NETWORK (Apr. 2021).

<sup>23</sup> *Id.*

<sup>24</sup> See CFPB, *Earned Wage Access* Advisory opinion, *supra* at 2.

or for smaller loans than previous.<sup>25</sup> Similarly, prior to uptake of EWA, 81% of them experienced NSF fees but afterwards 59% rarely or never overdrafted and another 31% overdrafted less frequently or for smaller amounts than previously.<sup>26</sup> Ninety-one percent also said that were less likely to pay bills late after gaining access to EWA than previously. As a result of access to EWA, employees stated they did not have to borrow as frequently from friends and family, pay late fees to a biller, incur NSF fees, pay for expenses with a credit card, or use a payday lender. In addition, by enabling them to reduce their reliance on these expensive alternatives, 77% of customers said that more frequent and convenient access to their wages enabled them save more money.

According to the same survey, 78% of users of the EWA product said they used the early access to funds to pay for groceries, 64% for utility bills, 54% for transportation and car insurance, and 53% for unexpected expenses. In light of high rates of inflation and energy costs in the economy today, it seems likely that many more consumers will be facing increasing budgetary pressure for expenses such as groceries, utilities, gasoline, and other necessities.

A study by AiteNovarica reported similar findings about the benefits to workers from access to EWA.<sup>27</sup> Before using DailyPay's EWA product, 57% of employees reported having paid a bill late, 49% borrowed from friends or family, 39% overdrew their bank account, 21% took out a payday loan, and 21% make a loan payment late or not at all. Overall, about 14% of survey respondents both overdrew their account *and* used a payday loan while about one-third did one or the other. Over 95% of employees reported that after using DailyPay they overdrew their accounts less often, used payday

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<sup>25</sup> See Mercator Advisory Group, *Customer Perceived Cost Savings: Study Sponsored by DailyPay*.

<sup>26</sup> *Id.*

<sup>27</sup> See AiteNovarica, *DailyPay Use and Outcomes: A Summary of Survey Findings* (Aug. 2021).

loans and borrowing from friends and family less frequently, and made fewer late bill payments than before. Research from other EWA providers confirms these findings.<sup>28</sup>

These industry surveys comport with the observations and experience of those of us who have studied the short-term lending market for years. It is clear that at least some use of small-dollar credit is for liquidity purposes to cover the lag between earning wages and receiving them. As a result,, it is hardly surprising that providing employees with access to their money on a more frequent basis at low or zero cost could substantially reduce their reliance on these expensive alternatives and enable them to better manage their financial affairs.

In this sense, arguments over whether EWA products should be classified as “credit” transactions and subjected to TILA disclosures and the like completely misses the point, especially now that an increasing number of EWA providers offer fee-free advances for basic access to one’s money, with a modest fee if the consumer seeks particular services such as faster access or a transfer to a different account than then provider-issued card. The rapid uptake of EWA where it has become available is a testament to the need it fills in the consumer finance ecosystem and regulators should be cautious about issuing regulations that could freeze the future development of this product. EWA is an ingenious solution to the longstanding difficulty of designing a product that can meet the liquidity needs of wage-earners at low cost and easy convenience.

### **Buy Now Pay Later (BNPL)**

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<sup>28</sup> See Instant, *Wages and Wellbeing: Analyzing the Impact of Same-day Pay* (April 2022).

BNPL is another emergent fintech product that represents an update on traditional methods of consumer finance, such as installment loans, credit cards, and layaway plans. The use of installment loans to enable purchases of consumer durables, such as appliances, electronics, and furniture, dates to at least the late-19<sup>th</sup> century in the United States. Because many of these products are in the nature of capital goods, there is substantial value to consumers from being able to change the time of purchase so as to acquire the goods and use them while paying for them. The emergence of credit cards and their widespread adoption beginning in the second half of the 20<sup>th</sup> Century made it possible for consumers to extend their use of credit from financing consumer durables to general consumption purposes.

BNPL emerged several years ago as a fintech solution to the traditional model of installment sales to finance consumer durables but has grown rapidly. According to one survey of consumer behavior during the Covid pandemic, the most common types of purchases made by consumers using BNPL were for consumer durables such as clothing, electronics, furniture, appliances, and housewares.<sup>29</sup> Today, BNPL increasingly is available for other consumer purchases beyond consumer durables, such as gasoline. The rapid growth in online shopping in response to the forced business closures associated with the Covid pandemic accelerated merchant and consumer uptake of BNPL.

The BNPL market is fragmented and many of the operations are outside the traditional banking system. Moreover, BNPL transactions are not included within the

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<sup>29</sup> C+R Research, *Buy Now, Pay Later Statistics and User Habits* (2021), available at [https://www.crrresearch.com/blog/buy\\_now\\_pay\\_later\\_statistics](https://www.crrresearch.com/blog/buy_now_pay_later_statistics). BNPL originally had disproportionate uptake by younger women, as BNPL focused on developing partnerships with female focused ecommerce brands. See CARDIFY, COVID-19 AND THE SURGE OF “BUY NOW, PAY LATER,” CARDIFY.COM (July 29, 2020), available in <https://www.cardify.ai/reports/buy-now-pay-later>. It is not clear whether this is still the case and the growing usage of BNPL for electronics purchases, for example, suggests that this disparity in use by sex may no longer be the case.

credit reporting system, thus there is minimal transparency to determine the exact size of the industry or the demographic characteristics of its users. The CFPB has announced that it is collecting information on the industry, which should provide useful information to better understand the structure of the industry and its operation.

It appears, however, that BNPL users are young and BNPL is often used as an alternative to credit cards, either by choice (BNPL is often less-expensive for most consumers than revolving credit card credit) or because the consumer either has no credit card or is nearly maxxed out and thus lacks available free credit lines.

A typical BNPL transactions if a point-of-sale loan that allows consumers to pay for online or in-store retail purchases over a set period, typically four payments every two weeks (1/4 at the time of purchase then additional payments every two weeks). Although modeled after traditional retail installment loans, most BNPL transactions are interest free consumers and are funded by the merchant through a discount rate of approximately 3-6% (higher than the cost of a typical credit card). This short-term no-interest financing is the predominant business model—according to one report, 70% of BNPL users are for short-term financing with no interest, 21% are for six months or less with no interest, and only 11% are for longer than six months with interest.<sup>30</sup> If the consumer makes payments on time, therefore, she usually incurs no fee or other costs from using BNPL, unlike a credit card for which the consumer will pay a finance charge if the balance is not paid in full at the end of the cycle.

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<sup>30</sup> See Hannah Gdaman, Meghan Greene, Necati Celik, *Buy Now, Pay Later: Implications for Financial Health: A FinHealth Spend Product Spotlight* at 4, Fig. 1 (March 2022).

Estimates vary as to how many households use BNPL. Some surveys have suggested that as much as 50% of consumers have used a BNPL service.<sup>31</sup> Although possible, this figure seems implausibly high to me. I suspect a more accurate estimate is around 10% of American households used BNPL in the past year.<sup>32</sup> According to one estimate, the number of BNPL users has grown by more than 300 percent per years since 2018, reaching 45 million active users in 2021 and today represents about 2 percent of U.S. online retail sales.<sup>33</sup>

BNPL has proven to be especially attractive to consumers who are otherwise underserved by the mainstream financial system, such as younger, lower-income, and credit-impaired consumers. Younger and less financially healthy households are more likely to use BNPL, particularly millennials and Generation Z, who either lack access to credit cards or prefer the interest-free nature of BNPL and its more simple and transparent terms relative to credit cards.<sup>34</sup> Households in weaker financial condition are also more likely to use BNPL than financially healthy households.<sup>35</sup> BNPL users are also almost twice as likely to report having subprime credit scores and 77% who have credit cards say they have carried a balance on their credit cards over the past year.

For all households, but especially households with impaired or thin credit, BNPL provides an inexpensive option to finance purchases without a credit card or without

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<sup>31</sup> See, e.g., Maurie Backman and Jack Caporal, *Study: Buy Now, Pay Later Services Grow in Popularity*, THE ASCENT, FOOL.COM (July 18, 2022), available in <https://www.fool.com/the-ascent/research/buy-now-pay-later-statistics/>.

<sup>32</sup> See Gdalman, *et al.*, *supra* at 4.

<sup>33</sup> See Julian Alcazar and Terri Bradford, *The Appeal and Proliferation of Buy Now, Pay Later: Consumer and Merchant Perspectives*, FED. RES. BANK OF KANSAS CITY PAYMENT SYSTEMS RESEARCH BRIEFING (Nov. 10, 2021), available in <https://www.kansascityfed.org/research/payments-system-research-briefings/the-appeal-and-proliferation-of-buy-now-pay-later-consumer-and-merchant-perspectives/>.

<sup>34</sup> See Gdalman, *et al.*, *supra* at 5.

<sup>35</sup> *Id.*

having to pay interest on revolving credit card balances.<sup>36</sup> Most BNPL purchases are modest in size—according to one survey, users of the short-term, no-interest mode reported owing an average of \$330 across all BNPL purchases at the time of the survey.<sup>37</sup> As with traditional credit cards or consumer credit, using BNPL enables these consumers to make purchases they otherwise would have been unable to make or would have been required to use a credit card for (which could be more expensive). Moreover, according to research by the Financial Health Network, 99% of BNPL users stated that they understood the terms and conditions associated with using the product.<sup>38</sup>

According to one research report, the most common reason consumers give for using BNPL is “to make checkout easier.” This group is made up of middle income people with incomes between \$40,000-\$80,000 and skew toward millennial-aged consumers who see BNPL as similar to payment platforms and digital wallet apps.<sup>39</sup> Higher income consumers often use BNPL to avoid taking on debt, especially credit card debt, and tend to be slightly older.

BNPL is particularly attractive to younger (Gen Z and millennial), lower-income, and credit-impaired consumers because they do not run a full credit check before extending credit. Most BNPL providers only run a soft credit check for interest-free installment loans thus are available to those with limited or impaired credit histories. Like traditional personal finance companies, the lender’s decision whether to extend credit rests primarily on the lender’s relationship with the customer rather than general credit record. Rather than issuing a line of credit based on the applicant’s general credit record,

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<sup>36</sup> Backman and Caporal, *supra*.

<sup>37</sup> Gdalmán, *supra* at 7.

<sup>38</sup> *Id.* 7.

<sup>39</sup> CARDIFY, CONVENIENCE, DEBT, AND NOVELTY: ANALYZING BNPL CONSUMER DATA (Sept. 8, 2021), available in <https://www.cardify.ai/reports/bnpl-trend-report>.



BNPL lenders will typically start a consumer with a small line of approved credit and raise the available amount over time based on the consumer's demand. Failure to pay can result in denial of access to future credit from that provider. Thus, although losses are possible, they are usually modest in amount for each non-performing borrower.

Beyond denial of future BNPL applications, the consequences of late payments and default are unclear and merit further study. Some lenders charge a fee for late payments but those are usually relatively small in amount and vary by lender. Although BNPL providers do not check your credit score before extending credit, some may report missed or late payments to credit bureaus, which could result in harm to a borrower's credit record. Some reports suggest that some BNPL providers send delinquent debt to collections, but it is unclear how often and under which conditions this is the case. I have found no evidence in my research that BNPL providers bring collections actions in court. If the economy tilts toward recession in coming months, it is likely that delinquencies and defaults will increase, which could create incentives for providers to take a more aggressive stance toward collections efforts—this is a development that bears monitoring by the CFPB and other consumer protection officials.

The rapid rise and development of BNPL, especially among younger consumers, reflects both the potential of fintech to serve traditionally underserved consumers as well as increasing the potential for a greater variety of products that can serve consumers better. There appears to be a potential dramatic shift ongoing in the way in which younger consumers use financial services.<sup>40</sup> In particular, after many decades of a tendency

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<sup>40</sup> I emphasize the term “potential” because it is not clear whether the current changes reflect a permanent change in the trajectory of use of consumer financial services or a temporary change that will lead Millennials and Generation Z back toward more traditional models of banking as they mature. See CFPB TASKFORCE REPORT, *supra* at Chapter 12.

towards “bundling” of financial services into one-stop shopping of integrated large banks, younger consumers increasingly are consuming financial services in a disaggregated fashion, using a variety of apps and platforms for payments, borrowing, investing, and the like. Younger consumers have also expressed some concern over financial privacy and distrust of the traditional banking system. As a result, the limited and disaggregated nature of BNPL products may be appealing to their lifestyle and privacy concerns.<sup>41</sup>

Younger consumers also appear to be financially “maturing” later than earlier generations of consumers. The availability of these alternatives to the traditional banking system has made it less necessary for them to open and maintain a traditional bank account than in the past. Bank accounts have become much more expensive in terms of fees and elevated restrictions, such as higher minimum monthly balances to avoid fees, have increased the cost and reduced access to traditional bank accounts. The primary driver behind these increased costs and reduced access to bank accounts has been a variety of expensive regulations enacted since the financial crisis, such as Dodd-Frank and the Durbin Amendment that placed price controls on debit card interchange fees. Other regulations, notably the Credit CARD Act of 2009, restricted access to credit cards for younger consumers, which in turn has delayed their building of a credit record. In turn, this has perpetually delayed the timing of their access to credit cards and other mainstream financial products.<sup>42</sup>

Of greater relevance will be developments in the BNPL market as interest rates continue to increase and the economy tips toward recession in over coming months. These developments will impact both consumer demand and provider supply of BNPL.

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<sup>41</sup> See CFPB TASKFORCE REPORT, *supra* at Chapter 12.

<sup>42</sup> CFPB TASKFORCE REPORT, *supra* at Chapter 10.

BNPL usage exploded during the government-imposed pandemic shutdowns as merchants scrambled to build greater capabilities for online shopping. BNPL usage growth has slowed since the economy reopened.

If the economy dips into recession and interest rates continue to rise, however, BNPL usage could increase by both merchants and consumers. As interest rates increase and household budgets become tighter, consumers can be expected to be increasingly attracted to the interest-free terms of BNPL as an alternative to higher interest rates on credit cards. Increasing prices of goods such as gasoline, energy, and groceries will likely lead to greater usage by consumers for these non-durable purchases. At the same time, recessionary conditions likely will lead to a tightening of access to credit cards and other consumer credit, especially among non-prime consumers, leading many consumers to turn to BNPL as an alternative. How consumers and providers respond to recessionary and high interest rate conditions will test BNPL's business model.

To date, most of the concerns that have been expressed about BNPL are largely theoretical and unsupported by tangible empirical evidence. It appears the primary concern about BNPL is that certain consumers will spend "too much" if they are given the opportunity to use BNPL too freely or will be unable to properly manage their finances. This vague concern has limited empirical support behind it to date. As with EWA and all other non-prime financial products, the most relevant question is what alternatives these consumers would be left with if they are unable to access BNPL as a result of regulations that end up restricting access to these products. Under conditions of high interest rates, high inflation, and recessionary economic conditions, BNPL could

turn out to be a crucial lifeline for consumers and smaller merchants to provide important resiliency during the coming challenging economic conditions.

### **Conclusion**

Thank you for your time and the opportunity to appear before you today and I am happy to take any questions you may have.