

WHITEPAPER

Next-Gen Lending Product: Buy Now, Pay Later

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What lenders and consumers need to know about this financing option

What is BNPL? Buy now, pay later has been around in different forms and accessible to consumers through various channels for a long time. For example, consumers shopping for furniture or appliances could be presented with an option to acquire desired items through installments at the point of sale. So, why the discussion around BNPL now, and what's so next generation about it?

A few elements came together to propel the rapid rise and acceptance of BNPL, including:

- ✓ Ecommerce growth and the COVID-19 pandemic accelerating digitization
- ✓ Structure and ease of access to these loans
- ✓ Gen Z and Millennials consumers' (who are more in tune with technology) preferences for friction-right transactions

The new structure of BNPL that caught the attention of consumers was the Pay in 4 product which allowed deferred payments. In other words, a consumer wanting to purchase merchandise for \$100 would make four payments. The first \$25 would be due immediately, and the remaining \$75 would be paid over three subsequent, biweekly payments. You'd incur no administrative or interest fees, and your time to make payments is extended. BNPL is much like the layaway plans of the past – with the benefit of immediate use.

BNPL lenders do offer traditional monthly installment loans as well, but they package them in the BNPL structure (that is, seamless integration into consumers' purchasing processes).

These are typically Pay Monthly products, and some key differences vs. Pay in 4 include:

- ✓ There might be interest charges applicable
- ✓ They're typically meant for larger purchase transactions
- ✓ They usually have longer-term periods for repayment

Research for the Q4 2023 TransUnion Consumer Pulse Survey discovered consumers' primary reasons for using BNPL were:

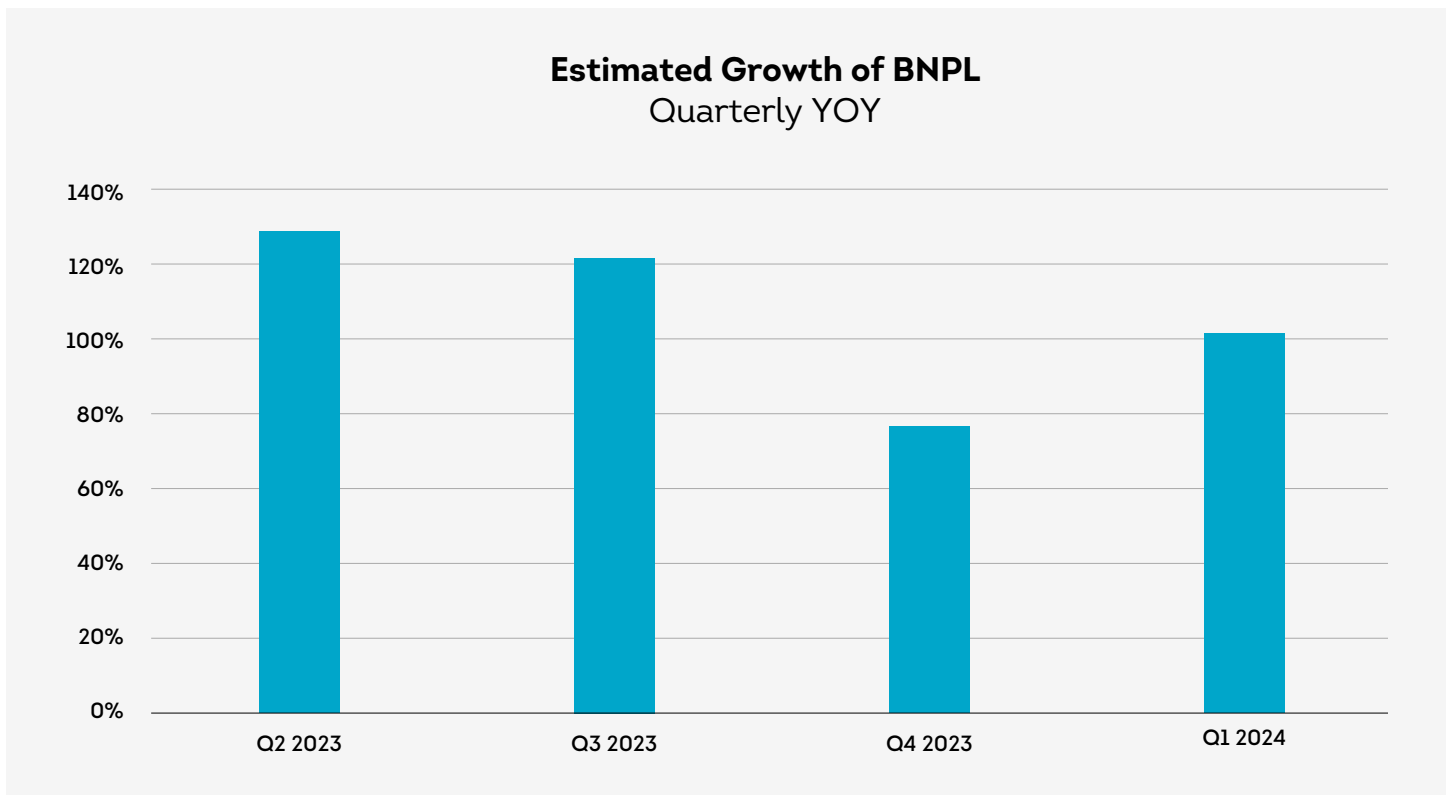
- ✔ To spread payments over time (18%)
- ✔ Wanted to try it (9%)
- ✔ Couldn't afford the purchase without it (9%)

TransUnion's BNPL study data, which has been supplied by some of the top BNPL providers in Canada, indicated the majority of Pay in 4 consumers tended to be card revolvers; consumers who do not pay their credit card balance in full. In contrast, the majority of Pay Monthly consumers were transactors – those who pay their credit card balance in full. There seems to be a combination of drivers, including financial need, financial savviness and the willingness to experiment with new products.

According to Straits Research,¹ the BNPL market could skyrocket from \$132 billion now to nearly \$3.7 trillion by 2030 globally.

What's driving the trend?

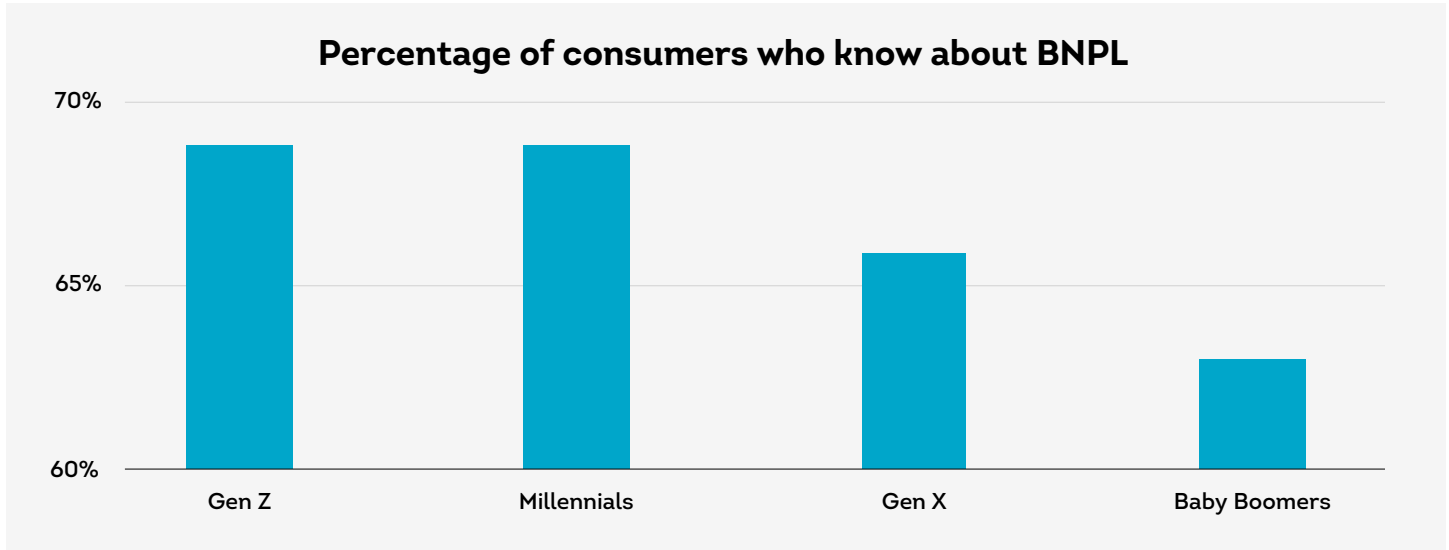
The market really picked up speed during the pandemic as savvy shoppers opted to take advantage of interest-free payments to buy what they wanted – and it doesn't appear to be slowing down. In 2023, BNPL (Pay in 4 and Pay Monthly) trade volumes continued to grow; Q2 and Q3 2023 saw more than 100% YoY growth², according to estimates from TransUnion Canada BNPL/POS Study data.



What insights do we have on the consumers using this product?

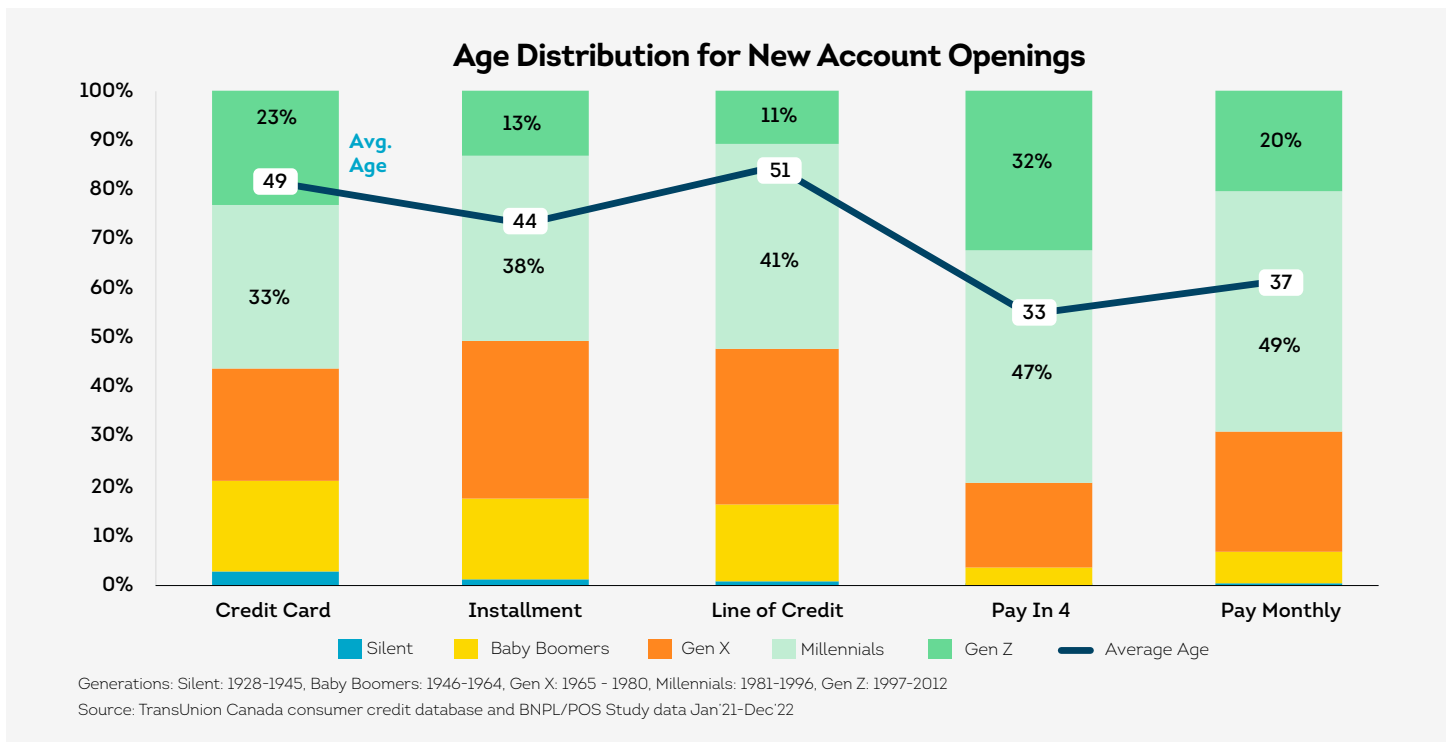
To truly understand the BNPL landscape, TransUnion analyzed the behaviors of consumers who opened a BNPL loan and compared them with those who opened other credit products. This is what we uncovered.

- 1. Millennials and Gen Z are leading the charge.** According to the Q4 2023 TransUnion Consumer Pulse Survey, more consumers have heard about BNPL compared to a year ago, and there's not a significant discrepancy in awareness by generation.



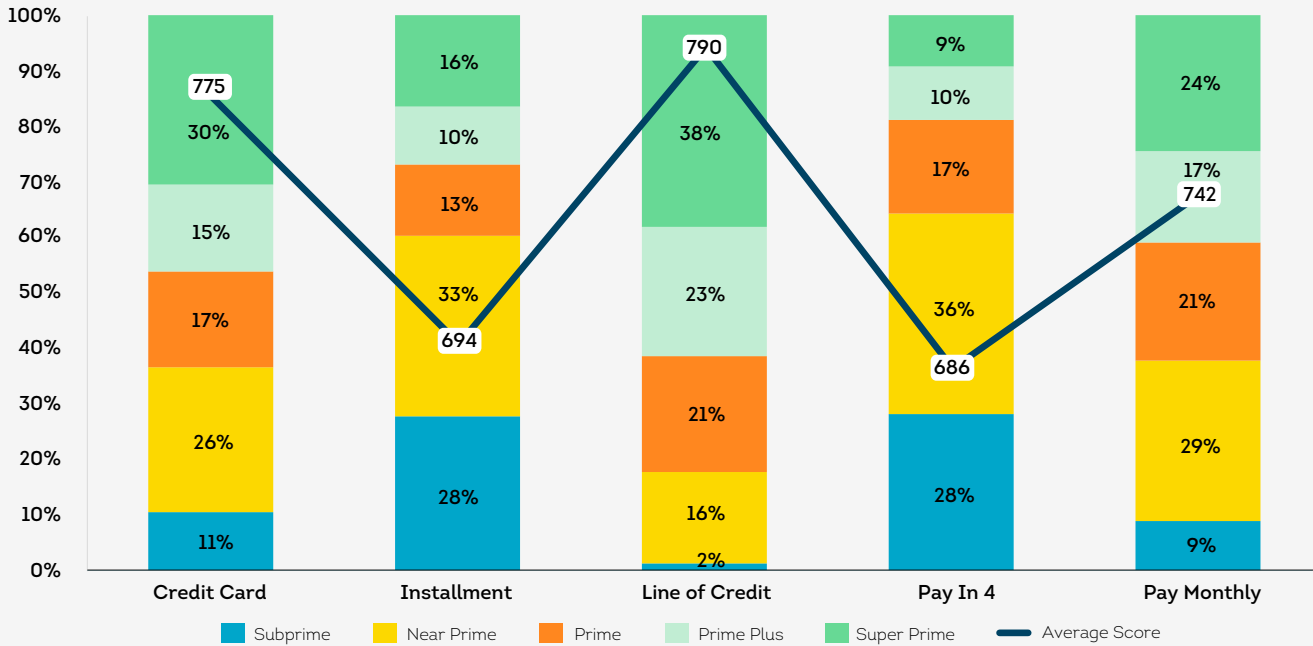
However, when you look at who's actually using BNPL services, the difference is clear. Overwhelmingly, Millennials and Gen Z are driving the increase in BNPL adoption.

Both Pay in 4 and Pay Monthly products appeal to younger consumers; Millennials and Gen Z contributed to nearly 80% of Pay in 4 volumes and nearly 70% in Pay Monthly Volumes. They want new ways to finance their purchases, and convenience and budgeting are top priorities for them.



2. Pay in 4 and Pay Monthly attracts a different risk profile. Early profiling of consumers applying for these products indicated Pay in 4 has a higher proportion of Non-Prime (lower credit score) consumers, while Pay Monthly has a higher proportion of Prime and above (higher credit score) consumers. These products can help consumers pay off their loans more quickly than a credit card with fixed payment plans and low or no interest charges. This is notable since some consumers may already be struggling to make payments on their existing credit card balances.

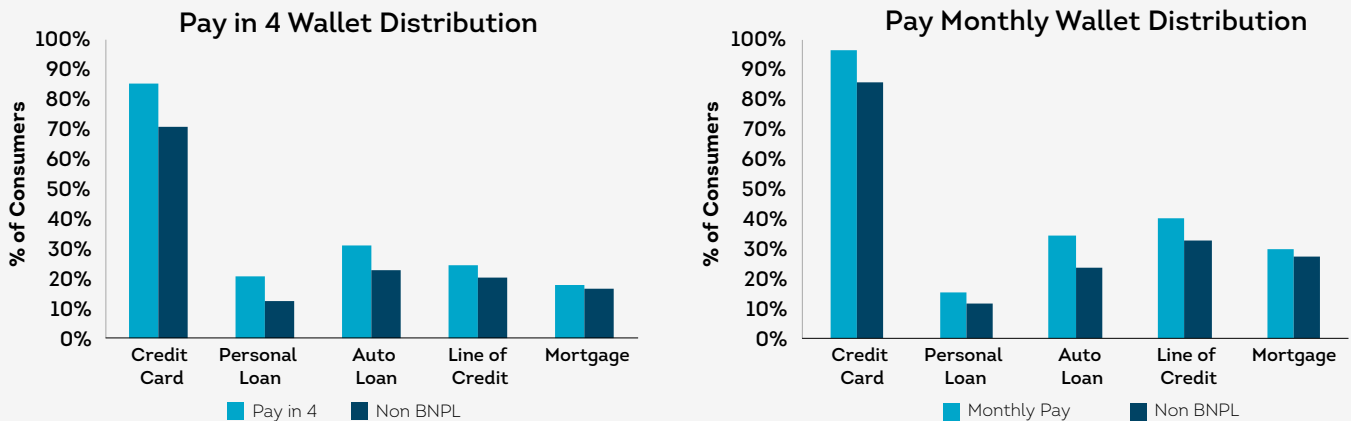
CreditVision Risk Tier Distribution on New Account Openings



Risk scores range between 300 - 900 (higher the better): Subprime = 300-639; Near prime = 640-719; Prime = 720-759; Prime plus = 760-799; Super prime = 800+
 Source: TransUnion Canada consumer credit database and BNPL/POS Study data Jan'21-Dec'22

3. BNPL consumers are highly credit active. They're more likely to hold other traditional credit products compared to non-BNPL consumers of a similar risk and age.

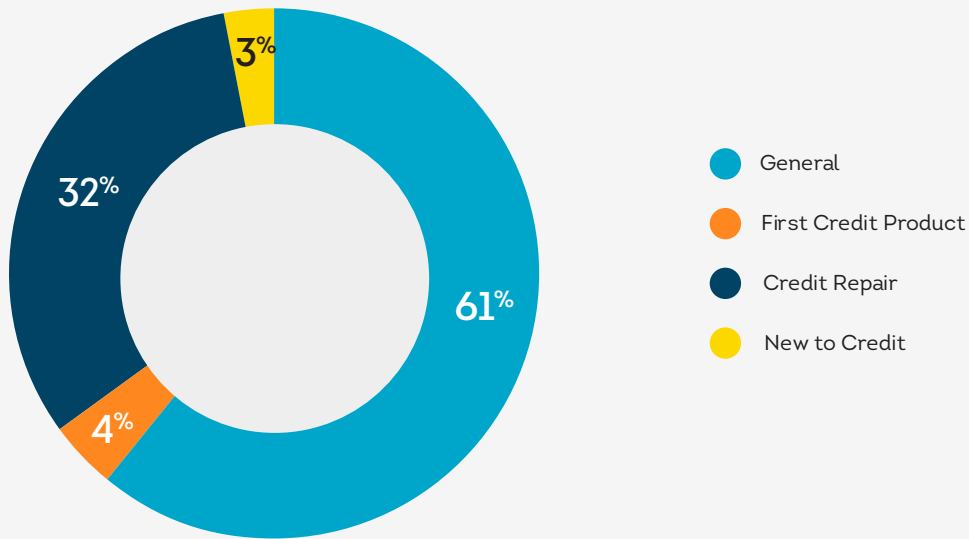
Percent of Consumers Holding Credit at BNPL Product Open



Source: TransUnion Canada consumer credit database and BNPL/POS Study data

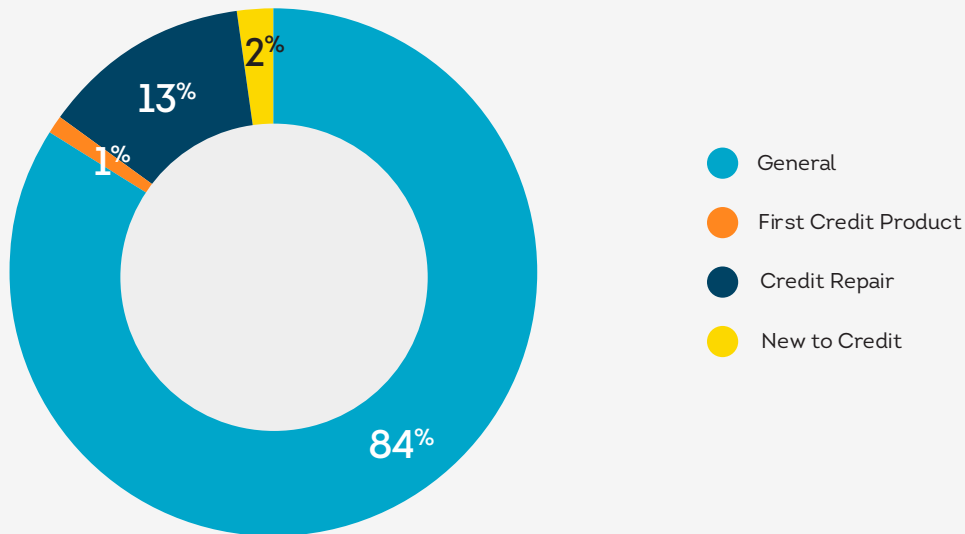
4. **BNPL loans can be a gateway for new-to-credit and credit repair consumers.** While BNPL consumers generally have other credit products, access to BNPL can provide a path to onboard new-to-credit consumers and help repair credit for others, benefiting both consumers and lenders.

Pay in 4 Consumer Type



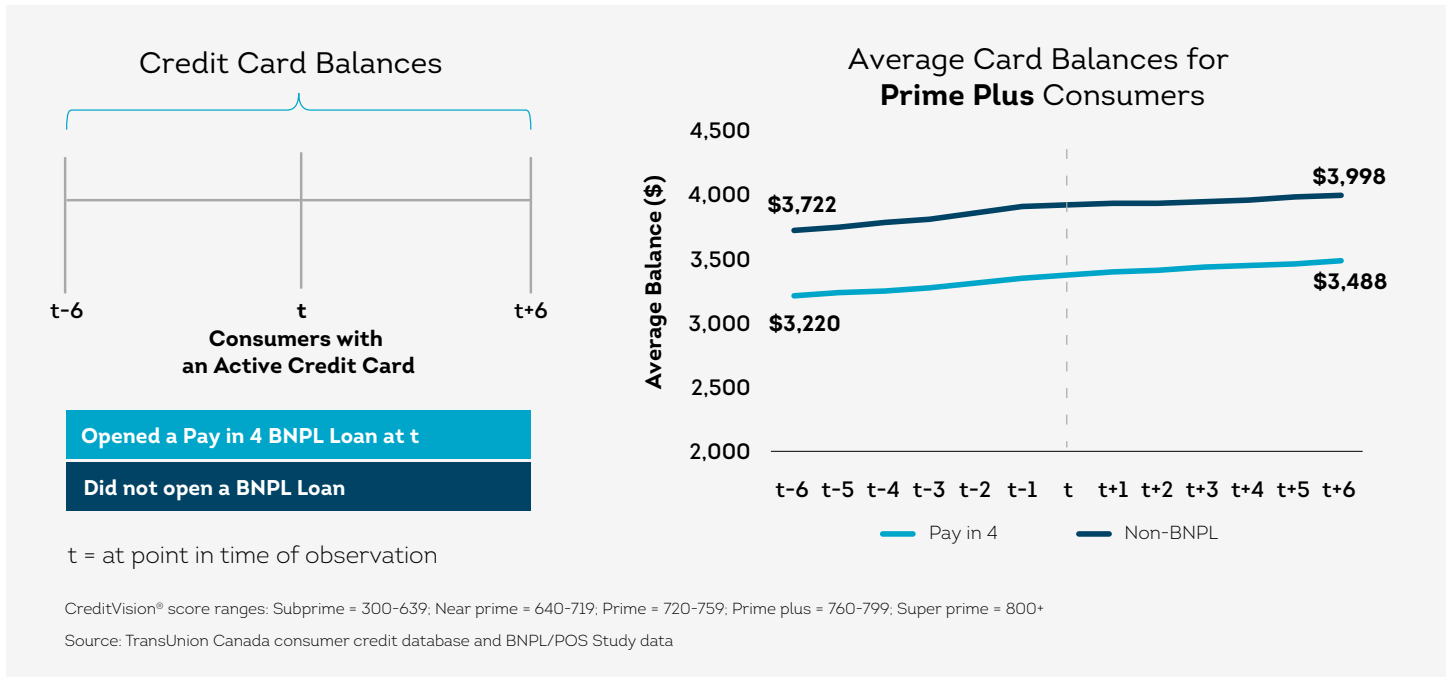
Source: TransUnion Canada consumer credit database and BNPL/POS Study data

Pay Monthly Consumer Type

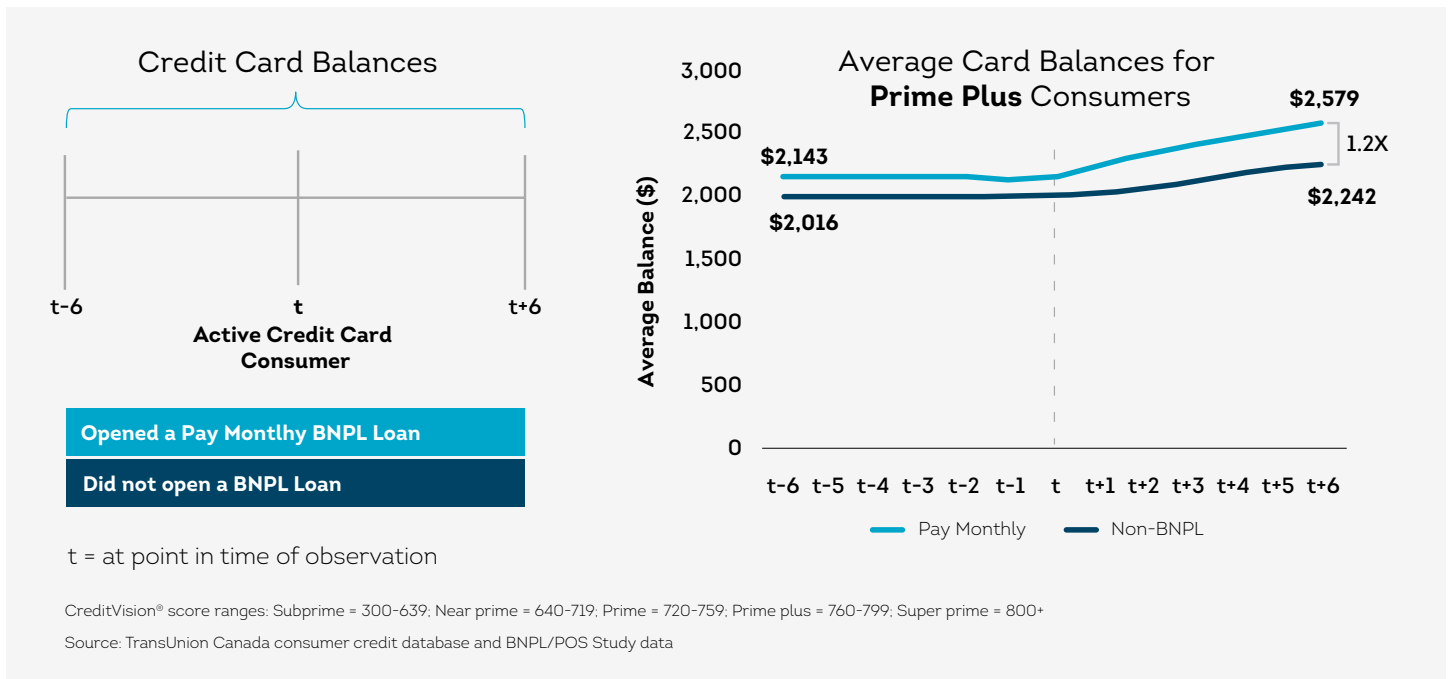


Source: TransUnion Canada consumer credit database and BNPL/POS Study data

5. BNPL is enabling and growing the market, and not replacing existing credit products. We looked at consumers' credit card and personal loan balances before and after getting their first Pay in 4 products and found their credit card balances grew at the same pace as those without a BNPL.



We saw the same pattern with Pay Monthly consumers. Ultimately, BNPL consumers are driving growth versus replacing existing forms of credit, creating opportunities for all lenders. However, there is the risk these consumers are over-extending themselves.



BNPL implications

Safe and well-regulated markets for consumer credit products are necessary for an efficient financial system. Credit products allow consumers to learn to plan and budget their expenses and be financially responsible.

Compared to traditional credit products, products like BNPL can offer multiple benefits, including:

- ✔ More affordable and easier access to credit⁴
- ✔ Increased competitive pressure on traditional credit products to innovate

Currently, in most of the international markets, Pay in 4 BNPL is not reported to credit bureaus. There are some reasons for this, including:

- ✔ A new product introduced in the market needs time to stabilize before any policy guidelines can be formulated³
- ✔ The product form and structure are different from typical credit products reported to bureaus⁴
- ✔ A segment of consumers falls under credit repair and might be more sensitive to potential score impacts⁴
- ✔ Some BNPL ticket sizes are nano-sized compared to traditional lending products

That said, regulators in other markets including Australia, UK and United States have taken note of this growing segment and are taking steps to introduce consultation/options paper^{5,7,8,9} – laying a path for building a framework around policy protections for consumers. With some key areas of focus being:

- ✔ Lending beyond a consumer's capacity or inappropriate lending practices, including excessive fees, advertising practices encouraging the use of BNPL for daily essentials like groceries or utilities that could contribute to financial stress, and hardship and other types of consumer harm
- ✔ Complaints handling processes and lack of hardship assistance for consumers
- ✔ Lack of reporting of BNPL loan information to credit bureaus, limiting the ability of other lenders to conduct proper credit checks and assess affordability of the consumer

There's an opportunity for lenders to proactively work toward an industry framework addressing the aforementioned concerns.

How reporting BNPL could benefit lender and consumers

With BNPL data, FinTechs and traditional lenders could more easily:

- ✔ **Find customers.** Consumers may choose to leverage BNPL products over traditional credit products due to the lower barriers of entry. This could enable more consumers to move into credit-visible territory if their BNPL activities are reported. This may help new-to-credit consumers gain access to other forms of credit, and others under credit repair showcase better payment behaviours⁴
- ✔ **Understand how much debt a prospective borrower is carrying.** This would enable better assessment of true risk before extending offers.⁶
- ✔ **Receive a better snapshot of consumers' creditworthiness.** By enabling lenders to see more of the consumers' payment obligations, it could allow lenders to consider consumers' overall capacities and affordability.⁴
- ✔ **Offer a service consumers want.** Reporting BNPL payments could be seen as a reward for consumers who pay on time, while deterring less-than-ideal borrowers.⁴

Alternative data: A view beyond credit scoring

Alternative data relates to:

- ✓ Non-traditional methods of assessing the creditworthiness of a consumer
- ✓ New forms of credit facilities that don't operate in the same way as traditional credit products reported on bureaus in either their structure or behaviour

TransUnion is analyzing the addition of various alternate forms of data, including BNPL, without initially impacting consumers' TransUnion credit scores. This data would offer lenders a wholesome picture of a consumer's capacity through income and debt obligations. The approach would help prevent unintended consequences for consumers by reporting of new types of data, allowing the market to mature and new scores to be developed to properly account for nuances vs. traditional credit data.

With alternative data:

- ✓ Consumers would benefit by becoming credit visible to lenders and be rewarded for responsible payment behaviours
- ✓ Lending solutions could be extended to consumers who would normally not be eligible for underwriting
- ✓ Targeting efforts can be improved, enabling the delivery of more relevant offers to the right people at the right time

Expanding the input selection to gain a holistic view of the consumer can help build your business and serve deserving consumers.

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