Buy Now Pay Later Services: Does India really need it?

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Abstract

The BNPL industry has been on the rise in various parts of the world. The industry is flourishing in developed nations like the USA and Europe. BNPL companies are a new concept for India. Companies are gaining traction and are expected to spur. BNPL companies claim their loans to be 'interest-free', but they really aren't. Credit comes with huge consumer risks. Considering all these risks and flaws in the BNPL model, most countries are coming up with stringent regulations to protect consumers. The paper comprehensively discusses the need for regulations and covers regulations by the USA, Hong Kong, and India. The paper then points to the question of the survival of the industry, "Does India really need it?". The paper then recommends further regulations that RBI can bring into the picture.

Introduction

Is it possible to buy goods worth more than your bank balance? Buy Now Pay Later (BNPL) services answer this question. BNPL rose to prominence in the last few years as online spending surged during the pandemic period. But there was a time when people followed the barter system that came with many complexities. Then we moved to the concept of coins and cash and modern-day cashless instruments like UPI and credit cards. Now we are heading towards BNPL services. We have come a long way from the barter system to BNPL services.

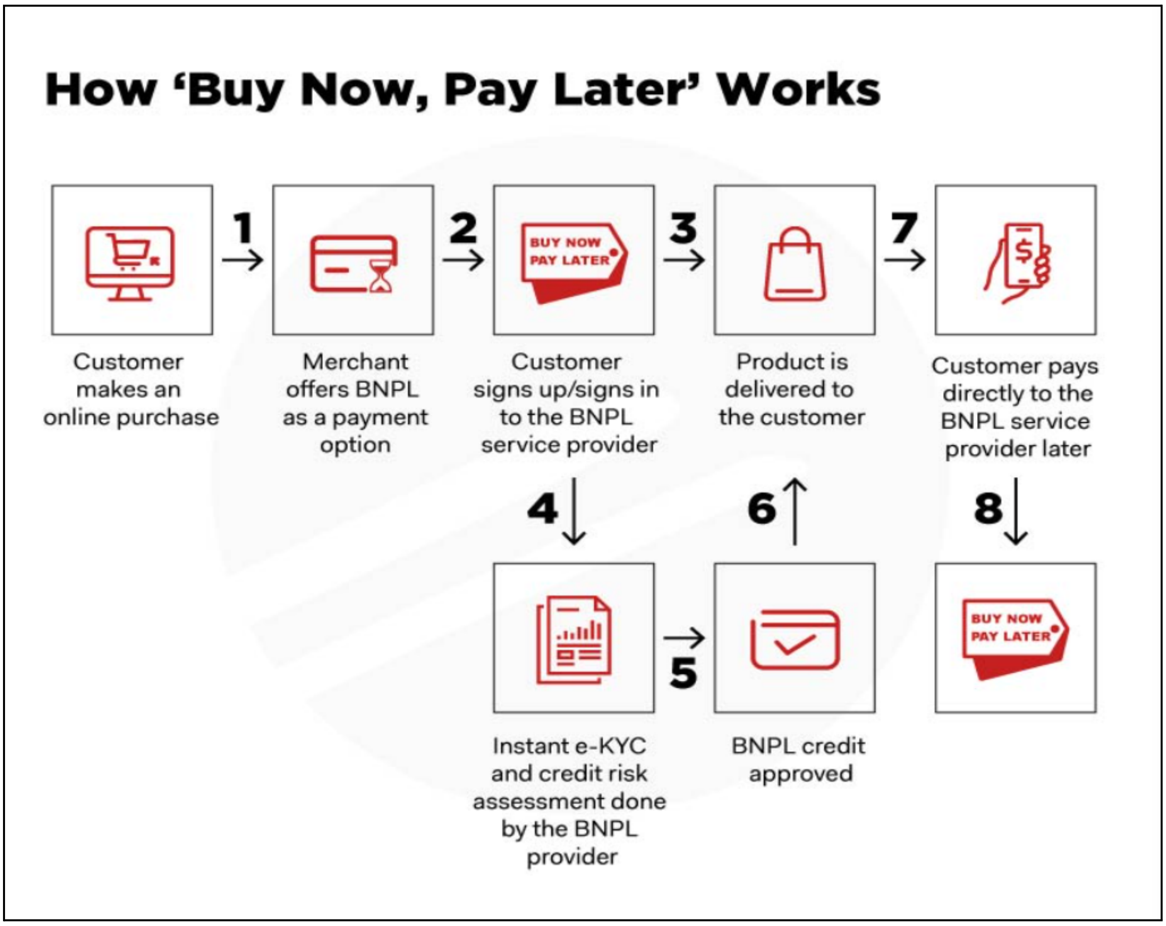
One must have heard phrases like "Khata mein likh dena" at local grocery stores. These "khata" are informal agreements between local grocery stores and their customers. The customer buys goods and pays a part of the purchase amount and pays the remaining amount whenever he/she has money.

The more formal way of "khata" are BNPL services, which charge their users a 0% interest rate. The customers need to make a down payment at the point of purchase and can split the outstanding amount into a few intervals. The BNPL companies partner with an NBFC or bank through which they provide a credit line to their consumers. The BNPL companies earn revenue through late fees, processing fees, and merchant commissions. The firms charge commissions from merchants they partner with and promise to bring a rise of about 25-30% in consumer traction.

There are two models through which BNPL firms acquire their customers.

- **Merchant partner acquisition model**
  In this model, BNPL lenders sign contracts with online retailers that allow them to embed their products on the retailer's website. Users can avail of this service and split their purchase amount into interest-free installments.

- **App-driven acquisition model**
  In this model, the BNPL lender has a proprietary app, and consumers must complete a credit application. Once approved, the users are provided with a bank/NBFC-issued digital card which can be used to make purchases. The card is accepted by all merchants even if merchants have not signed a contract with BNPL lenders.



Source: https://www.prove.com/blog/buy-now-pay-later-india

BNPL services: Different from credit cards

Both credit cards and BNPL offer deferred payment options but are worlds apart. Availing of a credit card requires a good credit history and involves a stringent verification process. BNPL service provides quick, easy access to credit, just a few steps away. The model is designed to cater population who are new to credit with low credit scores. One can simply choose BNPL at the point of purchase and split their payments. Credit cards require a lot of paperwork, full KYC, salary slips, employment status, etc, while BNPL service needs digital partial KYC and pan card details.

	Credit cards	BNPL services
Underwriting process	Full KYC, stringent verification process, needs a good credit score	Few basic details like PAN number, mobile number, etc required, given to people with low credit scores
Extra charges	Joining fees, annual maintenance fees, over-the-limit fees, late payment fees, and other hidden charges	Only a late fee is charged if one is not able to repay the outstanding amount in stipulated time
Interest-free credit period	Up to 45 days	Vary from company to company, some offer15 days, some even extend to 3 months
Interest rates	Depend upon various factors, generally high, ranging from 2.5-3% per month	0%

Current status of the BNPL industry

BNPL services have recently emerged as a new concept in India. It is gaining traction, and more and more people are availing of such services. During the pandemic, disposable income was severely affected. Hence, BNPL services came as a new way to finance the basic needs of the people.

Even RBI has jumped into the picture. The Payments Vision 2025 also discusses BNPL services as a new payment mode and the need to examine the services and issuance of appropriate guidelines. The discussion paper on digital lending suggested including BNPL services as part of balance sheet lending. The discussion paper also highlights that reforms need to be made to include BNPL services as part of the credit. RBI has rolled out a few other regulations that are discussed in succeeding sections.

ZestMoney, Flipkart Pay Later, Amazon Pay Later, CashE, and LazyPay are leading BNPL firms in India. The credit limit provided to users varies from company to company. Flipkart Pay Later provides a credit limit of up to ₹ 1 lakh, ZIP by Mobikwik provides ₹30,000, while CashE can issue a BNPL loan of up to ₹4 lakhs. Each company has a different repayment model. Some companies allow customers to choose an interest-free credit period of up to 15 days to split the purchase in EMIs of 3,6,9, or 12 months. Some firms provide an interest–free credit period of up to 3-4 months.

Traditional banks have also popped up in the BNPL segment. Either they are developing their own BNPL services or making strategic alliances with pure-play BNPL firms. One such case is the alliance of ICICI Bank with ZestMoney. Under this partnership, ICICI Bank is integrating the BNPL service offered by ZestMoney into its cardless EMI product. The customers will be given a credit of up to ₹10,00,000 for online transactions. The service is limited to online transactions only and is expected to increase the scope of in-store purchases.

BNPL companies are not only targeting e-commerce platforms. They are diversifying the BNPL loans in other sectors like tourism and healthcare. One such company is QubeHealth which offers healthcare now and pay later products. It provides a QubeHealth card that allows employees to cover their health and medical expenses that are not covered in health insurance by the company. More BNPL companies are surfacing in the healthcare sector.

India's BNPL space is an early-stage market and is expected to grow as a $43 billion market opportunity by 2025, growing at a compound annual growth rate (CAGR) of about 80%. The BNPL market in India is estimated to display an 11x growth from $4.1 Bn in 2021 to $43 Bn. The user base of BNPL services is expected to grow from 10-15 million currently to 35-40 million in near future. As an alternative to credit cards and increased convenience, the BNPL industry is expected to boom. Credit card penetration in India is merely 4.62% compared to the world average of 22.26%. Only 3 in 100 Indians have a credit card. BNPL services can emerge as a credit instrument for most Indians. 4 in 5 US consumers use BNPL for everyday purchases and believe that BNPL could replace their traditional payment methods. It is to be seen if it also applies to India's scenario. There is a darker side to the boom, although a rise in BNPL services is observed whereas the unit margins of BNPL companies are falling.

Unit margins denote how well the industry is flourishing. It is an incentive for new companies to enter the industry. Companies in the near future may be hesitant to enter the BNPL market as unit margins of the industry are falling. As per the reports by CFPB, the net transaction margins of five companies reported fell from 1.27% in 2020 to 1.01% in 2021. It can be attributed to a variety of reasons. One of the reasons is increased competition, new players entered the market and existing players expanded. It led to a fall in unit margins. The CFPB report highlights that the loan charge-off rate was 1.83% in 2020 which rose to 2.39% in 2021.

The falling unit margins can be attributed to the debt bubble that the BNPL industry has created. Due to easy access to credit, people are purchasing unnecessary goods. A survey that asked more than 1500 US consumers about their BNPL experience, claimed that 70% have spent more than they would if they had to pay for everything upfront. The survey highlighted that 42% of the consumers had made a late payment. The CFPB report also highlights the same, 10.5% of unique users were charged at least one late fee in 2021, a rise from 7.8% in 2020. This defaulting in BNPL leads to mounting credit losses.

On one side, the current BNPL industry in India is in the infant stage and is expected to boom. On the contrary, the unit margins as observed in most of the US firms are falling. It can be expected that India's BNPL industry will boom in the next decade and then will come to a halt.

Need for regulations

There is a need for regulations due to a variety of reasons. The underwriting process of the industry needs to be regulated, easy access to credit can increase the indebtedness of the users. The underwriting process needs to be based on the traditional "ability to pay" basis.

The terms and conditions provided are long and varies company to company. The users sometimes do not bother to read such long clauses which pose trouble for them later on.

The companies collect huge forms of data before sanctioning loans to their users. The data collected needs to be protected and companies should make sure that data breaches do not happen due to internal and external reasons. There have been a few instances of data breaches. Hence, regulation is required.

Underwriting process

The underwriting process of the consumers involved only a few steps and is entirely digital. Usually, the consumers' numbers are verified through a one-time password (OTP) followed by KYC verification through consumers' PAN cards. Some firms require only the last four digits of the PAN card number. The BNPL firms then inquire the credit bureau for credit information before sanctioning the credit limit. The firms use consumers' PAN details and mobile numbers to retrieve credit bureau reports.

As stated in the Dvara report, a few companies like Slice and ZestMoney required additional information like educational qualifications, marital status, date of birth, education fee receipts, employment details, work location, social media data, monthly income, and expenses before granting a BNPL loan. However, the provider did not seek any submission of documents except bank statements. This leads to a collection of irrelevant information and poses a threat to consumer data.

Terms and conditions

The terms and conditions (T&C) varied from company to company. All firms provided their T&Cs either on their websites or during the onboarding process. T&C of various companies violates RBI circulars. Sometimes companies do not differentiate between the T&Cs for BNPL products and other products offered by the company. For example, Kishht offers four different credit products, out of which one is a BNPL product. However, Kishht provides only one T&C without stating how provisions may alter from product to product.

Most BNPL companies provided Key Facts Statements (KFS) while it omitted key details like pricing, customer obligations, and penalties. This contravenes the RBI's circular on the Display of Information by banks. The users have to go through a long document of T&C to understand the product better. Sometimes, the composition excludes necessary information on charges and repayment procedures. Few companies do not disclose the Bank/NBFC's identity that will provide the credit until the customer's loan is sanctioned. Likewise, few financiers do not disclose the name of the digital lending partners they have partnered with. It violates RBI's circular on loans sourced by banks and NBFCs through digital lending platforms. This leaves customers with inaccurate information about the BNPL product they wish to purchase.

T&Cs of some companies include clauses of autopay. It must be the right of users if they wish to choose autopay or not. Autopays can lead consumers to take up additional loans to repay BNPL loans or skip other loans like personal loans, auto loans, etc. It is another risk for consumers.

Merely signing up with BNPL providers does not guarantee access to the services. The financiers can reject BNPL applications or keep them on hold without stating valid reasons. This is mentioned in the T&Cs of several firms. Companies like ZestMoney and LazyPay provide an indicative list of variables that are used for credit assessments while the variables are vaguely stated. This 'customer beware' policy can be problematic and places the responsibility of assessing the suitability of the credit line on the customer.

Data protection

The BNPL companies gather huge amounts of data like bank details, PAN details, education qualifications, occupation, mobile numbers, etc, before providing credit. Several companies use third-party apps to verify these details. Companies should look if these third-party vendors are secure enough to share their users' information. Governments across the world have identified data protection issues and have issued guidelines for the same. The RBI released a circular on Digital Payment Security Controls that requires regulated entities to perform routine assessments of their third-party associates to mitigate the risk of data breaches.

The consumers must read all the clauses specified in the T&Cs. The privacy policies that governed the use of personal data are often broad and non-specific, giving firms leeway in how to use personal data. Consumers can restrict providing access to non-mandatory data. The companies must take consumers' consent to receive promotional offers.

There have been a few instances of data breaches by several firms. Major firms like Klarna and AfterPay have been a victim of such cases.
In 2021, Klarna, a Swedish fintech company, experienced a technical glitch by which it exposed other users' data. Details like payments to pay, past purchases, etc were visible. Klarna temporarily locked down its app services. Klarna later clarified that the incident was not an external attack and claimed that it affected about 9,500 users for 30 mins. Klarna added that a human error caused a bug that led to such an incident, and the information visible was 'non-sensitive'.

The discussion paper on fintech by RBI presents current regulations for data protection in India. Section 43A of the Information Technology Act of 2000 states that in case of negligence in implementing reasonable security practices and procedures in handling sensitive personal data, the body is liable for payment of compensation. Section 72A of the act states that disclosure of information, knowingly and intentionally, without the consent of the person concerned can attract imprisonment for a term extending to three years and a fine.

Consumer risks

A few risks involved in using BNPL services that can adversely affect consumers' financial health are discussed below.

Overextension

The BNPL models are set such that users overextend their loans, and do not shift to other payment platforms. The repeat usage of BNPL services has been increasing steadily and driving incremental sales. The BNPL companies sign contracts with merchants claiming metrics like an increase in average order value, increase sales, a rise in repeat customer rate, and more transactions than other online shoppers.
Overextension leads to other risks: loan stacking and sustained usage.
<u>1. Loan stacking</u>
Loan stacking occurs when a user takes out concurrent BNPL loans at different lenders and is unable to repay some or all of them. The BNPL lenders do not have information about their users' borrowing activity on other platforms. This creates asymmetry in information and BNPL lenders unknowingly award loans to its users which are then unable to repay, worsens their financial health, and creates losses for companies. BNPL firms follow a "low and grow" strategy, low credit amounts are forwarded to first-time borrowers and slowly increase the amount over time with timely payments. Even if credit is not extended by one lender, consumers can easily shift to other lenders, leading to loan stacking.

2. Sustained usage

Sustained usage occurs when frequent BNPL usage leads to the borrower's inability to pay other non-BNPL financial obligations like student loans, personal loans, rent, auto loans, etc. The risk of sustained usage is borne by those users who regularly clear BNPL debts. Sustained usage takes time up to a year to appear. A study published by the Australian Securities & Investments Commission (ASIC) points out that in order to make BNPL payments on time, 20% of the users surveyed had to cut down essentials, and 15% of the users had to take an additional loan. BNPL borrowers have to skip essential bills to repay BNPL loans and keep their accounts open, this leads to worsening their financial condition.

Data harvesting

Data harvesting is the practice of harvesting and monetizing consumer data that threatens consumers' privacy and security. It may lead to the consolidation of market powers in the hands of a few big fintech that own the largest volume of consumer data. This may cause a monopoly in the BNPL industry and reduce choices for the users. The harvested data could be used to offer a targeted discount to some customers but not others. This is a situation of price discrimination, different group of customers are paying different prices based on their willingness to pay for the same good. The consumer data can be used to target marketing campaigns, and increase sales and this may further lead to overextension.

US regulations

BNPL is not officially regulated in the US at the federal level as these short-term loans and other forms of point-of-sale credit fall out of the purview in many countries. BNPL is subject to state regulations. In some states, BNPL is considered consumer credit and requires state licensing and compliance with state consumer credit laws. In other states, it does not require licensing and registration.

The Consumer Financial Protection Bureau (CFPB) is the governing body for consumer lending in the US, it has enforcement authority in certain cases. CFPB observed business trends and consumer risks in its September 2022 report. To address consumer harms, CFPB will identify potential guidelines, ensuring that BNPL adheres to appropriate supervisory examinations already established for credit cards. CFPB will examine types of transactional, demographic, and behavioral data collected for uses outside of the lending transaction including the purpose of sponsored ad placements, targeted discounts, sharing with merchants, and targeted products.

BNPL firms do not currently provide standard cost-of-credit disclosures which violate the Truth in Lending Act (TILA) implemented by Regulation Z. TILA requires lenders to provide consumers with clear cost-of-credit disclosures before consumers agree to take up a loan. The disclosure must include the amount financed, the total number of payments, the annual percentage rate, and potential late fee disclosures.

Hong Kong Regulations

Currently, most countries are struggling to figure out whether to include BNPL services as credit instruments or as payments instrument. But, Hong Kong is one of the few countries that clearly identifies BNPL services as 'credit'.

The Hong Kong Monetary Authority (HKMA) to safeguard consumer risks, rolled out seven consumer protection measures which are as follows,

- The banks need to include the educational message "To borrow or not to borrow? Borrow only if you can repay!" in the advertising and promotional messages of the BNPL products.
- Banks should not create an impression that BNPL does not entail borrowing. It must clearly disclose BNPL products as 'credit products'.
- Banks should examine the risk of impulsive borrowing if BNPL services are chosen as default or preferred payment methods on partnered e-commerce platforms.
- Banks must ensure that they clearly disclose applicable fees and interests in their all advertising and promotional materials.
- Banks must define what may happen to consumers' credit scores if they default on payment in the Key Facts Statement.
- Customers must be duly informed about how the repayment mechanism will function.
- In the underwriting process, banks must assess the user's credit status and take into account the ability to repay.

Banks are required to implement these measures by the end of this year. The measures are in the right direction and will help users to access accurate information, perform better decisions and avoid adverse risks.

Recent RBI regulations

BNPL services are labeled as a potential replacement for credit cards, a product for enhanced customer experience, and not as a credit product. Such transactions are not reported to credit bureaus as they do not qualify the definition of 'credit'. Hence, no regulations are applicable to them.

In June 2022, RBI announced that non-banks issuing pre-paid payment instruments (PPI) like digital wallets and pre-paid cards cannot offer customers a credit line on these instruments. Any non-compliance will attract penal action under the Payments and Settlement Systems Act, 2017. This notification severely impacted BNPL companies like Slice, Paytm, LazyPay, etc, that partnered with NBFCs to offer credit lines to their customers. Fintech companies started issuing their own PPIs which are financed byNBFCs with credit lines, loaded to these PPIs. The notification affects these fintechs.

The purpose of a PPI is supposed to act as a payment instrument. But with easily accessible credit lines, PPIs turned into credit instruments. There have been complaints made to RBI regarding KYC irregularities, disbursement of loans without consent, issuance of credit lines through wallets, and drop in credit scores. In order to regulate this, RBI issued these guidelines.

To adhere to these regulations, BNPL companies are exploring other business models. A few firms like Jupiter Edge and EarlySalary had to halt their services and figure out alternative business models. Some alternative business models that can spur in BNPL industry are discussed below.

1. Partnership with banks

BNPL companies that had partnered with banks remain unaffected by the recent notification. According to RBI's regulation, non-banks cannot issue PPIs with a credit line. So, a partnership with a bank will keep BNPL out of scrutiny by the RBI.

Banks come with increased regulatory oversight, and issuing credit to people with low credit scores will become difficult. This contradicts the very model of BNPL which serves people new to credit and who do not have stellar credit scores. Issuing co-branded cards with banks would be replicating the credit card model, eroding the scalability of the BNPL model.

Only if BNPL firms are able to prove their underwriting prowess and convince banks that they are taking well-calculated risks, banks won't have problems in issuing credit.

2. Loans through PPI

The notification does not allow credit lines to be disbursed through PPIs but loans can be disbursed. Credit lines and loans operate poles apart. A loan is non-revolving, borrowers borrow the amount they need, use funds, and make payments including interest. While a credit line is continuous, borrowers can use how much amount they require up to a credit limit and then make regular payments. Rather than disbursing credit lines, BNPL firms can change their model to offer loans.

3. Loans through a savings account

BNPL companies can disburse funds as loans to their customers' savings accounts. Customers can further use these funds through their debit cards.

4. Credit licenses of NFBC

RBI issues NBFCs with a net worth of ₹100 crores, and a credit card license. BNPL companies can partner with such NBFCs and can operate easily without altering their models.

Does India really need BNPL?

Every one in three Indians is categorized as 'middle class'. A report indicates that this population is about to double by 2047 where every two in three Indians will be middle class. India's income pyramid is likely to bulge from the middle, with the lower bracket shrinking and the bracket above expanding. BNPL services will cater to only the middle class as other poor strata won't have enough resources to access BNPL and the higher class does not require such services.

BNPL services will not reach the last mile, it cannot reach areas that even giant platforms like Ola, Flipkart, Amazon, and Zomato have not reached. India still has areas with poor connectivity with the cities. BNPL services won't be able to cater population where merchants do not deliver their products. BNPL is likely to offer its services to the urban middle population who are literate, and well aware of the latest technology.

Most Indians are overburdened with several kinds of loans, including education, health, personal loans, etc. While residents of developed nations do not have to bother about education and health as the government bears the burden. It is more likely that people in India will become victims of loan stacking and sustained usage.

Most people in India are still not well aware of the idea of BNPL. People aged above 50 are likely to regard BNPL as fraud and lack of awareness can drive down the BNPL industry. People's assumptions about the industry need to be reformed only then BNPL industry in India can spur.

Recommendations

- BNPL companies are sometimes projected as payment instruments and sometimes as credit instruments. If BNPL is regarded as a payment instrument, it will remain as an intermediate and remain out of the scrutiny of RBI. If it is regarded as a credit instrument, it will come under the direct ambit of RBI. Clarity on the nature of BNPL is required.
- RBI could place a credit cap that the BNPL firms can provide credit to its users up to a certain limit and follow a 'low and grow strategy'. Start providing BNPL loans with a

smaller amount if the users showcase an ability to pay higher loans then increase the loan amount.

- RBI can also start licensing BNPL companies. Provide a license to disburse credit only if the user base is less likely to default, has well-formulated T&Cs, and follows a stringent underwriting process. It will prevent these companies from turning into non-performing assets. The companies should be allowed to take a loan to stay in business for up to a certain limit.
- The regulation must be such the government can go for any criminal proceedings against the companies as well as customers of the company if they default on the loans.

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