

Consumer Finance Monitor (Season 7, Episode 30): Buy Now, Pay Later – Evolution, Regulation, and What You Need to Know about the CFPB Interpretive Rule Effective July 30

Speakers: Alan Kaplinsky, Joseph Schuster, and Mike Guerrero

Alan Kaplinsky:

Welcome to our award-winning Consumer Finance Monitor podcast, where we explore important new developments in the world of consumer financial services and what they mean for your business, your customers, and the industry. This is a weekly podcast show brought to you by the Consumer Financial Services Group at Ballard Spahr. I'm your host, Alan Kaplinsky, the former practice group leader for 25 years, and now senior counsel of the Consumer Financial Services Group at Ballard Spahr, and I'm very pleased to be moderating today's program.

For those of you who want even more information, don't forget about our blog, which also goes under the name Consumer Finance Monitor. The topic that I will introduce to you today is something that we have covered in great detail in our blog, so that definitely ought to be a source that you're going to want to look at, if you want to take an even deeper dive dealing with developments pertaining to buy now, pay later, just to let the cat out of the bag. But let me just get back to our blog for one moment. We've hosted our blog since July 21st, 2011, the very same day that the CFPB became operational.

We also regularly host webinars on subjects of interest to those in the industry. So if you want to subscribe to our blog or to get on our list for our webinars, please visit us at ballardspahr.com. And if you like our podcast, please let us know about it. You can leave us a review on Apple Podcasts, YouTube, Spotify, or whatever platform you regularly use to access your podcasts. And also, please let us know if you have other ideas for other topics that we should consider covering or speakers that we should consider inviting as guests on our show.

So I've already given you a little bit of information about the topic that we're going to be talking about today, and it is the buy now, pay later topic. Let me introduce two of my colleagues who are truly expert in this area, have done a ton of work for clients going back several years, dealing with buy now, pay later.

First of all, I'm going to introduce Joseph Schuster. Joseph is a partner in our Denver office, member of the Consumer Financial Services Group. His practice involves advising clients on payments matters, consumer, and small business regulatory matters. Particularly relevant to today's podcast, Joseph advises on the regulatory requirements associated with point of sale lending products, and buy now, pay later programs, which is a point of sale product very often. In addition to regularly speaking about developments relating to buy now, pay later, or we'll use the shorthand very often, BNPL. In addition to that, Joseph advises entities on technical consumer compliance requirements, as well as the commercial aspects of BNPL programs, including how to structure the commercial agreements and the back end money movement requirements.

So Joseph, a very warm welcome to our podcast show.

Joseph Schuster:

Thank you, Alan.

Alan Kaplinsky:

Next, another colleague of mine, Mike Guerrero. Mike is a partner in our firm's Los Angeles office. His practice is focused on product development and compliance. He frequently advises clients on a variety of financial services products, including BNPL, earned wage access, installment lending, credit sales, auto finance, and credit cards. There's hardly an area in the consumer finance world where Mike has not been involved.

Before joining our firm, he worked in-house at a company where he helped to design and launch a very early BNPL product. Mike has written very extensively on this topic. He published an article called Buy Now, Pay Later, in an Era of Increased Scrutiny and Economic Headwinds. That appeared in the March-April 2024 issue of the American Bankers Association Risk and Compliance periodical. Mike also presented on BNPL at the American Bankers Risk and Compliance Conference last year. The presentation was called BNPL, Risks and Rewards. Mike is very frequently quoted in periodicals where the articles deal with BNPL, including one periodical called Payments Dive, and the other one called Financial Brand.

Okay, Mike, a warm welcome to you.

Mike Guerrero:

Yeah, thank you Alan. Always good to be here.

Alan Kaplinsky:

Okay, well let's begin. Before we take that deep dive, let's dip our toes into the kiddie pool. All right, for some people they may not be all that familiar with buy now, pay later or BNPL. So Joseph, maybe you can give us a Reader's Digest version of what the product is, and then we're going to talk about what's happened to that product.

Joseph Schuster:

Certainly, Alan, thank you. It's a great question. A buy now, pay later product is a type of financial service that allows consumers to purchase goods and services and pay for them over time, rather than upfront. There is a continual evolution of consumer finance products that are available for point of sale lending. You can think way back to, there was layaway, there was store credit, there were store credit cards, there are general purpose credit cards. Buy now, pay later is, I'll say, a relatively recent, it's been around for a couple of decades, introduction in that point of sale financing.

So the way that it works is, you have an immediate purchase but you have deferred payment and it's an installment plan. Generally, four or fewer payments. You're generally making those payments every two weeks. So if you purchase something that's say, \$100, \$25 is likely due today, and then each of the two weeks after that, you're making additional \$25 payment to make that full \$100 payment. They're generally interest free, so when I say it's a \$100 purchase and you're making a \$25 payment, that is generally what consumers are doing with this product. So they are able to make those payments over time.

How it works mechanically, a person goes to a retailer, typically, you're going to see this in the online retailer space. They're at the checkout, at checkout, they can select different payment mechanisms. They can decide to pay with a credit card, or they can decide to pay with a buy now, pay later loan, if the retailer has partnered with a BNPL provider. If that's the case, the consumer will apply for a loan, and this is an important piece that will be relevant as we get into the new interpretive rule. Now, when you're applying for that loan, the BNPL providers attempt to make this as easy as possible. Each BNPL loan is a new loan, as opposed to a credit card where you have a credit card, it has a credit limit, and you can continue to use that credit limit. Each time you're doing a BNPL purchase, you are applying for a new loan with that BNPL provider. The next step would be, you are approved for that loan. You're provided with a payment schedule, those four payments. You accept that, and then finally, you complete the purchase, you receive the goods or services that you've ordered, and you're making the payments as agreed.

Now, the benefits that the consumer receives with this are that they're able to purchase perhaps an expensive item and spread the cost out over time. There's no interest and generally no or low fees associated with this product. And I think another benefit is people are not obtaining long-term debt. They're paying this off in four installments, as opposed to other types of credit that have been criticized by the CFPB as taking a longer period to repay. So yeah, I'm a little bit biased, it probably comes through. I think that this is an amazing and great product that solves a need for people when they need to pay for something a little bit over time.

So as I was preparing for this, I was thinking, well, what are the CFPB and other regulators, what are their concerns with these products? I think you have a few that I came up with. Late fees, if people pay late, there are fees associated with those late payments, but that exists in many, many places. The CFPB I think would say that this encourages overspending. I'm not sure that that's the case. I think that there are products that are expensive that need to be broken up into multiple installments, but

I think that that is something that the CFPB raises. And then one item that they do raise is confusion about due dates. So again, the payments will be due every two weeks. So if you purchase something on a Thursday, your next payment will be due two weeks on a Thursday. If you obtain multiple BNPL products, you'll likely have multiple different due dates over the course of a month. I think that there have been some ways to try to make that as simple as possible for consumers, but it is something that's out there.

So just a couple more things. I know this is the Reader's Digest version, but I think that this will lay the foundation for the rest of what we're going to get into. You have three main parties with BNPL products. You have the consumer, you have the merchant, and you have the credit provider. I should mention that there's a number of others involved, and I shouldn't discount them, such as BIN Sponsor and others for the backend for money movement.

But as we look at those three entities, the merchant has the benefit of increased sales. Perhaps they're able to sell a larger average order, they're able to attract new customers who may have a need for the retailer's goods or services, but need to spread out that payment over time. The merchant does pay a merchant discount rate generally, and that goes to the creditor as a means of compensating the creditor for this type of loan. I mention again that there's no interest for the consumer. How the creditor makes money is generally that merchant discount rate.

I will pause there. I think that that's kind of a general, Reader's Digest overview. Unless Mike, is there anything that you would add about how these products work?

Mike Guerrero:

Yeah, I'll add a couple of points. I think you've done a great job summarizing the product and outlining considerations that relate to the product. You might see folks refer to BNPL 1.0, or BNPL 2.0, and when they're saying that they're focused on the original version of BNPL, BNPL 1.0, which is this model where it's really focused on the relationship between the creditor and the merchant. So the creditor and a merchant have this relationship and the BNPL offering like Joseph just alluded to, is going to appear in the shopping experience, the checkout cart, and the consumer's going to choose to purchase that item through credit in that checkout experience and the application takes place there. All of the stuff that you've more or less seen over the past decade or so.

BNPL 2.0, or what the CFPB has called the walled garden version of it, is a newer model and it's still prevalent, but nowhere near as prevalent as the pure form of BNPL. And this is the form where the providers have gotten a reputation, they have trust of the consumers, so they create this experience where the consumer is first going to the provider's site or their app and then maybe submitting an application, getting a pre-approved limit or an open to buy, and then going shopping sometimes within the app itself. And we'll get to this a little bit later, but one of the items the Bureau was concerned with was the use of that data and impacting consumer behavior, because now you have the consumer shopping and getting credit all within the BNPL provider's account, but that's the 2.0 version.

The other thing I would note is particularly, or especially as it relates to the purest form of BNPL, it was structured in a way such that Regulation Z and Truth in Lending Act wouldn't apply. The bulk of Regulation Z's requirements are going to apply to a creditor, and a creditor requires that there be credit, but also that that credit be payable in more than four installments or with a finance charge, as it relates purely to closed end credit. Because the original iteration, where we're talking about these very discrete one-to-one extensions of credit, were not subject to a finance charge and were payable in four or fewer installments, then the Regulation Z generally didn't apply. So, that kind of sets the tone for where we are now and what the Bureau has addressed.

Alan Kaplinsky:

Yeah, so CFPB has been looking at this product for a few years, have done studies of the product, they've all been published. We've blogged about them on [consumerfinance.gov](https://www.consumerfinance.gov). And as Joseph put it, it's really a good product. I mean, the fact that consumers don't have to pay interest and they're not going to pay a lay fee unless they're actually late in making a payment. But if they comply with the contract, they're being, in a sense, extended credit four or fewer installments, and they get the product for the same price that they would have to pay if they had paid cash at the point of sale.

So it's really good product, but of course the CFPB, whenever they start doing surveys or they start publishing stuff, you know, we know from experience, the industry is in trouble because the CFPB just doesn't do that to educate themselves. It's part of the reason, but they're always... They've decided before they do the study where they're headed. At least that's my belief based on roughly 13 years of experience in following the Bureau's MO, initially under Richard Cordray, and now even more so under Director Rohit Chopra. So, no good deed goes unpunished at the CFPB, that is, you develop a product that you think is consumer friendly. Well, CFPB is going to find something wrong with it.

And so now Mike, tell us, what is it that they did that's really got people all in a lather, I guess you could say?

Mike Guerrero:

Yeah, and Alan, you touched on everything I was just going to touch on. So the interpretive rule, for example, it comes after study, right? The Bureau sent market monitoring orders to five of the largest participants about three years ago and asked them to describe and address the Bureau's concerns about the accumulation of debt, what they called regulatory arbitrage or structuring the product in a way that doesn't fit within the regulations, and data harvesting.

A year after that, the Bureau issued a report based on that study and they noted the prevalence of data collection and raised a lot of the same concerns that they already had indicated that they were already concerned about. So to your point, they had this kind of preconceived notion, and the market monitoring orders and the initial report were very in line with them. Data harvesting, debt accumulation, overextension, the big one that I think is addressed in this interpretive rule is inconsistent consumer protections. But I think the foreshadowing here was that the Bureau noted that BNPL use served as a close substitute for credit cards, and that's when we started to see the writing on the wall, because the credit card framework as we'll get into in detail, provides a robust mechanism for resolving consumer disputes and setting forth disclosures to permit shopping and informed access to credit. But by drawing or by pointing to credit cards, we kind of saw that the Bureau wants to get there.

So again, these are different than credit, your traditional revolving credit card products. Very favorable, 0% interest, streamlined, discrete transactions. Consumer can't tie themselves up for years of debt. It's literally due in four installments. It's a favorable product, but the Bureau was critical and there was skepticism in that first report. Another report came out a year later, it was based on a consumer survey, the Making Ends Meet survey, and the Bureau's tone really did soften, and that was encouraging at the time. I thought, maybe the Bureau's not going to be as aggressive in connection with these products, but we are here now.

So that brings us to today and the interpretive rule that was issued by the Bureau on May 22nd of this year, and they're calling it an interpretive rule. The effect of this interpretive rule is that, in my view, it's going to change both the look and the availability of this really favorable consumer product. I don't know that BNPL will be as prevalent as it was in light of this rule, because it really does have significant downward effects that are going to come into play, that really stem from compliance considerations that are not meant to address this type of product. But at its core, the rule is really focused on the definition of credit card, and in my view, it's broadening the definition of credit card.

Under Reg Z, a credit card is any card plate or other single credit device that can be used from time to time to obtain credit. And what the CFPB has done in the interpretive rule is they focus on what they're calling a digital user account. So when a digital user account is issued by a lender to consumers and that digital user account can from time to time access credit, that is going to be a credit card. We'll get into what a digital user account is shortly, but it's important to think about this, the digital user account as being distinct from the underlying credit. So when we're saying that the digital user account can be used from time to time, this is a concept that relates to the device, not the underlying extension of credit. We're not concerned for this purpose, about the underlying extension of credit being open-ended, revolving, replenishing. The Bureau notes in a footnote that all of these extensions of credit that they're concerned about and that are addressed by this rule are likely to be underwritten separately and they're likely to be discrete transactions by the consumer. So, this is closed-end credit being accessed through this digital user account, and that's not unheard of, a credit card to access closed-end credit, but the definition of digital user account is where the Bureau gets very broad.

Before jumping into that, we'll focus more on the framework of the rule. Once a lender is deemed to have issued a credit card, they become a card issuer under Reg Z. And that's important because when you are a card issuer, there are some provisions that apply to you, but what it really does is it brings you into the definition of creditor under Reg Z. Reg Z's requirements

predominantly apply to creditors. And the type of requirements that are going to apply to a creditor vary based on the type of credit that that credit card can access.

So, if you're a card issuer extending the traditional BNPL credit that we were talking about, BNPL credit that's payable by four or fewer installments and there's no finance charge, then you fit within a definition of creditor that's subject to sub part B of Reg Z. Those are the open-end provisions. If you're a creditor or a card issuer that is issuing credit that is payable in five or more installments or subject to a finance charge, the rule doesn't get into this much, but you are also a creditor and you're subject to different requirements. You're subject to some of sub part B, but you're also subject to all of sub part C, which is the closed-end provision C, the four box Truth in Lending Act disclosure that you might've seen when you get an installment loan or something along those lines. But depending on the type of credit that this card can access, very different requirements could apply. So there's, really small tweaks in a product could trigger very significant product issues. We're going to get into a lot of these compliance considerations I imagine, very shortly.

Right now, I think focusing on digital user account and what that is, the rule does a really poor job of describing this term or defining it, and it's problematic because it has such significance because it is a trigger for all of these follow-on requirements. It defines digital user account as a secure personal profile that the buy now, pay later provider activates for a consumer, enabling the consumer to access the BNPL credit. Consumers can use these digital user accounts through buy now, pay later websites, mobile apps, browser extensions, integrations with merchant websites, in a lot of ways but essentially to me, the definition I just read is really broad.

And when I look at that, I worry that anytime you're logging into an account, you've created an account with an entity that can provide credit, anytime you do that, you are running the risk of becoming a credit card issuer. And I don't know that credit card was intended to be that broad. I think particularly because it's not just in the BNPL context, it's any extension of credit really, but as soon as you have an account that a consumer can log into before getting credit, there's a concern that you might be issuing a credit card. So, assume we have a digital user account that is a credit card, now you're a card issuer. And like I was saying, most of these substantive provisions are going to apply because you become a creditor. What type of creditor, or subject to what provisions of Reg Z as a creditor are going to depend on the type of credit you're extending, but that really broad triggering event brings you within all of this.

And Joseph, I don't know if you had anything to add.

Joseph Schuster:

Yeah, I think that's a great background on really where this rule is going. A couple of things that I would say that you touched on is, number one, we're talking about this in the context of BNPL, but like you said, really what entities need to be looking out for is whether their credit is accessible through this new concept of a digital user account.

And I think that the accessibility through that digital user account is really what the CFPB is looking at, in terms of fitting this into the definition of credit card under Reg Z. And I'll give a little bit of credit here for the creativity and understand where they're coming from with this, in the sense that as I walked through how BNPL products work, you get to that checkout page on, let's say an online retailer, and you're given different options for how to pay and you could enter a sixteen-digit credit card number. Your name, the CVV, all of those types of things. Or, you could enter your email address and password that's associated with the BNPL provider. And either way, you're going to be financing those purchases.

So as you look at how the CFPB is fitting this in, they are saying that this digital user account is functionality that's equivalent to a credit card, that you can use that from time to time to access credit to purchase goods or services. And that's really how they're fitting this into the definition of credit card under Reg-Z.

I should also mention too, that this is an interpretive rule, implying that these were always credit cards, that the CFPB is not creating any new rules here. The CFPB is simply saying, this rule has existed and we want everybody to be aware of how we interpret this rule.

The only other thing that I will add is the effective date is July 30th. I think that this podcast will air likely right before that effective date. Interestingly, the comment period ends two days later on August 1st. So again, it's a difficult piece when you think about this as an interpretive rule with the comment period that is after the effective date of it.

Mike Guerrero:

Yeah, and if I could just add to that. It felt a little bit disingenuous when the Bureau basically said on the first page of this interpretive rule that, we don't have to take comments. This is not subject to the Administrative Procedures Act, but we're going to, and we'll determine whether we'll make any changes to this if we want to, essentially. And the Bureau's giving, yes, their position is nothing has changed, but the Bureau's giving the industry 60 days to get into or to build very, very robust compliance frameworks, and it just seems incredibly unreasonable.

Alan Kaplinsky:

Yeah, when I first read the rule, it left me a little bit breathless. Here you've got a product that until they, nobody knew exactly what the CFPB was going to do, when they were going to publish this thing and how much time you'd have to comply. And yeah, they were clever, Joseph, I agree, in trying to shoehorn this thing into credit card framework and the rules and regulations that apply to credit cards. Yeah, I give them an A for creativity, but they certainly weren't sensitive to the impact that this was going to have on the industry. That you're going to take all these companies, some of whom... There are some larger, more sophisticated companies, but there are also a lot of companies that have only been around for a couple of years. Some have voluntarily done certain things, but they've never been subject to a Truth in Lending Act and Reg Z regimen, and all of a sudden it's thrust on them.

So Joseph, what have you been telling, I assume you've been overwhelmed by clients in this business, both of you, you and Mike, and what do you tell them? They call probably, you probably got a lot of panic calls. Do you tell them, oh, don't worry, this is easy-peasy, we should be able to get everything up and running well within the deadline, which I think is the end of July. Am I right, Joseph?

Joseph Schuster:

Right, July 30th.

Alan Kaplinsky:

30th. Yeah, so what have you been telling our clients and prospective clients who call in a panic?

Joseph Schuster:

I think that panicking is the right reaction to this, and I think that the CFPB has not thought through all of the implications associated with this. So I think you are going to see in the short term, I think both you, Alan and Mike, mentioned that there's probably going to be a reduction in this beneficial credit in the short term, as entities try to figure out how to comply with this. In the longer term, I think you will see BNPL providers that are able to comply with the provisions of Reg Z associated with the credit card.

I'll tell you, I've built a credit card from the ground up with an entity that did not have a credit card, didn't have credit card platform at all. That took a lot of time, many months. And BNPL providers are being asked to do essentially that same thing in a 60-day period. As we look at Reg Z and these BNPL providers are now going to be subject to sub part B of Reg Z, these include things like disclosure requirements, account opening disclosures, periodic statement requirements, how payments are processed, how credit balances are treated, how billing errors are handled, how claims of unauthorized use, various other types of disputes. And I think there were a lot of players in this space, they've tried to be very consumer-friendly, who have processes to respond to disputes that consumers raise when there is a problem with the goods or services that they're purchasing or when there's a problem with the BNPL product.

The difficulty with this rule and a 60-day compliance framework is the complications of Reg Z and the intricacies that Reg Z has associated with these different rules. There are many credit card providers that are out there that work on complying with these rules and continually run into operational or regulatory difficulties with these. These rules have specific timelines in terms of responding, specific requirements in terms of what needs to be in those letters in the responses. How you are collecting payments. A lot of BNPL products have automatic EFT payments associated with them. If there are disputes, Reg

Z then talks about when you can or cannot take those types of payments. So there are a lot of questions. There's a lot to build. There's a lot of questions.

As we get in the questions, I bet I could go into any one of these topics in sub part B and spend a whole podcast on it. In the interest of brevity, I won't, I'll pick one. The statement requirements associated with Reg. Z. Statements have specific timeline requirements. Generally statements for credit cards have to be sent 21 days before the due date.

As we were talking about, the payments associated with BNPL products are generally due every two weeks. How do you send a 21-day statement when there's going to be a payment due? It'd be due in seven days from that, and you'd be talking about a payment that's due subsequent to the upcoming payment. That can't be what the CFPB wants, that would be confusing to them. If I have a payment that's due in seven days and I receive a statement that says I have a payment due in 21 days and I miss my upcoming payment, I say, well, look, you sent me a statement that says I have a payment due in 21 days. I'm sure that the Bureau is going to say, hey, that's deceptive that you sent that statement in that manner. But how do you comply with that rule then? What do you look at? Do you look at the credit that's extended as the credit card and subject to these rules? Because then you would have different statements for every single one, every single BNPL credit extension that you have.

Do you look at the digital user account as the credit card that's extended? Because then you have statements that have multiple due dates associated with them. I may have three BNPL products all with different dates, and now all of a sudden my statements have those three different dates on them. So, there are a lot of questions that are associated with this.

I think that having a comment period is particularly important on this one to understand how the CFPB is thinking about these different requirements. The interpretive rule specifically contemplates that BNPL products have payments due every two weeks, every 14 days. How do the statement requirements apply to that? I think it's something, and we've been working with a number of clients on how to comply with these statement rules. I think that it is something that the CFPB needs to be considering. They need to be considering how difficult it is to build this, as Mike said, it's a very robust compliance framework that has to exist to be a credit card issuer. And there are unique challenges associated with these types of products that we're working through at the industry, but I think that the CFPB needed to contemplate as well, as they dropped this rule with such a short effective date.

Alan Kaplinsky:

Yeah. Mike, do you have something to add to that? And then I've got a question for either one of you.

Mike Guerrero:

Yeah, sure thing. So even if you fit within the bucket for the periodic statement set permit, you just send it 14 days in advance. Joseph just outlined some very real concerns. How are you identifying transactions, right? These are separately underwritten, as the Bureau notes. You're going to have individual extensions of credit subject to their own terms, more or less, so they're going to have different due dates. And as the Bureau has noted throughout its reports, these are frequently utilized. So if a consumer has three or four BNPL products that they get in a week, how do you comply with that statement requirement? Are you sending four statements that week, and each week until they're paid off because each one has to go out at least 14 days in advance? Or is there a way to structure it more broadly and have a single statement? It becomes confusing.

And the other piece that's, I think, equally will be confusing to consumers especially is, we were talking about how different parts of Reg Z will apply, depending on the attributes of the extension of credit. Some providers have more than one product. Not everyone is just going to market with four or fewer, no written agreement, no finance charged product. Some will have that very traditional BNPL product, and then they'll have their six installment product with the finance charge, or maybe not a finance charge, but still six installments. Those products are subject to different requirements. So, it's going to be odd for a consumer to on one hand, go and get the account opening table that's connected to what you would typically see in a Schumer box credit card disclosure. And then on the other hand, get a four-box Truth in Lending Act disclosure. And it's what, the difference is two additional payments? So it's not, in my view, particularly beneficial to the consumer.

I think what the Bureau wanted to do was impose dispute requirements on the industry, and this was their way of doing it, because otherwise, the product was generally, and not in all instances, subject to the FTC's Holder Rule that would just let the consumer bring claims or defenses that they could have brought against the merchant against the lender. Here, there's a much

more robust framework. But the different disclosures is to me, something that really could have been addressed through comment, and folks have to think about that. Or, what happens if you're looking at the digital user account as this trigger, the credit card, but the digital user account can acts as one type of credit, but you want to add another one later? And do you have to do a change in terms? What does that look like? There's just a lot to unpack. And again, the industry has 60 days to do this now.

Alan Kaplinsky:

Yeah, so hey, here's a question that's been, I've been thinking about as you and Joseph have been describing this incredible problem that's been thrust on the industry. So, did the CFPB do what regulators sometimes do? And that is, when they recognize that this is something new, they'll often give a grace period. That is, they'll say, we're not going to, particularly here where we're accepting comments and the comments are going to come in, the deadline's after the effective date of the reg. Do they say, we're going to have a light touch? We're not going to go after anybody on July 31 or August one, and see if they're in violation, and if so, come down on them like a ton of bricks. Do they show some pity, some understanding, some indulgence? I don't know how else to put it.

Mike Guerrero:

No, I mean, not from my perspective and Joseph alluded to this at the outset. They're basically at its worst saying, this is how it always was, and giving it an effective date is interesting, right? What can you read into that? Well, this Bureau is not going to come down on you until then, I think is probably the most reasonable reading of that. But the way this was structured is, it's not like a rule with new compliance obligations. It's basically saying, we think you're a credit card and we're putting this kind of arbitrary effective data out there and this arbitrary concept of comment, but there's nothing to preclude anyone really, from making the assertions set forth in this interpretive rule now.

Alan Kaplinsky:

Right. Wow, but I guess one good thing, if you can see anything good in what they've done here, is that buy now, pay later companies are not non-banks. They're not subject to supervision by the CFPB. Am I right there? They're not under any larger participant rule.

Mike Guerrero:

Yeah, no, there's always the risk-based considerations. But Joseph, I think you were going to say something.

Alan Kaplinsky:

Yeah, go ahead, Joseph.

Joseph Schuster:

I was just going to add on the, Alan, you're asking if they're taking a pity. I was talking about the types of these loans that payments are due every two weeks, one payment's due up front, and then payments are due every two weeks. That makes these loans about 42 days in length, a little bit longer from a state law compliance perspective in some instances, like for California lenders. So as we look at the 60 days though, 18 days after this rule was published in the Federal Register, these loans started to trip into the timeframe where the effective rule will be effective for the loans. And there's a question of how to think about this rule for loans that have been previously funded. So that 60 days, it seems even shorter when you consider that these are ongoing loans and you're making loans that will trip into and after the effective date of this loan, and you're making those loans just 18 days after the rule was published in the Federal Register.

Alan Kaplinsky:

Yeah. So Mike, what else are BNPL providers considering? I mean, you mentioned that I guess, most of them were trying to comply to the best they can, but what else are some of them thinking about?

Mike Guerrero:

Yeah, I think there's a continuum that really goes to a far end on each side. On one end, there's complete embrace, and on the other, there's exit the market, and then there's a bunch in between. On the in-between side, you have folks that would be looking and really scrutinizing their product and they could be scrutinizing it from one of two ways. One, are we complying? What does our dispute framework look like? What do our payment reminders look like? Can we turn that into a periodic statement that's compliant? What do we have to do to get to full compliance?

Or, on the other hand, what do we have to do? And this goes to the Bureau's regulatory arbitrage comments, but what do we have to do to make our user experience not be deemed a digital user account? What happens if I'm going back to that very pure form of BNPL and I'm going to a merchant, getting an extension of credit, not doing any sign-on or application at the outset, and you know what? Maybe the creditor is the same creditor with whom I already have extensions of credit. And if that's the case, I have a servicing portal, but that servicing portal does me no good if I want to get a new extension of credit. I have to go individually and have this really discrete kind of car dealership experience where I'm getting credit and they don't have any information or account associated with me. Maybe that gets you there and maybe that's a product modification worth considering, but folks are looking at their products and operations and figuring out how to make really drastic changes.

And that latter instance isn't better for the consumer. You as a consumer have a relationship with a company and you enjoy their product and they give you a consumer-friendly product, and they should be able to streamline it. It helps with fraud risk, it does a lot of things, but now you have this rule that creates these ambiguous requirements that have real penalties. And the question is, do you want to be subject to that? It put the industry in a really bad spot.

Alan Kaplinsky:

Yeah, that's for sure.

Mike Guerrero:

With that, Alan, I'd be curious though. We just saw this week, the Supreme Court decision impacting Chevron deference, and I know you've spoken and written on this quite a bit. I'd be curious to get your take on what that might mean, as it relates to this interpretive role.

Alan Kaplinsky:

Sure. So yes, the Supreme Court came down with an opinion, and it's called *Loper Bright Enterprises v. Raimondo*, and it did exactly what most people were predicting. Although some thought that it would not be as extreme as what the Supreme Court did, although I predicted and other people at our firm were predicting that they were going to go all the way and they went all the way. And by that I mean they overruled the Chevron deference doctrine or it's sometimes called the Chevron framework, which refers to a 1984 opinion involving a Chevron affiliated company.

And the Chevron doctrine basically was something that favored agencies, because, and a lot of people will say that it was an un-level playing field if you were trying to challenge an agency rule, either a substantive rule or an interpretive rule. That you, under the two-step framework, number one, you have to determine, is there an ambiguity in the statute itself? Is the statute's silent. The thing that the CFPB did here? And if you conclude that there is an ambiguity or that there's a failure in the statute to cover what the CFPB has done, then the court was required to defer to, as it was mandatory deference, any reasonable interpretation as reflected in the regulation or the rule that the agency adopted. And it didn't matter whether that was the kind of interpretation that the court would reach on its own if it didn't have to defer to the agency.

Well, that's out the window, gone. Supreme Court concluded that the function of courts is to decide what the law is going to be, and the original Chevron opinion was basically a derogation from the principle that judges decide the law, agencies don't. And under section seven of the Administrative Procedure Act, that's basically what that statute says and that statute was on the books well before the Chevron case was decided. But Supreme Court took a very literal view of the language in section seven, and they hung their hat on that.

And the other thing that they said is, we are back to what we had before we had Chevron deference, and that's so-called Skidmore deference. And Skidmore deference is nothing other than, we'll take a look at what you've done, agency. We'll consider that and we'll listen to arguments that are made by other parties, and then we will reach the correct decision.

So my conclusion is from what everything I've read and what the two of you have described today, that if there were a challenge to this interpretive rule and by that I'm talking about a legal challenge, a lawsuit. And if this were in front of a pretty conservative judge, like let's say a judge in the Northern District of Texas, and if the backstop was the fifth Circuit Court of Appeals, I would say this rule would be in trouble. Well now with Chevron coming down, I think we'd be in extra trouble, but I don't see a plaintiff around anywhere, Mike. There are two trade associations that cater specifically to buy now, pay later providers and they seem to have embraced what the CFPB did here. I guess maybe on the theory that maybe they were expecting something a lot worse, but they embraced it, but yet what we're hearing from a lot of buy now, pay later companies is they're not happy with it. But I don't think any of them individually really wants to bring a lawsuit against the CFPB. Individual companies never liked doing that. They're always worried about retribution and getting singled out by the agency, and the agency's got a lot of power, let's face it. So I think that's where we are. We've got a good cause of action here, but not a plaintiff to be found, and I think that's unfortunate.

So, the other thing I wanted to just touch on, a couple of other quick things, then we have to wrap this up. Are there state laws also that create compliance responsibilities for buy now, pay later companies, or are they relatively benign?

Joseph Schuster:

There are a lot of state laws that are associated with BNPL products. This, state laws are what the industry has used as the framework for these types of products. Earlier I was mentioning that generally these loans are 42 days. I said longer, as a result of some states. That's because of requirements in the California Finance Lender Law. So, there are a lot of licensing requirements, there are a lot of substantive requirements, and the BNPL providers are structured to comply with those state laws.

Mike, if you would add anything there?

Mike Guerrero:

Yeah, I would add that much more frequently than is the case with longer-term installment products, these are loans that are being made directly by non-banks, as opposed to non-banks' marketing loans that are being made available by banks. So non-banks have more robust compliance requirements at the state level and just because you're not subject to the Truth in Lending Act doesn't mean you weren't already complying with and addressing a lot of these state laws. But this is just another thing that companies are going to have to do.

And what's interesting is, under the state law, this might be viewed as a closed-end installment loan, requiring closed-end disclosures. And then you could be in one of the creditor buckets under Reg Z that requires the open-end disclosures. So then you have to comply with both and you're going to be giving these really confusing disclosures. Again, it's just, all of this could have been fleshed out, and that's what's so disappointing.

Alan Kaplinsky:

Yeah, and I guess the other thing is they didn't say anything about preemption of state law in their interpretive rule, and I don't think they could say. Presumably, the preemption provision that's in the Truth in Lending Act itself would apply to either currently existing state laws or state laws that might be enacted in the future. But as I recall, the Truth in Lending Act, it doesn't purport to occupy the field and it only provides if there was a conflict. If you can't comply with the federal law, and if you're trying to comply with the state law, then that state law is preempted to the extent of the conflict, at least that's my recollection.

I want to end the program. I know it's maybe ending it on a little bit of a Debbie Downer note, but what happens if a company just decides, I'm not going to comply? I'm going to roll the dice here. And I'm sure there will be some companies like that, nobody that we would advise, of course. But what are the penalties that might apply? Because it gives me a thought that anybody in the buy now, pay later business, if they don't currently have a really good arbitration provision with a good

class action waiver that has been currently updated, has all the bells and whistles that we put into our arbitration provisions, they're making a mistake. I mean, that to me, in addition to trying to comply, you want to have a really good, strong arbitration provision that has been looked at currently, because the law's constantly changing in that area. But, what are the penalties?

Joseph Schuster:

So I think that there's a few different ways that this could be addressed. So I will say yes, we're getting to concluding remarks here, that I think being prepared and being able to defend that you are complying with these rules is going to be important because I think that the CFPB is going to be looking at this from an enforcement perspective. You could look at the implications just from a Truth in Lending perspective, but we maintain a database of all UDAP enforcement actions and different things that existed. In our UDAP database, a number of clients subscribe to, there is a checkbox of whether or not that UDAP is predicated on a different underlying law.

So, I think that if an action were brought here, it's not just going to be Truth in Lending. Truth in Lending you're looking at for class actions, the lesser of \$1 million or 1% of the net of the creditor. That's a lot. That's not my main concern. My bigger concern is the addition of the UDAP claim, where the penalties are unlimited, as well as, when you're looking at these BNPL providers, or... And again, not just BNPL providers, but they're also providers of other types of credit too. The CFPB could issue a cease and desist for this type of activity as well. You could see extreme implications for entities that are engaged in [inaudible 00:56:53].

Alan Kaplinsky:

They could throw you out of the business, right?

Joseph Schuster:

Exactly.

Alan Kaplinsky:

If they wanted to.

Joseph Schuster:

Exactly.

Alan Kaplinsky:

They could bar you from the business, they've done that.

Joseph Schuster:

That is the scarier piece, from my perspective.

Alan Kaplinsky:

Yeah, and then what about state attorneys general? They also could get involved in this party here, right?

Mike Guerrero:

Yeah, or state financial services regulators, depending on the state, right? Like California, under the CCFPL, gave the DFPI authority to enforce the provisions of Dodd-Frank. Connecticut just expanded the AG's authority to issue subpoenas, in addition to enforcement in connection with Dodd-Frank. So I mean, there's just a lot. Again, I remember waking up to this rule. I'm on the West Coast, it was like 6:00 AM, hit my mailbox and my day was gone because everyone was shocked by what came out. And I think it's still shocking, and we're still trying to figure it all out. There's a lot to unpack.

Alan Kaplinsky:

Yeah, yeah. So, we come to the end of the program and really want to thank both of you, you, Joseph, you, Mike, for doing a terrific job in describing the product and describing the pressure, the regulatory pressure, severe pressure that it's under right now, and the hoops that our clients have to jump through and had to jump through on a very, very prompt basis.

And I guess the other thing I got a little exercised about. CFPB, I think should have given a six month period for compliance under the Truth in Lending Act, but they elected not to do that since, I guess, they think you should have been complying all along. So, but that's another thing I think that could be something that could be, there could be litigation over if there were plaintiff.

But my thanks to both of you, Joseph and Mike. Also want to thank all of our listeners and just tell them that, make sure that you don't miss any of our future episodes. Please subscribe to our show on your favorite podcast platform, be it Apple, YouTube, Spotify, or wherever you listen.

Also, don't forget to check out our blog, consumerfinancemonitor.com. We've already done a lot of blogging about this topic, but we will be doing a lot more once the comment letters come out. I'm sure we'll be doing something about the comments that have been received and how the CFPB is reacting to this. And if you have any questions or suggestions for the show, please email us at podcast@ballardspahr.com. Stay tuned each Thursday for a new episode of our show. Thank you for listening, and have a good day.