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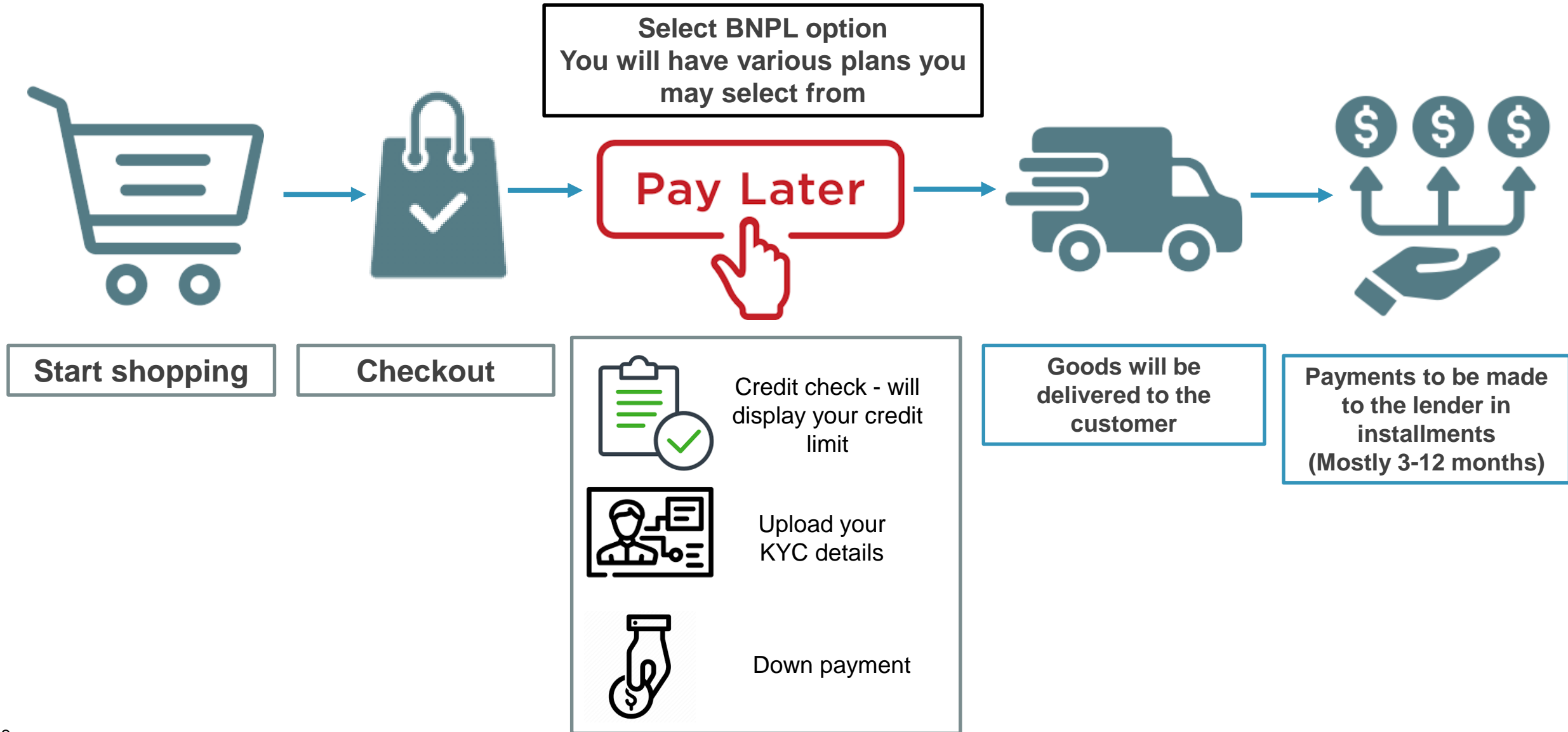
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How does BNPL work?



Features

- Low-cost, transparent, and frictionless financial product that enables –
 - Lightning-fast credit access
 - Hassle-free credit approval and disbursement
 - Repayment plans
- Allows them to split customer bills into parts at little to no cost
- point-of-sale installment loans
 - type of short-term financing that lets your customers pay for purchases over time, often with zero or little interest.
- BNPL players focus on generating revenue from merchants but not off of customers
- Loans are for smaller amounts
- Linked to purchase of a good/service
- Real-time and fully digital origination process of credit,
 - In a few seconds the BNPL credit can be opened.
- Only limited information is to be provided
- upfront payment (typically 25% of the overall purchase amount) at the time of purchase + predetermined (fixed schedule) small number of installments at future dates to reimburse the remainder.
- soft-credit score, which uses other info (like e.g. all details of your current and past purchases) than the traditional credit scoring systems and doesn't affect your credit score(unless there is a late payment or a failing to pay).
- Upfront payment to the seller/ merchant



Financial inclusion

Digitalisation

BNPL

Is an NBFC registration necessary?

- NBFC means a company which carries on as its business financing.
- Extending short-term loans –
 - FinTechs offering BNPL lending to be registered as NBFCs.
- To counter this need for registration, **BNPL service providers partner with NBFCs.**
- These partner NBFCs **extend credit to consumers** and **settle transactions with merchants** in separate cycles.
- In the absence of any financial activity, a Fintech should be seen as a **pure service provider, only focusing on a particular product or activity.**

Economics for parties involved in BNPL



- A consumer would traditionally use credit or debit card
- With BNPL, they will pay nothing upfront and instead make payments at a later date in installments
- Many Consumers don't have a credit card to pay with
 - Didn't qualify
 - Don't have a long credit history
 - They are too young
- BNPL loans are interest-free, so even consumers that have access to alternative credit sources may use.
- Psychology where consumers don't feel like they're paying "out of pocket"
 - may spend more than they otherwise would have.



- Pays the merchant at the time the transaction occurs
 - A discounted amount
- Collect payments from the consumer over the course of the BNPL term.
 - equal the full amount of the customer's purchase price.
- The difference between what they pay and what they collect over the course of the BNPL term is the lender's primary source of revenue



- Extending credit at the POS would otherwise require the merchant to underwrite the credit risk themselves
- Merchants already giving up margin to Payment Processors for credit card transactions
- BNPL customers spend more and likely to purchase goods/ services
 - that they otherwise could not have afford

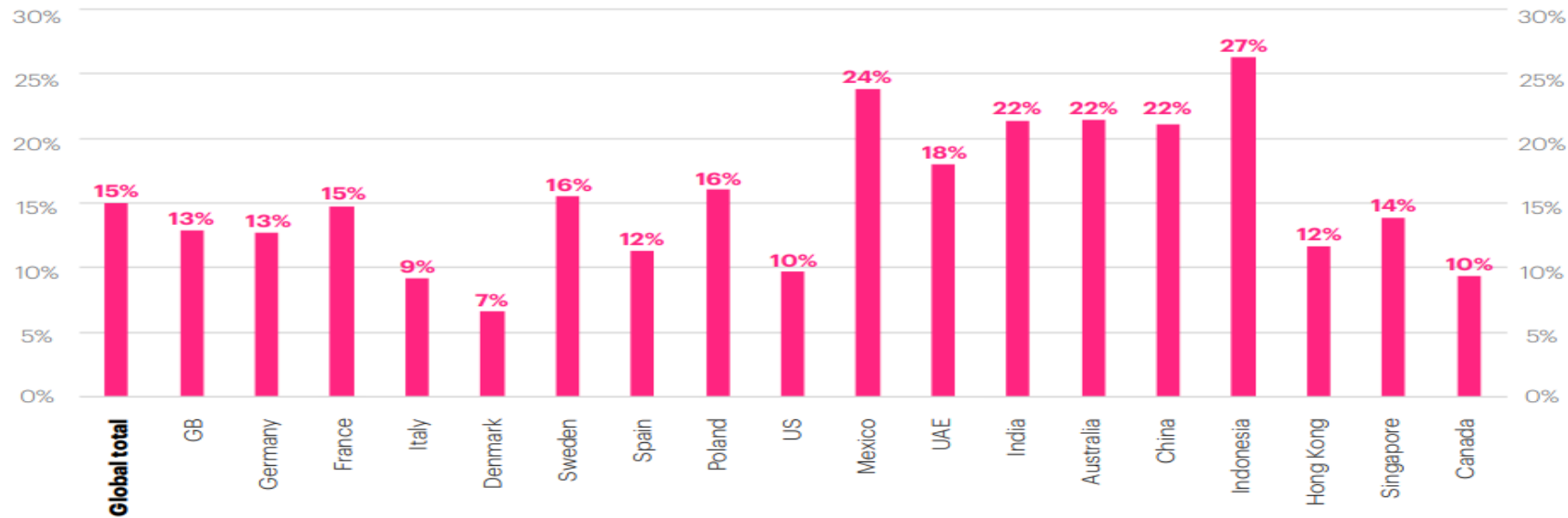
BNPL Growth

- **Digital Wallets to Represent Half of Global eCommerce Sales by 2023**, According to 5th Annual Worldpay Global Payments Report
 - by 2023 with 52 %market share.
- Expected to be fastest-growing online payment preference globally over the **next 5 years**.
- Fastest-growing online payment method in Australia, Brazil, France, Japan, the Netherlands, the United Kingdom and the United States, and is set to grow at a 28% compound annual growth rate globally over the next 5 years

- Razorpay - spike of 163% in the number of BNPL transactions it facilitated in November 2020.
- Lazypay - recorded 75K new users every month.
- Simpl - increase in daily essential transactions by 50% of the pre-Covid levels through online orders.
- Zestmoney recorded 50% growth in the average ticket size of edtech transactions, 30% in personal loans and 15% in ecommerce during 2020 as compared to 2019.

Growth of BNPL (as on March 30, 2022)

Made a purchase using a Buy Now Pay Later in last three months by country



Average – 17%
India – 22%

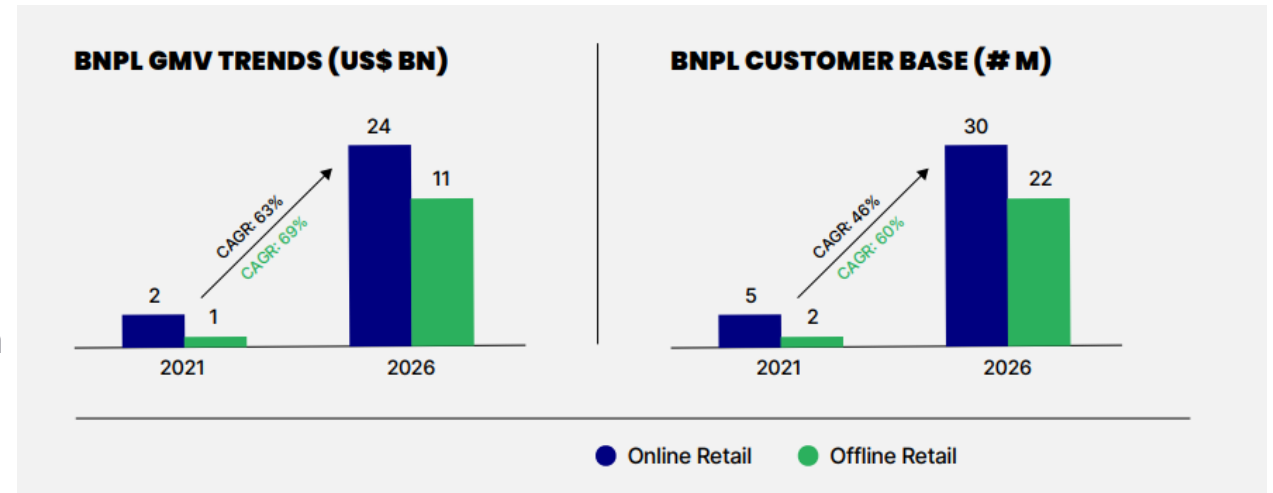
● Made a purchase using a buy now pay later plan (i.e. you get the item immediately and pay it off in interest free installments over time)

Made a purchase using a Buy Now Pay Later in last three months by age (Global)						
	Global total	18-24	25-34	35-44	45-54	55+
Made a purchase using a buy now pay later plan (i.e., you get the item immediately and pay it off in interest free instalments over time)	15%	16%	20%	18%	15%	11%

Source – [yougov report](#)

Why is BNPL soaring?

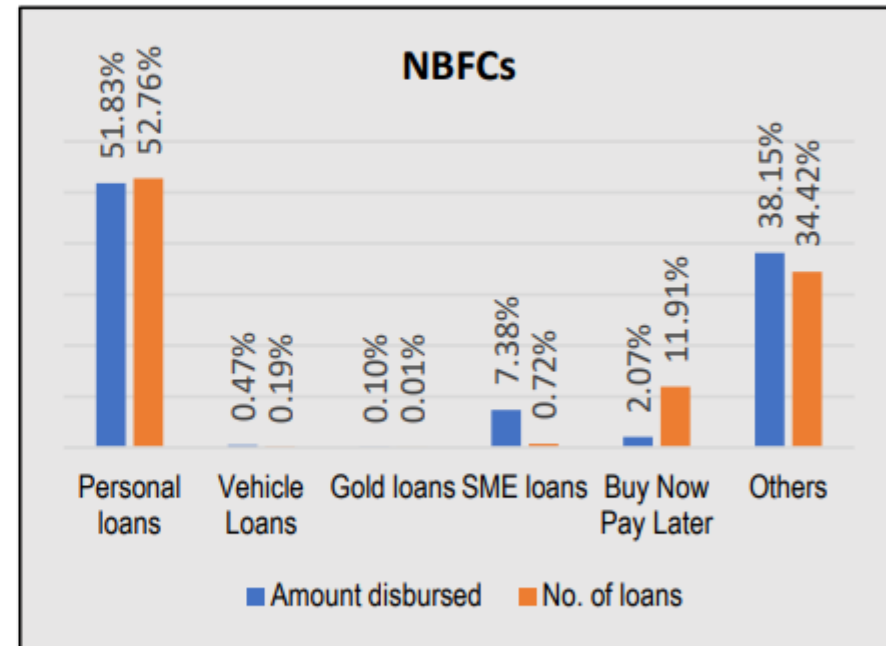
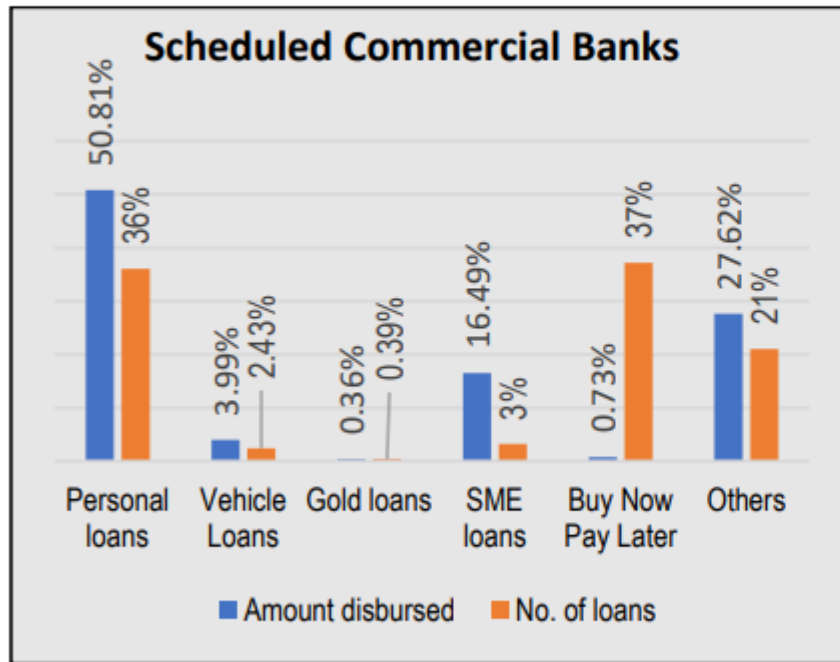
- Covid-19 pushed economy to go into e-mode
 - Companies were forced to establish/ increase digital presence
- Younger generation of millennials attracted by this offer
 - Apprehensions about other means of credit, such as credit cards by today's generation
- Growth in e-commerce
 - Higher internet penetration
 - Mobile phones
- Purchases of durables and essentials through Pay Later options have seen double digital growths during the pandemic.
- Not everyone qualifies for getting a credit card
 - BNPL players give loans to people whom credit card companies reject
- India is under penetrated with credit card penetration at 3% (per 100 population) which is among the lowest in the world as compared to global standards.



Source - [The India BNPL report 2021 | ZestMoney](#)

Percentage share of loans

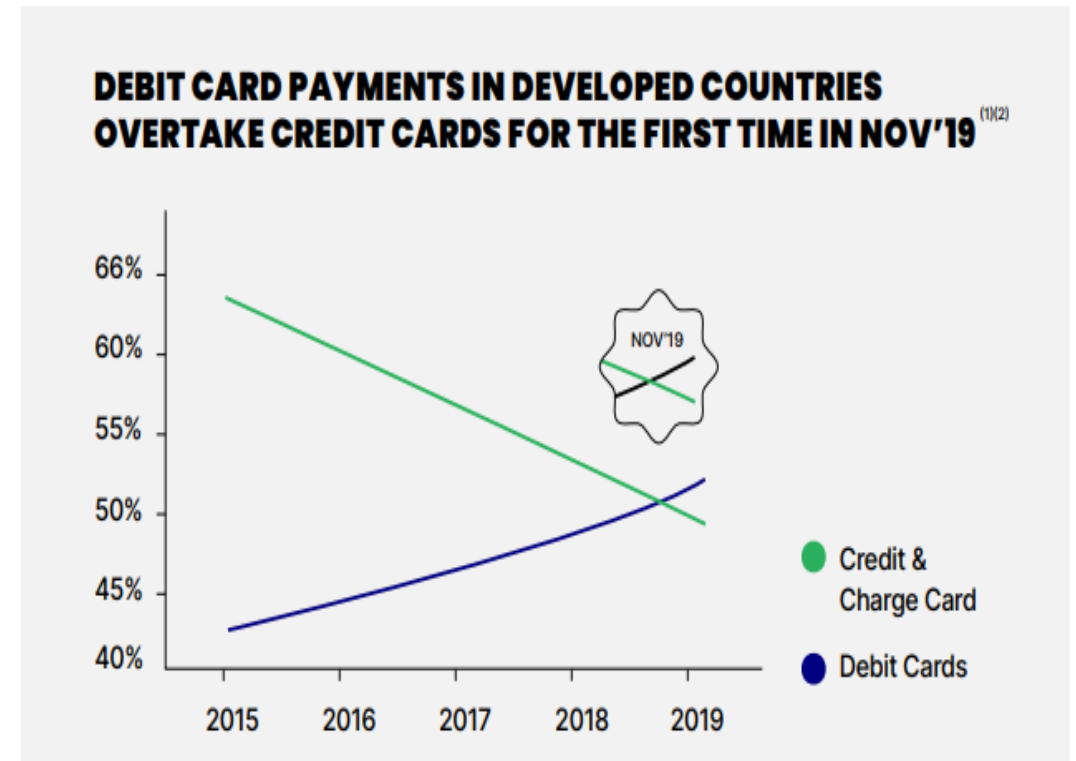
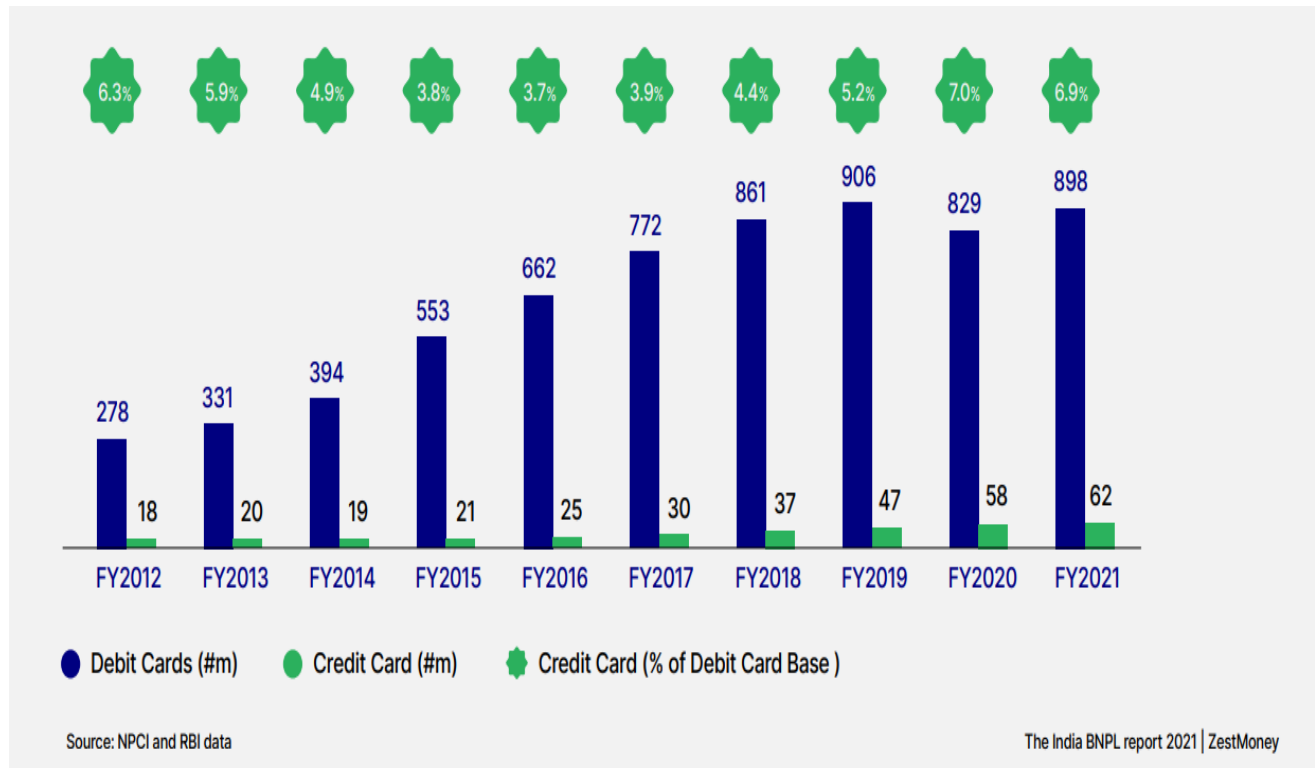
Percentage share of different types of loans in total loans (both amount as well as number of loans) disbursed through digital channels



Source: Analysis based on representative data collected from banks and NBFCs

Even though the amount disbursed under BNPL loans is only 0.73 per cent (SCBs) and 2.07 per cent (NBFCs) of the total amount disbursed, the volumes are quite significant indicating a large number of small size loans for consumption

Lower growth in credit cards



Source - [The India BNPL report 2021 | ZestMoney](#)

Reasons why Gen-Z and Millennials are shunning Credit Cards

- High cost of usage – High Cost of Credit
 - exorbitant interest rates,
 - steep penalties for delayed payments
 - hidden costs (maintenance fee, transaction fee, credit limit exceeding charges, and GST)
- Lack of transparency
 - credit cards are laden with opaque and confusing terms
- Requirement of credit history
 - credit cards need good credit history,

Credit card vs. BNPL

Basis	Credit Cards	BNPL
End-use	No end-use Can be used for any purpose	Specified end-use Tie-ups with retail merchants
Cash withdrawal	Possible	Not possible
Credit score	Needed	Not needed
Eligibility criteria	Minimum income with good credit score	No eligibility criteria
Time involved	Higher	Within seconds
Credit limit	Depends on what your income is, credit score etc.	Depends on the issuer's limit
Interest-free period	40-50 days (max)	15-30 days
Minimum due	Pay only the minimum amount due	Pay the EMI

Benefits for the parties

Customer

- Credit card – like convenience without an actual credit card
- Buyers want immediate access to their goods without having to wait until they have the full funding to purchase
- Cheap (mostly free) funding of purchase, which they otherwise would not have been able to afford

Bank/ NBFC

- Majority revenue from the merchants.
 - Collect a low percentage (or sometimes, a flat) fee on each transaction)
- Late fees if/when the consumer gets behind on payments.

Merchant/ Retailer

- Lower cart abandonment rate
 - consumers only purchased a good or service because they had an option to Pay Later.
- Shoppers are willing to spend more.
 - By not having to pay upfront, shoppers tend to add items into their cart
- Products move out faster
 - shopper needs to keep the product until the time of payment,
- Funds upfront.
- Builds loyalty with shoppers
- Can act as a customer acquisition channel

Risks/ Hurdles

- It is promoted to consumers as a payment option rather than credit
- Consumers may not apply the same level of scrutiny to their decision-making as they would for other credit products
 - including consideration of the potential consequences of failing to repay
- Consumers think they are protected
 - Product was regulated and came with associated protections
- No consideration for the affordability of the commitment the consumer is taking on
- Consumers make impulsive decisions that are not in their best interest
- No checks on creditworthiness
- Potential to create high-levels of indebtedness
 - Average amount borrowed per transaction may be comparatively quite small
 - But consumers may have multiple outstanding transactions across different providers
 - Risk the overall amount owed can be much greater.
- Late payment fees, defaults and collection practices
- Impact on wider credit market
 - No reporting mechanism to CICs
 - Lack of transparency means regulated credit providers like Banks/NBFCs may not have a complete view of a consumer's financial position when assessing credit worthiness
 - Lead to consumers being approved for credit which they in reality can't afford

Concerns on BNPL

- Concerns –
 - how the product is promoted to consumers and presented as a payment option
 - misunderstanding of the product by consumers, including the absence of information given to consumers about the features of the agreement;
 - absence of any requirements to undertake creditworthiness assessments;
 - potential to create high levels of indebtedness;
 - inconsistency of treatment of customers in financial difficulty;
 - impacts on the wider credit market including little visibility of BNPL debts on an individual's credit file.
- to consult stakeholders to ensure a balanced and proportionate approach is taken, recognising that their interest-free nature is inherently lower risk than interest-bearing products, and that this type of credit provides a valuable mechanism to spread payments for many consumers.

Risky customers + Risky Companies

Regulatory concerns world-wide (UK)

- UK government has announced regulation of BNPL on June 20, 2022
 - [Consultation paper](#) in October, 2021
 - Lenders will be required to carry out affordability/ credit checks
 - for new BNPL customers or increasing credit limits.
 - Advertisements are fair, clear, and not misleading
 - Lenders offering the product will be approved by the Financial Conduct Authority (FCA)
 - Borrowers can make complaint to the Financial Ombudsman Service (FOS).
 - Adequate' pre-contractual explanations that place the customer in a position to assess whether BNPL is adapted to their needs and financial situation
- Concerns –
 - BNPL taking advantage of exemption-
 - In consumer credit regulation, exemption to allow the delayed payment of goods and services as long as that delay was time-limited and did not involve the charging of interest - A60F(2)
 - Invoicing arrangements between a supplier and customer
 - Invoicing did not fall within the definition of regulated consumer credit, but also covers arrangements whereby goods are paid for through a number of instalments
 - promotion to consumers, poor consumer understanding of the product, lack of affordability assessments and inconsistent treatment of customers in financial difficulty
 - Unsecured consumer credit is regulated under the framework provided by the Consumer Credit Act 1974 (CCA) and the Financial Services and Markets Act 2000 (FSMA).
 - Firms which offer regulated credit agreements must be authorised to do so by the FCA, and must comply with relevant FCA rules as well as requirements in the CCA.

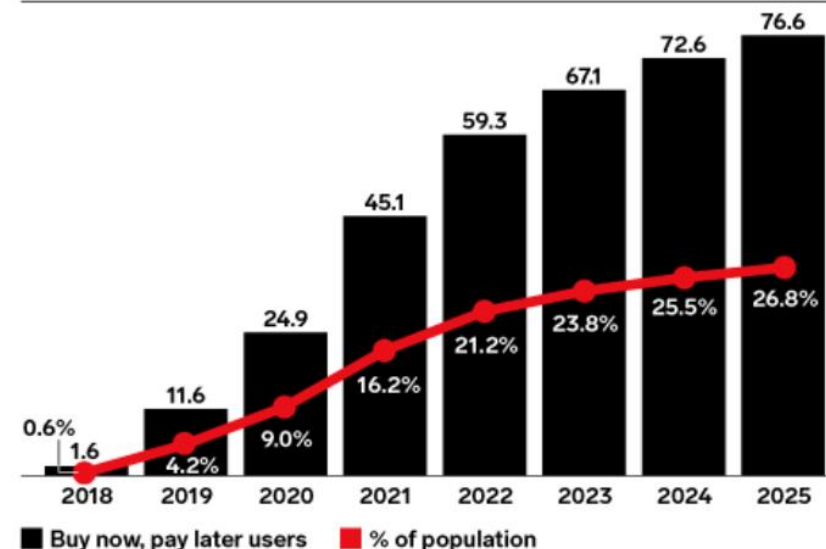
USA

- The Consumer Financial Protection Bureau (CFPB) is keeping a close eye on consumer credit products.
 - In December 2021 asked major players Affirm, Afterpay, Klarna, PayPal, and Zip to provide insight into the risks and benefits of their products
- **House Democrats** pushed the CFPB to closely examine BNPL ahead of potential regulations, while Republicans warned stronger regulations could curtail a product that provides financial flexibility for consumers.
- BNPL lending **falls outside regulations** for longer-term credit that carries interest payments, such as the Truth in Lending Act.
- Concerning issues in case of BNPL –
 - Accumulation of debt -consumers may spend more than they anticipated, and this may result in charges and fees if the user is not able to pay.
 - Regulatory arbitrage. In view of the regulator, some BNPL companies may not be evaluating and/or adhering to the specific consumer protection laws they believe apply to their products. BNPL providers were providing lending services without a license.

- The letter made to companies was provided under the section under its market monitoring power (which is usually used to issue specific rules)
- Did not use the words that such letter will not be used for any enforcement action (which is usually done in case of only market monitoring) - “The Bureau reserves the right to use the information for any purpose permitted by law

US Buy Now, Pay Later Users, 2018-2025

millions and % of population



Note: ages 14+; internet users who have accessed a buy now, pay later account digitally and have made a payment toward a purchase at least once in the past year; includes purchases of goods and services

Source: Insider Intelligence, May 2021

Australia

■ Concerns highlighted

- Australia's [Department of the Treasury](#) found that 30% of the revenue from BNPL comes from "bad debt," which it defines as debt used for consumption rather than wealth creation. And considering late fees for BNPL lending, the APR for BNPL can be as high as 68%, according to the Australia's treasury.
- **BNPL also offer lines of credit and fixed instalment loans – yet all of the players are unregulated**
- BNPLs exploit a current loophole in the Credit Acts in Australia and New Zealand
- The Australian National Consumer Credit Protection Act 2009 (NCC) - The NCC does not apply to certain loans, including: low-cost short-term credit (less than 62 days).
- ASIC belatedly has applied for 'urgent action' to close this loophole – action is next week with a report into the 'industry'
- New Zealand has a Credit Contracts Act which currently exempts Lay-buy programs – a review of the current Law started in 2019 and has not taken any action.
- BNPL is effectively unregulated with ASIC and the RBA declining to act. As a result, BNPL apps are not regulated and they have no legal requirement to offer hardship programs nor do they have to register with a dispute resolution scheme, like the Australian Financial Complaints Authority.
- BNPL apps are only paying merchants after goods are dispatched, which can be days or even weeks post-purchase.
- these apps lead to financial stress, write offs and promote increased spend among young consumer
- Consumers used as "off balance sheet" securitized borrowings.
- Small 'loan' amounts over a short period.
- BNPL typically do not assess a consumer's ability to repay. □ Majority do not use credit bureau for new applications or update performance. □ Majority do not report payment obligations or default to credit bureaus
- A report from the [Australian Parliament](#) found BNPL funding is a factor in one out of five consumer insolvencies, compared to 3% for credit cards

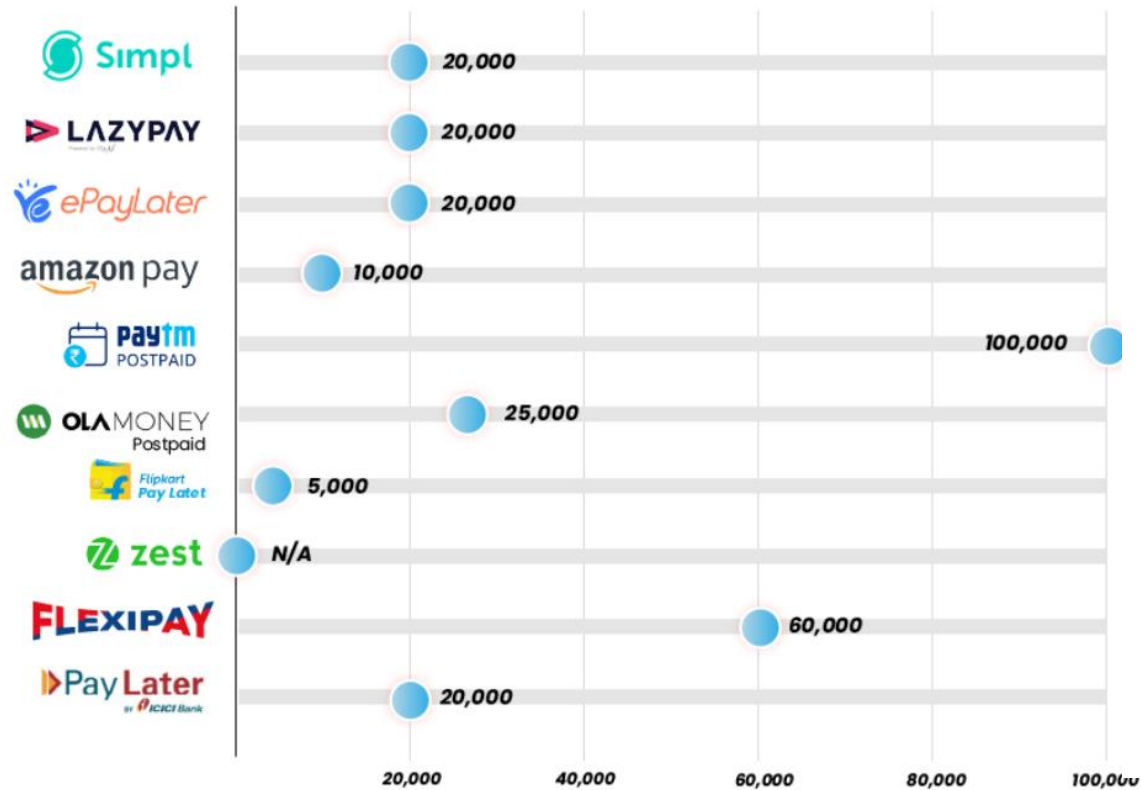
Top players in India



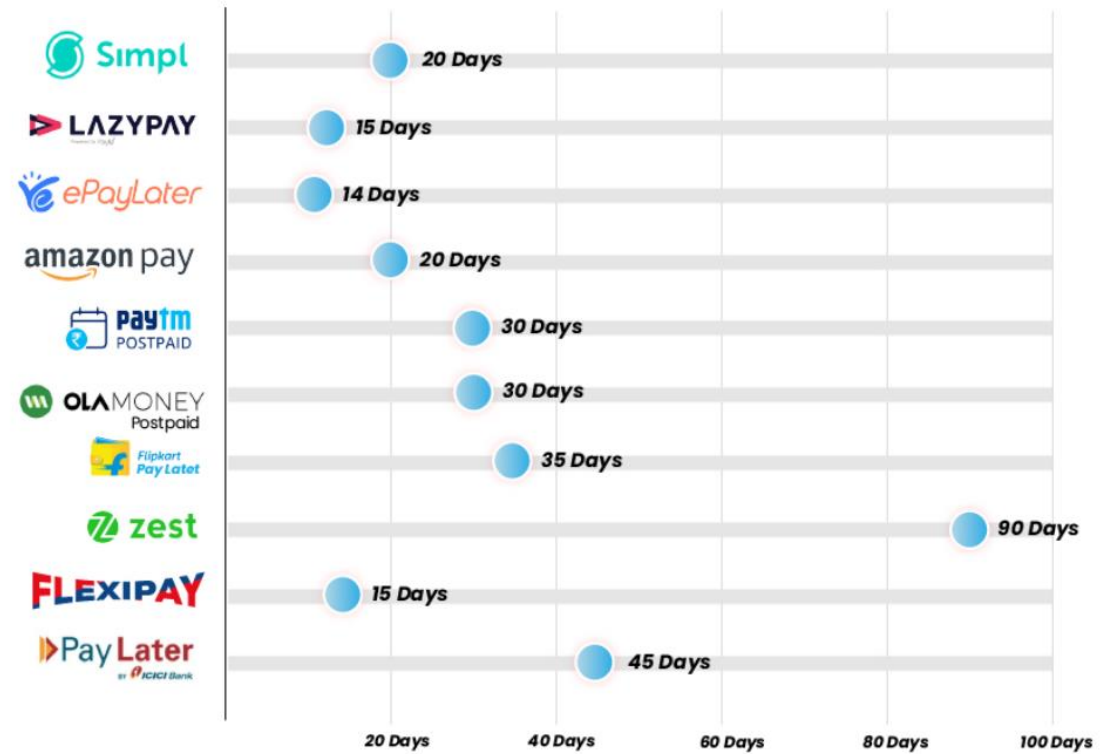
- Pureplay BNPL startups - Simpl, Lazypay, Zestmoney, ePayLater,
- Ecommerce marketplaces - Flipkart and Amazon India offer their own BNPL products,
- Fintech and payments companies such as PhonePe (via Flipkart) and Paytm
- Ola – Ola postpaid - offers a pay-later option for 300+ third-party platforms, besides Ola itself.

Terms across BNPL Players

Credit Limit Offered By BNPL Players In India



Repayment Cycle For BNPL Players Vary Wildly



Source – [INC24](#)

An ideal scenario

NBFC/ Lender



- Will be taking exposure on the borrower
- Exposure will be seen on the books of accounts of the borrower
- Lender will undertake credit check and take decision on lending
- Lending agreement will be between the borrower and the lender
- Lender to comply with FPC norms
- Lender to undertake grievance redressal
- Names of digital lending platforms engaged as agents shall be disclosed on the website of banks/ NBFCs.
- A copy of the loan agreement along with a copy each of all enclosures quoted in the loan agreement shall be furnished to all borrowers at the time of sanction/ disbursement of loans.
- Effective oversight and monitoring shall be ensured over the digital lending platforms engaged by the banks/ NBFCs.

Platform

- Role of BNPL player will be restricted to becoming the sourcing and technology partner (DSA and DMA)
- Should not be involved in decision making
- May onboard customer and undertake initial formalities
- May be the point of interface
- Digital lending platforms engaged as agents shall be directed to disclose upfront to the customer, the name of the bank/ NBFC on whose behalf they are interacting with him.

Notification issued to PPI issuers by RBI

- RBI issued guidance to non-banks –
 - PPIs shall be permitted to be loaded/ reloaded by cash, debit to the bank account, credit and debit cards.
 - PPI-MD does not permit loading of PPIs from credit lines. Such practice, if followed, should be stopped immediately.

- Definition of credit card –
 - Payment instrument carrying a means of identification (of the user), issued with a pre-approved revolving credit limit, and to be used towards purchase of goods and services, or for drawing cash advances,

- As per reports –
 - After PPI notification, online credit service platforms like LazyPay, Jupiter, EarlySalary and KreditBee have halted 'buy now pay later' transactions.

- As a result -
- If the BNPL product meets the definition of 'credit cards' under the Credit Card Master Directions, then the issuer must qualify under the eligibility criteria under Credit Card Master Directions. In the case of NBFCs, this means that prior approval from the RBI will be required.
- If the BNPL product is a PPI, then such PPI cannot be funded through credit lines if being issued by **a non-bank.**

- BNPL – BNPL card to the customer
- Linked to a credit line of an NBFC
- As soon as a customer swipes, money will move from credit line to the card, and then to the merchant
- Acting like a credit card
- PPI issuer banke issuing credit cards – getting a licence for credit cards is tougher than getting PPI licence

RBI to regulate BNPL

■ Payment Vision 2025 of June 2022

- *BNPL services have developed into a new payment mode alongside the existing payment modes like cards, UPI, and net banking. This channel, facilitated by a few payment aggregators, leverages the existing nodal account (escrow account after authorisation) to route payments between BNPL customer and a merchant. This novel method shall be examined, and issuance of appropriate guidelines on payments involving BNPL shall be explored.*

■ RBI DLP Report

- New digital lending products involving short term, unsecured/ secured credits going under the guise of deferred payments or the like, such as BNPL should be treated as part of balance sheet lending, if not in the nature of operational credit by merchants. Since these products do not meet the requirements of traditional credit facilities, a suitable notification may be issued by the Government of India in this regard.
- "Buy Now Pay Later (BNPL)" which is a form of point of sale credit – buyers/ purchasers are typically given a 15-30 day interest-free repayment period. Such transactions are not reported to the credit bureaus, as they do not fall under the definition of 'credit'. It is often labelled as a product for enhanced customer engagement and seamless user-experience, a potential replacement for credit cards, but not a credit product. However, if the user fails to make the payment in the interestfree period, he may be a charged penalty, fees and the outstanding amount may be converted into EMI. Though BNPL models are being deployed in partnership with banks /NBFCs, many FinTechs are also taking the exposure on their balance sheet and treating them as deferred payments.
- Bring newer products like BNPL within the definition of credit
- The BNPL model is currently gaining traction especially in e-commerce - loans are being offered at 0% interest rate. The platforms claim that since there is no interest being charged, they are not required to book the loan on a NBFC or to report it to a credit bureau. Hence, no regulations are applicable to them. The platforms do take [107] creative steps once a loan turns NPA, including post-facto creation of a loan on the books of NBFC. RBI must clearly re-define what constitutes credit so as to classify BNPL as a loan and hence bring it under regulatory coverage

Recommendations of the Working group on Digital Lending - Implementation

- RBI has implemented recommendations of the WG
 - August 10, 2022
- **Principle** - lending business can be carried out only by entities that are either regulated by the RBI or any other law.
- Digital Lending will cover BNPL
 - Loan+ given digitally (all parts of the transaction are digital)
- What does it mean for BNPL?
 - All new digital lending products extended by REs over merchant platforms involving short term credit or deferred payments are required to be reported to CICs by the REs

A merchant provides a credit facility to a customer. The lender comes and provides financial support to the merchant. Is this a case of digital lending?

Not. It is a facility given by the lender to the merchant, and not to the customer buying the goods or services of the merchant.

A vendor sells goods on credit to a buyer, and gets the receivables funded, by way of a recourse/non-recourse facility – is it a case of BNPL?

Under this case, the merchant avails a loan against the security of receivables. This seems to be a case of invoice financing and not a case of BNPL.

RBI Guidelines on Digital Lending

■ Meanings –

- 1) RE – Regulated entity – NBFC
- 2) LSP – Lending service provider – any person/ entity providing any service to the RE in connection with the loan
- 3) Digital lending – Nature of a loan + Entire transaction is done online

Impact on BNPL

- 1) BNPL will be treated as digital lending
- 2) Will be a part of lending for the RE
- 3) Reporting will be done to Credit Information Companies
- 4) Platform will be an LSP and outsourcing guidelines will be applicable

Question

- REs have to ensure that all loan servicing, repayment, etc., shall be executed directly in their bank account without any pass-through account/ pool account of any third party. The disbursements shall always be made into the bank account of the borrower. Exceptions would be considered for disbursals covered exclusively under statutory or regulatory mandate, flow of money between REs for co-lending transactions, and disbursals where loans are mandated for specified end-use as per regulatory guidelines of RBI or of any other regulator.

Will this apply to BNPL?