

CREATING  
**RISK**  
INTELLIGENT  
PROFESSIONALS



**GRMI**

**GLOBAL RISK  
MANAGEMENT  
INSTITUTE**

***TOPIC : Buy Now Pay Later / 23-11-2021***

PROGRAMME  
ENDORSED BY



ASSOCIATE  
PARTNER



STRATEGIC  
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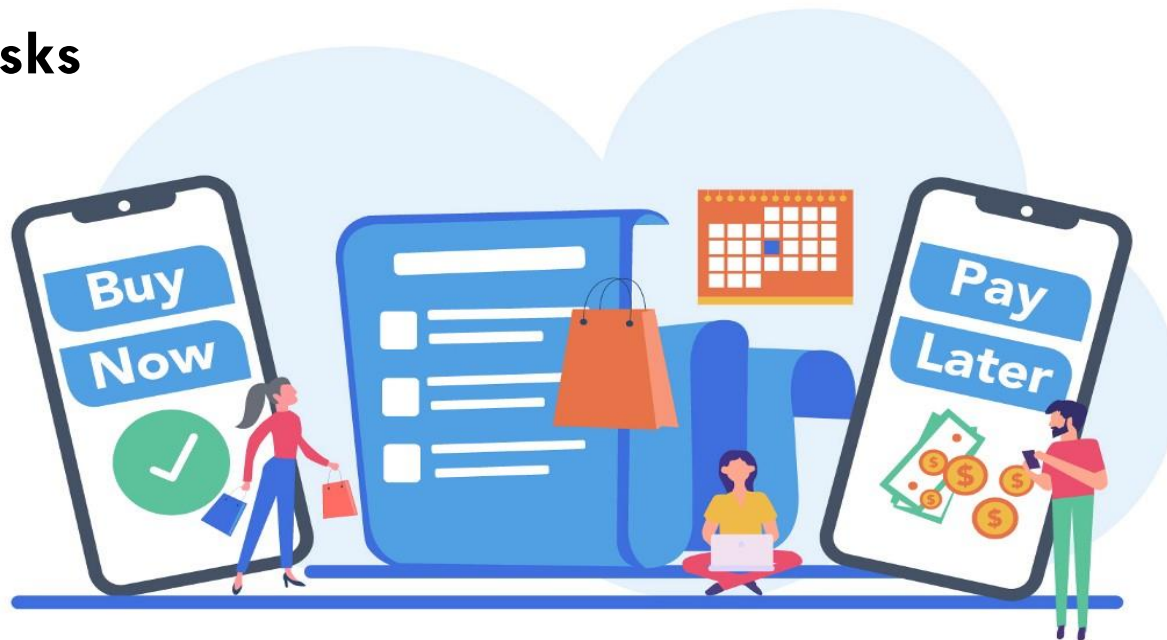


STRATEGIC  
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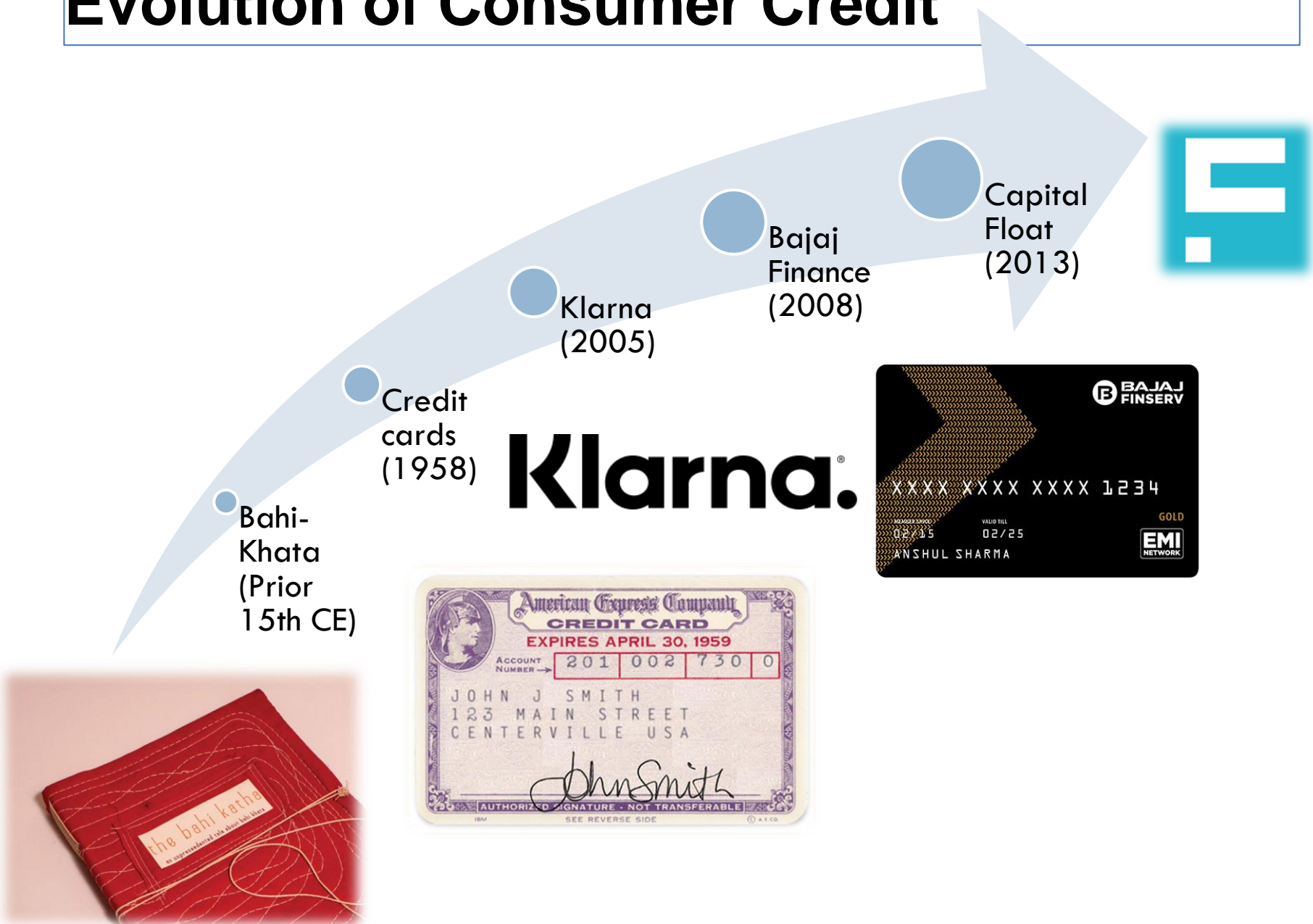


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# Evolution of Consumer Credit



# Credit cards Vs BNPL

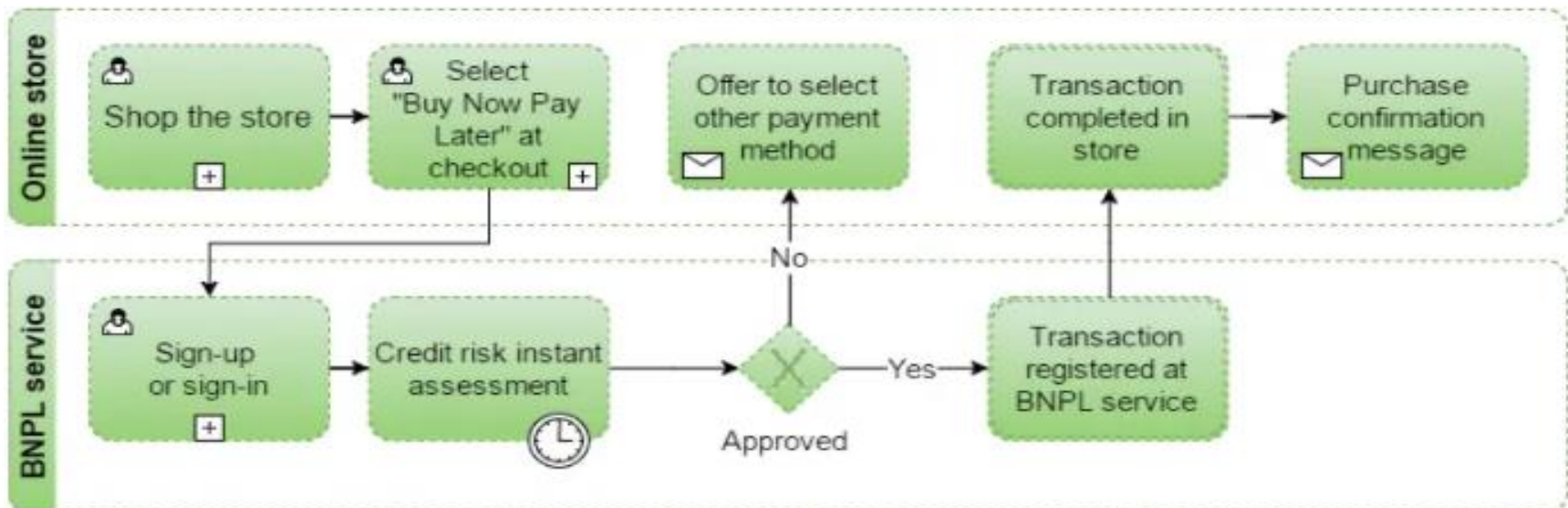
Credit cards	BNPL
Long application approvals.	Easier and instant approvals.
Require a good credit history to avail a credit card. Thorough credit check is conducted.	Need not have a credit history. Only soft check is conducted.
Charge interest from 21-42% p.a	Charge interest from 0-24% p.a
Hidden charges are levied.	Follows a low cost and transparent model.

# Introduction to BNPL

Buy Now, Pay Later (BNPL) is a type of short-term financing that allows consumers to make purchases and pay for them at a future date, often interest-free. Also referred to as point-of-sale installment loans, BNPL arrangements are becoming an increasingly popular payment option, especially when shopping online.

- Investopedia

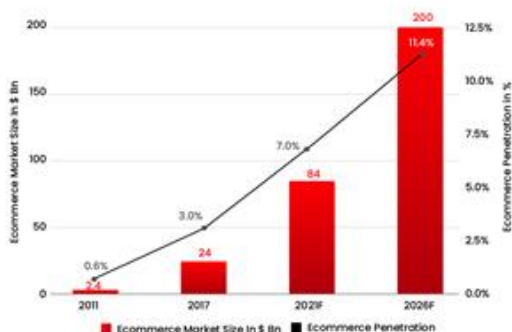
Key players in BNPL business are Affirm, Zest Money, Lazy Pay, Amazon Pay, Paytm Postpaid, Flex money, Ola pay, After pay, Razor, Post-pay.



# Trends driving BNPL

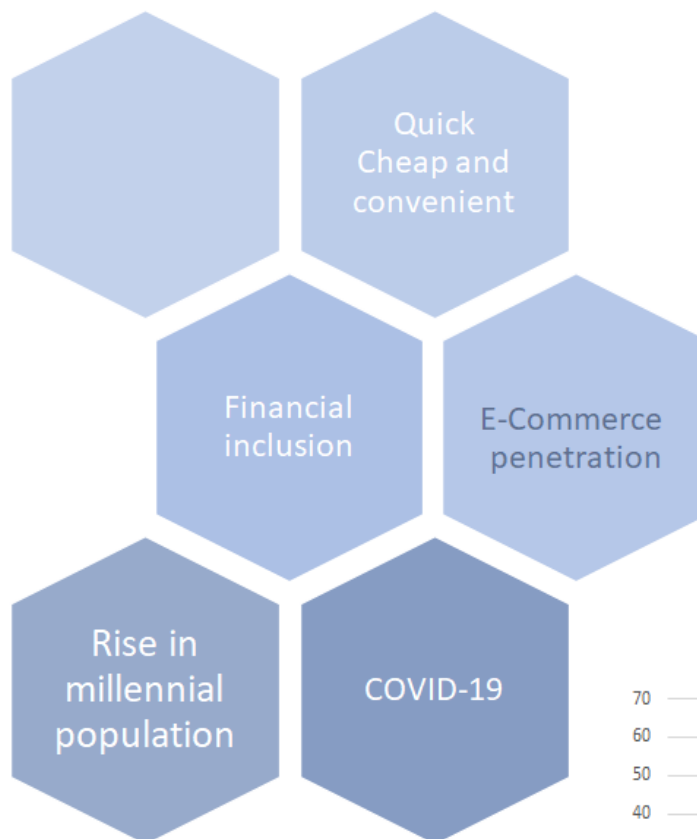
## Rise In Ecommerce Penetration To 11% In 2026, Paves Way For The Future Growth Of BNPL In India

Driven by rise in digital infrastructure, Indian ecommerce market is poised to reach \$200 Bn By 2026

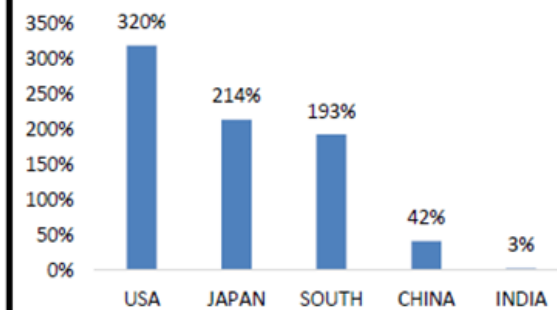


Note: Ecommerce penetration is a percentage share of ecommerce in total retail market of India  
Source: Deloitte "Unravelling the Indian Consumer", February 2019 report

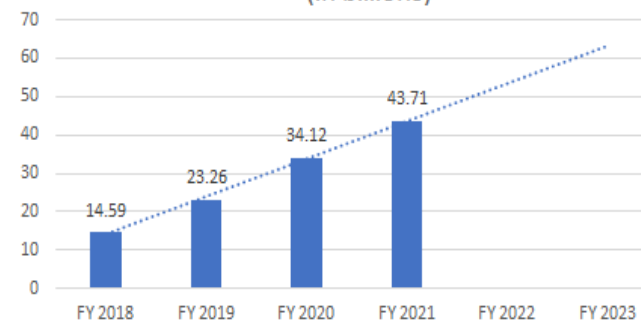
Inc4Plus



## Credit card Penetration



## Total number of digital payments across India (in billions)





# Models in BNPL



Integrated Shopping Apps

- Create super-apps with well-integrated shopping, payments, financing, and banking ecosystems on a single platform.
- Resulted in higher conversions, repeat high ticket purchases, Average Order Value (AOV), and lower cart abandonment rates.
- Afterpay, Klarna, and Sezzle adopt the integrated shopping apps approach to BNPL.



Card-linked Installments

- Predominant form of Point of Sale (POS) financing
- It is basically a no-cost EMI option (using credit cards) with the capability to enable high ticket purchases
- Card issuers have allowed post-purchase instalment payments while Fintechs leverage this opportunity by introducing card-linked BNPL instalments in the pre-purchase, at purchase, and post-purchase stage for EMI conversions.
- Split It, Bajaj Finance.



Off-card financing

- Off-card financing solutions mandate consumers to pay a 0% APR for a certain period and then a subsidized Annual Percentage Rate (APR).
- Over 80% of consumers in this model have high credit scores with sufficient credit card availability.
- Merchants use it for categories with higher-ticket, lower-frequency purchases where cart conversions are critical

# Models in BNPL contd.



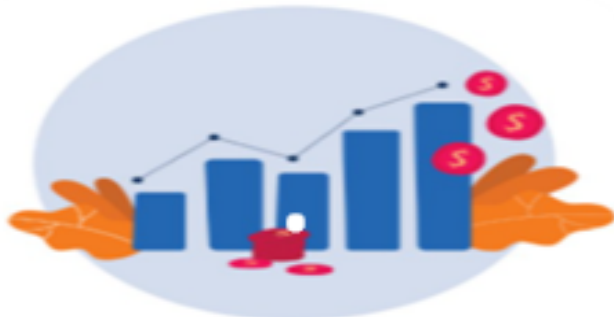
Virtual rent-to-own

- The virtual rent-to-own (VRTO) is an arrangement where consumers make payments for items they wish to own. Once all the payments are done, the purchase is deemed complete.
- home appliances, mattresses/furniture and electronics, and other goods that can be repossessed.
- Targets the subprime consumer base with a poor credit score.
- Acima, Acceptance Now, and Progressive Leasing



Vertical focused larger ticket plays

- The vertical focused larger ticket plays model focuses on financing high-value purchases between \$2000 and \$50,000.
- Cater to high ticket industries such as elective and non-elective healthcare, veterinary, power sports, and home improvement.
- CareCredit in healthcare and GreenSky in home improvement are category specialists in this form of BNPL.
- Excellent fit for banks that seek to acquire high-credit



SME sales financing

- SME sales financing is a great deferred payments model for small businesses running low on capital.
- Players like CIT and Dell Financial Services deliver POS financing
- They need to centralize expense management and integrate the BNPL option into their payment ecosystem. As the financing is for underlying business transactions, the lenders gain a comprehensive understanding of the risk profile and repayment ability.



# Business model

<u>Key Partners</u> <ul style="list-style-type: none"><li>• Payment Lenders</li><li>• Merchants (E-com / POS platforms)</li></ul>	<u>Key Activity</u> <ul style="list-style-type: none"><li>• POS lending</li><li>• Product Development</li><li>• Global Opportunities</li></ul>	<u>Value Propositions</u> <ul style="list-style-type: none"><li>• Flexibility</li><li>• Conversion rate</li><li>• Average order value</li><li>• Retention</li></ul>	<u>Customer Relationships</u> <ul style="list-style-type: none"><li>• Loyalty and reward program</li><li>• Flexible payment</li></ul>	<u>Customer segment</u> <ul style="list-style-type: none"><li>• Early phases : Millennials and Gen Z</li><li>• Evolved phase: Gen X</li><li>• Merchants</li></ul>
	<u>Key Resources</u> <ul style="list-style-type: none"><li>• Brand value</li><li>• Merchant Relationships</li></ul>		<u>Channel</u> <ul style="list-style-type: none"><li>• Merchant checkout</li><li>• Card linked installments</li></ul>	
<u>Cost Structure</u> <ul style="list-style-type: none"><li>• Technology development and customer acquisition</li><li>• Regulatory and Compliance Fees</li></ul>			<u>Revenue Stream</u> <ul style="list-style-type: none"><li>• Merchant Fees</li><li>• Late Payment Fees</li></ul>	

# Economics of BNPL business

$$\text{BNPL Profits} = \text{GMV} * [\text{Net Take Rate} - \text{Debt financing cost} - \text{Debt management cost} - \text{Provision for Debt impairment}] - \text{Marketing \& Sales expenses} - \text{General \& admin expenses}$$

**Net Take Rate** : Commission charged to merchants (take rate)  
- processing fees paid by BNPL Co.

**Debt financing cost** : interest BNPL providers pay banks for liquidity

**Debt management cost** : credit check cost + payment collection cost – late payments collected from customers

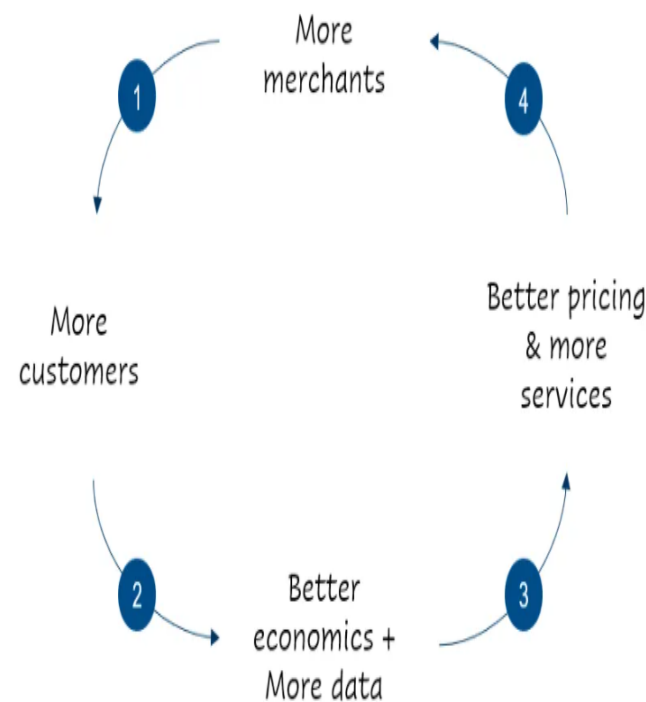
**Provision for debt impairment** : weighted average % of loans that are not paid back

**GMV (Gross Merchandising Value)** : sum of all the payments conducted on the BNPL platform.

**Marketing and sales** : expenses incurred on acquiring and onboarding both merchants and customers

**General and administrative expenses** : team salaries , technology and infrastructure costs.

## CONSUMER-MERCHANT FLYWHEEL



# Regulations

## European Union moves to protect customers

### EU consumer credit rules

- Information related to credit must be presented clearly so that customers understand what they are signing up for
- Called out detrimental products , because of high costs they entail or high late payments fees.
- There are calls for unsolicited sale of credit or the unilateral increase of a consumers' overdraft or credit card limit to be prohibited
- Credit providers should make thorough assessment of consumer's creditworthiness based on the consumer's income and expenses as well as other financial and economic circumstances.

These rules may discourage sign ups more onerous credit checks may make it harder for consumers to sign up for new services.

## Australia

BNPL providers enjoyed a relaxed regime in Australia, as the provisions of the Australian National Consumer Credit Protection Act of 2009 do not apply to certain types of loans, including short-term interest-free credits. The industry has eventually adopted a self-regulatory approach.

**The Australian Finance Industry Association (AFIA) announced on the 1st of March 2021 that its Code of Practice for the BNPL sector has come into effect.**

BNPL providers that are compliant with this Code must carry out assessments before a customer can make a purchase and conduct additional checks to prevent consumers from stretching their arm further than their sleeve will reach.

BNPL disputes under the code will be managed by the Australian Financial Complaints Authority, where a designated committee will have the power to publicly denounce companies that provide loans services outside the Code's standards.

# Regulations contd.

## Regulatory issues for BNPL in UK

**Consumer credit regime** : Falling within this regime means 1. Mandatory regulatory authorisation from FCA or PRA 2. Compliance to consumer credit rules 3. Requirement of Consumer credit Act 1974 – mandatory disclosures of credit agreements with prescribed wording

Regulated lending (Merchant model) b. Regulated broking (Partner model )

Exclusions : 60F

1. The credit agreement is for a fixed sum of credit and which is made by the lender under pre-existing arrangements with the merchant;
2. The number of payments to be made by the borrower is not more than 12 and those payments are required to be made within a period of 12 months or less (beginning on the date of the agreement); and
3. The credit is provided without interest or other charges.

**Money laundering regime** : the scope wide – it applies to any ‘lending’.

The consequences of falling within this regime are that the person must (1) apply customer due diligence measures (for example, verifying the identity of the customer) and (2) be registered with the FCA Financial Conduct Authority (for the purposes of money laundering supervision).

For the Merchant Model, it is likely that the merchant would fall within scope. For the Partner Model, it is likely that the BNPL provider would fall within scope but the merchant may not depending upon how the arrangements are setup (because the broking of credit does not fall within the scope of the anti-money laundering regime).

**With these conclusions in mind, the Government intends to make legislative changes as soon as parliamentary time allows.**

# Regulations contd.

## US

- According to a study by Credit Karma, 40% of US consumers who used BNPL have missed more than one payment, and 72% of those saw their credit score decline.
- Fitting BNPL into the US regulations is relatively challenging since laws vary by state.
- regulated by federal and state laws under consumer credit regimes, depending on the different definitions of credit covered by those laws.
- The loan regulations in the country can't be fully applied to BNPL providers, because they don't make loans per se to consumers, but they facilitate and support the instalment plans, on behalf of the customer.

## CASES:

At the beginning of the year, some tensions occurred in California. The **California Department for Business Oversight (DBO)**, a division of the state government that regulates financial services, has taken over several cases focused on BNPL services.

- BOD refused to grant Sezzle a Financing Law license to carry out its operations.
- As well, in March 2021, DBO accused Afterpay of collecting taxes from more than 640,000 Californians in transactions that were in fact 'illegal loans'.
- As a result of the **settlement**, Afterpay, which had 5.6 million active users in the US as of June 30, 2020, was forced to **return USD 900,000 to consumers and pay USD 90,000 in administrative fees.**



# Regulations contd.

## India

1) **The Reserve Bank of India Act, 1934** - broadly defines NBFCs to include a company which carries on as its business or part of its business financing, whether by way of making loans or advances or otherwise, of any activity other than its own. It would therefore appear that the activity of extending short-term loans would require Fintech's offering BNPL services to be registered as NBFCs.

To alleviate the need for such a registration, BNPL service providers typically partner with NBFCs.

If, a Fintech is underwriting any bad-debt risk or financing the debt owed by the consumer through any mechanism, then it may qualify as having undertaken NBFC activities. This may in turn, trigger the need for appropriate registration with the RBI.

2) **The Payments Act** governs payments systems which enable payment between a payer and a beneficiary, including systems enabling credit card and similar operations.

Requires approval since a BNPL feature relies heavily on a financial partner registered as an NBFC for payments and settlements, Fintech entities offering BNPL do not obtain authorization.

3) The need for any additional government intervention, as proposed in the RBI discussion paper, will also have to be thought through, as such intervention may hinder growth and stifle innovation. For example, digital wallet companies have in the past made representations to the RBI to lessen regulatory interference fearing that increased regulatory requirements will affect product use. Innovation, and consequently, the Fintech space, can only thrive in an evolved regulatory environment.

# Risks in BNPL

## • Merchant fraud risk

- Dishonest merchants can be a channel of fraud.
- Failure to identify legitimate from illegitimate merchants.
- Illegitimate merchants can submit falsified orders using real or fictitious consumer PII and collect payments for products sold but not shipped.

## • Merchant Default risk

- Due to pandemic some merchants are at a greater risk of failure. Some might be coping with declining revenues, rising variable costs and high fixed costs, or any other scenarios in business where they are unable to pay the fees which contribute to increasing merchant default risk.
- Merchant shutting off their business without notice is problematic if they owe fund to its BNPL partners.

## Buy Now, Pay Later FinTechs leverage 3rd Party Solutions to Mitigate Risks

- BNPL players are trying to mitigate merchant fraud and merchant default risk by combining data, such as risk detail, business cash flow analysis, previous payment performance etc.
- Additionally, BNPL FinTechs are seeking assistance from 3rd-parties with expertise in data analytics, risk score/index modelling and decision automation.
- These powerful risk management strategy enables quick approve/decline decision making.
- Ongoing merchant monitoring will enable timely responses to changing risk conditions.

# Risks in BNPL contd.

## • Customer Default risk

- Soft credit checks
- Opaque debt performance reporting – lenders could underestimate a borrower's debt level.
- With job losses and unemployment, consumers who may want to but who do not have enough income to make repayments- may fall into debt trap.
- **15% Australian consumers using BNPL had to take out additional loan to pay off their obligations.**

**Mitigating step:** Economies of scale along with data analysis will help in eliminating bad customers which ultimately will reduce customer default risk

## • Cyber and Fraud Risk

1. **Chargeback** is always an issue with compromised accounts and the liability falls on the BNPL.
2. Fraudsters are known to use **synthetic identities** to pass through fraud, KYC and credit checks with zero intention of paying back the purchase. **Account takeover attacks (ATO)** can also take place on such platforms, with fraudsters using bots to exploit weak passwords, or purchasing stolen credentials from paste bins on the dark web.

# Risks in BNPL contd.

- **Default fraudulent charge back**

- Chargeback liability might fall on BNPL service providers when consumers notice an unauthorized purchase or makes the purchase and attempts to claim it as fraudulent.

- **Market Risk**

- The BNPL sector is growing drastically. In addition to pure BNPL startups, e-commerce platforms, banks as well as fintech/payment companies have entered this space.
- Flywheel effect – will lead to consolidation in the market (small players unable to achieve economies of scale or raise enough money will have to exit the space)

- **Interest Rate Risk**

- BNPL players may not always be able to obtain loans from payment facilitator at desired interest rate.

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# Thank you!

