BUY NOW, PAY MORE LATER? INVESTIGATING RISKS AND BENEFITS OF BNPL AND OTHER EMERGING FINTECH CASH FLOW PRODUCTS

HYBRID HEARING

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TASK FORCE ON FINANCIAL TECHNOLOGY

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BUY NOW, PAY MORE LATER? INVESTIGATING RISKS AND BENEFITS OF BNPL AND OTHER EMERGING FINTECH CASH FLOW PRODUCTS

Tuesday, November 2, 2021

U.S. HOUSE OF REPRESENTATIVES,
TASK FORCE ON FINANCIAL TECHNOLOGY,
COMMITTEE ON FINANCIAL SERVICES,
Washington, D.C.

The task force met, pursuant to notice, at 10 a.m., in Room 2128, Rayburn House Office Building, Hon. Stephen F. Lynch [chairman of the task force] presiding.

Members present: Representatives Lynch, Torres; Davidson, Sessions, Luetkemeyer, Emmer, and Steil.

Ex officio present: Representative Waters.

Chairman LYNCH. Good morning, everyone. The Task Force on Financial Technology will come to order. Without objection, the Chair is authorized to declare a recess of the task force at any time. Also, without objection, members of the full Financial Services Committee who are not members of the task force are authorized to participate in today's hearing.

Today's hearing is entitled, "Buy Now, Pay More Later? Investigating Risks and Benefits of BNPL and Other Emerging Fintech Cash Flow Products."

I now recognize myself for 4 minutes to give an opening statement.

In the last few years, a number of emerging fintech liquidity products have garnered increased attention for both their explosive growth among merchants and their popularity among consumers, as well as the potential for consumer protection risks. Products such as buy now, pay later (BNPL), earned wage access, and overdraft avoidance are designed to help consumers manage their cash flow at lower cost than many traditional alternatives.

A recent study by McKinsey reports that buy now, pay later fintechs have diverted between $8 billion to $10 billion in revenue from traditional banks. Indeed, it is difficult to shop online without seeing a buy now, pay later option, and Early Pay has become a popular benefit for both employers and employees.

However, these products also raise important questions about the use of consumer data, the exploitation around spending patterns, the application of lending laws, and the potential for unsustainable levels of consumer debt.

Point of sale, or buy now, pay later providers typically partner with merchants and offer consumers the opportunity to purchase a product and pay over time through installments. These products are most commonly offered on retail, fashion, electronics, beauty, and travel websites. Users of buy now, pay later products tend to be younger consumer cohorts who have a limited or a thin credit history and do not qualify for traditional credit. Both the numbers of merchants offering these services and the customer base has grown exponentially during this pandemic.

While companies and proponents argue that these products can be beneficial because they allow consumers flexibility and are cheaper alternatives to credit cards, consumer advocates and research groups have raised concerns over the risk of consumers overextending their finances and taking on unsustainable levels of debt, noting that most buy now, pay later companies do not assess ability to repay. Additionally, most BNPL companies do not report buy now, pay later transaction histories to credit bureaus, which would be a missed opportunity to help consumers build creditworthiness.

The lack of consumer disclosure has also raised concerns. The Pay in 4 business model, which typically offers customers the option of 4 installments in 2-week intervals at zero-percent interest, has been criticized by some for being specifically designed to evade lending regulations such as the Truth in Lending Act. Earned wage access companies typically partner with an employer or a payroll company to offer consumers advances on earned wages prior to payday. Providers recoup advances directly from subsequent employee paychecks. Similar direct-to-consumer overdraft avoidance companies establish direct connections with consumers' bank accounts to monitor cash flow. Companies then offer consumers advances based on those cash flow patterns and recoup advanced funds from account balances.

Overdraft avoidance companies can monetize this service through membership fees, interchange fees, or directly through employers. Other overdraft avoidance companies monetize through so-called voluntary tips. These products have become popular with hourly workers who live paycheck to paycheck because they offer additional liquidity between paydays. Critics of this service argue that the products should be regulated as loans and be subject to lending laws, including an APR requirement. Consumer advocates have been particularly critical of the tipping model, and question whether a tip influences a consumer's likelihood of being offered an advance.

The emergence of these products raises larger questions about consumer cash flow needs. Policymakers have taken some actions in response to these questions. The California Department of Financial Protection and Innovation took action against several buy now, pay later companies and issued a legal opinion classifying these products as loans. The Consumer Financial Protection Bureau (CFPB) also released a blog post encouraging consumers to be keenly aware of the details of these products before choosing them. Additionally, the New York State Department of Financial Services led a multi-State investigation of a number of earned wage access and overdraft avoidance companies to determine whether they had violated State lending laws.

Today, we have a distinguished panel of witnesses who will be able to discuss these issues more deeply. Throughout this hearing, I hope to dive deeper into these products and explore the merits and risks that they raise and the true nature of these products and the implications for borrowers engaging in unsustainable borrowing patterns.

With that, I would like to recognize my friend, the ranking member of the task force, Mr. Davidson, for 5 minutes for his opening statement.

Mr. DAVIDSON. Thank you, Chairman Lynch, and thanks for our witnesses and the work that you have done in advance to make sure we have a great discussion today. We are talking about buy now, pay later, but frankly, this is just the whole concept of credit. Fintech didn't create the concept of credit, but the focus will, of course, be on what has changed in light of this fintech innovation. What is innovative going on in the marketplace?

The exceptional growth and popularity of programs such as buy now, pay later, earned wage access, and overdraft avoidance products exemplifies some of the benefits that fintech has brought to consumers in recent years, and today's hearing will assist this task force in understanding just how and why these products are becoming preferred over traditional financial products that also extend credit. Until we gather a sound understanding of these products and how they are used, we should refrain from implementing overly burdensome regulations that would overly impede consumers from receiving the benefits that the programs bring.

It is important to recognize just how far these products, or really access to credit, has evolved over the past several years. According to a Forbes article from last month, the percentage of Gen Z'ers in the U.S. using buy now, pay later, for instance, has grown sixfold, from 6 percent in 2019, to 36 percent in 2021. Millennials' use of buy now, pay later has more than doubled. Meanwhile, Gen X'ers' adoption has more than tripled.

Additionally, according to a Mercator study in 2020, we already have millions of workers using earned wage access programs. It is estimated that the total addressable market is around 45 million workers, with many of these individuals working in the gig economy. I would note that often it seems the employers are the ones extending credit to the employees as they have actually worked the hours.

Lastly, in the midst of the pandemic, we saw many banks migrate away from overdraft fees and adopt overdraft avoidance tools, such as up-to-the-minute notifications and grace periods to repay a negative balance. With these developments in mind, we cannot deny that there is a strong market demand for the products. Consumers are undoubtedly deriving more benefits from the financial services industry than they were just a few years ago. The access to short-term liquidity is easier now more than ever thanks to technology and advancement, with more ways to access credit.

Which demographics are more inclined to use these products? Do these products help to address the unbanked or underbanked? How are these products affecting small businesses in our macro economy? I am confident that this hearing can provide clarity on some of these issues, given the range of witnesses that we have here today, but it is important to note that we must exercise caution before we take regulatory action against products, and some products we may need to overly protect.

The exponential growth of these alternative financial products clearly shows that consumers want them, so we should avoid doing two things. We should avoid punishing new products for not fitting within regulatory buckets that were already built, and we should clarify how they would fit into to this current regulatory scheme. We should avoid overly impairing consumer choices on how they spend money, and we should facilitate innovation. Does this mean that I am advocating for a completely hands-off approach? Certainly not. As I say often, I am a Republican, not an anarchist. But if there is a harm that the products impose on consumers, then hopefully this hearing can weigh out the problem and help us find a way to solve it.

Proactively legislating or promulgating rules always runs the risk of failing to adequately address the problem. In fact, many times it addresses a problem that isn't there. Conversely, failing to address known problems really puts a heavy burden on our regulators, and often see we regulation by enforcement in the market which punishes innovation and fails to protect consumers.

Lastly, I would just reiterate the importance of protecting consumer data as we continue to adopt these new financial technologies. As many probably remember, consumer data privacy was the prime focus of our task force's last hearing. I encourage my colleagues to always keep that in mind any time we are discussing new financial products where consumers are providing sensitive information. I am sure we will continue to discuss these topics further within the committee as alternative financial products become more widely adopted and innovation continues to flourish here in America. This hearing will hopefully serve as groundwork for future hearings, and I look forward to the discussion with our witnesses on the range of issues.

Chairman LYNCH. The gentleman yields back.

Today, the ranking member and I welcome the testimony of our distinguished witnesses: Dr. Kristen Broady, a fellow at the Metropolitan Policy Program at the Brookings Institution; Ms. Penny Lee, the CEO of the Financial Technology Association; Ms. Lauren Saunders, the associate director of the National Consumer Law Center; Ms. Marisabel Torres, the director of California policy with the Center for Responsible Lending, who is joining us virtually; and Mr. Brian Tate, CEO and president of the Innovative Payments Association.

The witnesses are reminded that their oral testimony will be limited to 5 minutes. You should be able to see a timer on the screen, or on the desk in front of you, that will indicate how much time you have left. I would ask you to be mindful of the timer so that we can be respectful of both the witnesses' and the taks force members' time.

And without objection, your written statements will be made a part of the record.

Dr. Broady, you are now recognized to offer a 5-minute presentation of your testimony. Thank you.

STATEMENT OF KRISTEN E. BROADY, FELLOW, METROPOLITAN POLICY PROGRAM, THE BROOKINGS INSTITUTION

Ms. BROADY. Good morning, Chairman Lynch, and members of the Task Force on Financial Technology. My name is Kristen Broady, and I am a fellow in the Brookings Metropolitan Policy Program. Thank you for the opportunity to appear before you to discuss consumer lending products offered by our technology-focused fintech companies.

Financial technology companies can mitigate racial, financial, health, and wealth gaps that hamper Black and Hispanic families' financial security through product offerings and policies they put in place. Through technology and automation, they can reduce costs and prices, speed up delivery, and increase convenience for underserved populations. Over the past 20 years, fintech companies have provided new ways to capture data, reach broader audiences, and expand access to credit. These companies also have the potential to think differently about policies and programming that can amplify opportunities for Black and other minority communities. These private-sector innovations can be paired with public policy interventions as well as address some of the systemic issues that have contributed to the financial health and wealth gap.

Fintech companies can create inclusive financial services products for people who are credit invisible or low-credit individuals. For example, fintech companies can smooth and stabilize cash flow by collaborating with enterprise. Financially vulnerable populations experience greater income and expense volatility. Offering accounts that do not have overdraft fees, minimum balance requirements, and account maintenance fees can help reduce the negative impacts of this volatility.

It can provide interest-free, buy now, pay later capabilities so that consumers can comfortably make purchases and spread out payments as they get paid. Klarna's buy now, pay later option is an example of this. It allows customers to split the cost of their purchase into four smaller payments without paying any interest or impacting their credit score. This allow consumers the ability to try items before they pay for them and only pay for items that they keep.

Further, with respect to saving and investing, fintech companies can help Americans build emergency savings. According to an AARP national survey of U.S. adults aged 30 and older, 3 in 5 African Americans experienced an unexpected financial challenge in the past year. A study by the Economics Policy Institute (EPI) found that in 2016, half of families had no retirement savings at all and that disparities existed by race. Two-thirds, or 68 percent, of White, non-Hispanic families have retirement savings, compared to 41 percent of Black families and 35 percent of Hispanic families. To increase the saving ability of Black and Hispanic families, fintech companies can offer high-yield savings accounts, automated savings features, and robo- and micro-investing tools to increase savings opportunities.

They can use alternative data and machine learning to extend affordable credit to a larger population of consumers. They can provide fast, fair, and flexible small business lending products that do not require a personal credit score. We know that Black and Hispanic people are likely to have lower credit scores traditionally than White people, which means that these companies are helping them to build savings and buy products that they need. They can focus on access to capital through a racial equity lens.

In addition to being deliberate in how small business credit products meet the needs of Black-owned small businesses, it can capitalize on opportunities to work with government stakeholders and provide a fintech perspective so that as laws and regulations are updated, they reflect the changing landscape of financial services. Fintech companies can offer products that bridge the gap between cash and traditional financial services that empower people to participate in the digital economy. They can hire more people of color, particularly Black people, as we see banks leaving Black neighborhoods and Black people having less access to traditional banking products.

They can meet people where they are in their communities working more intentionally with local leaders, minority depository institutions (MDIs), and community development financial institutions (CDFIs). They can partner with banks that are focused on racial equity at a time that we see racial equity disappearing from the banking industry. They can engage with people of color in their communities, in churches, in sororities, and work with Historically Black Colleges and Universities (HBCUs) and minority-serving institutions to increase financial literacy so that these underserved populations have a better idea of what their products are and what they have to offer. With respect to public policy, they can take steps to increase financial health by increasing investments in CDFIs. They can create mandatory financial curriculum for middle and high schoolers to help educate people earlier.

Thank you.

[The prepared statement of Dr. Broady can be found on page 32 of the appendix.]

Chairman LYNCH. Thank you. Ms. Lee, you are recognized for 5 minutes to offer a summation of your testimony.

STATEMENT OF PENNY LEE, CEO, FINANCIAL TECHNOLOGY ASSOCIATION (FTA)

Ms. LEE. Thank you, Chairman Lynch, Ranking Member Davidson, and members of the Task Force on Financial Technology for the opportunity to testify before you today on innovations in financial services that are empowering consumers and businesses with greater choice, opportunity, and access. My name is Penny Lee, and I am the chief executive officer of the Financial Technology Association (FTA), a nonprofit trade association representing some of the world's leading technology-centered financial services. We educate consumers, regulators, policymakers such as yourselves, and third-party industry stakeholders on the value of trusted digital financial services, and advocate for the modernization of financial regulation to support innovation and promote inclusion.

We are in a transitional time when technology allows financial services to be more accessible and to facilitate faster and easier transactions. Consumers and businesses are shifting to modern tech-driven solutions to manage their payments, facilitate transactions, secure a loan, track expenses, and access capital. If anyone had a meal, medicine, or groceries delivered during the pandemic, that likely took place over financial technology, a fintech platform. By using internet and mobile platforms, machine learning automation, and other emerging technologies, fintech companies are providing consumers with improved personalized services, greater convenience, increased transparency, reduced costs, and broader access to capital for individuals and businesses.

These advances are coming at a critical time for the American economy. Millions remain underbanked and underserved and lack access to fair credit. Student debt continues to mount, income and wealth inequality continues to grow, and small businesses seek to rebuild from the devastation caused by the COVID-19 pandemic. Fortunately, fintech solutions offer a new paradigm and are reshaping the financial landscape in powerful ways.

I will focus my remarks today on a particular area of the fintech innovation, which is called buy now, pay later (BNPL). FTA is pleased to count many of the global leaders in BNPL as founding members of the organization.

There is a shift in how consumers, especially Millennials, Gen Z, and others, are spending their money. They are saving more and utilizing credit cards less, preferring debit cards with no fees or revolving interest. Buy now, pay later is an alternative payment method that allows for small, short-term purchases that are typically paid in interest-free installments. BNPL products are structured to have payment terms that require consumers to pay for a purchase in a matter of weeks or a few months. This is in contrast to revolving credit and high-interest products that may take years to pay down, blur the true cost of a purchase, and oftentimes keep consumers in vicious debt due to continuous interest charges and rollovers.

BNPL products are preferred by consumers for several reasons. One, they charge little or no interest fees, unlike credit cards which can sometimes cost consumers up to 225 percent of their product purchase value in interest expenses. They are transparent and provide greater cost certainty for consumers. They help users budget and, as a result, help manage cash flow better and avoid risky debt products. They are flexible and offer more relief when consumers face an unexpected emergency. And they typically result in less debt, and repayment takes place over much shorter terms.

BNPL products are regulated. They are subject to key consumer protection laws and regulations, including anti-money laundering, fair lending, credit reporting, debt collection, privacy, fair treatment of customers, and electronic fund transfers. They are also subject to similar State consumer protection laws.

Our members are committed to regulatory frameworks that safeguard consumers, and are actively engaged with financial regulators, such as the CFPB, in this pursuit. FTA appreciates the opportunity to engage with the committee today and use this as just the start of an ongoing dialogue. Fintech innovation, including

BNPL solutions, is driving competition and choice for consumers that result in lower costs and better financial outcomes. We believe strongly that balance and thoughtful regulation is key to long-term success for all involved stakeholders, including providers, consumers, and merchants utilizing new payment systems.

We look forward to helping inform this important process. Thank you.

[The prepared statement of Ms. Lee can be found on page 40 of the appendix.]

Chairman LYNCH. Thank you, Ms. Lee.

Ms. Saunders, you are now recognized for 5 minutes to give an oral presentation of your testimony.

STATEMENT OF LAUREN SAUNDERS, ASSOCIATE DIRECTOR, NATIONAL CONSUMER LAW CENTER (NCLC)

Ms. SAUNDERS. Thank you. Chairman Lynch, Ranking Member Davidson, and members of the task force, thank you for inviting me to testify. I am here today on behalf of the low-income clients of the National Consumer Law Center, which works for economic justice for low-income and vulnerable consumers.

We are seeing an explosion of products that claim to help people manage gaps between income and expenses. Some, if well-designed, can help meet consumers' needs, but some are designed to evade consumer protection laws or fall outside of critical consumer protection laws. Funding or liquidity provided today, that is repaid today, is credit. Even if clothed in shiny fintech garb, new credit products need basic consumer protections for credit to ensure that it is affordable, responsible, transparent, and fair.

Buy now, pay later products may help consumers manage larger purchases without the long-term debt and high cost of credit cards. When they operate as promoted, they can be a win-win, but multiple loans can be difficult to manage and could lead to unaffordable debt loads. Abusive profit models may be built on late fees from struggling consumers. Refunds may be difficult to obtain if there is a problem with the item or service financed.

Earned wage access products are a form of payday loans—funds advanced ahead of payday and repaid on payday—even if they are generally lower cost and less dangerous than traditional payday loans. Most employees re-borrow every pay period and fees can add up and increase with charges for instant access. In the end, low-wage workers may simply be paying to be paid. The trend for employers and payroll providers to offer free early pay and free early wage access repaid through payroll, if used occasionally, may help manage cash flow, but more study is needed.

One of the more deceptive and invasive forms of credit I have seen is the use of reportedly voluntary tips. The tips model is spreading and is used in fake earned wage access apps like Earnin, which have no connection to employers; supposedly overdraft fee-free forms of overdraft credit on non-banked deposit accounts, like Chime; cash advance features on other non-banking apps, like MoneyLion and Dave; and platforms, like SoLo Funds, that purport to be mere arrangers of peer-to-peer loans.

Tips are a disguised form of interest. Companies have ways of pushing people into tipping. Access may be restricted. Default tips may be difficult to undo. When caught using one method of pressing tips, another will surface. All the tip products I just listed are balloon payment loans that undoubtedly lead to a cycle of re-borrowing. Just like the $15 charge on a conventional $100 payday loan, tips on fintech payday loans may seem small, but they can add up to high-dollar amounts and high APRs that can reach 200 percent or higher.

Notably, products that claim not to be credit may also deny being subject to the Equal Credit Opportunity Act. As we reckon with systemic racism and the impact of new technologies, we must not countenance evasions of fair lending laws. We must also keep a close eye on how products evolve. as products may not stay free or low cost, or the ultimate business model may be different than it appears.

My recommendations are that financing and liquidity products are and should be subject to Federal and State lending laws. Regulators should closely examine and crack down on evasive pricing models. All forms of credit should be based on ability to repay, and those that are not may be unfair, deceptive, or abusive. Point of sale credit should have the same chargeback rates, reasonable penalty fees, ability to repay, and statements like credit cards have. The CFPB should begin examining providers of fintech products, and regulators should look out for inappropriate use of consumers' data and for disparate impacts.

Thank you for inviting me to testify. I look forward to your questions.

[The prepared statement of Ms. Saunders can be found on page 45 of the appendix.]

Chairman LYNCH. Thank you, Ms. Saunders.

Ms. Torres, you are now recognized for 5 minutes for a presentation of your testimony.

STATEMENT OF MARISABEL TORRES, DIRECTOR, CALIFORNIA POLICY, CENTER FOR RESPONSIBLE LENDING (CRL)

Ms. TORRES. Thank you. Good morning, Chairman Lynch, Ranking Member Davidson, members of the task force, and members of the committee. My name is Marisabel Torres, and I am the director of California policy at the Center for Responsible Lending. Thank you for the opportunity to testify in today's hearing.

As a Latina who is first generation, my immigrant parents did not come to this country equipped with knowledge of the U.S. financial system. I have seen firsthand how easily people can be preyed upon with credit offers that may promise financial opportunity but that can result in financial harm. As a consumer advocate who has worked on policy issues around financial inclusion, including predatory inclusion, I know that my family's experience was not unique.

Our discussion today is timely. The availability of fintech products and services is increasing as many consumers face tightened household budgets and heightened financial insecurity in the wake of a health crisis with dire economic consequences. More consumers may be looking for financial help after forbearance periods expire and stimulus payments have ended. Lenders who offer seemingly low cost or even free credit are well-positioned to capture this market share, but while these products may appear straightforward, consumers and policymakers must ask themselves, what is the catch? We need data to understand what they are, their prevalence, and whether further protections are needed. The testimony I have submitted for the record details our concerns with products, including buy now, pay later, earned wage access, and so-called overdraft avoidance products. My oral testimony will focus on buy now, pay later.

In my State of California, the previous commissioner of our financial regulator, the Department of Financial Protection and Innovation (DFPI), discovered that by offering these products to California consumers, certain buy now, pay later providers were making them illegally, without a license to make loans in this State. On this basis, DFPI brought enforcement actions against them and required their licensing in California. Because they were then licensed, DFPI was able to begin gathering data. We are awaiting public disclosure of key points, but, at a minimum, we know that the take up of these products has exploded in California. Of the loans that DFPI has published data on, the top six buy now, pay later lenders accounted for nearly 11 million, or 91 percent, of the total consumer loans originated in 2020. If there are problems, their impact will be felt on a wide scale.

As described by recent surveys of buy now, pay later users, there are a number of issues identified with the surge in this lending. More providers are entering this market, and we cannot delay their examination to fully understand the impact on consumers. There are signs that borrowers who miss payments may be racking up late fees at a high rate. A Credit Karma study found that of the 1,000 users surveyed, one-third reported they had fallen behind in all payments. Of those people, over half said their credit scores had declined thereafter. Not all of the buy now, pay later providers will pull credit to determine a consumer's ability to pay, but those that do will also report missed payments through a credit bureau, so these products can lead to damaged credit.

As with payday loans, buy now, pay later requires the user to give lenders access to a bank account or a credit card to withdraw payment. This can lead to problems such as overdrafts, not having sufficient funds to cover the payment, and the inability to pay other bills. These products are also targeting and attracting younger consumers. As we saw with credit cards being pushed on college campuses, this can saddle young people with debt, starting their journey into adulthood with damaged credit and the potential for lifelong negative financial consequences. There is also concern that the entire business model of buy now, pay later rests on driving borrowers to purchase items they would not otherwise buy.

Finally, these products are algorithmically-driven. We can assume that they will be subject to inevitable algorithmic bias. It is, therefore, vital that they be subject to regulatory examination to see if there are fair lending and related concerns. This all reinforces the need for the Consumer Financial Protection Bureau (CFPB) to use its authority to identify and address the risk that they pose to consumers. The CFPB should collect data and move towards supervision of these products.

Thank you again for letting me be part of this discussion. I look forward to your questions.

[The prepared statement of Ms. Torres can be found on page 69 of the appendix.]

Chairman LYNCH. Thank you, Ms. Torres.

Mr. Tate, you are now recognized to present a 5-minute summation of your testimony.

STATEMENT OF BRIAN TATE, PRESIDENT AND CEO, INNOVATIVE PAYMENTS ASSOCIATION (IPA)

Mr. TATE. Chairman Lynch, Ranking Member Davidson, and members of the Task Force on Financial Technology, my name is Brian Tate, and I am the president and CEO of the Innovative Payments Association (IPA). It is my privilege to appear before you today to share the IPA's views on emerging fintech cash flow products, with specific emphasis on the use of earned wage access. IPA is a non-profit trade association that serves as the leading voice of the electronic payment sector, including prepaid products, mobile wallets, and peer to peer (P2P) payments. IPA's mission is to encourage efficient use of electronic payments, cultivate financial inclusion, and empower consumers.

As we have learned through the pandemic, even the best-laid plans cannot always protect families from unexpected financial disruptions. The Federal Reserve's 2018 survey of household economics found that 40 percent of American households would struggle to come up with $400 to pay for an unexpected bill. Many consumers have few options should they face an unexpected expense between paydays, and the traditional options have proven to be expensive. The U.S. Department of Labor reports that nearly two-thirds of U.S. businesses pay their workers on a biweekly, semimonthly, or monthly schedule, which means that workers are, in essence, giving their employers an interest-free loan. A study by the Financial Health Network found that 38 percent of respondents reported timing mismatches between wage income and expenses.

During the past 10 years, the payment innovators have developed new services and products to help consumers meet these timing mismatches. One of the most practical and affordable options is earned wage access, or EWA. Simply put, EWA programs allow consumers to access their own money prior to payday. Getting paid daily is not a new concept. Many Americans, including wait staff, taxi drivers, and bartenders, can get paid at the close of their shifts. The two former leaders of the Consumer Financial Protection Bureau, Directors Cordray and Kraninger, didn't agree on much, but both took concrete steps to support EWA. Director Cordray exempted employer-sponsored programs from his 2017 payday lending rule, and Director Kraninger issued an advisory opinion explaining that certain EWA programs are simply not credit. IPA agrees with both Cordray and Kraninger and maintains that EWA products are not loans or credit products. Therefore, they should not be subject to the Truth in Lending Act (TILA).

The Financial Health Network's report on EWA found that consumers in financial distress may consider title, payday, or pawn loans as options. With the average cost per EWA transaction ranging from $2.59 to $6.27, the report makes it clear that EWA is far less costly than other options. EWA has grown in popularity because it is safer, cheaper, and a more efficient alternative to other short-term products on the market. EWA providers do not impact customers' credit ratings, and they do not share information to credit reporting bureaus. EWA is offered with no recourse and providers have no rights against the user in the event of non-payment, loss of employment, closed accounts, or blocked payments. These are non-recourse transactions, which means the risk of loss is on the provider.

As someone who has been working since the age of 14, I can easily relate to a retail worker, single parent, or young adult facing a financial emergency and lacking easy access to short-term liquidity. At different points in my life, I have walked in the same shoes as millions of Americans who find themselves unable to pay for a utility bill, childcare, or an unexpected medical expense. Treating EWA as credit would be a mistake and would remove a valuable tool from a consumer's financial toolkit.

Thank you for the opportunity to present the views of the IPA, and I welcome any questions the task force may have.

[The prepared statement of Mr. Tate can be found on page 65 of the appendix.]

Chairman LYNCH. Thank you, Mr. Tate.

I will now recognize myself for 5 minutes of questions.

This is an interesting dilemma, because often on this committee, the full committee, especially Chairwoman Waters and the ranking member, often talk about banking the unbanked or underbanked. So, here we have a suite of services or products that, you have to admit, seem to be going not entirely at the cohort that we are interested in, but they are going at younger consumers who have a thin credit file or no credit history at all. So, they are sort of going at the problem, but yet in many respects, and I know this has been brought up by Ms. Torres, and Ms. Broady, and Ms. Saunders, that the buy now, pay later providers don't necessarily share the credit transactions or the credit history with credit rating agencies. And so, we don't have all the data that we would desire. And ironically, data flows so seamlessly in this industry. It is ironic that the only data that is not flowing is the flowing to the credit agencies that might actually help some of these consumers with thin credit files.

But what are we seeing out there? I know that a number of you had testified about the situation in Australia, where I assume that the adoption rate is a little bit more robust than it is here in the United States. I think they got an earlier start because of some of their regulatory framework. But what are we seeing right now in terms of defaults, late fees, late payment penalties? What are we seeing in this space, especially compared to, I guess, the more onerous payday lending products that are out there or high-interest-rate credit cards? Ms. Broady, do you have any data on that?

Ms. BROADY. I do not.

Chairman LYNCH. Okay. Ms. Saunders?

Ms. SAUNDERS. I set this out in my testimony. One survey done for Credit Karma found that 34 percent of people who had tried a buy now, pay later loan had fallen behind on one or more of their installment payments. In the United Kingdom, one bank found that 10 percent of customers who made a payment to one of the two large providers have overdrawn their account beyond the amount that they were allowed to overdraw. There is one provider, Afterpay, in Australia, which had 20 percent of their new revenue from late fees. So, we do have troubling indications that there are a number of consumers who are late, who may be struggling, and I am also worried that some of the providers may be building their profit models on those late fees.

Chairman LYNCH. Right, and there is a lack of data from some of these providers. Ms. Torres, do you have anything you want to add on that? Any other data that we are getting?

Ms. TORRES. Yes. I would say that related to what Ms. Saunders brought up of those Credit Karma users, the Credit Karma survey participants, they did mention that of those people who had fallen behind on payments, 72 percent also reported that they had seen a hit to their credit, which is also a pretty concerning rate.

Chairman LYNCH. Let me ask then, would it be helpful if Congress, if we introduced legislation that would require these buy now, pay later and alternative financing methods to actually report their credit histories to the credit rating agencies? Would that be helpful? At least, it would give us a richer, a more granular credit history on these consumer patterns.

Ms. BROADY. We are urging that the CFPB use its supervisory powers to collect data to get a better understanding of what the consumer experience actually is among all of the users of these products, especially because, as you mentioned, it has been mentioned they are skewing younger, and maybe more consumers who are not as familiar with the credit system as other seasoned users might be.

Chairman LYNCH. Okay. And, Ms. Torres, is that what California is doing?

Ms. TORRES. California has licensed them as lenders so they are able to take in data, and this is the first year that we have had data related to exactly what the volume is. But we are not exactly sure about what the user experience is, which is why we are asking the CFPB to supervise and analyze the data to get a better picture view not just at the State level.

Chairman LYNCH. Okay. Thank you. And, Ms. Saunders, do you have anything to add to that in terms of any efforts to get a more granular look at some of these borrowing patterns?

Ms. SAUNDERS. I definitely support CFPB supervision and data collection. I think it is worth considering whether they should be reporting to credit bureaus, but I also think it is a misconception that most of these users don't have credit or have a thin score. I think a lot of them do or could, and certainly Dr. Broady mentioned cash flow underwriting. There are plenty of ways to become eligible for traditional credit, but lending without the ability to pay is not the best way to do that.

Chairman LYNCH. Okay. Thank you. I have exhausted my time.

I now recognize the ranking member of the task force, the gentleman from Ohio, Mr. Davidson, for 5 minutes.

Mr. DAVIDSON. Thank you, Mr. Chairman. Ms. Lee, when I started thinking about this hearing, as I stated, buy now, pay later is simply the idea of extending credit. That has been around way before the internet. But as we think about the payment systems today, could you briefly explain why this is different than payment options that have been around for years, maybe as far back as the innovation of the pencil?

Ms. LEE. Sure. It is fundamentally different, and a lot of that has changed because of the technology in which you were are able to facilitate many of these transactions or have these relationships. A lot of people want to make the analogy to a layaway program, and it is different in that it is an alternative method in which to make payments. And unlike the past, in which you went directly to a merchant to sign your contract as far as on a layaway, you now have a fintech platform that is facilitating, both from a merchant standpoint and from a consumer standpoint.

These are products that are designed for low interest, no fees, to be able to have consumers be able to make their payments within their own budgetary needs, and so it gives the consumer the power. It puts them back into kind of how they want the flexible payment to be able to fit their needs in which they are performing. It is something that just is fundamentally different in that it is not a revolving debt situation. It is one in which they want to satisfy their own obligations in a very timely and in a short period of time.

Mr. DAVIDSON. Yes. Thank you for that, and timing is one of the biggest things and the amount of automation. And in general, there is a third party involved that is providing the service versus going to the general store, and signing the book behind the counter—I saw that on an episode of, "Little House on the Prairie." The innovation in the technology has made it so much more accessible. So, who is using BNPL products?

Ms. LEE. As has been alluded to, Millennials are predominantly, along with Gen Z, but we are starting to see it in other generational cohorts as well. Right now, 2 out of 3 Millennials do not own a credit card. They prefer debit cards. They prefer to have the control of their own pocketbook within the access to their own bank accounts, so that is who is predominantly using it. Eighty-five percent of users using BNPL use a debit card and not a credit card, which, again, inflates the overall cost. It gives them certainty. It gives them the ability to budget, and it gives them the ability to pay within their own means.

They are usually drawing every 2 weeks. We usually pay people every 2 weeks, and so it allows them to have that flexibility to meet what their payroll needs are as well. And in the U.K., most people get paid once a month, so it is usually payment in three. So it is a very different model in that sense, but it is giving consumers that flexibility to be able to meet and budget these needs in a timeframe which they prefer.

Mr. DAVIDSON. Thank you for the summary. Mr. Tate, when I think about earned wage access programs, I remember one of my first jobs working in a restaurant. I was a high school student. I was either at school or at practice when the bank was open. I would work at night when I had time, and then often, on Saturday morning back in the day, the bank was open, but I would have a meet, or a game, or something like that, so it was hard to get to the bank. So, I had this piece of paper when we got real paychecks, but I didn't have money, and it was hard to have access to that. Thankfully today, with the age of the internet, you can deposit this stuff online. You have internet banking, but you still need to access the wages.

Could you explain how earned wage access is working, and I would say just if you could also mention, and you touched on it in your opening statement, but where we are at from the CFPB and their treatment of earned wage access?

Mr. TATE. First, we have similar backgrounds. When I was a teenager, my first job was as a busboy. So really quickly, EWA, the way it works is, generally speaking, especially if you fall into the framework of the CFPB, is that an EWA provider will partner with an employer. The employer should do their due diligence to find the right provider for them. And when they make that service available after they have an agreement, it is voluntary. They cannot compel an employee to use it. Generally speaking, again, if you fall into the framework, there should be no fees for the transaction itself, although the CFPB permits a subscription fee. Your calculations are based on accrued wages, so the money you have earned up and to that point in the pay period. There is no debt collection, and there is no recourse.

And so, there is a very confined, kind of limited space for those agreements to take place. Many of those agreements through the employer are made free in many cases or at very low cost. Some are even as cheap as a dollar. And if a need should arise, the employee can then voluntarily participate in the program, and the provider will make those funds that have accrued available.

Mr. DAVIDSON. Thank you for the summary. My time has expired. I thank all of the witnesses for your testimony. I look forward the rest of the hearing, and I yield back.

Chairman LYNCH. The gentleman yields back.

The Chair now recognizes the gentleman from New York, Mr. Torres, for 5 minutes.

Mr. TORRES OF NEW YORK. Thank you, Mr. Chairman. My first question is for Mr. Tate. Can you use earned wage access to access your income on a daily basis?

Mr. TATE. In some cases, yes. There is a wide variety of programs and providers on the market, so there is no one-size-fits-all model.

Mr. TORRES OF NEW YORK. But it could be in theory. Okay. If I heard your testimony correctly, the fee-per-transaction could exceed $6?

Mr. TATE. It could. There are some that do.

Mr. TORRES OF NEW YORK. Okay.

Mr. TATE. But according to the Financial Health Network, that is the range. And, again, as I mentioned—

Mr. TORRES OF NEW YORK. I just want to move on, if I can.

Mr. TATE. There is a wide majority of free products—

Mr. TORRES OF NEW YORK. I am going to reclaim my time. So, $6 is the high. If you are a low-wage worker earning a minimum wage of $7.25 an hour, then that fee is almost an hour's worth of work. It is almost one-eighth of an 8-hour workday. That strikes me as excessive. Does that not strike you as excessive?

Mr. TATE. No. If it is Tuesday, and I have worked a week-and-a-half and have accrued wages, and I have a flat tire or I need to go to the store, I am not sure why I have to wait until Friday to make that happen.

Mr. TORRES OF NEW YORK. I am referencing the fee, but let's move on. I have a question for Ms. Lee. The Australian Finance Industry Association has adopted a code of conduct for buy now, pay later companies, a code of conduct that governs matters such as late fees and minimum wage. Does the American trade association for buy now, pay later companies have its own code of conduct?

Ms. LEE. We are working with the CFPB, and we have been in active conversations with them and hold our members up to—

Mr. TORRES OF NEW YORK. But you don't have one yet?

Ms. LEE. We are brand new as a trade association.

Mr. TORRES OF NEW YORK. Okay. Mr. Tate, does the American trade association for earned wage access companies have its own code of conduct?

Mr. TATE. I am not familiar with that trade association.

Mr. TORRES OF NEW YORK. No, is there a trade association for earned wage access companies?

Mr. TATE. We represent, but whatever the title you used—

Mr. TORRES OF NEW YORK. Do you have a code of conduct?

Mr. TATE. No, we do not.

Mr. TORRES OF NEW YORK. Okay. Ms. Lee, what should the minimum age be for a customer who uses buy now, pay later financial products?

Ms. LEE. The FTA's buy now, pay later—ages 18 to 34 is who is using the product right now.

Mr. TORRES OF NEW YORK. Could you legally use the product below the age of 18?

Ms. LEE. I will have to double check on that.

Mr. TORRES OF NEW YORK. Okay. But would you support regulations that require a minimum age of 18 and older?

Ms. LEE. I will confirm with our members as to if there is a minimum age.

Mr. TORRES OF NEW YORK. What should the minimum age be?

Ms. LEE. I will refer to the members.

Mr. TORRES OF NEW YORK. Okay. Because you said we should advocate for thoughtful and balanced regulation.

Ms. LEE. I said the average cohort right now is between 18 and 35, and I will double check with the members to see if they have set a minimum age.

Mr. TORRES OF NEW YORK. Okay. But I am asking your opinion about what should the regulation be.

Ms. LEE. I will refer to the members on that.

Mr. TORRES OF NEW YORK. Okay. Is buy now, pay later a loan?

Ms. LEE. In California, it has been designated as a loan. It depends. Different jurisdictions verify or—

Mr. TORRES OF NEW YORK. Do you think it should be classified as a loan, as a general matter?

Ms. LEE. It is an extension of credit, and it is a payment alternative program that allows people to be able to pay for a good in their own time.

Mr. TORRES OF NEW YORK. But if I—

Ms. LEE. That is an extension of credit.

Mr. TORRES OF NEW YORK. If I spent—

Ms. LEE. In different jurisdictions, it is described—

Mr. TORRES OF NEW YORK. Sure, but if I spend your money now, and then I pay you back with my money later, common sense would dictate that I am borrowing from you and that you are lending to me. If it looks like a duck, and swims like a duck, and quacks like a duck, then it is probably a duck. Actually, I will ask this question of Ms. Lee. If a consumer pays on time and in full, buy now, pay later companies do not typically report payments to credit rating bureaus. But if a consumer fails to pay on time and in full, then those same companies might report nonpayment to creditors' rating bureaus. Is it fair to report one without reporting the other?

Ms. LEE. FTA members that are in the BNPL space do not report either side. They are actively working with credit bureaus right now. Right now, the credit bureaus are trying to figure out how this data collection works, to be able to model accordingly. Traditionally, credit bureaus have used credit based off of monthly pulls for longer-term loans, such as mortgages, student loans, and—

Mr. TORRES OF NEW YORK. I am going to interrupt you. I want to make sure I heard you correctly. There are no BNPL companies that report nonpayment?

Ms. LEE. There are some that engage with it.

Mr. TORRES OF NEW YORK. Would you characterize that as unfair to do one without the other?

Ms. LEE. We want to work with the credit bureaus to make sure that they do capture those who pay on time, a regular payment, because we do think that it is an ability to help provide good credit. When someone who is paying consistently for 2 weeks on a minimum of time—

Mr. TORRES OF NEW YORK. I see my time has expired, but I think you said earlier that buy now, pay later leads to more savings, but there was a Cardify AI survey suggesting that buy now, pay later shoppers increased their spending by 10 percent to more than 40 percent. Is there a concern that the buy now, pay later product might cause consumers to live beyond their means and potentially take on unsustainable debt?

Ms. LEE. Yes, they are using those because of the certainty. They know exactly what the cost is going to be. They are not incurring increased interest fees, they are not incurring additional cost, and so they are using these products because it gives them certainty. They know exactly when the payments are due, and 97 percent of those using buy now, pay later products do not incur a late fee. So, it gives them that consistency in being able to budget better within their own means.

Mr. TORRES OF NEW YORK. My time has expired, but thank you.

Chairman LYNCH. The gentleman yields back.

The Chair now recognizes the gentleman from Texas, Mr. Sessions, for 5 minutes and 30 seconds.

Mr. SESSIONS. Mr. Chairman, thank you very much, and thank you for this very worthy, insightful hearing, and for the opportunity to hear our panel provide us their ideas.

Mr. Tate, I would like to see if you have an opinion about something that has been an issue, the Earned Wage Access Program. Previously, we have had CFPB Directors who viewed this favorably, and it presumptively was a positive part of the ability for people to use this. I am wondering if you have an opinion about this, and the success of the model and what you think of it?

[No response.]

Mr. SESSIONS. That question is for Mr. Tate.

Mr. TATE. I'm sorry. I had to turn my microphone on.

Mr. SESSIONS. Yes, sir, and I apologize if you did not hear the question. I should have said, "Mr. Tate," earlier. Did you hear my question, Mr. Tate, about the earned wage access?

Mr. TATE. Yes, sir.

Mr. SESSIONS. Thank you, sir.

Mr. TATE. To answer your question, back in 2017, Director Cordray released what is now known as the Payday Rule, set aside provisions within that rule, earned wage access products as an alternative, and then he laid kind of a framework or a foundation for these products to thrive and grow. And Director Kraninger, in 2020, when she issued an advisory opinion, expanded on the groundwork that Director Cordray laid back in 2017. And, in fact, Director Cordray, when he released the rule, I guess gave a speech or made a statement which is on the CFPB's website today, talking about how these products are a positive thing for people.

And I have a quote here: "The rule also excludes from coverage some new fintech innovations, such as certain no-cost advances and programs, to advance earned wages when offered by employers or their business partners."

And again, in 2020, Director Kraninger kind of built upon that, and then said and made it clear that even if you don't fall within the framework of the advisory opinion, it said that they would take a totality of the circumstance view of each product and provider and make a determination on their own. And just because you are not within the framework does not, per se, make you credit.

So I think that together, they didn't agree on much, but I think together, they have expanded this product, which is, as you mentioned, very popular. I think there are about 45 to 55 million users here. And if you read the Financial Health Network's report, or Mercator's report, or KPMG's report, they all talk about how this product is significantly less than alternatives that are out there on the market.

Mr. SESSIONS. Mr. Tate, thank you very much. This is the kind of feedback that I believe helps the committee to recognize that programs like this actually help the people that it was intended for, and that was insightful.

And, Mr. Chairman, I want to thank you for not only having this hearing, but actually vetting out, not just the CFPB, but also people who are in the marketplace, to give opinions about the effectiveness of what we are trying to do, and that is to help consumers with a balance, but also to make sure that the net comes out with an advantage overall for the consumer in this process.

And Mr. Tate, and Ms. Lee, I want to thank you very much for your participation today.

Mr. Chairman, I yield back my time.

Chairman LYNCH. The gentleman yields back.

The Chair is now very pleased to recognize the Chair of the full Financial Services Committee, Chairwoman Waters, who has been working on this issue for a very, very, very long time.

Chairwoman WATERS. Thank you so very much. I appreciate the opportunity to share a few remarks, and maybe ask a question or two.

Ms. Saunders and Ms. Torres, earned wage access allows employees to access part of their earned income immediately, without them having to wait until the end of the pay period. To me, this sounds very similar to a payday loan. However, it seems that the CFPB, under former Director Kraninger, did not agree.

In late 2020, the CFPB issued an advisory opinion which stated that certain earned wage access (EWA) products were not credit under the Truth in Lending Act (TILA). Earned wage access may create a cycle of unsustainable borrowing as employees who should be paid a viable wage borrow on their own hard-earned income, and are forced to pay additional fees to access their income. I fear that the underlying problem is the fact that too many employees are not paid a livable wage. Earned wage access products have been developed by fintechs, but it seems that their basic business model is less about innovation and more about evasion.

Do you think it is a priority for the new CFPB Director, Rohit Chopra, to revisit the advisory opinion, or do you think that earned wage access should be treated as credit, and can you tell us how earned wage access users, who are oftentimes working-class hourly workers, are affected by the lack of TILA protections, in particular?

Ms. SAUNDERS. I will start. Yes, I do think that the CFPB should revisit the opinion issued under Director Kraninger. What happened under Mr. Cordray is he was addressing the horrible abuses of conventional payday loans, and this was a different product that posed less, although still significant concerns.

But evasions of credit laws are incredibly important to stop, and this does create a cycle of reborrowing, and if you can't pay an expense, this just leaves a hole in the next week, and that causes fees. And as Congressman Torres said, that could be an hour or more of a wage worker's pay.

Chairwoman WATERS. Thank you very much, and I appreciate the opportunity. I yield back.

Chairman LYNCH. The gentlelady yields back.

The Chair now recognizes the gentleman from Missouri, Mr. Luetkemeyer, for 5 minutes.

Mr. LUETKEMEYER. Thank you, Mr. Chairman. This is an interesting hearing today, and Ms. Lee, I want to thank you for your testimony today. You indicated that Mr. Tate, a while ago, made a comment in his testimony that the Federal Reserve had a study which said that almost 40 percent of Americans could not cover a $400 emergency tonight.

So, if I go home tonight and my refrigerator is out, it takes anywhere from $800 to $1,000 to go buy a new refrigerator. We have two kids at home, and I have to be able to get them something to eat tonight, and tomorrow for breakfast, and the next evening as well. I have to have a refrigerator. So, I go someplace, and for them to be able to sell me one, I may have to give them $200 today, and $200 next week, or in 2 weeks, and so on.

And your comments are that it empowers an individual to make decisions on what they want to do. They can do without or they can go borrow money from someplace else, or they can go use this method of payment, buy now, pay later, and they need control. This gives them the control to make that decision. It gives them the flexibility to help with their budgeting.

And you indicated that 97 percent of the people experienced no late fee. Is that correct? Did I hear you correctly on that?

Ms. LEE. That is correct.

Mr. LUETKEMEYER. So in other words, 97 percent of the people use these products and this method of purchasing things and paying for things in an appropriate manner?

Ms. LEE. Correct.

Mr. LUETKEMEYER. Ms. Saunders continues to talk about all of the abuse that is going on, and I am kind of curious, do you know what percentage of that 3 percent who are late, are abused by late fees?

Ms. LEE. If I am hearing your question correctly, it is on the revenue model of a BNPL, less than 15 percent of their revenues are attached to a late fee. So, these are not models that reward late fees or recurring debt. BNPL products help consumers have a flexible payment option, with clear and assignable payment periods that they can meet. It is in their interest for them to meet these payment requirements so that they can use this product over and over again, and have—

Mr. LUETKEMEYER. My point is that when only 3 percent of the people even experience a late fee, and how many of those are abused by companies, I would think that would be a pretty small figure of that 3 percent.

Ms. LEE. Yes.

Mr. LUETKEMEYER. Now, I am not condoning those folks. They should not be doing that. We should be finding a way to punish them and keep that from happening. But I think, just don't overblow the problem here and throw the baby out with the bathwater, and that this is a very, very good way of allowing people to purchase products, and to pay for them in a timely manner, as they can afford them.

Ms. LEE. And I would just say, one thing you also need to understand about the mechanics behind this is when someone does miss a payment or have a late payment, their account is immediately paused. They are not able to participate in any more buy now, pay later products, or have that service provided to them again until they rectify or until they satisfy that original obligation.

So, it is not something that is trying to reward more buying power when you cannot meet the minimum payments. It is trying to design people to have clear and assignable and accurate payment methods accountable to what their pay periods might be.

Mr. LUETKEMEYER. I think that brings up the question of, what responsibility does the consumer bear with repaying a debt, with repaying a buy now, pay later situation? They made the decision to purchase something in this manner. The responsibility falls on them, does it not?

Ms. LEE. Yes, it does.

Mr. LUETKEMEYER. And we shouldn't be penalizing the people who are trying to sell products and services in that manner.

Also, I think one of the things pointed out, and I think the chairman did a good job of this today, with regards to some folks who are—97 percent of the people who are paying on time and making their payments appropriately don't seem to be getting credit for that with the credit bureaus, and you are indicating that your association is working with the credit bureaus to see if this can be done. We do this with utilities and rent. I know on this committee, over the last several years, we have added those things to credit bureau files for people to be able to have reported on them, so when they do make timely payments, they are getting credit for that. I think that is something that we need to be continuing to work on. Could you just elaborate a little bit more on that, please?

Ms. LEE. And we applaud the efforts to modernize credit bureaus, and are working with them actively so that they can properly assess and analyze what those data that we would be sending them. This is data that would be coming into them—

Mr. LUETKEMEYER. Let me interrupt. My time is about up. I apologize. So, are you talking about us having to legislatively tell people, when you implement a program like this you are going to have to automatically report, or are the credit bureaus working with the different business entities and different associations to say, "Hey, we want to work with you to be able to help the consumers be able to utilize these products?"

Ms. LEE. It would be the latter. Private companies are actively working with the credit bureaus so that they understand kind of what this data is saying, how the consumers are using it, what it means for someone to be paying $25 every 2 weeks over the course of 4 to 6 to 8 weeks. What that means for them from a credit perspective is something that is consistently paying, on time, not incurring late fees, how that can be a positive aspect for how someone could build credit. And so, we want to make sure that they are capturing that data correctly and that it can be seen as a positive, that it is not being seen as a negative tool, just because of the frequency in which they are using these products.

These are new products coming onto the marketplace. We want to ensure that the credit bureaus understand them properly so that they do not do harm to the consumers, but actually add to the overall positive credit history.

Mr. LUETKEMEYER. I thank you for that, and I encourage your association to continue to work with the credit bureaus to make sure that folks can have their successful use of these products as well.

Thank you, Mr. Chairman. I yield back.

Chairman LYNCH. The gentleman yields back.

The Chair now recognizes the gentleman from Wisconsin, Mr. Steil, for 5 minutes.

Mr. STEIL. Thank you very much, Mr. Chairman. We are experiencing a labor crisis in the United States. You can drive almost anywhere—on my drive to the airport to come out to Washington, D.C., I see help wanted signs. There is a mismatch in our economy right now between the 10 million jobs that are available and getting workers back to work. I think it is something that we should spend a lot of time digging into.

This is an interesting hearing, in particular as we look at the ability of EWA to really kind of alter some of the labor market. Mr. Tate, I am curious about the role that EWA products can play in encouraging worker participation, in improving employee retention, where we can actually better connect the work and labor of an individual to the quick payout. I often think of how a waiter or a waitress or a bartender has quick access to their cash. They can actually flex how much money they make by maybe picking up an extra shift, working a Friday night, or a Saturday night. That is hard work, but you get to walk home at the end of that shift with money in your pocket.

It's different if you are working for some of the largest companies in the United States. You do not have that opportunity to pick up an extra shift and put money in your pocket. I am thinking you might know you have a bill due on Monday, or you might have a need for some extra cash as people are going out and doing Christmas shopping, and you want to pick up an extra shift. But you might not have that ability to pull that cash forward to be able to benefit from the labor that you did that weekend so you can knock out some Christmas shopping, maybe on Sunday.

Can you comment on how EWA services are provided through some of these employee partnerships with the employers and whether or not it has an impact on employee retention?

Mr. TATE. Certainly. I agree with my colleague on the panel, Ms. Broady, when she touched on bringing financial services to people where they are, and I think technology allows us to do that in ways that we could not conceive of 5 or 10 years ago.

From everything that I have read, and the companies that I have talked to, this is used, as you mentioned, as a tool to retain employees. It helps them manage their money. It helps them smooth out income volatility. I also think, at the same time, this is a dignity and empowerment tool. I think this is a way for people to take more control of their money and allow them to make decisions in real time, again, in need, if something were to come up, which I have certainly experienced.

I think the conversation in mind that we are all having today about all of these products is specifically on EWA. We should be keeping the consumer in mind, and what would you do in those places, and we should be giving those consumers more tools to manage their day-to-day financial needs.

Mr. STEIL. Earlier, you were being asked questions about the fee range, and you said that the top end was around $7. What is the low end?

Mr. TATE. In a lot of cases, it is free.

Mr. STEIL. It is free. So, that means somebody ultimately is footing that bill, but it would often then be the employer that is viewing this as value-additive to their workers in that structure.

Mr. TATE. Absolutely. And in many cases, this is a popular benefit, and you can see in the future where you can see a worker or an employee, a potential employee, thinking, gee, Company A does have EWA, and Company B doesn't, and so I am going to the company that has the EWA option, and that is one of many factors.

Mr. STEIL. And maybe for the same reasons, some people are attracted to certain service industries that are tipped heavy.

Mr. TATE. Correct.

Mr. STEIL. My example of working in a restaurant—I used to work at an Applebee's, and I worked at an Olive Garden. You walk away at the end of that shift with money in your pocket. But this gives other types of employers that opportunity to directly connect the work and the labor that is being provided by an individual with that payment.

Let me shift gears, if I can with you, Mr. Tate. One of the concerns would be, of course, what happens if an employee pulls that money forward and then, for whatever reason, life changes, and they leave the job. Holy smokes, would they be on the hook for this money that is pulled forward?

Mr. TATE. The employer?

Mr. STEIL. The employee. The employer—good luck to that person. I am concerned about the workers.

Mr. TATE. No. These are no-recourse products, especially if you are fitting within the CFPB's framework that was developed by Director Cordray.

Mr. STEIL. So, there is no risk to the employee that they are going to be on the hook for pulling a wage forward?

Mr. TATE. No. Similar to the numbers on buy now, pay later, it is 97 percent recovery, and that is reported in Mercator as well as the Financial Health Network.

Mr. STEIL. I think that is an important point, and you and I know that, but I don't think that everybody fully appreciates that. Because I think in your head, you are thinking this is probably a recourse loan, as it wants to be portrayed, but it is not.

Mr. TATE. It is not a loan.

Mr. STEIL. It is not a recourse and it is not a loan. I think that is just a really important point to walk away with.

You are familiar with the CFPB's issue, their advisory opinion last year, that EWA services are not credit, exactly what you are saying?

Mr. TATE. Correct.

Mr. STEIL. Can you further explain the CFPB's stance on this, briefly?

Mr. TATE. When they issued the advisory opinion, again, they were building on the principles laid out, or that were set aside in the payday rule in 2017 by Director Cordray. Director Kraninger expands upon that, but if you read the commentary and kind of the footnotes in those conversations when they lay out what fits in the framework, they also make it clear, again, that they are taking a totality of the circumstance test. So in essence, they are allowing variations of the framework they are putting in place because—I can't put myself in their shoes, but I would assume that they recognize that we are in a marketplace with lots of innovation. I don't know what new products are going to come out next week or next year.

Mr. STEIL. I appreciate your time, and I appreciate all of you being here. I wish I had time to dive into additional questions. Mr. Chairman, with that, I will yield back.

Chairman LYNCH. The gentleman yields back. The Chair now recognizes himself for 5 minutes, and I would like to talk about the earned wage access piece. I was an ironworker for about 20 years. I worked mostly for steel erectors. But it was customary in our industry that we worked Monday through Friday, and then payday was the following Wednesday. In my business, the ironworking industry, we had what we called a, "drag." You could actually get what you call now, "earned wage access." You could get no more than a couple hundred bucks in advance of your payday the following week.

In my situation, however, I was a member of a union, so we had union protections that were between me and my employer and the bank, so that I had added reassurance, and I had recourse to make sure that I was treated fairly.

I am just curious, in some of these low-wage industries where there are not those protections, is there a conflict? I know it seems like this is an employer decision as to which fintech they choose to deal with, which platform, if you will, and the terms of payment are various, the arrangements that are made here. I am just curious, is there a danger where the employees is not part of this conversation regarding the terms on which that early wage access might be gained? Is there a danger that their interest may be harmed in that agreement between the employer and the fintech company that is going to conduct this?

Ms. Saunders, any views on that?

Ms. SAUNDERS. I am concerned about companies having a hard time competing in their providers. I know that there are some that offer these programs for free and they have a hard time competing against ones that charge the employer, and some employers would rather have the low-wage worker pay.

Chairman LYNCH. Okay.

Ms. SAUNDERS. That concerns me.

Chairman LYNCH. Let me jump to something else. Lately, we have been hearing about some of the big players getting involved here. Visa is looking at the amount of money that is being generated, diverted from the traditional banking system. Mastercard and some of the other big players are getting involved in the buy now, pay later space. There seems to be more going on here. There is cross-selling, and the importance of that data itself.

What other implications might there be with respect to—and we had Mr. Chopra in from the CFPB last week, and he wanted to ask Amazon and Apple and others regarding their data collection on the financial services side. So, are there some issues that we should be cognizant of or actively investigating with respect to how consumer data is being used in this context? Ms. Saunders?

Ms. SAUNDERS. Yes, absolutely. Any time consumer data is being collected, we want to make sure that it is in ways that consumers would expect, and that they would approve of. And I am concerned that some of these models that look great, look too good to be true, are they really vehicles to collect data, to pitch other products? Are they something different than what they appear? It is always important to know what the real business model is and how data is being used.

Chairman LYNCH. Ms. Broady, are there any limitations in terms of how that data is gathered and used in this space?

Ms. BROADY. These companies use data and algorithms to measure how people are going to pay, but it doesn't affect their credit score like it does for payday lenders or credit cards. Of course, we have to have some type of data, but this data doesn't stay on your credit report and affect it for 7 to 10 years like a FICO score would.

Chairman LYNCH. Yes, okay. Ms. Torres?

Ms. TORRES. Yes. I think that another concern to be aware of is that this data can be used to push other products onto a consumer who might not have been looking for that product in the first place. And so, it is another way to maybe try to entice—do the cross-selling of products to consumers to assume more debt that they might not be able to handle, or that they weren't looking for in the first place.

Chairman LYNCH. Ms. Lee?

Ms. LEE. FTA's BNPL players only share consumer data with merchants for the fulfillment of an order.

Chairman LYNCH. Okay. And Mr. Tate, any concerns regarding the use of data, especially with some of these big players getting into the space?

Mr. TATE. Not that I am aware of, no.

Chairman LYNCH. Okay. Thank you. My time has expired. I now recognize the ranking member of the task force, the gentleman from Ohio, Mr. Davidson, for 5 minutes.

Mr. DAVIDSON. Thank you, Mr. Chairman, and I am glad we get an extra round to ask some questions here. and Mr. Torres, just to react to one of your comments on cross-selling, I love cross-selling. I go to Amazon. Jeff Bezos has built a heck of a company because, hey, if I like this, I might like that. That is one of the best uses of data, if the information can be protected and kept private. And the privacy concerns, I think need to be paramount. For our whole economy, one of the most important things Congress could do would be to pass an updated privacy law. Within just the jurisdiction here, I was so encouraged by our last hearing on financial privacy, because there are a lot of things that go on there.

Ms. Lee, if you go back to the cartoon days, probably everyone has heard the phrase, "I'll gladly pay you Tuesday for a hamburger today." That is an extension of credit. You know that you don't have to give the hamburger. It is just an offer. It is a service that is provided.

Now, some people go from personally lending to a friend, at no cost, or say, "I'll give you a hundred bucks, and you give me back $110 next week," and no one does the math. It is just a simple fee. Then, you formalize it and go from, "I did that for a friend or two. Maybe I will just start a business." How does somebody get into this business? Do you have to launch a bank? Can you get into this space just applying the technology, and then what are the obligations to protect consumer privacy if you do set up a business in this space?

Ms. LEE. I would say it is probably not as easy as creating a burger stand, but a little bit more complicated and complex. And there are a lot of players in this space already, I would say, and it does require you to be adherent to Federal laws, State laws, State consumer protection laws, a whole host of regulations that are there to protect the consumer.

It would require a tremendous amount of product design, the capabilities, the relationships to have with lending partners, banks and others, and to have those relationships with merchants, along with then going out and building a product to entice consumers to be able to use this product in a responsible manner.

So, there is a whole host of different things. It is not just something that you can turnkey overnight. These are sophisticated. The members that I work with are very large, sophisticated companies, but what they are doing is providing that service, and that means, and making it easier. To the early analogy, there is that platform, as we are all now more mobile, as we are all more digital, as we are using our payment systems at the click of a button. They are able to talk to merchants and consumers so that people can have both the certainty of when that payment is occurring, and know that the payment is going to be taken in a responsible manner. Merchants also have that comfort in knowing that platform allows them to also receive payment for their products.

So, it is an ecosystem that is large, it can be complex, but one that technology is allowing us to have.

Mr. DAVIDSON. Yes. I think you made the point that there are no laws. There are laws that all of these businesses would have to be subject to, and, frankly, they also have duty of care with the data. They would potentially face liability for inappropriate use or breach, things like that.

We should clarify some of our laws, and one of the things that I think we try to force everything that is innovative into something that is in the past instead of often doing the work here to update the framework.

When you think about alternative remittance systems, I think of the hawala network. In America, our system is not really built around that, but it is certainly permissible to do it. That doesn't mean you are exempt from money service business laws or know-your-customer requirements if you are in that business, but it operates differently in terms of how the payments are due, to whom they are due, and whether information moves or the cash moves, all that happens.

How would you explain, yes, we are compliant with some laws, but we shouldn't be treated as if we are payday lenders, or should you, or when should somebody?

Ms. LEE. Sure. I would say that we are fundamentally different. Payday lenders are enticing people—or not enticing, but they are products that are built for people to have a long-term debt cycle, they have high interest rates, and people are getting in revolving debt that takes years oftentimes to pay off, whereas buy now, pay later, is satisfying that obligation in a very short time, with low fees, and zero interest, to enable the consumers to have that flexibility. So, fundamentally, they are two very, very different products, and should be treated as such.

Mr. DAVIDSON. Thank you. My time has expired, and I really appreciate the time given to prepare for this and the hearing.

Chairman LYNCH. I thank the gentleman. The gentleman yields back. The Chair now recognizes the Chair of the full Financial Services Committee, Chairwoman Waters, for 5 minutes.

Chairwoman WATERS. Thank you very much. I would like to direct this question to Dr. Broady. I am interested in how low- and moderate-income consumers, and borrowers of color, in particular, are using these emerging fintech consumer loan products. Buy now, pay later allows a consumer to buy and take immediate possession of an item while paying for it over a period of time.

While I am hopeful that emergent fintech products can offer assistance, I am concerned that some of these new entities may not be providing consumers with clear disclosures about the terms and conditions of these new products, as is typically required for extension of credit under the Truth in Lending Act. Additionally, as many buy now, pay later products do not report payments, I wonder, what does this mean in relationship to credit bureaus and whether or not they are reported or how that is handled?

Let me just say that some of these products that I am hearing about are similar to products that were used years ago. There was something that was familiar to the Black community called layaway plans, and with the layaway plans you would see an item that you would like to have, but you couldn't afford it. You would pay something down on it, and then continue paying for it until it was paid for, and then you would get the item. I don't think you got it ahead of time.

And, of course, we are familiar with the old installment loan payments that we used to do when families wanted to buy a refrigerator or something that they could not afford. They would get the refrigerator, and it would be on an installment loan. You would pay something down, and then pay every month until you paid it off.

Now, some of these sound like convenient ways to get things done, but what I am interested in is this: Because of the wealth gap in the Black community, we have often paid an awful lot of money in order to get some products that we desperately needed. Some of the money was hidden because the products we were buying were way overpriced anyway—the televisions, the refrigerators, and all of that. And I guess now what we are looking at, the possibility of a buy now, pay later, but there may be some interest charges here somewhere.

Tell me what you know about all of this and what do you think about it?

Ms. BROADY. There are a couple of differences. One, payday lenders and layaway plans and things like that can be targeted to Black neighborhoods. We know that payday lenders are overrepresented in Black neighborhood, where the programs that you are speaking about are not targeted. They are on the internet. Everyone has access to them, so they are not targeted towards a specific population. In that way, they are not as predatory as payday lenders.

The second thing is that they do provide people with the ability to buy things that they need in an emergency, without charging set interest that is associated with payday lenders. So in that way, you can get something, and you can get it immediately, while you are still paying for it. If you don't finish paying for it, then there is no real penalty to it. It is not like the interest keeps accruing. So you get the product, you pay for it, and if you don't pay for it, then you don't get to use that particular system again. So, the penalty really is with the company that is providing the loan, not as much with the consumer, like with payday lenders.

Chairwoman WATERS. I am interested in your thinking that products are not targeted. Targeting is absolutely a way by which sales are done, communities are identified, and communities are excluded. So, what do you mean that they are not targeted?

Ms. BROADY. They are not targeted in the same way as payday lenders, who literally set up a brick-and-mortar place, a place of business, in a Black neighborhood.

Chairwoman WATERS. How do you know that?

Ms. BROADY. I did my dissertation on payday lenders, so I know how they target—

Chairwoman WATERS. But I am talking about the other products that you say now are widely targeted, rather than specifically targeted. Targeting is a process that is used on the internet in so many different ways. So, when you say that it is not targeted to certain communities, certain products, I am interested in, how do you know that?

Ms. BROADY. I would simply say it is not in the same way as locating in a particular area, that they can target based on what you searched for or things that you have looked at online, but they are not setting up in a particular neighborhood based on who is located there, like payday lenders would.

Chairwoman WATERS. I question that, but I like the idea that we need the Consumer Financial Protection Bureau to look at all of these products so that we can understand them and know what we are buying, know what we are paying, know where the hidden fees are, and all of that. So, I appreciate your information, but I do recommend that we get the Consumer Financial Protection Bureau to look deeply at all of these.

I yield back, and thank you very much.

Chairman LYNCH. The gentlelady yields back. Just following up on that, Ms. Broady, a lender can target people with thin credit files, and in a way, that does target a certain demographic, right?

Ms. BROADY. Yes.

Chairman LYNCH. Not geographic, but a demographic.

Ms. BROADY. Yes.

Chairman LYNCH. Thank you.

The Chair now recognizes the gentleman from New York, Mr. Torres, for 5 minutes.

Mr. TORRES OF NEW YORK. Thank you, Mr. Chairman. Buy now, pay later companies typically charge fees to merchants but not to consumers at the point of sale, but buy now, pay later companies do charge late fees to consumers who fail to pay on time and in full. My question for you, Ms. Lee, is if there were only fees to merchants but no late fees to consumers, would the buy now, pay later companies remain profitable?

Ms. LEE. I would say yes, and that is what their modeling is based off of. Right now, we have 45 million users in the United States spending this last year about $21 billion. Now, that might seem like really large numbers, but it is also only 2 percent of the overall online retail spend, so there is a lot of growth to occur. But yes, that is a revenue model on charging just merchants fees to be successful.

Mr. TORRES OF NEW YORK. And, Ms. Saunders, do you have research on the extent to which the BNPL companies depend on late fees to be profitable?

Ms. SAUNDERS. I don't, but I do know that some observers of the market have pointed out that merchant fees may go down with competition, and so I am worried that costs may shift more to consumers.

Mr. TORRES OF NEW YORK. Ms. Lee, I want to revisit a question I asked you, because I was puzzled by the resistance to answering what I thought was a straightforward question. Should there be a minimum age requirement for the use of buy now, pay later financial products?

Ms. LEE. I would say many of the FTA's companies that I represent do have a minimum of not allowing anybody under the age of 18, and so these are standards that—I can't speak for the entire industry; I can only speak for those that are members of our organization. And so having that minimum, I think, is a responsible matter.

Mr. TORRES OF NEW YORK. Okay. So, you do support them. And Ms. Lee, what percentage of buy now, pay later customers have fallen behind on their payments? There are reports that as many as a third of customers have fallen behind on their payments. Are you aware of those reports?

Ms. LEE. I would say on the membership in which I represent, 97 percent of consumers do not incur a late fee.

Mr. TORRES OF NEW YORK. Okay. Ms. Saunders, Ms. Torres, do you have any thoughts on the extent of delinquency in the BNPL industry?

Ms. SAUNDERS. I would just point out that they secure repayment automatically. So, they take your debit card or, in some cases, a credit card. Some people are paying credit to get credit. So, it is easy to collect, and that doesn't mean that it is affordable, but Ms. Torres may have more to add.

Ms. TORRES. This is based on user data. The survey that we are citing was done by Credit Karma, of 1,000 users, and a third of those 1,000 surveyed said that they were not able to keep up with payments. And as Ms. Saunders pointed out, because they do have direct access to your bank account, or a credit card to get that payment, that can pose a number of risks for consumers who don't have that money available to them, such as overdrafts, and nonsufficient funds, which can lead to someone ultimately falling out of the banking system if they are not able to keep up with these payments. So, I think that this is definitely another reason that we underscore the reason for the CFPB to take a look at what the consumer experience is, and a comprehensive overview of all of the members who participate in this type of lending.

Mr. TORRES OF NEW YORK. Ms. Broady, these fintech cashflow products exist to serve those who have historically been underserved by the traditional financial system. Do these products actually affect the racial and socioeconomic disparities in access to financial services?

Ms. BROADY. They do provide access to banking services that many people don't have or that haven't had as banks move out of their neighborhoods. So in that way, they do provide access. I can't particularly speak to how they have changed the racial wealth gap.

Mr. TORRES OF NEW YORK. Are there any studies that have shown a reduction in access to financial services, or a reduction in racial disparities in access to financial services?

Ms. BROADY. Yes. Actually, the Brookings Institution is releasing a study in that regard later today that will talk about banks that have been leaving Black neighborhoods, and how that has affected savings rates. I cannot speak to how fintech companies have changed that, though.

Mr. TORRES OF NEW YORK. Okay. So, we don't know. We don't have enough information yet to determine if these products are actually reducing racial disparities in access to financial services.

Ms. BROADY. I don't. Someone may, but I do not. I can speak to the banking part, how banks leaving has hurt Black neighborhoods and communities, but I can't speak specifically to how fintech companies have helped. I believe that they are helping, but I can't provide particular data at this time.

Mr. TORRES OF NEW YORK. Okay. That is the extent of my questioning. Thank you.

Chairman LYNCH. The gentleman yields back.

This has been a very good discussion, and it was helpful having a mix of perspectives. I would like to thank our witnesses for their testimony today.

The Chair notes that some Members may have additional questions for these witnesses, which they may wish to submit in writing. Without objection, the hearing record will remain open for 5 legislative days for Members to submit written questions to these witnesses and to place their responses in the record. Also, without objection, Members will have 5 legislative days to submit extraneous materials to the Chair for inclusion in the record.

This hearing is now adjourned. Thank you.

[Whereupon, at 11:35 a.m., the hearing was adjourned.]

A P P E N D I X

November 2, 2021

BROOKINGS

QUALITY, INDEPENDENCE, IMPACT.

How Fintech Companies Can Mitigate the Racial Wealth Gap*

Testimony submitted to
The Task Force on Financial Technology

"Emerging Fintech Consumer Products: Buy Now Pay Later, Earned Wage Access, and Related Products"

November 2, 2021

Written testimony of Dr. Kristen E. Broady
Fellow
Metropolitan Policy Program
The Brookings Institution

Dr. Kristen Broady: Written Congressional Testimony, November 2021

Good morning, Chairwoman Waters and members of the Task Force on Financial Technology. I am Kristen Broady, and I am a fellow in the Brookings Metropolitan Policy Program.

Thank you for the opportunity to appear before you to discuss consumer lending products offered by technology-focused fintech companies.

Introduction

The coronavirus pandemic has created an economic crisis and worsened the racial wealth gap in the United States. African American and Native American people are contracting and dying from the virus at higher rates than white Americans. In August 2021 COVID-19 cases per 100,000 people were 8,915 for Native Americans and 6,524 for African Americans compared to 5,482 for white Americans (Health Equity Tracker). According to the Centers for Disease Control and Prevention (CDC), COVID-19 related deaths per 100,000 people as of August 2021 were 220 for Native Americans, 175 for African Americans and 147 for white Americans. On the economic front, job losses have been concentrated among minorities, women, and low-wage workers. But the discussion started long before the impacts of COVID-19 were realized. The socioeconomic position of Black people and other minorities in America cannot be fully contextualized without considering the marginalization of their racialized social identities as minorities who have historically combatted subjugation and oppression with respect to income, employment, homeownership, education, and political representation.

Data and research show that Black people have on average higher unemployment rates, lower earnings, lower rates of homeownership, and pay more for credit and banking services – all factors that result from a history of structural racism in the U.S. These factors contribute to vast disparities in financial health, and wealth creation and accumulation between their households and white households. The ability of Black households to spend, save, borrow and plan – within the context of structural racism – can be used to explore the nuances of disparities in financial health and wealth creation. Moreover, financial knowledge or financial literacy is one of the determinants of an individual's or group's financial behavior with regard to accumulation or loss of wealth. The deficiency in widely available products that meet the needs of various households is another major factor.

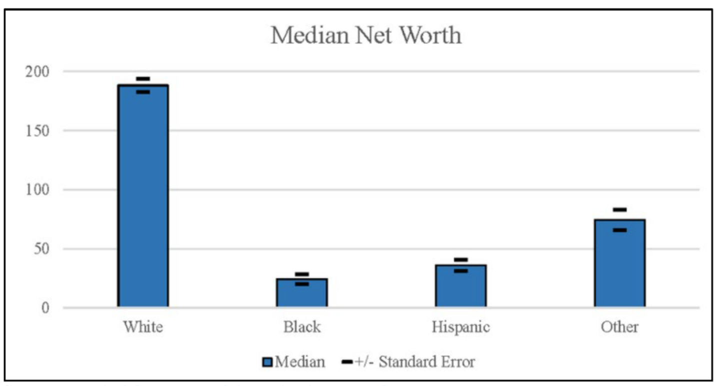
Generally, financial institutions provide financial tools, such as credit cards, personal loans, 401(k) loans, and personal lines of credit. Fundamentally, financial institutions rely on traditional metrics, particularly credit scores, in decisions over the provision of liquidity to individuals – but these measurements may be subject to racial bias, thereby contributing to wealth inequality.

The Racial Wealth Gap

The racial distribution of wealth is a comparison of the wealth of members of different racial groups and demonstrates significant economic inequality in the United States. In 1990, white people accounted for 75.64 percent of the United States population and in the first quarter of that year white households held $18.88 trillion (90.1 percent) in household wealth, compared to $0.83 trillion (4 percent) held by Black households where Black people accounted for 11.75 of the population and $0.44 trillion for Hispanic households (2.1 percent) with Hispanic or Latino people making up 8.99 percent of the population (Federal Reserve and U.S. Census Bureau). Thirty years later, in the second quarter of 2020, white households held $94.04 trillion (83.9 percent) in household wealth while according to 2019 U.S. Census data white people accounted for 60.1 percent of the U.S. population. Though the percentage of white people in the U.S. population decreased by 15.5 percent, the share of wealth held by white households only decreased by 6.2 percent. Comparatively Black people accounted for 13.4 percent of the U.S. population in 2019 and Black households held $4.64 trillion (4.1 percent) in household wealth in the second quarter of 2020. The Hispanic or Latino population increased to 18.5 percent in 2019 and Hispanic or Latino households held $2.69 trillion (2.4 percent) in household wealth (Federal Reserve and U.S. Census Bureau).

In 2016 the median net worth (in 2019 dollars) of the typical white non-Hispanic household was $181,900, nearly ten times greater than that of the typical Black household's wealth, $18,200 (Board of Governor of the Federal Reserve System). Four years later, in September 2020, new data was released in the 2019 Survey of Consumer Finances (SCF), which showed a continuation of the long-standing and substantial wealth disparity between Black and white households. The data showed a slight decrease in the disparity in family wealth for white and Black families. In 2019, the median net worth of a typical white household, $188,200, was 7.8 times greater than that of a typical Black household, $24,100 (Board of Governors of the Federal Reserve System). Figure 1 shows median net worth by race in 2019. Between 2016 and 2019 white household wealth increased by 3 percent, while Black household wealth increased by 33 percent. Hispanic or Latino households experienced the greatest percentage increase in household wealth between 2016 and 2019, 65 percent, from $21,900 to $36,200.

Figure 1. Median Net Worth by Race: 2019



Source: Board of Governors of the Federal Reserve System

While the numbers discussed in the previous paragraph illustrate a small redistribution of wealth between white, Black and Hispanic or Latino households, they also illustrate the historical racial wealth gap that exists in the United States. And though the racial wealth gap has decreased since 2016, only one percent (or fewer) of the wealthiest families in the U.S. were Black or Hispanic in

2019 (Bricker, et. al, 2020). According to the Survey of Consumer Finances, nearly 75 percent of the families in the wealthiest 1 percent own privately held businesses and private business assets make up more than one-third of their balance sheets, illustrating the importance of private business ownership to wealth accumulation (Bricker, et. al, 2020). In addition to private business ownership that leads to a positive return on investment, net worth or wealth is a function of inheritance, past levels of disposable income, and the propensity to save (Lamas and McNeil, 1988). In addition to its obvious negative impact on Black and Hispanic individuals and communities, the racial wealth gap also constrains the U.S. economy as a whole and it is estimated that it will dampen consumption and investment by between $1 and 1.5 trillion between 2019 and 2028, 4 to 6 percent of the projected GDP in 2028 (Noel, et al., 2019).

Fintech Companies Can Mitigate the Racial Wealth Gap

Financial technology (fintech) companies can mitigate racial financial health and wealth gaps that hamper Black and Hispanic families' financial security through product offerings and policies they put in place. Through technology and automation, they can reduce costs and prices, speed up delivery and increase convenience for underserved populations (Saunders, 2019). Over the past 20 years, fintech companies have provided new ways to capture data, reach broader audiences, and expand access to credit (Strochak, 2017). These companies also have the potential to think differently about policies and programming that can amplify opportunities for Black and minority communities. These private sector innovations can be paired with public policy interventions as well to address some of the systemic issues that have contributed to the financial health and wealth gaps.

- **Create inclusive financial services products for people who are credit invisibles or low credit individuals. For example:**

  Cash Flow

  - **Smooth and stabilize cash flow by collaborating with enterprise.** Financially vulnerable populations experience greater income and expense volatility. Offering accounts that do not have overdraft fees, minimum balance requirements, and account maintenance fees can help reduce the negative impacts of this volatility (Walsh, 2020).
    - One example is the Build Card. Through its Build Card, a $500 unsecured credit card, FS Card (acquired in 2018), Inc., founded in 2014 by Marla Blow, an African American woman, looks beyond past credit history to provide customers with a buffer to pay for necessities when their income is unexpectedly lower or when expenses rise without warning (Gerhardt, 2017). FS Card is designed to move small-dollar loan customers into more affordable products and provide honest mainstream financial products to the mass market, allowing under-served borrowers to meet their everyday liquidity needs (The Moguldom Nation).
  - **Provide interest-free buy now, pay later capabilities so that consumers can comfortably make purchases and spread out payments as they get paid.** Klarna's buy now, pay later option allows customers to split the cost of their purchase into 4 smaller payments, without paying any interest or impacting their credit score. This

allows consumers the ability to try items before they pay for them and only pay for items that they keep.

Saving and Investing

- **Help Americans build emergency savings.** According to an AARP 2020 national survey of U.S. adults aged 30 and older, 3 in 5 African Americans experienced an unexpected financial challenge in the past year. A study by EPI found that in 2016 half of families had no retirement savings at all and that disparities existed by race. Two-thirds (68 percent) of white non-Hispanic families had retirement savings, compared to 41 percent for Black families and 35 percent for Hispanic families. To increase the saving ability of Black and Hispanic families, fintech companies can offer high-yield savings accounts, automated savings features, and robo and micro investing tools to increase savings opportunities (Walsh, 2020).

Credit

- **Use alternative data and machine learning to extend affordable credit to a larger population of consumers** (Walsh, 2020). While traditional credit-scoring mechanisms are backward looking, new data and algorithms provide the opportunity for fintech companies to use better indicators to determine creditworthiness (Strochak, 2017). People generally need credit and access to other financial services to buy homes and cars, finance businesses, and send their children to college, in addition to non-credit contexts including hiring processes for some jobs (Robinson and Yu, 2014). Credit scores can significantly impact consumers' financial lives as lenders rely extensively on them in decision making for mortgages, auto loans and credit cards (Consumer Financial Protection Bureau). Financial institutions are exposed to the risk of adverse selection. To mitigate this risk, FICO credit scores are used to assess the financial health of potential customers and borrowers. Providing an alternative application method that includes cash flow data, or an interview to assess creditworthiness would provide access to credit services for populations that may not qualify through traditional credit scoring. Additionally, fintech companies should participate in algorithmic bias assessments in order to identify and solve for potential inherent biases in their machine learning capabilities that may be part of any credit underwriting assessments.

- **Provide fast, fair, and flexible small business lending products that do not require a personal credit score for underwriting.** The same alternative data and machine learning solutions mentioned above in the context of consumer credit, can also be applied to small business lending. Eliminating the use of FICO scores and reducing collateral requirements will enable greater access to these underserved communities of entrepreneurs.

    - PayPal Working Capital, established in 2014, offers fixed-rate loans to small business owners based on the small business' sales to assess creditworthiness. This method allows for a transparent and flexible fixed cost loan that can be repaid through a percentage of the small business' future sales. Past research, conducted by PayPal has shown that PPWC loans are over-indexing to low-and-moderate income communities as well as areas with greater minority population.

- **Focus on access to capital through a racial equity lens. In addition to being deliberate in how small business credit products meet the needs of Black-owned small businesses, capitalize on opportunities to work with government stakeholders and provide a fintech perspective so that as laws and regulations are updated they reflect the changing landscape of financial services. For example:**
    - Engage in the Bureau's Section 1071 Rulemaking process
    - Participate in the Bureau's Special Purpose Credit Program (SPCP)
    - Engage with OCC Project Reach
    - Engage with FDIC tech sprints
- **Offer products that bridge the gap between cash and traditional financial services that empower people to participate in the digital economy. For example:**
    - Customers can use the PayPal app or the PayPal Cash Card to load money or withdraw cash from your PayPal account at Walmart.
- **Hire more people of color and institute employee financial wellness initiatives like providing equity to all employees and raising wages.** Income disparity falls squarely at the intersection between racial wealth inequality and financial health. Fintech companies should institute hiring policies that require interviewing a diverse pool of applicants for any open position. They should also implement employee financial wellness initiatives whereby employees at all levels earn a living wage (target 20% of net disposable income), and are provided with company equity as part of base compensation.
- **Meet people where they are in their communities, working more intentionally with local leaders, MDIs (Minority Depository Institutions) and CDFIs (Community Financial Depository Institutions).**
    - MoCaFi is a great example. Founded by Wole Coaxum, an African American, Oxford-educated Wall Street executive in 2014, Mobility Capital Finance Inc. (MoCaFi) is a digital banking platform that has enrolled more than 25,000 users, raised more than $6 million in seed funding, collaborated with Fortune 100 companies, and established a presence in major U.S. cities. MoCaFi's objective is to empower Black households and businesses by:
        - Collaborating with community organizations, local officials, and area businesses in targeted cities;
        - Addressing unbanked and underbanked communities of color by providing affordable banking and credit counseling services;
        - Increasing African American homeownership by 100 percent in designated cities; and
        - Working with cities to implement a plan for African American business hubs (MoCaFi).

- **Partner with banks that are focused on racial equity.** Whether national or regional banks, do your research to ensure that financial institutions you partner with are meaningful and deliberate in their hiring practices, investments, and products offerings.
- **Engage with BIPOC VCs when looking for financing and with BIPOC asset managers when investing.**

Public Policymakers Can Take Steps to Increase Financial Health

- **Increase Investments in the CDFI Fund and Make Any Relevant Programs that Sunset (like NMTC) permanent.**
- **Create a mandatory financial health curriculum for middle and high schoolers.** As referenced in the introduction of this paper, financial knowledge or financial literacy determine an individual's or group's financial behavior with regard to the accumulation or loss of wealth. Congress has the ability to mandate that our public schooling system equip middle and high schoolers with some form of education so that they know what types of products are available to best meet various needs throughout their adult lives.
- **Enhance broadband deployment.** The potential that fintech provides can only be fully realized when there is 5G internet capabilities spread evenly across the country. Federal and state/local governments should prioritize connectivity, particularly in low-income areas so these communities can unlock the potential of digitization.
- **Raise minimum wage for companies with over 500 employees.** By design, minimum wages boost the pay of workers who are among the lowest-paid in the U.S. labor market. And Black workers have the highest share of those who are paid the minimum wage among all major racial and ethnic groups in the United States. Increasing the minimum wage to $15 an hour, for example, would increase the earnings of 38.1 percent of Black workers, compared to 23.2 percent of White workers. This calculation is based on a combination of workers in states whose minimum wage is determined by the current federal minimum wage of $7.25 per hour, workers in states with a state minimum wage below the federal minimum, and workers in all other states who are currently earning less than $15 per hour (Derenoncourt, Montialoux, and Bahn, 2020).
- **Foster Utilization of the CFPB Special Purpose Credit Program (SPCP).** The Equal Credit Opportunity Act (ECOA) and Regulation B prohibit discrimination on a prohibited basis in any aspect of a credit transaction. The Special Purpose Credit Program (SPCP) provisions of the Equal Credit Opportunity Act (ECOA) and Regulation B, however, provide targeted means by which creditors can meet special social needs and benefit economically disadvantaged groups (Bernard and Ficklin, 2020).
- **Revise and Revive the SBIC program under the SBA to incentivize private sector investments in BIPOC founders.** SBA's Office of Investment and Innovation (OII) leads programs that provide the high-growth small business community with access to two things: financial capital and research and development funds to develop commercially viable innovations. The Small Business Investment Company (SBIC) Program is an investment program that increases access to capital for growth stage businesses. The SBIC program is effective and distinct because the private sector leads with its capital and investment expertise, and then SBIC leverage follows to augment the impact of the private

investment. The government does not pick winners and losers, private investors guide capital to the companies with the best potential (U.S. Small Business Administration, 2018).

- **Revise SBA 7(a) program to enable fintechs to more easily engage with the program.** By modernizing the SBA's lending facilities, private sector participants can come in and help distribute capital to the most underserved areas. Some key aspects of this modernization include, reducing paperwork, improving API architecture to streamline functionality and data access, and update how the lender interacts with the SBA's systems and personnel.
    - The cap on guarantee is at 50% for 7(a) Express program similar to regular 7(a)
        - A higher guarantee will provide better terms (rate and duration)
    - Extending the term of the loan to enable greater cashflow, particularly during this time as SMBs are recovering will be key
        - Innovative companies like PayPal and our competitors have the ability to use innovative underwriting process to serve small businesses. We would love to work with SBA to use technology to expand opportunities.

Conclusion

The ongoing COVID-19 pandemic has disproportionately impacted the Black community in terms of health and economic effects and shined a light on historical racial wealth and financial health gaps in America. Closing these gaps will require that structural, systemic, and historical economic disparities are addressed through significant public policy changes (Moss et al., 2020).

FINANCIAL TECHNOLOGY ASSOCIATION

Testimony of Penny Lee
Chief Executive Officer
Financial Technology Association

Before the
House of Representatives Committee on Financial Services
Task Force on Financial Technology hearing on

"Buy Now, Pay More Later? Investigating Risks and Benefits of BNPL and Other Emerging Fintech Cash Flow Products"
November 2, 2021

Thank you Chair Lynch, Ranking Member Davidson, and members of the Task Force for the opportunity to testify before you today on innovation in financial services that is empowering consumers with greater choice, access, and opportunity.

I am the Chief Executive Officer of the Financial Technology Association (FTA), a nonprofit trade organization that educates consumers, regulators, policymakers, and industry stakeholders on the value of technology-centered financial services and advocates for the modernization of financial regulation to support inclusion and innovation. The FTA is focused on informing tomorrow's regulations, policy frameworks, and public understanding to safeguard consumers and advance the development of trusted, digital financial markets and services.[1]

Technology-driven innovation is transforming the way we offer, access, and benefit from financial services and markets in the United States. By using internet and mobile platforms, machine learning, automation, and other modern technologies to deliver financial products and services, financial technology (or "fintech") companies are improving efficiency and transparency, broadening equity, access and inclusion, reducing costs, and increasing choice and opportunities for consumers and businesses.

These advances are coming at a critical time for the American economy. Millions remain underbanked or underserved and lack access to fair credit, income and wealth inequality continues

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[1] FIN. TECH. ASS'N, www.ftassociation.org (last visited Oct. 12, 2021). The FTA's members include Afterpay, Betterment, BlueVine, Brex, Carta, Figure, Klarna, Marqeta, MX, Nium, Plaid, Ribbit Capital, Sezzle, Stripe, Truework, Wise, Zest AI, and Zip.

to grow, and small businesses seek to rebuild from the devastation caused by the COVID-19 pandemic.

Fortunately, fintech solutions offer a welcome new paradigm for equitable financial services and are reshaping the financial landscape in powerful ways. I will focus my remarks today on a particular area of fintech innovation: and that is the broadly termed “buy-now, pay-later” (BNPL) space. FTA is pleased to count many of the global leaders in BNPL as founding members of the organization.

Buy Now, Pay Later: Advancing Consumer-Centric Innovation

With respect to BNPL, a new generation of fintech innovators are offering consumers new payment options that can reduce debt and alleviate budget stress. Americans on average pay approximately $1,000 per year in interest on revolving credit card debt, and credit card interest rates are amongst the highest as compared to other major consumer finance product categories.[2]

Fintech innovators in the broadly defined BNPL space offer consumers a number of tailored and flexible payment options, including direct payments, pay after delivery, and installment plans that typically involve equal payments over a six to eight week post-purchase period. BNPL firms typically charge consumers zero or low fees for installment payment plans and perform no or only a soft credit pull on consumers. Additionally, BNPL firms generally charge much lower late fees than those charged by credit cards or banks in the case of delinquency or default. There is ample research noting that the biggest banking issue for vulnerable households is unexpected or substantial credit card fees.[3]

BNPL solutions are being offered to solve pain points associated with traditional payment options, including high cost revolving debt, harmful credit checks, and over-indebtedness. BNPL products are preferred by consumers relative to traditional credit options for a number of reasons, including that:

- They are lower cost, charging little or no interest or fees, unlike credit cards, which make the majority of their revenue from interest charges and have been found to cost vulnerable consumers up to 225% of product purchase value in interest expenses.[4]

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[2] The Motley Fool, *Americans Pay Almost $1,000 Per Year in Credit Card Interest* (Dec. 11, 2020), available at https://www.fool.com/credit-cards/2020/12/11/americans-pay-almost-1000-per-year-in-credit-card/.

[3] *See e.g.,* Financial Health Network, *The FinHealth Spend Report 2021* (2021), available at https://s3.amazonaws.com/cfsi-innovation-files-2018/wp-content/uploads/2021/04/19180204/FinHealth_Spend_Report_2021.pdf.

[4] Nerdwallet, *How Do Credit Card Companies Make Money?* ((May 17, 2021), available at https://www.nerdwallet.com/article/credit-cards/credit-card-companies-money; *see also* Accenture/Afterpay, *The Economic Impact of Buy Now, Pay Later in the US* (Sept. 2021), available at https://afterpay-corporate.yourcreative.com.au/wp-content/uploads/2021/10/Economic-Impact-of-BNPL-in-the-US-vF.pdf (noting that consumers save up to $459 million in credit card fees by making purchases with Afterpay BNPL solutions).

- They are more transparent, helping consumers better understand – and hence control – their finances.
- They help users budget, and as a result, help manage cash flow and avoid risky debt products.
- They are more flexible and offer more relief when consumers have an unexpected emergency; and
- They result in less debt and repayment takes place over shorter terms.

BNPL products are structured to have payment terms that require consumers to pay for a purchase in a matter of weeks or a few months. This contrasts with revolving credit and high-interest products that may take years to pay down, blur the cost impact of a purchase, and oftentimes keep consumers in a vicious cycle of debt due to continuous interest charges or rollovers.

Notably, BNPL solutions also support merchants by enhancing the customer experience, facilitating economic activity, and driving customer satisfaction. A recent survey of 1,051 US merchants found that offering BNPL payment solutions to customers resulted in a better customer experience, increased sales, and increased sales conversion rates.[5] The benefits of BNPL are apparent regardless of merchant size, with large and small merchants seeing considerable improvement across business metrics. Another recent survey found that merchants using a particular BNPL solution enjoyed 13% more new customers.[6]

Merchants also increasingly have started offering multiple BNPL services along with traditional credit and debit payments options. Merchants cite customer demand, increasing total business sales, and expanding customer choice as the key reasons for offering multiple payment solutions, including BNPL, as part of the regular offering.

Given higher conversion rates and resulting increased sales from consumers' preference for BNPL, merchants offering BNPL payment solutions typically pay a fee to the BNPL provider, none of which is passed along to the consumer.

Given the above, it is not surprising that a broad range of consumers prefer BNPL payment solutions as a responsible, low risk, and low-cost option for making consumer purchases. A 2020 survey of BNPL users found that more than 75% of consumers using a BNPL payment solution had funds available to cover the full purchase price of the target item at the time of the transaction.[7]

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[5] Zip, *Is 2021 the Year of BNPL? 6 Facts You Need to Know About This Payment Method* (June 10, 2021), available at https://zip.co/us/merchant-hub/retail-insights/retail-insights-top-bnpl-trends-2021

[6] *See* Accenture/Afterpay, *The Economic Impact of Buy Now, Pay Later in the US* (Sept. 2021), available at https://afterpay-corporate.yourcreative.com.au/wp-content/uploads/2021/10/Economic-Impact-of-BNPL-in-the-US-vF.pdf.

[7] Cardify, *COVID-19 and the surge of "buy now, pay later"* (July 29, 2020), avialbale at https://www.cardify.ai/reports/buy-now-pay-later..

In fact, the majority of users had 5x the total purchase amount in their account at the time of using the BNPL payment option.

The same survey found that BNPL users are predominantly female and younger, with millennials and Gen Z customers making up the vast majority of users. The user base also includes lower-income consumers, which may correlate with a higher incidence of lacking access to traditional forms for credit or banking services.

BNPL Products are Subject to Robust Regulation

BNPL products are subject to key consumer protection regulations and FTA members are committed to informing regulatory frameworks that safeguard consumers. Regardless of the BNPL offering, all BNPL products are subject to key consumer protection laws and regulations, including around anti-money laundering, fair lending, credit reporting, debt collection, privacy, fair treatment of customers, and electronic fund transfers. They also are subject to similar state consumer protection laws.

Some BNPL products may not qualify as a loan when they are structured as "credit sales" or "retail installment sales," where the legal seller of the goods and/or services agrees to accept the sales price in installment payments over time. In these instances, though, there are state based frameworks that govern such offerings. Other BNPL providers do offer loans either directly through state licensure or through regulated bank partnerships.

Informing Future Policy

It is an exciting time for consumers and merchants, and the BNPL providers who are working to serve those two stakeholder groups with innovative, consumer-centric payment solutions. While there is clear evidence of the benefits BNPL provides, FTA recognizes it is still early in the development of this space. We also believe it is important to remain vigilant against unscrupulous actors or products that drive poor consumer outcomes.

To this end, we are supportive of partnering with policymakers to increase understanding of how consumers use BNPL solutions and the impact on their financial well-being. Future policy should be predicated on proper analysis of real-world outcomes, including with respect to credit reporting, financial health, and consumer choice and preferences.

FTA members are engaged in active discussions with credit reporting agencies to be sure scoring models properly account for BNPL products and are also actively pursuing real-world research to better understand economic impact and outcomes.[8] Our members look forward to continuing this work, including in partnership with policymakers and regulators.

FTA members also believe in the importance of providing consumers with clear descriptions of BNPL products so that they can make informed decisions. FTA's BNPL member companies are leaders in ensuring that product offerings, rates, fees, and terms are disclosed in clear, concise, transparent, and accurate language. FTA members are committed to continuing to advance industry standards that safeguard consumers, including transparent and consistent disclosures. To this end, we welcome engagement with the government to ensure consumer interests are properly served.

While today's discussion revolves around Buy Now, Pay Later and similar consumer liquidity products, the FTA also strongly encourages appropriate consumer protection in other areas of consumer finance, including proposals to enhance overdraft fee protection. Legislation that establishes fair and transparent practices related to the marketing and provision of overdraft practices and meaningful disclosure of overdraft fees would be a welcome development for millions of consumers. Similarly, given the huge influence that credit bureaus exercise over Americans' financial health and well-being, FTA believes Congress should examine efforts to modernize credit bureaus and their business models in order to make their scoring practices more transparent and inclusive, and data collection efforts more secure and accountable.

Conclusion

FTA appreciates the opportunity to engage with the committee today and views this as just the start of an ongoing dialogue. Fintech innovation, including BNPL solutions, is driving competition and choice for consumers that results in lower costs and better financial outcomes. Yet, we believe strongly that balanced and thoughtful regulation is key to long term success for all involved stakeholders, including providers, consumers, and merchants utilizing new payment solutions. We look forward to helping to inform this important process.

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[8] *See* Accenture/Afterpay, *The Economic Impact of Buy Now, Pay Later in the US* (Sept. 2021), available at https://afterpay-corporate.yourcreative.com.au/wp-content/uploads/2021/10/Economic-Impact-of-BNPL-in-the-US-vF.pdf.
Accenture/Afterpay, *Millennials and Gen Z in the US: Next Gen Index* (Aug. 2021), available at https://afterpay-corporate.yourcreative.com.au/wp-content/uploads/2021/08/Afterpay_NextGen_US.pdf

Testimony of Lauren Saunders

Associate Director, National Consumer Law Center

(on behalf of NCLC's low-income clients)

Before the

Task Force on Financial Technology

U.S. House Committee on Financial Services

On

"Buy Now, Pay More Later?

Investigating Risks and Benefits of BNPL and Other Emerging Fintech Cash Flow Products."

November 2, 2021

Chairman Lynch, Ranking Member Davidson, and Members of the Task Force:

Thank you for inviting me to testify today on behalf of the low-income clients of the National Consumer Law Center.

Since 1969, the nonprofit National Consumer Law Center® (NCLC®) has used its expertise in consumer law and energy policy to work for consumer justice and economic security for low-income and other disadvantaged people in the United States through its expertise in policy analysis and advocacy, publications, litigation, expert witness services, and training. NCLC works with nonprofit and legal services organizations, private attorneys, policymakers, and federal and state government and courts across the nation to stop exploitative practices, help financially stressed families build and retain wealth, and advance economic fairness. Our 21-volume consumer law series includes several treatises that cover issues relevant to the forms of credit discussed in this hearing, including Consumer Credit Regulation, Truth in Lending, and Unfair and Deceptive Acts and Practices.

1. Introduction and Summary

We are seeing an explosion of new products allowing consumers to purchase goods and services on credit or to take advances when money runs out before payday. Some are balloon-payment loans, repaid in full with the next deposit or paycheck. Others are repaid over time, some in four installments, others over a longer time period. Some of these products are free, some purport to be free but have hidden or deceptive costs, others charge interest.

Some new types of financing products are seizing opportunities posed by gaps or failures in the current marketplace. If well designed, they may have a place in meeting consumers' needs. Other fintech liquidity products appear primarily to be designed to evade consumer protection laws.

I am worried about credit products that claim not to be covered by federal or state credit laws. Even credit products that can help consumers to manage their finances need to be covered by basic consumer protections, including interest rate limits, underwriting for ability-to-repay, cost transparency, dispute rights and fair lending laws.

However they are styled, products that provide funding or cash today and that are repaid later are credit. The use of new technologies or models does not make these products fundamentally different than forms of credit that have been around a long time. Shiny fintech garb does not remove the need for basic consumer protections to ensure that credit is affordable, responsible, transparent, and fair.

We must keep a close eye on how products evolve, as products may not stay free or low-cost. The ultimate business model may not always be or remain what it appears.

In brief, here are my observations about some of the newer forms of credit that have caught our eye and that are designed in ways that claim to be outside of some or all credit laws:

- **Buy-now-pay-later products**, if affordable and truly free to the consumer, may help consumers manage larger purchases without the long-term debt and high costs of credit cards. But some BNPL products may have deceptive and abusive profit models built on the expectation of late fees from struggling consumers. Consumers may be led to take on debts they cannot afford to repay, and managing frequent irregular BNPL payments can be challenging. If there is a problem with the product or service the consumer financed, refunds may be difficult to obtain, without the dispute rights that credit cards have.

- **Earned wage access products** are a lower-cost form of payday loan – wage advances repaid on payday – and should be regulated as credit. The trend is for employers to offer access to earned wages for free, which may help workers if used sparingly, but more study is warranted. Regulators should not carve loopholes in lending laws for fee-based products, which can be more expensive than they appear and frequently lead to a cycle of reborrowing that may not ultimately provide useful liquidity. Instead of encouraging employees to spend next week's pay today, employers should focus on savings programs; affordable small dollar installment loans; regular, predictable schedules; and paying a living wage.

- **Fake earned wage advance products that are offered directly to consumers** have no direct connection to earned wages. These payday cash advances have most of the negative features and impacts of standard payday loans.

- **Overdraft and cash advance apps and loans that collect "tips" have an evasive and deceptive business model** that attempts to disguise finance charges and to evade interest rate limits, including the Military Lending Act's 36% cap, and other lending laws. The "tips" model is found in fake earned wage access products; in "fee-free" overdraft and cash advance loans on non-bank banking apps; and on "peer-to-peer" loan platforms. Tips added by default can result in annual percentage rates (APRs) that can reach 520% APR and create cycles of debt. Though purportedly voluntary, companies have continuously evolving ways of pressuring people into "tipping" or making it difficult not to tip. Regulators will be playing whack-a-mole if they let this dangerous model continue.

Highlights of my recommendations are:

- Newer financing and cashflow products should be viewed as **credit** and subject to federal and state lending and fair laws. The CFPB should reverse or significantly revise its recent actions on earned wage access programs.

- Regulators should closely examine and crack down on **evasive pricing models** built on "tips," late fees, or inflated "expedite" fees.

- **Responsible underwriting and affordable loan structures** are essential for all forms of credit. Fintech models targeted at struggling consumers or designed to result in a cycle of debt may be unfair, deceptive or abusive and warrant attention.

- Credit offered at the point of sale should have the same **chargeback, reasonable and proportional penalty fees, ability-to-repay, and statement** requirements that apply to credit cards.

- The CFPB should use its **supervision authority** over payday lenders or larger participants in financial markets to examine providers of fintech credit products.

- **Data should be used in ways consumers expect**, and Congress should improve privacy laws.

- Regulators should look out for **disparate impacts** posed by fintech credit products.

I discuss these issues in more detail below.

2. **Buy-now-pay-later products**

The term "buy-now-pay-later" (BNPL) typically refers to payment plans in four installments (sometimes after a down payment) with no interest or finance charges. Products are structured in that manner in order to fit outside of the scope of the federal Truth in Lending Act (TILA), which, with some exceptions, only covers creditors who regularly extend consumer credit subject to a finance charge or payable by written agreement in more than four installments.[1]

The term "buy-now-pay-later" is sometimes used to refer to other types of installment loans, with more than four payments and interest charges. These types of installment loans are clearly covered by TILA and are not addressed in this testimony, though there issues in that area as well.[2]

BNPL products are clearly credit – the right to incur a debt and defer its payment.[3] Although they may fall outside of TILA's scope,[4] they can be covered by state licensing and credit statutes.[5]

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[1] 15 U.S.C. §1602(g). TILA does cover some forms of credit that do not have four installments or finance charges, including credit and charge cards.

[2] Point-of-sale installment loans, like buy-here-pay-here credit, also do not have the chargeback rights and other protections that apply to credit cards. Some use rent-a-bank schemes to charge high, predatory rates that violate state laws, and some loans offered through auto mechanics, pet stores, furniture stores and other locations engage in highly deceptive practices. *See, e.g.,* Congress Must Protect Consumers from Predatory Lending, https://consumerfed.org/wp-content/uploads/2021/03/Rent-A-Bank-Stories_By-State-2021.pdf (collecting consumer complaints).

[3] 15 U.S.C. §1602(f).

[4] BNPL products could potentially fall within TILA's scope if they are structured to hide a finance charge, such as in an inflated purchase price or in fees. Depending on how they are set up and evolve, some BNPL products could be viewed as credit cards.

[5] California announced settlements in late 2019 and early 2020 with Quadpay, Sezzle and AfterPay under which the three companies agreed to refund roughly $1.9 million in fees to consumers and to obtain licenses and comply with applicable lending laws. California recently issued a report with data on the top six buy now pay later lenders. *See* Calif. Dep't of Fin'l Prot'n & Innov., Press Release, "DFPI Report Shows Changes in Consumer Lending,

The BNPL market is exploding. Nearly every day there is an announcement about a new BNPL product or partnership. Companies with BNPL products include AfterPay (now acquired by Square), Affirm, Klarna, Sezzle, Splitit and Zip (previously QuadPay). Banks and established payments players like Capital One, Goldman Sachs, MasterCard, PayPal, and Synchrony Bank also have or are developing BNPL products. Many BNPL providers also offer traditional installment loans or other products.

BNPL products are most visible in online shopping, but BNPL options are also becoming available for in-person purchases. The potential uses of BNPL are endless. For example, Gravie,[6] which works with brokers of health care plans for employers, and Scratchpay,[7] which works through medical providers, both offer BNPL for medical expenses. One study found that 42% of respondents used BNPL to finance home and furniture goods, followed by electronics (30%) and apparel (24%), but uses also included music festivals and luxury items.[8]

Consumers are predicted to make nearly $100 billion in purchases using BNPL programs in 2021, up from $24 billion in 2020.[9] According to a 2021 survey conducted by the Mercator Advisory Group, around 52% of customers aged 18-24 had used BNPL solutions in the past 12 months.[10]

Though the BNPL explosion appears to be primarily driven by merchants looking to increase sales and payment providers worried about being left out, the BNPL market also exploits the flaws of credit cards, which do not always serve consumers well. Credit cards provide a convenient way to make purchases on credit. But it is far too easy to get deep into credit card debt, and minimum payments that go heavily to interest and do little to reduce principle make it far too hard and take too long to pay off that debt. These problems have provided an opportunity for point-of-service installment loans and have led to installment loan features on credit cards. BNPL products go to the next level by limiting the number of installment payments and eliminating interest.

When they operate as promoted, BNPL can help consumers manage larger purchases without the long-term debt and high costs of credit cards. There are real benefits to being able to pay on credit with clear, simple payments that will quickly pay off the purchase at no greater cost than paying in cash.

Decrease in PACE Program" (Oct 7, 2021), https://dfpi.ca.gov/2021/10/07/dfpi-report-shows-changes-in-consumer-lending-decrease-in-pace-program/.

[6] https://www.gravie.com/blog/gravie-pay-prioritizing-health-without-compromising-financial-wellbeing/.

[7] https://scratchpay.com.

[8] Credit Karma, Press Release, "Buy now pay later surges throughout pandemic, consumers' credit takes a hit" (Sept. 9, 2021) (describing survey by Qualtrics on behalf of Credit Karma).
Kate Fitzgerald, American Banker, "Missed payments don't faze new buy now/pay later lenders" (Sept. 17, 2021), https://www.americanbanker.com/news/missed-payments-dont-faze-new-buy-now-pay-later-lenders.

[9] Ron Shelvin, Forbes, "Buy Now, Pay Later: The "New" Payments Trend Generating $100 Billion In Sales" (Sept. 7, 2021),https://www.forbes.com/sites/ronshevlin/2021/09/07/buy-now-pay-later-the-new-payments-trend-generating-100-billion-in-sales/?sh=7144ed5a2ffe.

[10] https://www.grandviewresearch.com/industry-analysis/buy-now-pay-later-market-report

No product is free to offer, and much of the cost of BNPL products is covered by merchants, who see a benefit to paying fees to BNPL providers in order to increase sales. When the cost is borne by merchants and BNPL is free and affordable to consumers who make their payments as scheduled and do not get overloaded with debt, these products can be a win-win.

Younger consumers are heavy users of BNPL,[11] and distrust of credit card debt may be part of the appeal to younger generations. Credit vehicles that require full repayment in management payments over a reasonable time period can provide a safer way to access credit than those that result in long-term debt. But some BNPL users may not fully appreciate that BNPL products are credit and, like credit cards, can create unmanageable debt loads.

The short time-horizon of BNPL products – six to eight weeks – is not all that different from how a credit card could be used without incurring interest. Depending on when in the statement cycle a credit card purchase is made, it might not need to be paid off for six weeks. It is not clear if BNPL payments are much more affordable than paying a credit card bill in full, or if they are merely designed to make a purchase price look lower or more manageable.

There are troubling indications that BNPL products may lead consumers to incur debt they cannot afford to repay. Disturbingly, part of the business model of some BNPL providers may count on consumers who do not pay on time and who incur late fees.

BNPL providers do not directly consider the consumer's ability to repay. Even if they check do a soft check of credit reports, those reports may not reveal BNPL debt. Industry analysts have warned that BNPL providers may underestimate consumers' debt levels and may be headed for even higher default rates.[12]

Some advertise "no credit check," appealing to those who may already be overextended. A report by the former head of the United Kingdom's Financial Conduct Authority pointed out that BNPL products may play on behavioral biases and understate the impact of late payments, encouraging impulse purchases rather than careful consideration about affordability.[13] The report also highlighted concern about the high use of point-of-sale credit by consumers with mental health problems.[14]

BNPL products should not be viewed as a way to build credit or to provide credit to those who are underserved. BNPL products do not generally report payments to credit bureaus, so they do not help consumers to build access to traditional credit. But late or defaulted payments

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[11] R. Shevlin, Buy Now, Pay Later: The "New" Payments Trend Generating $100 Billion In Sales (Sept. 7, 2021), https://www.forbes.com/sites/ronshevlin/2021/09/07/buy-now-pay-later-the-new-payments-trend-generating-100-billion-in-sales/?sh=7929e54c2ffe.

[12] Weizhen Tan, CNBC, The 'buy now, pay later' trend could be the next hidden source of consumer debt, analysts warn (Aug. 10, 2021), https://www.cnbc.com/2021/08/10/buy-now-pay-later-instalment-plans-may-cause-consumer-credit-card-debt-to-rise.html.

[13] Financial Conduct Authority, The Woolard Review – A review of change and innovation in the unsecured credit market at 47 (Feb. 2, 2021), https://www.fca.org.uk/publication/corporate/woolard-review-report.pdf ("Woolard Review").

[14] Woolard Review at 48.

may be reported,[15] so BNPL products may have the potential to harm but not help credit access. Lack of underwriting is more of a flaw than a benefit. With the advent of cashflow underwriting, it is increasingly possible to underwrite those who have the ability to repay but do not have previous credit history.[16] Offering credit without any underwriting at all is not the path to financial inclusion.

Small purchases can add up. A 2020 survey by Cardify.ai found that nearly half of shoppers said they increased their spending between 10 percent to over 40 percent when they used BNPL instead of a credit card.[17] Serial BNPL purchases, potentially at multiple BNPL providers, can mount in ways that are not obvious.

A series of BNPL loans can be more difficult to understand and manage than a credit card bill. Under TILA, credit cards are required to send monthly statements, which accumulate all purchases into a single balance and have a single monthly payment, with a clear due date and amount. No such consolidated statement is required from BNPL providers, and consumers may not be able to use the same BNPL provider at different merchants. Due dates will vary, depending on the date of the purchase, and could be biweekly rather than monthly. Consumers with multiple BNPL debts could have multiple payments due at random dates throughout the month. Many consumers who have incurred late fees have simply lost track of payments.[18]

A recent survey found that 34% of people who have tried a BNPL loan have fallen behind on one or more of their installment payments.[19] Younger consumers were more likely in one survey to report missing payments. More than half of Gen Z and millennial respondents said they had missed at least one payment, compared to 22% of Gen X and just 10% of Boomers.[20]

In the United Kingdom, one bank found that 10% of its customers who made a payment to one of the two large BNPL providers overdrew their accounts beyond their overdraft allowance that month.[21]

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[15] Woolard Review at 49.
[16] *See* Testimony of Chi Chi Wu, National Consumer Law Center, before the U.S. House of Representatives Committee on Financial Services, Task Force on Financial Technology, Regarding "Preserving the Right of Consumers to Access Personal Financial Data" (Sept. 21, 2021), https://financialservices.house.gov/uploadedfiles/hhrg-117-ba00-wstate-wuc-20210921.pdf.
[17] Penelope Wang, Consumer Reports, The Hidden Risks of Buy-Now, Pay-Later Plans (Feb. 14, 2021), https://www.consumerreports.org/shopping-retail/hidden-risks-of-buy-now-pay-later-plans-a7495893275/.
[18] Anna Irrera, *As 'buy now, pay later' surges, a third of U.S. users fall behind on payments*, Reuters, Sept. 9, 20210 https://www.reuters.com/technology/buy-now-pay-later-surges-third-us-users-fall-behind-payments-2021-09-09/ (reporting on an August 2021 Qualtrics survey of 1,044 adults on behalf of Credit Karma).
[19] Credit Karma, "Buy now pay later surges throughout pandemic, consumers' credit takes a hit" (Sept. 9, 2021) (describing survey by Qualtrics on behalf of Credit Karma), https://www.creditkarma.com/about/commentary/buy-now-pay-later-surges-throughout-pandemic-consumers-credit-takes-a-hit; Kate Fitzgerald, American Banker, "Missed payments don't faze new buy now/pay later lenders" (Sept. 17, 2021) (describing Qualtrics survey), https://www.americanbanker.com/news/missed-payments-dont-faze-new-buy-now-pay-later-lenders.
[20] *Id.*
[21] Woolard Review at 49.

AfterPay also had a high proportion of late fee revenue at 20%,[22] down somewhat from 25% the previous year.[23] In the Australian BNPL market overall, 21% of users surveyed had missed a payment in the last 12 months.[24] Some consumers who used BNPL experienced "financial hardship, such as cutting back on or going without essentials (e.g. meals) or taking out additional loans, in order to make their buy now pay later payments on time."[25] Another Australian report found bad debts (BNPLs not repaid) averaging 30% of revenue, and late fees that equated to 68% APRs.[26] ZipMoney also got 61% of its revenue from other consumer fees.[27]

Reliance by some BNPL providers on late fees as a hidden, back-end payment mechanism is especially troubling. Some of the worst financial abuses can occur when there are misaligned incentives between the provider and the consumer – when the provider wins when the consumer loses. Overdraft fees,[28] predatory lending,[29] and credit cards that put consumers in the "sweat box"[30] are examples of dysfunctional markets where companies promote and profit off of products or practices that harm consumers. We cannot let these misaligned incentives take over the BNPL market.

Some have questioned the viability of the BNPL profit model, even with late fees.[31] As competition for merchants drives down merchant fees, BNPL providers will look elsewhere for revenue, which could increase costs for consumers. BNPL products may primarily be a way to acquire customers who are then pitched other products.[32]

BNPL products also may pose problems for consumers seeking a refund or redress if there is a problem with the item or service financed. Consumers have the right to contest credit card charges if they did not get what they paid for. Most consumers do not understand that the

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[22] Australian Securities & investments Comm'n, Report 672: Buy now pay later: An industry update at 9 (Nov. 2020) ("Australian Report 672"), https://download.asic.gov.au/media/5852803/rep672-published-16-november-2020-2.pdf.
[23] Australian Securities & Investments Comm'n, Report 600: Review of buy now pay later arrangements at 10 (Nov. 2018), https://download.asic.gov.au/media/4947835/rep600-published-28-11-2018.pdf.
[24] Australian Report 672 at 4.
[25] *Id.*
[26]McLean Roche Consulting Group, Submission to Treasury Inquiry – Payments System Review 2020/21 at 39, https://treasury.gov.au/sites/default/files/2021-02/147719_mclean-roche_0.pdf. ("McLean Roche Submission").
[27] Australian Report 672 at 9.
[28] *See, e.g.,* Peter Smith et al., Center for Responsible Lending, Overdraft Fees: Banks Must Stop Gouging Consumers During the COVID-19 Crisis (June 2020), https://www.responsiblelending.org/sites/default/files/nodes/files/research-publication/crl-overdraft-covid19-jun2019.pdf.
[29] *See* Lauren Saunders, et al., National Consumer Law Center, Misaligned Incentives: Why High-Rate Installment Lenders Want Borrowers Who Will Default (July 2016), https://www.nclc.org/issues/misaligned-incentives.html.
[30] Ronald Mann, Columbia Law School, Bankruptcy Reform and the "Sweat Box" of Credit Card Debt (2006), https://scholarship.law.columbia.edu/faculty_scholarship/1407/.
[31] McClean Roche Submission at 39 ("The BNPL profit model is highly questionable); Jemima Kelly, Financial Times, "Is 'buy now pay later' a viable business model?" (Oct. 7, 2021), https://www.ft.com/content/ddb2e207-2450-4ca8-bad0-871290d80ea7.
[32] *See id.*; McKinsey & Company, Buy Now, Pay Later: Five Business Models to Compete (Jul. 29, 2021), https://www.mckinsey.com/industries/financial-services/our-insights/buy-now-pay-later-five-business-models-to-compete.

TILA chargeback and claims and defenses rights that apply to credit cards do not apply to BNPL products. They should.

Finally, BNPL products may not receive adequate oversight. In some states they are subject to licensing, and banks that offer BNPL products are subject to supervision. But non-bank players are not currently supervised at the federal level. They should be, given the dramatic growth in this market and the potential impact on consumers.

3. **Earned Wage Access Products**

Earned wage access products are styled as a way for workers to access wages they have already earned ahead of the regular payday. Some are more problematic than others, though all are balloon-payment loans that lead to a cycle of reborrowing. They are a form of payday loan, albeit lower cost and less dangerous (at least for now). Fee-based products should be regulated as credit.

The term "earned wage access" properly refers to programs that, through a connection to the employer's time and attendance system, assesses the wages that the employee has worked but has not yet been paid and provides advances on those wages ahead of payday. Companies offering earned wage access include Branch, Ceridian, DailyPay, Even, Finfit, FlexWage, Gusto, Instant Financial and PayActiv.[33] Providers generally estimate the net wages due to the employee after deductions, but at least one provider has visibility into actual deductions, including any garnishments. Advances are often, but not always, limited to 50% of expected net wages. Repayment may be by payroll deduction; by offsetting incoming direct deposits to an associated debit or payroll card; by intercepting the wages through an intermediate pass-through account (which could delay receipt of wages); or, in certain circumstances, from the employee's bank account.[34]

Fake earned wage access products, *i.e.*, Earnin, discussed in the next section, have no connection to wages or time and attendance records and are repaid by debiting the bank account.

Pricing models vary. Some are free, paid for completely (or partially) by the employer, payroll provider or provider of a payroll or debit card. Some charge $1 to $2 per advance, sometimes with a weekly or biweekly cap. But workers who want their pay right away – and almost all do[35] – pay $1 to $2 more per advance for instant access. Other providers charge monthly for a package of services.

Earned wage access products are loans. While claiming to pay actual wages, earned wage access products are a form of payday loan – an advance on pay by a third party, repaid later on

[33] *See* Leslie Parrish, Aite, Making Ends Meet: On-Demand Pay and Employer-Based Loans (Feb. 2021).
[34] Bank account debits may be used when an advance is requested after payroll has closed or in states where regulatory issues preclude payroll deduction.
[35] I understand from conversations with earned wage access providers that it is common for 90% of workers to request instant access.

payday. Whether particular federal or state laws apply can be complicated,[36] but earned wage loans should generally be considered subject to lending laws, especially if there is any cost, including rate limits, licensing, and disclosure rules.

Earned wage providers characterize their products as something other than a loan, analogizing that the consumer is only paying a "convenience fee" for accessing their "own money." But employees have no right to wages until payday, and time worked is not a bank account from which the employee has the right to make withdrawals. Unpaid wages are merely an asset securing a payday advance, just as another lender might secure a loan with a car, a diamond ring or home equity. Indeed, many states explicitly characterize loans secured by wage assignments as loans.[37]

Assessing the hours the borrower has worked since the last paycheck is merely a form of underwriting. Payday lenders also evaluate whether a borrower gets a regular paycheck and when the borrower's payday will come. Indeed, payday borrowers may not take out their first loan on the day they are paid, but instead when money runs out as payday approaches – after they have worked for several days and accumulated some unpaid wages. Exemptions for earned wage providers could be exploited by conventional payday lenders.

Repayment through payroll deduction does not distinguish loans based on earned wages from other loans; it is a common method of repaying loans. Payroll automated program interfaces (APIs) are making it even easier for lenders to obtain payment: "This sort of 'voluntary garnishment' can reduce losses for lenders … [P]ulling directly from payroll puts the lender in question at the top."[38] One commentator observed that "getting consumers to agree to this voluntary garnishment via signing over access to payroll systems is going to be much easier because people have gotten used to giving Plaid, Venmo and others access to their accounts."[39]

Earned wage loan providers typically retain the right to debit future, unearned payrolls if the first is insufficient, reinforcing the fact that these are loans.[40] Most earned wage access programs do

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[36] For an analysis of the applicability of TILA, see Letter from National Consumer Law Center & Center for Responsible Lending to CFPB Direct Rohit Chopra (Oct. 12, 2021) ("NCLC CFPB EWA Letter"), https://www.nclc.org/images/pdf/banking_and_payment_systems/fintech/EWA-letter-to-CFPB_Oct-4-2021.pdf. For an analysis under California law, see Letter from National Consumer Law Center & Center for Responsible Lending to Calif. Dep't of Fin'l Prot'n & Innov. at 11-12 (Mar. 15, 2021), https://www.nclc.org/images/pdf/high_cost_small_loans/payday_loans/CRL_CA_DFPI_EWA_Comments.pdf.

[37] California, for example, defines "finance lender" to include the business of "lending money and taking … as security for a loan … any lien on, assignment of, or power of attorney relative to sages, salary, earnings, income or commission." Cal. Financial Code § 22009.

[38] Anish Acharya, Seema Amble, and Rex Salisbury, Andreessen Horowitz, The Promise of Payroll APIs (Oct. 20, 2020), https://a16z.com/2020/10/20/payroll-apis/,

[39] Timothy Ogden, Financial Access Initiative, The Weekly faiV, The Wage Garnishment Edition (Mar. 8, 2021), https://www.financialaccess.org/faiv/2021/3/8/the-wage-garnishment-edition.

[40] *See* Program Terms and Conditions ¶ 3.2 at 3, Appendix A to Compliance Assistance Sandbox Submission to CFPB from Payactiv, Inc. ("PayActiv Sandbox Submission"), https://files.consumerfinance.gov/f/documents/cfpb_payactiv_approval-request_2020-12.PDF.

not have full information about actual net wages, including garnishments, so they could be advancing pay that will not be received in the next paycheck and will have to be repaid later.

Chronic reborrowing is the norm, and fees often start small, but add up quickly. Most workers take advances multiple times a month, one or more every pay period:[41]

Company	Typical Frequency Of Use	Typical Advances Per Year*
Daily Pay	1.5 times per week	78
Even	1.4 accesses per month	17
FinFit	Limit of 1 access per pay period	24
FlexWage	1 to 4 accesses per month depending on employer settings	12 to 48
Instant Financial	4 to 5 accesses per pay period	96 to 120
Payactiv	1 to 4 accesses per pay period	24 to 96

Source: Aite.
*NCLC calculations assuming semi-monthly pay.

PayActiv, for example, has one version of its product that charges $1 per access, up to $3 for a one-week pay period, plus $1.99 per transfer to employees who want their funds instantly. Thus, at the high end, a worker who took three instant delivery advances per week could pay more than $36 per month in fees.

Moreover, those fees may buy very little. They often just help restore the paycheck to a bit less of what it would have been if the employee had not taken an advance the previous pay period. A $100 advance taken out five days before payday with a $5 fee is equivalent to a 365% APR.

[41] Leslie Parrish, Aite, Employer-Based Loans and Early Pay: Disruption Reaching Scale at 13-14 (April 2019). The typical advances per year were calculated by NCLC assuming semi-monthly paychecks.

Fees also may increase in the future, especially if these lenders secure exemptions from lending laws. Indeed, earned wage lobbyists are pushing legal interpretations and state bills that would exempt their loans from lending laws regardless of cost.

Analogies that earned wage providers make to ATM fees for accessing one's cash bear a striking resemblance to the arguments that payday lending lobbyists used decades ago to seek exemptions from usury laws. Most payday loan laws do not use the term "loan" but instead govern "deferred deposit presentment," as lenders claimed that the loans were not loans but were simply check cashing fees for post-dated checks.[42]

The CFPB's 2020 advisory opinion and sandbox approval order concluding that certain earned wage access products are not "credit" were deeply flawed and should be reversed.[43]
In late 2020, the CFPB issued an Advisory Opinion concluding that free, employer-based earned wage programs that are repaid by payroll deduction do not create "debt" and thus are not "credit" under the Truth in Lending Act (TILA).[44] The CFPB has not previously addressed the definition of "debt," which is not defined in TILA, and the CFPB took this action under an Advisory Opinion Program, adopted in 2020, that allows industry players to seek legal interpretations with no opportunity for consumers or the general public to comment.

While completely free earned wage access programs may not be covered by TILA for other reasons,[45] the slippery slope of the CFPB's flawed reasoning became clear a month later when the CFPB granted an "approval order" under the CFPB's "compliance assistance sandbox program"[46] to PayActiv.[47] The approval order found that PayActiv was not offering credit even for programs that charge fees that could reach $36 a month and that could involve the debiting of

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[42] *See* Calif. Fin. Code § 23001 (defining "deferred deposit transaction" as "a transaction whereby a person defers depositing a customer's personal check until a specific date, pursuant to a written agreement for a fee or other charge"); *See also* McGhee v. Arkansas State Bd. Of Collection Agencies, 375 Ark. 52, 289 S.W.3d 18 (2008) (Service fees authorized by Check-Cashers Act constituted "interest" subject to usury provisions of state constitution since fee was in reality an amount owed to check-casher in return for the use of borrowed money, especially when customer chose a deferred-presentment option, in which check-casher would not cash check customer wrote, in exchange for another fee).

[43] For a more detailed discussion, see Letter from National Consumer Law Center & Center for Responsible Lending to CFPB Director Rohit Chopra (Oct. 12, 2021) ("NCLC CFPB EWA Letter"), https://www.nclc.org/images/pdf/banking_and_payment_systems/fintech/EWA-letter-to-CFPB_Oct-4-2021.pdf.

[44] CFPB, Advisory Opinion, Truth in Lending (Regulation Z), Earned Wage Access Programs, 85 Fed.Reg. 79404 (Dec. 12, 2020), https://files.consumerfinance.gov/f/documents/cfpb_advisory-opinion_earned-wage-access_2020-11.pdf. TILA defines "credit" as "the right granted by a creditor to a debtor to defer payment of debt or to incur debt and defer its payment." 15 U.S.C. §1602(f). TILA does not define "debt,"

[45] The providers may not be "creditors" covered by TILA if they do not extend credit repayable in more than four installments or with a finance charge. 15 U.S.C. §1602(g).

[46] The sandbox program created in 2020 allows industry players to seek approval orders that provide immunity from the law, without any public input, even if the CFPB's interpretation of the law turns out to be wrong.

[47] *See* CFPB, Press Release, Consumer Financial Protection Bureau Issues an Approval Order to Facilitate Employee Access to Earned but Unpaid Wages (Dec. 30, 2020), https://www.consumerfinance.gov/about-us/newsroom/consumer-financial-protection-bureau-issues-an-approval-order-to-facilitate-employee-access-to-earned-but-unpaid-wages/.

future, unearned pay.[48] PayActiv has been mischaracterizing the order to imply CFPB endorsement of its products, to gain an upper hand over competitors, and to push for exemptions from state payday loan laws for its products regardless of cost.[49] As outlined in a lengthy legal analysis[50] and in a letter from 96 consumer, labor, civil rights, legal services, faith, community and financial organizations and academics,[51] the CFPB should reverse the advisory opinion and approval order, as the legal reasoning was deeply flawed and could lead to widespread evasions of both credit and fair lending laws.

Exempting fee-based earned wage programs from credit laws may stifle the trend of employers and payroll providers to provide early wage access for free. Increasingly, employers are offering early wage access for free as a benefit, covering the costs of the earned wage lender. Some payroll providers also provide free programs as part of their services. Regulating earned wage products as credit could help to encourage the trend towards free products, which otherwise have a hard time competing against those that offer services free to the employer by pushing the costs onto low-wage workers.

It is not clear if free earned wage loans, even if free, help or exacerbate money management problems. The cycle of reborrowing earned wage loans is not surprising due to their balloon-payment nature. If an expense cannot be handled with this week's paycheck, then a worker is likely to struggle with a hole in the next paycheck. The ability to spend next week's pay today, given the constant press of expenses low-wage workers face, may make it harder to stay on a budget or to cover large monthly bills like rent. Surveys may reflect consumers' belief that earned wage products help them avoid overdraft and late fees,[52] but the help may only be covering the shortfall from the previous earned wage advance. Payday loan users also report that the loans help, and many do not appreciate the costs and cycle of debt. More study is needed. The better earned wage access programs not only are free, but they do not depend on use of earned wage loans for profits and do not drive workers to use them. Instead, the loans are one option in a suite of services that includes the better options of savings and budgeting tools.[53]

Employers can play a role in helping workers manage their finances. But encouraging savings is a higher priority, and affordable small dollar installment loans may be a better option for unplanned expenses. A $200, three-month loan at 36% APR repaid semi-monthly has a $35.09 payroll deduction, costs $10.54, and is fully repaid in three months. A worker who takes a $200

[48] Under the approval order, PayActiv is permitted to charge $1 per access, capped at $3 for a one-week pay period and $5 for a biweekly pay period, plus $1.99 per instant transfer. At the high end, assuming 12 instant accesses per month, the cost would be almost $36.
[49] NCLC CFPB EWA Letter at 27-34.
[50] NCLC CFPB EWA Letter.
[51] Letter from 96 consumer, labor, civil rights, legal services, faith, community and financial organizations and academics to Director Chopra (Oct. 12, 2021), https://www.nclc.org/images/pdf/banking_and_payment_systems/fintech/CFPB-EWA-letter-coalition-FINAL2.pdf.
[52] *See* Leslie Parrish, Earned Wage Access Use and Outcomes: Findings From a Survey of DailyPay Customers (Sept. 9, 2021), https://aite-novarica.com/report/earned-wage-access-use-and-outcomes-findings-survey-dailypay-customers.
[53] But when there is a fee for that package of services, the earned wage loans may be the primary service the employee is buying, and the fee should be considered a finance charge.

wage advance and pays $5 per semi-monthly pay period, reborrowing $200 each pay period for three months, would pay $30 in fees and still have a $205 hole in the next paycheck. Used sparingly, free earned wage loans might be a tool to help workers manage expenses, but more research is needed.

4. Fake direct-to-consumer earned wage access products that debit bank accounts

The only true "earned wage" loans are through employers based on time-and-attendance records. But at least one app, Earnin, purports to offer access to wages but has no connection to payroll or the employer's time and attendance records. Instead, it uses various methods to estimate earnings and then provides payday advances that are repaid by debiting the consumer's bank account.

The lack of connection to earned wages is also apparent from the terms and conditions. Consumers must promise to ensure that there are sufficient funds in their account to repay an advance, and "Failed or rejected debits may be reinitiated at any time up to 150 days after the first debit."[54]

Overdraft and nonsufficient funds (NSF) fees can add to the costs, as Earnin's estimates of the amount or timing of expected pay can be wrong. While Earnin promises to reimburse those fees, often it has not, and Earnin paid $12.5 million to settle a class action.[55] Even after that settlement, one user complained about $180 in overdraft fees that Earnin refused to reimburse, and others have complained as well.[56]

Earnin makes money through purportedly voluntary "tips" (discussed in the next section). A $100 advance taken out one week before payday with a $10 "tip" would have an APR of 520%. Those fees can add up quickly with a cycle of reborrowing. These are simply fintech payday loans and should be regulated as such.

5. The "tips" evasion

The use of purportedly voluntary "tips" to disguise interest charges is an evasion, pure and simple, that should not be countenanced. The tips are unlikely to be truly voluntary, and the label does not change the cost to or the impact on consumers.

The "tips" model is spreading. The cost of "tips" is typically downplayed in promotions about these products implying that loans are free:

- Earnin, the fake earned wage advance app described above, advertises "no fees" to access "your paycheck."[57]

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54 https://www.earnin.com/privacyandterms/#terms.
55 Tara Siegel Bernard, New York Times, Apps Will Get You Paid Early, for a Price (Oct. 2, 2020).
56 *See* Letter from National Consumer Law Center & Center for Responsible Lending to Calif. Dep't of Fin'l Prot'n & Innov. at 11-12 (Mar. 15, 2021), https://www.nclc.org/images/pdf/high_cost_small_loans/payday_loans/CRL_CA_DFPI_EWA_Comments.pdf. Numerous other complaints are available at https://www.bbb.org/us/ca/palo-alto/profile/financial-services/earnin-1216-642613/complaints.
57 https://www.earnin.com/; https://earnin.com/privacyandterms.

- Chime, a non-bank[58] deposit account, offers "Overdraft fee-free up to $200," comparing the "$0" Chime SpotMe fees to a $34 traditional overdraft fee.[59]
- Dave, another non-bank "banking" app, advertises "up to $200 advances without paying a fee" and "no interest.[60] Dave collects "tips" and "donations," and also charges an "Optional Express Fee" of $1.99 to $5.99, depending on the amount advanced.[61]
- MoneyLion, another non-bank banking app, offers "cash advances up to $250 with no interest." MoneyLion collects "tips" plus "delivery fees" of $3.99 to $4.99 for instant delivery.[62]
- Solo is a "community" where consumers can access "short-term funds."[63] To solicit lenders, consumers first set a "lender appreciation tip."[64] The sample loans shown are 14-18 days with tips that generally equate to 260% APR, though no APR is shown.[65]

These are all balloon-payment loans, with repayment in full with the next deposit or on a short schedule. Like other balloon-payment loans, they are likely to lead to dependency and a cycle of reborrowing.

Companies can employ strategies to make it difficult not to tip or to make the consumer feel compelled to tip. Earnin users reported having their access to advances restricted if they did not tip enough.[66] Earnin appears to have changed that practice after it became public. The SoLo app – which requires consumers to designate the "tip" in advance of funding -- "notes that loans are much more likely to be funded when users tip the maximum amount."[67]

Default tip amounts are often set in advance and may be difficult to undo. An Earnin user reported being completely unable to undo the default tip, even after deleting the app and reinstalling it.[68] An article about SoLo noted that "the only way to avoid [a tip] is through a

[58] Chime was forced to stop calling itself a bank in response to state enforcement actions. *See* Anna Hrushka, BankingDive, California regulator orders Chime to stop calling itself a bank (May 6, 2021), https://www.bankingdive.com/news/california-regulator-orders-chime-to-stop-calling-itself-a-bank/599710/; State of Illinois, Dep't of Fin'l and Prof'l Reg., Settlement agreement and Consent Order, In re Chime Financial, Inc., No. 2021-DB-01 (March 25, 2021), https://www.idfpr.com/banks/cbt/Enforcement/2021/2021%2003%2025%20Chime%20-%20IL%20Settlement%20Agreement%20and%20Consent%20Order.pdf
[59] https://www.chime.com/.
[60] https://dave.com/.
[61] https://dave.com/terms.
[62] https://www.moneylion.com/instacash/.
[63] https://solofunds.com/.
[64] https://solofunds.com/borrow/ (under "Your Terms").
[65] Three examples are for a $100 loan with $10 tip for 14 days and one is a $100 loan with $6 tip for 18 days.
[66] Kevin Dugan, New York Post, Cash-advance app Earnin gets subpoenaed by NY regulator: source (Mar. 28, 2019) ("Earnin encouraged users to leave a tip of anywhere between zero and $14 on a $100 weekly loan. Users who don't leave a tip appear to have their credit restricted. Meanwhile, a $14 tip would equate to a 730-percent APR — nearly 30 times higher than New York's 25 percent cap.").
[67] Fast Company, These 2 Black founders aim to offer a fairer alternative to payday loans (Feb. 18, 2021).
[68] Conversation with Brent Adams, Woodstock Institute.

toggle in SoLo's settings menu, which must be reactivated for each request. There's no way to opt out of donations while making the request itself."[69]

Apps may also use different user interfaces to send psychological signals and encourage quick action without thought about the default tip. Disingenuous statements encourage borrowers to "pay it forward" and to support a "community,"[70] ignoring the large companies and wealthy hedge fund investors who profit from the "tips."

Even without direct messages or policies to disadvantage low tippers, consumers may believe they must make ample tips or they will be cut off – a threat to people who are caught in a cycle of debt.

The tipping model takes advantage of consumers' lack of awareness of how the tips add up, and how the price easily gets into the territory of payday loan pricing. The supposedly voluntary nature of the tips makes it easier to get sucked into a cycle of debt. As one borrower described:

> Earnin didn't charge Raines a fee, but asked that he "tip" a few dollars on each loan, with no penalty if he chose not to. It seemed simple. But nine months later, what was originally a stopgap measure has become a crutch.
>
> "You borrow $100, tip $9, and repeat," Raines, a highway-maintenance worker in Missouri, told me. "Well, then you do that for a bit and they raise the limit, which you probably borrow, and now you are in a cycle of get paid and borrow, get paid and borrow." Raines said he now borrows about $400 each pay cycle.[71]

Most borrowers likely have no idea what a high rate of interest they are paying:

> One former Earnin user, Nisha Breale, 21, who lives in Statesboro, Georgia — another state where payday lending is illegal — said she hadn't fully realized that, when converted to an annual percentage interest rate, what seemed like a small $5 tip on a $100 advance payment (repayable 14 days later) was actually equivalent to a 130 percent APR.
>
> "I definitely didn't think about the payback time and the interest," Breale, a student at Georgia Southern University, said. "They just portray it as being so simple and so easy."[72]

[69] Fast Company, These 2 Black founders aim to offer a fairer alternative to payday loans (Feb. 18, 2021) ("When requesting a loan, for instance, SoLo asks borrowers to choose a "donation" to the app on top of their tip to the lender, starting at 7% or $3.50 for new borrowers seeking $50 loans. Technically, the donation is optional, but the only way to avoid it is through a toggle in SoLo's settings menu, which must be reactivated for each request. There's no way to opt out of donations while making the request itself. Industry watchdogs have also raised concerns about the tipping model. While SoLo's tips are also voluntary, and about 7% of loans funded on the platform involve no tipping at all, the app notes that loans are much more likely to be funded when users tip the maximum amount. Between tips and donations, users may end up paying a rate that's not much more favorable than payday loans, even if the model for late payments is less predatory.").

[70] https://www.chime.com/spotme/.

[71] Sidney Fussell, The Atlantic, The New Payday Lender Looks a Lot Like the Old Payday Lender (Dec. 18, 2019).

[72] Cyrus Farivar, NBC News, Millions use Earnin to get cash before payday. Critics say the app is taking advantage of them. (July 26, 2019).

A small number of users may manage to use tip-based services for free. But for-profit enterprises counting on tips as a profit center, with investors who need a significant return on investment, will not put up with a lot of non-paying users.

Regulators cannot be expected to constantly monitor the subtle and not so subtle back-end ways that companies will make sure that the vast majority of their borrowers tip. When caught using practices to coerce tips, companies may change their policies, but they will devise new ways to ensure that they get paid. Allowing lenders to escape credit laws whenever they claim that interest payments are voluntary will only lead to a game of whack-a-mole.

Using the "tips" label does not make a high-cost balloon-payment payday loan any less dangerous and any less likely to lead to a cycle of debt and reborrowing. Nor should claims that high interest charges are "voluntary" allow a loan to evade lending laws or exceed interest rate limits, whether under the federal[73] or state[74]laws. Regulators must put a stop to the tips model before it spreads further.

6. **Collection of consumer data**

Many fintech credit products collect consumer data. It is not always clear whether that data is being used or shared in ways that consumers do not expect and would not allow. The ultimate goal of acquiring consumers may also be obscure. The business model presented may not be the long-term game plan, which instead may be to harvest data or pitch other products.

As one report explained, the "most prevalent misconception across banks and traditional players is that shopping apps offering 'buy now, pay later' (BNPL) solutions are pure financing offerings.... The largest players are steadily building scale and engagement with an aspiration to become a 'super app,' similar to large China-based players such as TMall or Ant Group, that offer shopping, payments, financing, and banking products in a single platform. These large

[73] As the Federal Reserve Board stated before authority over TILA was transferred to the CFPB: "The Board has generally taken a case-by-case approach in determining whether particular fees are 'finance charges,' and does not interpret Regulation Z to automatically exclude all 'voluntary' charges from the finance charge." 61 Fed. Reg. 49,237, 49,239 (Sept. 19, 1996). The Military Lending Act generally, with some exceptions, relies on TILA's definition of "credit" and "finance charge."

[74] As California Chief Justice Roger Traynor explained:

> "The theory of (the Usury) law is that society benefits by the prohibition of loans at excessive interest rates, even though both parties are willing to negotiate them. Accordingly, 'voluntary' payments of interest do not waive the rights of the payors. 'Payments of usury are not considered voluntary, but are deemed to be made under restraint.' (Citation.) If no loophole is provided for lenders, and all borrowers save fraudulent ones are protected, usurious transactions will be discouraged."

Stock v. Meek, 35 Cal.2d 809, 817, 221 P.2d 15, 20 (1950) (citing cases); *accord* Hardwick v. Wilcox, 11 Cal.App.5th 975, 988-89 (2017); Buck v. Dahlgren, 100 Cal.Rptr. 462 (Ct. App. 1972); Heald v. Friis-Hansen, 52 Cal.2d 834, 837, 345 P.2d 457, 459 (1959) ("In the absence of fraud by the borrower, the parties to a usurious transaction are not in pari delicto, and, where a loan agreement calls for usurious interest, the borrower may recover any interest paid.").

providers already monetize consumer engagement through offerings other than financing (for example, affiliate marketing, cross-selling of credit cards and banking products)."[75]

The Gramm-Leach-Bliley Act provides some, but inadequate, limits on the ability to share data, and also imposes security standards to safeguard information, which the FTC recently strengthened. The Fair Credit Reporting Act also may be implicated depending on how and what data is collected, used or expected to be used. Regulators must keep an eye out for inappropriate collection, use and safeguarding of data, and Congress should update our inadequate privacy laws.

7. **Disparate impacts on communities of color and evasions of fair lending laws.**

New technologies can impose disparate impacts on communities of color and other disadvantaged people. But evasions of credit laws could also result in evasions of fair lending laws.

Many of the products discussed in my testimony are aimed at or used by people who are struggling to manage their finances paycheck to paycheck, have blemished credit histories, or are concerned about managing debt or credit.

These consumers will disproportionately come from Black and other communities that have been deprived of assets, income and affordable credit options due to centuries of discrimination and systemic racism that continues today. They are best served by fair, transparent and affordable forms of credit, not those with unaffordable balloon payments that lead to a cycle of debt, hidden and multiplying fees, or credit not based on ability-to-repay that increases unmanageable debt loads.

New forms of credit that rely on new technologies may also use alternative forms of data, algorithms and other technologies to market to and review consumers. These technologies also can result in disparate impacts that further harm disadvantaged communities.

It is essential that our anti-discrimination laws apply fully to new financial products and new technologies. Yet lenders whose products are styled to evade credit laws may also argue that they are not covered by fair lending laws. The Equal Credit Opportunity Act (ECOA) uses a similar (though somewhat broader) definition of "credit" to TILA's. Some products – like buy now pay later – may be clearly covered under ECOA's definition even if they are outside of TILA's.[76] But for some other products, the same arguments used to claim that TILA does not apply could be

[75] McKinsey & Company, Buy Now, Pay Later: Five Business Models to Compete (Jul. 29, 2021), https://www.mckinsey.com/industries/financial-services/our-insights/buy-now-pay-later-five-business-models-to-compete.

[76] Under ECOA, credit "means the right granted by a creditor to a debtor to defer payment of debt or to incur debts and defer its payment or to purchase property or services and defer payment therefor." 15 U.S.C. §1691a(d). This definition includes a second prong – the right "to purchase property or services and defer payment therefor" – that is absent from TILA. In addition, the term "creditor" has a broader definition under ECOA than under TILA, not tied to a finance charge or four installments. *Compare* Reg. B, 12 C.F.R. §1002.2(l) *with* Reg. Z, 12 C.F.R. § 1026.2a)(17).

used against ECOA coverage. That is yet another important reason why evasions of our consumer protection laws must not be tolerated.

8. Recommendations

Whatever form credit takes, certain fundamental consumer protections are important:

- Interest rate limits;
- Price transparency and the ability to compare the cost of different forms of credit using a single metric, the APR;
- Responsible underwriting and affordable loan structures to ensure that consumers have the ability to repay the credit without reborrowing while meeting other expenses;
- Protection when there is a problem with the product or service financed and the consumer did not get what they paid for;
- Transparent, safe and fair use of consumers' data;
- Fair lending and the assurance that new forms of credit and underwriting models will not have disparate impact on disadvantaged and protected communities;
- Supervision and oversight to ensure compliance with the law and to prevent unfair, deceptive or abusive practices.

Unfortunately, many of these fundamentals are missing in new forms of credit. To remedy these gaps, my recommendations are:

1. **Newer financing and cashflow products should be viewed as credit and subject to federal and state lending laws**, including TILA, the Military Lending Act, state interest rate laws and other lending laws. The CFPB should rescind or significantly limit its recent actions on earned wage access products. Legislators and regulators should not carve loopholes in lending laws to exempt old wine in new bottles.

2. **Regulators should closely examine and crack down on evasive pricing models**, with interest charges hidden in purportedly voluntary "tips," late fees, inflated "expedite fees," or other obscure or back-end forms of pricing. Profit models built on penalty fees should be viewed as unfair, deceptive and abusive.

3. **All forms of credit should be based on ability-to-repay and should have affordable repayment structures.** Not every loan requires extensive underwriting, and new technologies and data are making it easier to assess whether a consumer can afford to take on additional debt. Regulators should discourage balloon-payment loans that merely put consumers in a cycle of debt without providing additional liquidity. Business models that primarily derive profits from consumers who do not have the ability to repay credit are unfair, deceptive or abusive.

4. **Products promoted at the point of sale should have chargeback protections, reasonable and proportional penalty fees, ability-to-repay, and statements.** These protections apply to credit cards, and they are important for BNPL loans as well. Consumers presented with multiple payment options at the point of sale should not have to be consumer law experts. They should be confident that whatever payment method they choose will be safe.

5. **The CFPB should begin supervising providers of fintech credit products** to ensure compliance with the law and to prevent unfair, deceptive or abusive practices. The CFPB can use its supervision authority over payday lenders and its ability to designate and supervise the larger participants in particular markets. Even generally responsible and useful credit products need oversight. Products may not always perform as they appear, and the long- term game plan with consumers may change.

6. **Regulators should ensure that data is used in ways consumers expect**, and Congress should improve privacy laws.

7. **Regulators should look out for disparate impacts** posed by fintech credit products. Any product aimed at people who have difficulty making it from paycheck to paycheck or accessing mainstream credit will disproportionately impact communities of color and other disadvantaged people. It is critical to ensure that those communities not be exploited by products that put them farther behind.

Thank you for the opportunity to testify. I would be happy to answer your questions.

Testimony of Brian Tate
President and CEO of the Innovative Payments Association
Before the House Financial Services Committee Task Force
on Financial Technology
on
Investigating Risks and Benefits of BNPL and
Other Emerging Fintech Cash Flow Products

Tuesday, November 2, 2021

Chairman Lynch, Ranking Member Davidson, and members of the Task Force on Financial Technology, my name is Brian Tate, and I am the President and CEO of the Innovative Payments Association (IPA).

It is my privilege to appear before you today to share IPA's views on emerging Fintech cash flow products with specific emphasis on the use of earned wage access services.

IPA is a non-profit trade association that serves as the leading voice of the electronic payments sector, including prepaid products, mobile wallets, and P2P payments. IPA's mission is to encourage efficient use of electronic payments, cultivate financial inclusion, and empower consumers.

As we have learned throughout the pandemic, even the best laid plans cannot always protect families from unexpected financial disruptions.

The Federal Reserve's 2018 Survey of Household Economics found that 40% of American households would struggle to come up with $400 to pay for an unexpected bill. Many consumers have few options should they face an unexpected expense between paydays, and the traditional options have proven to be expensive.

The U.S. Department of Labor reports nearly two-thirds of U.S. businesses pay their workers on a bi-weekly, semi-monthly, or monthly schedule, which means that workers are, in essence, giving their employers an interest-free loan. A study by the Financial Health Network found that 38% of respondents reported timing mismatches between wage income and expenses.

During the past ten years, the payment innovators have developed new services and products to help consumers meet these timing mismatches. One of the most practical and affordable options is Earned Wage Access, or EWA. Simply put, EWA programs allow consumers to access their own money prior to payday.

Getting paid daily is not a new concept. Many Americans, including wait staff, taxi drivers, and bartenders, can get paid at the close of their shifts.

The two former leaders of the CFPB – Directors Cordray & Kraninger – didn't agree on much, but both took concrete steps to support EWA. Director Cordray exempted employer-sponsored programs from his 2017 payday lending rule. And Director Kraninger issued an advisory opinion explaining that certain EWA programs are not credit. IPA agrees with both Cordray and Kraninger and maintains that EWA products are not loan or credit products, Therefore, they should not be subject to TILA.

The Financial Health Network's report on EWA found consumers in financial distress may consider title, payday, or pawn loans as options. With the average cost per EWA transaction ranging between $2.59 - $6.27, the report makes it clear that EWA is far less costly than those other options.

EWA has grown in popularity because it is a safer, cheaper, and more efficient alternative to other short-term products on the market. EWA providers do not impact customers' credit ratings and they do not share information to credit reporting agencies. EWA is offered with no recourse and providers have no rights against the user in the event of nonpayment, loss of employment, closed accounts, or blocked payments. These are non-recourse transactions, which means the risk of loss is on the provider.

As someone who has been working since the age of 14, I can easily relate to a retail worker, single parent, or young adult facing a financial emergency and lacking easy access to short-term liquidity. At different points in my life, I have walked in the same shoes as millions of Americans who find themselves unable to pay for a utility bill, childcare, or an unexpected medical expense.

Treating EWA as credit would be a mistake and would remove a valuable tool from consumers' financial toolkit.

Thank you for the opportunity to present the views of the IPA and I welcome any questions the Task Force may have.

Testimony of Marisabel Torres
Director, California Policy
Center for Responsible Lending

Before the U.S. House Committee on Financial Services – Task Force on Financial Technology
"Buy Now, Pay More Later? Investigating Risks and Benefits of BNPL and Other Emerging Fintech Cash Flow Products"

November 2, 2021

I. Introduction and Overview

Good morning Chairman Lynch, Ranking Member Davidson, Chairwoman Waters, Ranking Member McHenry, members of the Task Force, and members of the Committee. I am Marisabel Torres, Director of California Policy for the Center for Responsible Lending (CRL). Thank you for the opportunity to testify today.

CRL is a nonprofit, non-partisan research and policy organization dedicated to protecting homeownership and family wealth by working to eliminate abusive financial practices. CRL is an affiliate of Self-Help, one of the nation's largest nonprofit community development financial institutions. For 40 years, Self-Help has created asset-building opportunities for low-income individuals, rural communities, women, and families of color. In total, Self-Help has provided over $9 billion in financing to 172,000 homebuyers, small businesses, and nonprofit organizations and serves more than 160,000 mostly low-income families through 72 credit union branches in North Carolina, California, Florida, Illinois, South Carolina, Virginia, Washington, and Wisconsin.

We appreciate the Task Force's focus on emerging, rapidly growing products marketed as solutions to managing cash flows or access to affordable credit. Like many fintech platforms, these providers offer consumers something that appears new, inviting, even altruistic. But often, "innovation" in the financial space is more about shiny packaging than fundamental changes to age-old financial products. And often, those age-old financial products have long been, and thus remain, predatory. We are particularly concerned that without vigilant monitoring and appropriate regulation, products that promise to promote financial inclusion may exacerbate financial exclusion. This risk is especially high where fintechs rent a bank charter in an effort to evade state law.

Buy now, pay later may indeed be a preferred way for some to purchase goods. But there are clear concerns about the affordability of loans in this market. **Earned wage access** loans – those actually integrated with the employer and repaid only via deduction from future pay, without providing the lender access to the checking account – are far preferable to payday loans but still pose risks and should not be given a regulatory free pass to evolve outside of the regulation of credit. **Faux earned wage access** loans – where the lender repays itself from the borrower's checking account – are, for all intents and purposes, payday loans and should be regulated as such. **"Overdraft avoidance"** products also pose risks by accessing the borrower's checking account and should be regulated as credit.

Our top-line recommendations are as follows:

- **Buy Now, Pay Later (BNPL):**
  - CFPB should use its market monitoring authority to collect, analyze, and publish data from the largest providers (anonymized) to better identify risks within the market.
  - CFPB should also issue a larger participant rule to define the market and then actively supervise large BNPL lenders to ensure, at a minimum, that they are not engaged in unfair, deceptive, or abusive acts or practices or unlawful discrimination.
  - CFPB should ultimately ensure that BNPL lenders make loans only after determining the borrower's ability to repay, considering both income and expenses or obligations, and that these lenders are not charging unfair fees.
  - States should require BNPL lenders to obtain state licenses and consider collecting data to better illuminate the risks involved in these programs.
- **Earned Wage Access (EWA):**
  - CFPB should repeal or significantly amend its actions concluding that certain EWAs are not credit (see October 2021 letter from the National Consumer Law Center (NCLC) and CRL);[1]
  - States should generally regulate EWA programs under their state credit laws.
- **Faux EWA and "overdraft avoidance" apps:**
  - CFPB should supervise these lenders pursuant to its authority under Dodd-Frank to supervise payday lenders regardless of their size;
  - States should regulate these lenders under their state credit laws;
  - CFPB and states should affirm that "tips" on extensions of credit are evasive attempts to disguise interest charges;
  - CFPB and states should monitor use of "participation fees" to ensure they are not being used to evade regulation as credit.

II. Buy Now, Pay Later

Buy Now, Pay Later (BNPL) loans are typically designed in a way that may precisely avoid coverage under the Truth in Lending Act (TILA).[2] That law excludes from the definition of "creditor" one who extends credit that doesn't require a finance charge and is repayable in four or fewer installments. BNPL products are typically structured with no finance charge and as repayable in no more than four installments. The fact that this appears to be a "free credit" product raises the question: What's the catch?

It turns out there are a number of catches – some demonstrable, some potential – which require regulatory attention and response. We address these in subsection B. below.

Our discussion of concerns is not to disregard that – for borrowers who have the ability to repay – BNPL may be preferable to a credit card or other forms of borrowing. U.S. consumers with revolving credit

[1] *See* Letter from National Consumer Law Center & Center for Responsible Lending to CFPB (Oct. 12, 2021), https://www.responsiblelending.org/sites/default/files/nodes/files/research-publication/crl-nclc-ewa-letter-to-cfpb-oct2021.pdf.

[2] BNPL loans could fall under TILA if they are structured to hide a finance charge or if they are deemed analogous to charge cards.

card debt pay over $100 billion annually in related interest and fees.[3] These consumers tend to be those without the means to pay off their entire balance each month and find themselves in debt month after month for years on end. To the extent no- or low-cost installment loans could offer responsible closed-end credit that consumers pay off within a reasonable time period, consumers may indeed benefit substantially. But it is imperative that these loans be responsible and the payments affordable – and not just the interest rate, which may be zero percent, but the principal. Otherwise, these loans will often simply pile unsustainable debt onto debt burdens consumers are already struggling to manage. And without at least regulatory oversight, we can only hope for responsible, affordable lending.

A final introductory note: We are wearied by the now-familiar claim, particularly among many occupying the "fintech" space, that extending credit, without any accompanying requirement that it be affordable, promotes financial inclusion. **Unaffordable credit may provide a quick inflow of cash, but it exacerbates financial exclusion over the longer term which, in the case of BNPL, can be just a few weeks or months down the road.** And a number of incentives in the BNPL space make it particularly susceptible to unaffordable lending.

A. BNPL is exploding, so risks present on a large and growing scale.

As has been widely reported, the BNPL market has exploded over the last year or two, with data suggesting it has increased anywhere from 200% to 350% over the last year.[4] Afterpay's November 2021 sales were more than double those a year earlier.[5] One survey found that 42% of American consumers have used BNPL.[6] The valuations of the major BNPL firms are in the tens of billions of dollars. Projections show BNPL reaching 10% of all e-commerce dollar volume by 2024:

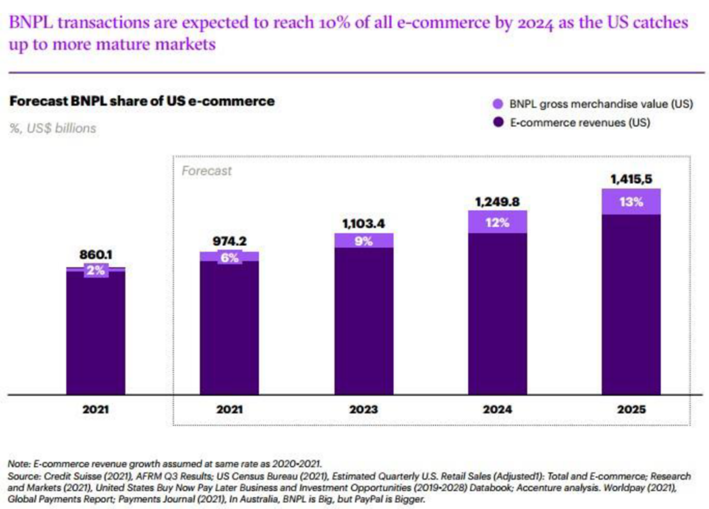
[3] Financial Health Network, The FinHealth Spend Report 2021, at 27, https://s3.amazonaws.com/cfsi-innovation-files-2018/wp-content/uploads/2021/04/19180204/FinHealth_Spend_Report_2021.pdf.

[4] Cardify, Covid-19 and the surge of "buy now, pay later" (July 29, 2020), https://www.cardify.ai/reports/buy-now-pay-later; Kate Fitzgerald, *Missed payments don't faze new buy now/pay later lenders*, American Banker, Sept. 17, 2021, https://www.americanbanker.com/news/missed-payments-dont-faze-new-buy-now-pay-later-lenders?position=editorial_2&campaignname=AB%20Daily%20Briefing-09202021&utm_source=newsletter&utm_medium=email&utm_campaign=V2_AB_Daily_2021%2B%27-%27%2B09202021&bt_ee=nGfLaLr2vIJND2KI3HAiDNOjCYfFNKMqHuorZKCNJNBjX8N7b5T9YololuV%2FB6GO&bt_ts=1632142941186.

[5] Penelope Wang, *The Hidden Risks of Buy-Now, Pay-Later Plans*, Consumer Reports, Feb. 14, 2021, https://www.consumerreports.org/shopping-retail/hidden-risks-of-buy-now-pay-later-plans-a7495893275/ ("Consumer Reports, 2021").

[6] Nelson Akeredolu, Andrew Braden, Joshua Friedman, and Laura Udis, CFPB, *Should you buy now and pay later?* (July 6, 2021), https://www.consumerfinance.gov/about-us/blog/should-you-buy-now-and-pay-later/ (citing Credit Karma/Qualtrics survey, https://www.creditkarma.com/insights/i/buy-now-pay-later-missed-payments) ("CFPB, BNPL 2021").

Figure 1:



SOURCE: Accenture (Commissioned by Afterpay), The Economic Impact of Buy Now, Pay Later in the U.S. (Sept. 2021)[7]

California regulatory data released earlier this month – which the state has collected after wisely determining that BNPL lenders are making "loans" within the state and requiring them to be licensed as consumer finance lenders (discussed further below) – show a "surge" in BNPL lending.[8] The top six BNPL lenders in California accounted for 10.9 million, or 91%, of the 12 million total consumer loans originated in the state in 2020.[9]

Thus, it is clear that to the extent there are risks within the BNPL market, they exist on a wide and growing scale.

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[7] Accenture (Commissioned by Afterpay), The Economic Impact of Buy Now, Pay Later in the US, at 13 (Sept. 2021), https://afterpay-corporate.yourcreative.com.au/wp-content/uploads/2021/10/Economic-Impact-of-BNPL-in-the-US-vF.pdf ("Accenture (Commissioned by Afterpay)").

[8] Ca. Dept. of Financial Protection and Innovation, Annual Report of Finance Lenders, Brokers, and PACE Administrators Licensed Under the California Financing Law, at 2 (2020), https://dfpi.ca.gov/2021/10/07/dfpi-report-shows-changes-in-consumer-lending-decrease-in-pace-program/.

[9] *Id.*

B. Causes for concern with BNPL

1. Unaffordable loans

BNPL lenders do not engage in traditional underwriting.[10] They generally verify identity and require a debit card or credit card to make payments and run a "soft" credit check but not a hard credit inquiry.[11] Lenders often also check the consumer's performance history with that particular lender. Several factors suggest that BNPL loans are not meaningfully underwritten for ability-to-repay, resulting in unaffordable loans:

- Rates of bad debts: Data out of Australia (which has the same largest BNPL market provider as the U.S.) found that, among its eight largest BNPL lenders, bad debts amounted to 30% of revenues.[12]

- Rates of delinquency: According to a Reuters-commissioned survey released in September, more than a third of BNPL borrowers had fallen behind on one or more payments.[13] A 2020 study found that 43% had fallen behind, although two-thirds said the reason was having lost track of payments (another risk with BNLP loans) rather than lack of funds.[14]

- Provider access to payment devices reduces incentives to underwrite: BNPL lenders typically require a debit card or credit card to be linked to the borrower's account, against which the lender applies payments. They likely encourage large portions of customers to enroll in auto-pay to avoid missing payments. Reliance on autopay reduces incentives to underwrite since the lender can expect to debit the account even when the borrower may not have sufficient funds.

  Notably, some BNPL providers also permit repayment via credit card. For those with revolving credit outstanding on their cards, these charges will begin to accrue interest from the day they post, and the so-called "free" BNPL loan will not, in fact, be free. This practice – essentially using a credit card to pay off other debt – is one that credit card issuers often don't permit with traditional credit card debt. For example, Visa and Mastercard do not permit a credit card to be paid off with a different credit card. The practice is prohibited for certain debts like federal student loans.[15] This BNPL practice prompted one major credit card issuer to stop processing

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[10] CFPB reports that BNPL providers only require that the borrower be at least 18 years old, have a mobile phone number, and have a debit or credit card to make payments, and ensure they can validate the borrower's identity, CFPB, BNPL 2021.

[11] *Id.*

[12] McLean Roche Consulting Group, Global Payments 2020-30, A seismic shift in the next ten years, Submission to Treasury Inquiry, at 37, https://treasury.gov.au/sites/default/files/2021-02/147719_mclean-roche_0.pdf.

[13] Anna Irrera, *As 'buy now, pay later' surges, a third of U.S. users fall behind on payments*, Reuters, Sept. 9, 2021, https://www.reuters.com/technology/buy-now-pay-later-surges-third-us-users-fall-behind-payments-2021-09-09/ (reporting on an August 2021 Qualtrics survey of 1,044 adults on behalf of Credit Karma).

[14] Consumer Reports, 2021.

[15] *See*, *e.g.*, https://www.chase.com/personal/credit-cards/education/basics/can-you-pay-off-a-loan-with-a-credit-card.

credit card payments to BNPL lenders, noting that BNPL loans can be risky for the consumer and the bank.[16]

- Multiple BNPL loans, potentially across BNPL lenders: One survey found that Quadpay and Sezzle borrowers average four-to-five transactions per month; Afterpay and Klarna borrowers four per month; Affirm borrowers two per month.[17] Without credit reporting (discussed further below), the borrower's BNPL debts across lenders are not aggregated anywhere and, even with credit checking, lenders (BNPL or other lenders) have no lens into how much BNPL debt borrowers are carrying. There are reports in the U.K. of retailers offering five different BNPL deals for the same purchase, which the consumer could use cumulatively to amass the amount of credit needed to make the single purchase.[18]

- Buying more with BNPL than without: One survey found that nearly half of BNPL borrowers spent 10-40+ percent more using BNPL than with a credit card.[19] Indeed, as discussed further in the following section, the BNPL business model relies on merchant payments which presumably merchants are willing to make because they see more or larger purchases resulting.

- Lending to those who may lack capacity for more credit: Those who cannot qualify for other credit – whom some BNPL lenders claim to be helping especially – often do not qualify for other credit because they have been overburdened by credit already and cannot afford to repay more credit.[20]

Of note, earlier this year, the U.K. Financial Conduct Authority (FCA) announced plans to supervise BNPL providers, and reforms contemplated included requiring hard credit checks and affordability assessments.[21] Just this month, major BNPL lender Klarna announced it will give consumers the option

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[16] Byron Kaye, *Capital One stops 'risky' buy-now-pay-later credit card transactions*, Reuters, Dec. 7, 2020, https://www.reuters.com/article/us-capital-one-fin-payments/capital-one-stops-risky-buy-now-pay-later-credit-card-transactions-idUSKBN28H0OR?il=0. Capital One has since announced it will test its own BNPL product but has not changed its practice of not permitting BNPL lenders to charge against its credit card.

[17] Cardify, Convenience, Debt, and Novelty: Analyzing BNPL Consumer Data (Sept. 8, 2021), https://www.cardify.ai/reports/bnpl-trend-report.

[18] Matthew Vincent, *FCA calls for full regulation of 'buy now, pay later' credit: UK financial watchdog finds 'significant potential' for consumer harm*, Financial Times, Feb. 2, 2021, https://www.ft.com/content/2c9bd737-80a6-45d7-a7f3-bf672850b3bd.

[19] Consumer Reports, 2021 (citing Cardify.ai survey).

[20] *See, e.g.*, Which?, Under Pressure: Who uses BNPL, Policy Report, at 24 (May 2021) (explaining why some BNPL borrowers may use BNPL because they believe they cannot access other forms of credit: "It may also be that BNPL brands make credit available to people for whom other forms of credit are not affordable.").

[21] Matthew Vincent, *FCA calls for full regulation of 'buy now, pay later' credit: UK financial watchdog finds 'significant potential' for consumer harm*, Financial Times, Feb. 2, 2021, https://www.ft.com/content/2c9bd737-80a6-45d7-a7f3-bf672850b3bd.

to share bank account transactional data that Klarna will use to determine their ability to repay.[22] While we are skeptical that establishing this policy as optional is likely to lead to the dramatic change needed in assessing affordability in the BNPL space, the policy illustrates the feasibility of BNPL lenders' conducting meaningful underwriting.[23]

The consequences of unaffordable BNPL loans can be severe. When the borrower's BNPL loan is linked to a bank account that lacks sufficient funds for payment, the BNPL lender's payment attempts will typically trigger highly punitive non-sufficient funds (NSF) and/or overdraft fees. These fees in turn are highly associated with closed bank accounts and exclusion from the financial system. Or, the borrower may have sufficient funds for the BNPL payment but then be left without sufficient funds for other essential living expenses or debts.[24] And many BNPL providers charge their own late or returned payment fees on top of the fees charged by banks.

2. Merchant subsidy-driven business model, today and as competition increases

The BNPL business model is driven by BNPL lenders' relationships with merchants. Afterpay, for example, reportedly earns 3-6% of the purchase price plus a $0.30 fee per transaction[25] (significantly more than credit card interchange fees).[26] BNPL lenders market themselves to the merchant on the basis that their partnership will drive increased sales volume. A report commissioned by the U.K. FRA reports that, anecdotally, some BNPL providers claim they will increase sales by 30%.[27] It notes that Klarna refers to "increased conversion" rates to describe shoppers who complete purchases.[28] Afterpay boasts estimates that it drove $8.2 billion in new sales revenue for merchants in 2021 (representing an 11% increase in profit margin); that the average Afterpay merchant obtains almost 13% more new customers; and that "basket sizes [i.e., shopping carts] are 17% higher in value" than before Afterpay:[29]

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[22] Ryan Browne, *Klarna strengthens credit checks in the UK as regulators crack down on 'buy now, pay later'*, CNBC, Oct. 18, 2021, https://www.cnbc.com/2021/10/17/klarna-tightens-credit-checks-in-uk-ahead-of-buy-now-pay-later-rules.html.

[23] *Id.*

[24] One major U.K. bank reported that, in November 2020, 10% of its customers who had made a payment to two large BNPL providers had exceeded their overdraft allowance in the same period. Financial Conduct Authority, The Woolard Review – A review of change and innovation in the unsecured credit market, at 49 (Feb. 2, 2021), https://www.fca.org.uk/publication/corporate/woolard-review-report.pdf ("Woolard Review").

[25] Tristan Rose, *How Does Afterpay Make Money (Business and Revenue Model)* (Oct. 7, 2021), https://entrepreneur-360.com/how-does-afterpay-make-money-13180.

[26] Brian Riley, *The Buy Now Pay Later Merchant Proposition: Credit Card Interchange Is Cheaper*, Mar. 26, 2021, https://www.mercatoradvisorygroup.com/Templates/BlogPost.aspx?id=9029&blogid=25506.

[27] Woolard Review at 47.

[28] *Id.*

[29] Accenture (Commissioned by Afterpay) (data and graphic on following page).

Thus, there is concern that the entire business model rests on driving borrowers to purchase items they would not otherwise buy, which is concerning in and of itself and even more so when coupled with lack of underwriting for affordability.

Another risk is that merchants may seek to recoup the charges they pay BNPL lenders through hidden charges in the form of inflated prices and/or extra fees on BNPL purchases.

Moreover, as this market continues to grow, increased competition may create downward pressure on the merchant subsidy. This raises questions about whether lenders will seek to compensate for lower merchant subsidies, either through the interest rate, or through additional fees, or by more aggressively pushing purchase volume without affordability assessments.

3. Reliance on late fees, for some providers

Some BNPL lenders charge late fees.[30] For example, Afterpay charges late fees of the lesser of $8 or 25% of the purchase.[31] A report out of Australia found that Afterpay's total late fees were "very high," amounting to up to 68% APR.[32]

One U.K. survey found that about 20% of respondents had missed a payment,[33] and substantial portions of those borrowers, as reflected in the chart below, reported having been charged a late fee, as well as receiving a letter from a debt collection agency or being visited by debt collectors:

[30] CFPB, BNPL 2021.

[31] Trina Paul, *Afterpay review: Everything you need to know about this short-term 'buy-now, pay later' option*, CNBC, Oct. 31, 2021, https://www.cnbc.com/select/afterpay-review/.

[32] McLean Roche Consulting Group, Global Payments 2020-30, A seismic shift in the next ten years, Submission to Treasury Inquiry, at 39, https://treasury.gov.au/sites/default/files/2021-02/147719_mclean-roche_0.pdf.

[33] *See*, *e.g.*, Which?, Under Pressure: Who uses BNPL, Policy Report, at 21 (May 2021).

Figure 2:

Table 2: Breakdown of consequences BNPL users who had missed a payment claimed to have experienced, by brand

	Klarna	ClearPay	Laybuy	OpenPay	Payl8r	Flava
Base	138	100	74	86	64	65
I have had my account blocked and/or suspended	37%	39%	47%	51%	48%	49%
I was charged a late fee	Not applicable	54%	57%	58%	53%	Not applicable
I received a letter from a debt collection agency	51%	39%	51%	49%	64%	Not applicable
I was visited by debt collectors	39%	34%	43%	55%*	55%	Not applicable
My credit rating was damaged	Not applicable	42%	54%	Not applicable	55%	Not applicable

SOURCE: Which?, Under Pressure: Who Uses BNPL, Policy Report (May 2021)[34]

4. Evasion of state credit laws

Though BNPL loans may skirt TILA regulation, many state laws define credit more broadly. The California Department of Business Oversight (DBO) brought enforcement actions against three BNPL lenders for making loans within the state without obtaining the required license. The agency found that the lenders' practice of purchasing purported credit sales contracts from merchants (rather than registering as consumer finance lenders and explicitly lending themselves) was "structured to evade otherwise applicable consumer protections."[35] Settlements with these lenders collectively resulted in refunds of fees of approximately $1.9 million.[36]

DBO also issued a legal opinion concluding that BNPL products are indeed "loans" under the California Financing Law, since the Civil Code defines a loan as "a contract by which one delivers a sum of money to another, and the latter agrees to return at a future time a sum equivalent to that which they

[34] *Id.* at 23.

[35] https://dfpi.ca.gov/2020/03/16/point-of-sale-lender-afterpay-agrees-to-cease-illegal-loans-pay-refunds-in-settlement-with-the-department-of-business-oversight/; https://dfpi.ca.gov/2020/01/16/point-of-sale-lender-sezzle-agrees-to-cease-illegal-loans-pay-refunds-in-settlement-with-the-california-department-of-business-oversight/.

[36] https://dfpi.ca.gov/2020/04/22/point-of-sale-lender-quadpay-agrees-to-cease-illegal-loans-pay-refunds-in-settlement-with-the-california-department-of-business-oversight/.

borrowed."[37] BNPL lenders then typically obtained consumer finance licenses in California during 2020 and, as a result, the California Department of Financial Protection and Innovation was able to begin gathering data.

5. Dispute protections

Unlike a credit card, BNPL does not provide dispute protections, and product returns can be complicated. Even if a borrower returns an item financed through a BNPL loan, the borrower may have to keep paying the BNPL lender at least until the merchant and lender sort out the return.

6. Interaction with credit reporting

Most BNPL lenders do not report repayment to credit reporting agencies.[38] As a result, BNPL does not typically enable people to build or improve credit scores. When BNPL lenders do report to credit bureaus, late payments may negatively affect credit history.[39] One survey found that of the 38% of BNPL borrowers who responded that they had missed a payment, 72% saw their credit scores decline thereafter.[40]

Another effect of lack of reporting is that regulated providers that do check credit reports will not see a BNPL borrower's full credit picture, complicating the ability of other credit providers to make informed credit assessments. Indeed, those BNPL lenders that check a credit report before making a loan typically do a so-called "soft pull," which means that other creditors will not even see that there was an application for credit.

7. Targeting youth market

A number of studies show that BNPL is much more prevalent among younger consumers than older consumers. One study found that of those who participated in a BNPL program last year, 27% were aged 19 to 25, while 48% were 26 to 34.[41] Another study found that nearly half of Gen Z consumers (roughly

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[37] https://dfpi.ca.gov/2019/12/30/dbo-denies-lending-license-sought-by-unregulated-point-of-sale-financer-and-issues-related-legal-opinion/. The opinion acknowledges that BNPL contracts bear similarities to retail installment sales contracts, which are not loans, but concludes based on its analysis of a range of factors that the substance of the BNPL transaction is a loan. These factors include the intent of the parties, whether the merchant and third party are closely related or have a preexisting relationship, whether the third party assumes the contract at the point of sale or later, whether the third party determines eligibility for the contract, and whether the transaction would be regulated under another law.

[38] CFPB, BNPL 2021.

[39] *Id.*

[40] Gaby Lapera, *72% of Americans saw their credit scores drop after missing a 'buy now, pay later' payment, survey finds*, Feb. 8, 2021, https://www.creditkarma.com/insights/i/buy-now-pay-later-missed-payments.

[41] Consumer Reports, 2021 (citing Cardify.ai).

age 18-24) had used BNPL to pay for purchases of $100 or less.[42] It also found that more than half of Gen Z or millennials (roughly 18-30 years old) had missed at least one payment.[43]
BNPL could be saddling young people with unaffordable debt, with long-term consequences. A UK case study concluded that BNPL marketing "overwhelmingly draw[s] on images of young people, and typically young women."[44] The CA DBO found that Afterpay, "[l]ike other point-of-sale financers, targets young consumers who are unable to qualify for traditional financing options like credit cards."[45]

8. Fair lending concerns

To the extent BNPL loans are underwritten, the process is largely if not exclusively algorithmically driven. It is thus subject to algorithmic bias, which reinforces the need for data and oversight to identify and address any fair lending concerns.

C. Recommendations addressing BNPL

Whether or not BNPL is subject to TILA, CFPB has broad authority to identify and address risks it poses to consumers. The CFPB should engage in active oversight of BNPL lenders. In the near term, it should use its market monitoring authority to collect, analyze, and publish data from the largest providers (anonymized) to better identify risks within the market. It should subsequently issue a larger participant rule to define the market and draw a line to identify larger participants; it should then actively supervise those larger BNPL lenders to ensure, at a minimum, that they are not engaged in any unfair, deceptive, or abusive acts or practices or unlawful discrimination. CFPB could also study checking account data, which it should be collecting in any event in order to monitor bank overdraft practices, to study the interaction between BNPL products and borrowers' checking accounts, in particular NSF and overdraft fees. The Bureau should ultimately ensure that BNPL lenders are making loans only after determining the borrower's ability to repay, considering both income and expenses or obligations, and that the lenders are not charging unfair fees. BNPL borrowers should also be given rights to dispute transactions and obtain refunds analogous to those credit card users have. And the Bureau should ensure that providers are not violating the Electronic Fund Transfer Act's prohibition of conditioning the extension of credit on preauthorized electronic transfers.

We also strongly encourage states to require BNPL lenders to obtain state licenses and to consider collecting data to better illuminate the risks involved in these programs.

III. Earned Wage Access

Note: The written testimony for today's hearing of Lauren Saunders of the National Consumer Law Center (on behalf of its low income clients) (NCLC) will cover earned wage access and faux earned wage

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[42] Anna Irrera, *As 'buy now, pay later' surges, a third of U.S. users fall behind on payments*, Reuters, Sept. 9, 2021, https://www.reuters.com/technology/buy-now-pay-later-surges-third-us-users-fall-behind-payments-2021-09-09/ (reporting on an August 2021 Qualtrics survey of 1,044 adults on behalf of Credit Karma).

[43] *Id.*

[44] *See, e.g.*, Which?, Under Pressure: Who uses BNPL, Policy Report, at 4 (May 2021).

[45] https://dfpi.ca.gov/2020/03/16/point-of-sale-lender-afterpay-agrees-to-cease-illegal-loans-pay-refunds-in-settlement-with-the-department-of-business-oversight/.

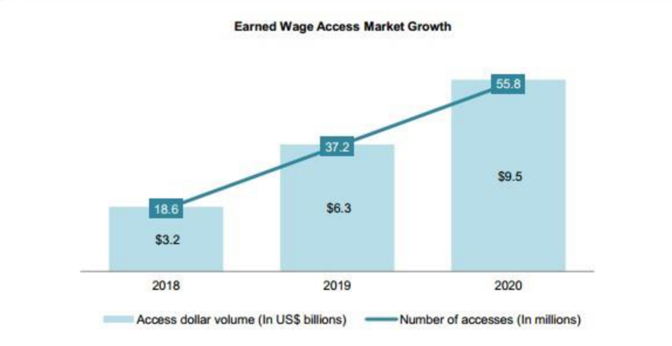
access products in more detail than our sections III and IV do here. We generally share the concerns discussed in her testimony.

We begin by being clear about what we mean by "earned wage access" (EWA) programs. EWA programs, at a minimum, are (1) integrated with the employer, (2) extended based on earned wages verified via the employer or its payroll provider, (3) repaid solely via deduction from the borrower's pay, without permitting the provider to access the borrower's checking account or other payment mechanism, and (4) without debt collection efforts when the borrower's pay is insufficient to repay to the advance.

A "fintech" provider that attempts to position itself as an EWA provider, but is not employer-integrated and takes authorization to debit the borrower's checking account to repay the loan, is not in fact an EWA provider and poses heightened risks to consumers. We discuss faux EWA products in Section IV below.

EWA products have soared in use in recent years, with estimated volume nearly tripling from 2018 ($3.2 billion) to 2020 ($9.5 billion). Three of the four largest employers are reported to be offering EWA to their employees. Particularly given this exploding growth, we appreciate the Task Force's the attention to this market.

Figure 4: EWA Market Growth



Source: Aite Group

SOURCE: Leslie Parrish, Making Ends Meet: On-Demand Pay and Employer-Based Loans, Aite Group LLC (Feb. 2021)[46]

EWA programs offer consumers an advance on wages at typically a fraction of the cost of typical payday loans and without the severe risks involved when lenders take access to a borrower's checking account. Users of one EWA provider responded in a survey that their use of the product was decreasing their

[46] Leslie Parrish, Making Ends Meet: On-Demand Pay and Employer-Based Loans, Aite Group LLC, at 17 (Feb. 2021), https://aite-novarica.com/report/making-ends-meet-demand-pay-and-employer-based-loans.

usage of payday loans and overdraft fees.[47] This is welcome news, and we should continue to monitor the extent to which these products replace rather than pile on to higher-cost credit. But even a clearly better option should not get a free regulatory pass.

The CFPB, under prior leadership in 2020, determined that EWAs in certain circumstances do not constitute a "debt" and thus cannot be considered "credit" under the Truth In Lending Act. We disagree with this conclusion and much of the rationale the Bureau applied to reach it; these concerns are detailed in a letter CRL and the National Consumer Law Center (on behalf of its low income clients) submitted jointly to CFPB last month[48] and are shared by the nearly 100 consumer, labor, civil rights, legal services, faith, community and financial organizations that also weighed in with the Bureau.[49]

In short, an advance of wages by a third party, even if earned and even if repaid via payroll deduction, is a debt that the borrower must repay. And exempting EWA from "credit" at the federal level could have broad ramifications and pose risks to consumers, including at the state level. In state legislatures earlier this year, we saw a significant uptick in the efforts of EWA providers to earn explicit exclusions from state credit laws. The proposed legislation that would create such exclusions typically does not include limits on pricing, meaning that EWA providers could operate outside of credit laws that would otherwise prevent predatory pricing. Moreover, these efforts often involve excluding from credit laws not only EWA providers but also faux EWA providers; see further discussion in Section IV. below.

In other state activity, the California Department of Financial Protection and Innovation (DFPI) has entered into memoranda of understanding with a few EWA providers (Even, Payactiv and Branch) (as well as a faux EWA provider (Activehours, which does business under the name Earnin) and an "overdraft avoidance" product (Brigit)), as it collects data on these programs. The DFPI was clear that the MOUs do not reflect DFPI's approval of any business model or conclusion that they comply with the law. We have urged DFPI to regulate all of these products as credit under state law.[50]

EWAs are not without risks to consumers, and users of EWA may be particularly susceptible to harm. EWA borrowers are typically hourly, relatively low-wage workers. Research suggests that Hispanic adults and younger workers are more likely to use EWA than the population as a whole. Indeed, one study found the adoption rate among the general population was 14%; among Hispanics, it was 25%.[51]

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[47] https://www.dailypay.com/blog/our-survey-says-dailypay-saves-employees/.

[48] *See* Letter from National Consumer Law Center & Center for Responsible Lending to CFPB (Oct. 12, 2021), https://www.responsiblelending.org/sites/default/files/nodes/files/research-publication/crl-nclc-ewa-letter-to-cfpb-oct2021.pdf.

[49] Letter from 96 consumer, labor, civil rights, legal services, faith, community and financial organizations and academics to CFPB (Oct. 12, 2021), https://www.responsiblelending.org/research-publication/96-organizations-and-academics-urge-cfpb-regulate-fee-based-earned-wage-access.

[50] *See* Letter from National Consumer Law Center & Center for Responsible Lending to CA Department of Financial Protection and Innovation (Mar. 15, 2021), https://www.responsiblelending.org/sites/default/files/nodes/files/research-publication/group-comment-dfpi-ewa-15mar2021.pdf.

[51] Michael Moeser, Earned Wage Access: Faster wage payments disrupt the traditional payday, Original research from American Banker and Employee Benefit News (ebn), at 7 (June 2021), https://www.americanbanker.com/research-report/faster-wage-payments-disrupt-the-traditional-payday.

Data show that consumers who use these advances tend to use them frequently,[52] which means costs can add up, particularly for the low-wage workers who tend to use the product. Where one advance is taken out simply to cover the gap left by repayment of a prior advance, consumers are essentially getting the benefit of only the initial advance but continuing to pay for each subsequent advance. Moreover, and critically, whatever EWA programs look like today may not be what they look like in the future if they are given a free regulatory pass: In a world where EWA is not considered credit at the state or federal level, a payday lender that manages to integrate itself with an employer could charge as high a rate it can get away with.

Top-line recommendations on EWAs:

- CFPB should repeal or significantly amend its actions concluding that certain EWAs are not credit (see October 2021 letter from NCLC and CRL);[53]
- States should generally regulate EWA programs under their state credit laws.

IV. Faux Earned Wage Access, "Overdraft Avoidance" Products, and Others That Routinely Access the Borrower's Checking Account/Payment Device

A product that purports to lend against earned wages but is not employer-integrated and takes access to the borrower's checking account is, for all intents and purposes, a payday loan. Indeed, the wages payday lenders lend against typically are earned to some degree, too. Though some newer products may be lower cost, even significantly, there is simply no reason these products should be regulated as something other than credit – subject to all applicable federal and state credit laws, including applicable interest rate limits.

These products can inflict severe financial harm on a borrower through their access to the borrower's checking account. When the borrower's account lacks sufficient funds for repayment, the borrower typically incurs non-sufficient fund (NSF) and/or overdraft fees triggered by the attempted repayment. Litigation against Earnin resulting in a $3 million settlement described how when a borrower took out multiple Earnin advances within the same pay period, each individual repayment attempt for each individual advance triggered an NSF fee or an overdraft fee; a borrower was charged four $29 fees within three days, totaling $116, all directly triggered by Earnin's repayment attempts.[54]

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[52] *See* Devina Khanna and Arjun Kaushal, Earned Wage Access and Direct-to-Consumer Advance Usage Trends, Financial Health Network, at 9-10 (April 2021), https://s3.amazonaws.com/cfsi-innovation-files-2018/wp-content/uploads/2021/04/26190749/EWA_D2C_Advance-_sage_Trends_FINAL.pdf (finding more than 70% of users took advances in consecutive semi-monthly periods over one year; 10% took advances consecutively for at least 10 semi-monthly periods; and 30% took advances in every semi-monthly period between their first and last advance during the period covered by the data -- on average, 6.5 monthly periods); Leslie Parrish, Employer-Based Loans and Early Pay: Disruption Reaching Scale, Aite, at 13-14 (April 2019), https://aite-novarica.com/employer-based-loans-and-early-pay-disruption-reaching-scale.

[53] *See* Letter from National Consumer Law Center & Center for Responsible Lending to CFPB (Oct. 12, 2021), https://www.responsiblelending.org/sites/default/files/nodes/files/research-publication/crl-nclc-ewa-letter-to-cfpb-oct2021.pdf.

[54] *Perks, et al. v. Activehours, Inc.. d/b/a, Earnin*, Case No. 5:19:cv-05543-BLF (N.D. Ca.), Complaint at 6-7, http://www.perksearninsettlement.com/media/3125364/aup__class_action_complaint.pdf.

Even where funds are sufficient to repay the advance – which will often be the case since the lenders generally monitor checking accounts and time repayments to coincide with the next direct deposit – repayment may leave the borrower without funds for essential expenses and/or lead to the incurrence of NSF fees and overdraft fees later in the pay period unless the borrower takes out a new advance.

Therefore, faux EWA providers should not be given the carveouts from credit laws they seek. Not only do current faux EWA providers pose risks, but if they are given a carveout from state laws, we should expect payday lenders – even in states whose usury limits currently keep payday lenders out – to begin attempting to operate within those carveouts.

In addition, NCLC's testimony discusses concerns, which we share, about the evasive "tip model" in the faux EWA space.

"Overdraft avoidance" programs extend advances typically repaid via access to the borrower's checking account, to consumers whose accounts are running low and risk incurring overdraft fees. These products also can reduce costs, especially given the outrageously high level of overdraft fees. But these products obtain repayment by debiting borrowers' checking accounts and also pose risks via NSF fees, overdraft fees, and not leaving enough funds for other essential expenses. These programs should also be regulated as credit and, to the extent they rely on "tips," those tips should be treated as finance charges.

Top-line recommendations on faux EWA and "overdraft avoidance" apps:

- CFPB should supervise these lenders pursuant to its authority under Dodd-Frank to supervise payday lenders regardless of their size;
- States should regulate these lenders under their state credit laws;
- CFPB and states should affirm that "tips" on extensions of credit are evasive attempts to disguise interest charges;
- CFPB and states should monitor the use of "participation fees" to ensure they are not being used to evade regulation as credit.

V. Conclusion

Thank you again for holding this hearing and for the opportunity to provide input on these critical issues. I look forward to addressing any questions you may have.

House Financial Services Committee
Task Force on Financial Technology
Hearing Entitled
"Buy Now, Pay More Later? Investigating Risks and Benefits of BNPL and Other Emerging Fintech Cash Flow Products"

Statement for the Record
Ram Palaniappan, CEO, Earnin
November 2, 2021

Chairman Lynch, Ranking Member Davidson, and Members of the Task Force, thank you for the opportunity for Earnin to provide a written statement for the record. We write to address an ongoing conversation around Earned Wage Access (EWA) and the ways it can support low-income Americans. We hope that with clarity around EWA products, their purpose, and how they function, we can build on the work the House Financial Services Committee and the Consumer Financial Protection Bureau (CFPB) have already done to advance our shared goals of protecting consumers and addressing the financial challenges our users face through innovation.

Earnin's mission is to build products for a fairer financial system that works for people. Millions of families suffer from the consequences of living paycheck to paycheck.[1] While the issue of a livable wage continues to be debated in the United States, the real-life impact of paycheck timing is of critical importance to many Americans. Earnin is designed to free people from the traditional pay cycle and give them control of their money, starting from when they earn it.

The advent of monthly or biweekly paychecks dates back to the 1940s and was a way to make payroll easier for employers following the implementation of the federal income tax.[2] However, periodic pay schedules create everyday hardships for workers because their financial obligations often do not coincide with employer-chosen pay dates. In short, the current system for wage delivery favors employers at the expense of employees. The result of this imbalance is that workers delay obtaining much-needed goods and services or put off medical care until they receive their next paycheck.[3] In an era of on-demand technology, it is time to end the restrictive schedule of wage payment.

Liquidity Gap

Conversations about supporting low-income Americans often revolve around the wealth gap: the fact that some people have much less in assets and net worth than others do.
Those conversations conceal a more insidious and pervasive problem that families face daily – the liquidity gap. The liquidity gap is when people have a paycheck coming in next week, but they need to pay rent or buy groceries this week. This phenomenon is felt disproportionately by people of color. Research suggests[4] that a sudden loss in income will have a greater effect on a Black or Hispanic household than a white household.

<u>Harmful impacts when the liquidity gap is ignored</u>
Historically, low-income Americans facing a significant expense without the cash available to cover it have turned to expensive and often predatory forms of liquidity like payday loans and bank account overdrafts.

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[1] 54% of consumers in the U.S. today live paycheck to paycheck, including 53% of those who earn $50,000 to $100,000 per year, https://www.pymnts.com/study/paycheck-to-paycheck-consumer-finances-american-households/
[2] https://www.thenation.com/article/archive/breakdown-why-are-we-paid-every-two-weeks/
[3] E.g., https://www.businesswire.com/news/home/20181023005517/en/Earnin-Survey-Shows-Majority-of-Americans-Are-Delaying-Medical-Care ("More than half of Americans (54 percent) have delayed medical care for themselves in the past 12 months because they could not afford it.")
[4] https://www.nber.org/system/files/working_papers/w27552/w27552.pdf

These types of financial services often trap consumers in a never-ending cycle of debt. In turn, the burden of these high fee forms of short-term credit falls disproportionately on people of color.

As the National Consumer Law Center (NCLC) testified at the June 2021 House Financial Services Committee hybrid hearing, *A Biased, Broken System: Examining Proposals to Overhaul Credit Reporting to Achieve Equity, "There is need to mitigate the punitive impact of a system that treats consumers who have fallen on hard times as irresponsible deadbeats.[5]"* Earnin is doing exactly that; empowering consumers to take charge of their financial future. Our tip-based, non-recourse model speaks to the good faith we have in consumers; that they can responsibly self-regulate and manage their budgets.

Consumers deserve solutions that genuinely address the liquidity gap, not exploitative credit tools that prey on consumer vulnerability. We believe that the CFPB and consumer advocates who have been engaged in this conversation would agree with that goal. We are confident that Earnin's current EWA offering unquestionably helps to align income and expenses safely, while also enabling consumers to avoid reliance on payday loans and overdrafts.

What does "safely" mean? Earnin believes a safe EWA product means:

- Flexibility on price
- No employer data sharing (worker privacy)
- Reasonable estimation of accrued earnings
- No selling of customer data
- Non-recourse, and no reporting to credit bureaus

Earnin provides a suite of services to help families manage their money

Earnin's comprehensive suite of tools include: Cash Out, which provides access to income as it's earned; Earnin Express, a free, FDIC insured, demand deposit account that gives people the option to receive their paycheck up to two days early; Balance Shield, a low balance alert to help maintain a positive bank balance; Financial Calendar, to help people budget and schedule payments; and Tip Yourself, an easy way to set aside money to reach savings goals. With Earnin's EWA product, Cash Out, users can access up to $100 of their accrued earnings per day, and up to $500 of their accrued earnings per pay period.

Earnin is consumer-friendly

Earnin is a no mandatory fee, no-interest, non-recourse financial tool. Users can choose to provide voluntary "tips," though one's access to Cash Out or any of our financial tools is in no way dependent on tipping. Credit agencies and debt collectors are never involved, and Earnin bears the entire risk if a Cash Out isn't recovered – the consumer bears none.

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[5] Testimony of Chi Chi Wu, National Consumer Law Center Before the U.S. House of Representatives Committee on Financial Services regarding "A Biased, Broken System: Examining Proposals to Overhaul Credit Reporting to Achieve Equity" June 29, 2021

Furthermore, we provide our services “Direct to Consumer.” This means that anyone with a paycheck can use our services – regardless of employer. Any employee in the U.S. with a bank account who receives their paycheck via direct deposit can use Earnin, including small business and government employees.

Community Impact

Our customers use Earnin to pay for essentials on time. Top uses are for food, groceries, gas, utility bills, avoiding overdrafts, rent, and unexpected expenses.[6]

A May 2021 research study of 4,735 EWA consumers showed that EWA helps working families stuck in a traditional pay cycle with the tools they need to manage their finances.[7] The study found that without EWA, 44 percent of users would otherwise consider not paying certain bills and more than one-third of consumers would deliberately overdraft or use a payday loan because of cash flow constraints.

Additional findings from the study show:

- 92% of consumers given EWA reported that it helped them to pay bills on time, avoid overdraft fees and payday loans, and become less dependent on credit cards; empowering them to achieve at least one of their financial goals in 2020.
- An overwhelming majority of consumers (91%) said they understand how the EWA service works and understand the associated fees (89%).
- A strong majority of EWA users reported a boost in their overall well-being after using the service. Eight in 10 reported feeling less stressed about their financial situation (82%), having higher self-esteem (81%), and an improvement in their mental health (77%).

As noted above, Earnin is available to anyone with a job and a bank account. To ensure we are serving all community members equally, regardless of demographic group, we conducted a third-party analysis by Charles River Associates, a leading global consulting firm. Results showed that Earnin treats all demographic groups equally and may be advantageous to protected classes (Hispanic / female) relative to their comparison groups (not Hispanic / male).[8]

Earnin is a service that is valued by millions of Americans

In 2020, more than 3 million Americans opened the Earnin App, and more than 1.3 million used it to Cash Out, Earnin’s EWA product. As of September 2021, Earnin has performed more than

[6] Earnin internal survey: Dec 10 2020 - Jan 1, 2021: 1122 Responses
[7] Research was conducted online by FTI Consulting’s Digital & Insights team, on behalf of Brigit, MoneyLion & Earnin. FTI Consulting researched n=4,735 of Brigit, MoneyLion and Earnin’s Direct to Consumer (D2C) Earned Wage Access (EWA) service consumers between the dates of April 21st, 2021 – May 18th, 2021, and results were weighted in equal proportions to ensure equal representation among the consumers of each participating company. https://www.earnin.com/assets/pdf/earnin-infographic.pdf.
[8] Disparate impact analysis done by Charles Rivers Associates, March 2021

125 million transactions and provided access to $10 billion in earnings for its members. A survey of our customers in late 2020, showed that 68% of them were 25-44 years old, 77% made less than $75,000 per year, and 70% identified as female; 36% identified as white, 32% as black or African American, and 18% as Hispanic or Latinx. *In the month preceding this hearing, more than 100 Congressional staffers used Cash Out to access their accrued earnings.*

Existing consumer protection laws already address EWA

In 2017, the CFPB promulgated the Payday, Vehicle Title, and Certain High-Cost Installment Loans (the "Payday Rule")[9] which specifically exempted EWA or "no-cost advances" from coverage under the Rule. Clarifying that no-cost advances are "likely to benefit consumers," the Bureau concluded that such products are "unlikely to lead to the risks and harms [associated with traditional payday loans]," such as "default, delinquency, and re-borrowing."[10] Because Earnin's service does not present the risks and harms associated with short-term lending that generally justify regulation, the CFPB determined that such services should be specifically exempted from the Payday Rule.

Despite being exempted from the Payday Rule, Earnin maintains a comprehensive compliance program. This includes policies and procedures related to electronic funds transfers, and unfair, deceptive, or abusive acts or practices (UDAAP), as well as data privacy laws, such as the Gramm-Leach-Bliley Act (GLBA), and financial crimes regulation from the Treasury Department's Office of Foreign Assets Control (OFAC).

We have been working with industry colleagues and state lawmakers to craft a legislative framework that creates regulatory certainty for EWA providers that includes strong consumer protections, and data sharing requirements that allow governments to better understand how EWA helps working families.

This framework ensures workers have access to an essential tool that is not only consumer friendly, but more accesible than payday loans, traditional bank loans, and high bank fees. EWA services like Earnin bridge the liquidity gap for consumers who are unable to access high-interest bank loans or get approved for credit cards – ensuring they can still achieve financial freedom and pay for essential goods and services when they need them.

Earnin would be glad to work with the Task Force to craft legislation to protect this important financial tool, which provides consumers access to their earnings with no fees, no interest and no recourse – which traditional loans, banks, and payday lenders do not provide.

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[9] https://www.govinfo.gov/content/pkg/FR-2017-11-17/pdf/FR-2017-11-17.pdf (Pg 265)
[10] 82 Fed. Reg. 54472, 54548 (Nov. 17, 2017)

Earned Wage Access is non-recourse liquidity, it is not credit

As the Task Force explores EWA and the best approach for supporting and protecting consumers, some have suggested regulating EWA as credit. We argue that EWA should not be regulated as credit for two simple reasons:

1) EWA fundamentally falls outside the definition of credit

EWA falls outside of the definition of credit because:

a. There are no finance charges and no interest paid by consumers.
b. Customers are not required to make any mandatory payments to obtain EWA from Earnin.
c. EWA provides access to accrued earnings as an alternative to credit.
d. EWA is non-recourse. The transactional risk is borne entirely by the provider rather than consumers. Providers have no right to repayment and cannot report to credit reporting agencies or engage in collection activities (see Earnin ToS[11]). If a customer does not repay their funds, the only recourse available to providers is to deny future access to the service. The amount involved in an EWA transaction does not roll over or compound.

Because Earnin does not charge users for its service or force users to choose between re-borrowing, defaulting, or falling behind on other obligations, and because failure to repay a Cash Out does not cause injury to anyone but Earnin, Earnin's service is unlikely to present consumer protection concerns often associated with traditional lending. To the contrary, Earnin provides a valuable consumer benefit: Earnin's service puts workers, not their employers, in charge of when they get paid, and it gives users the ability to manage their finances without having to rely on exploitative traditional lending products.

2) Regulating EWA as credit will lead to worse outcomes for consumers

EWA is fundamentally different from both the predatory credit products that have taken advantage of struggling Americans for years and the exclusive products that make liquidity available to wealthier Americans but remain off-limits to those most in need.

Chairwoman Maxine Waters (D-CA) said at the June 2021 Financial Services hybrid hearing, *A Biased, Broken System: Examining Proposals to Overhaul Credit Reporting to Achieve Equity*, *"I encourage my colleagues to join me in reevaluating how we determine creditworthiness…and learning how we can harness new technologies to build a fairer and equitable credit system."*

Chairwoman Waters' statement strongly resonates with Earnin's mission – as technology has enabled new business models to use alternative ratings for risk outside of credit, regulators should not attempt to force them into old buckets. While EWA provides the same benefits as other financial services (the ability to weather financial shocks and smooth consumption), it

[11] https://www2.earnin.com/privacyandterms/

does not pose the same risks as legacy financial products that bear little resemblance to the consumer-friendly qualities of EWA.

Regulating EWA as credit would:

a. Transfer the downside risk from providers to consumers. Currently, providers bear all of the legal and financial risks of non-repayment. If EWA were treated as credit, customers would have a legal obligation to repay. This would greatly increase the costs of non-payment by making EWA recipients vulnerable to debt collection, and increasing the risk of adverse credit reporting which could follow them for years to come.
b. Impact the accessibility of EWA products. Higher fees will make the products less accessible leading to a cycle of debt.

Accessing earnings is closer to an ATM transaction than credit

EWA providers transfer funds that represent accrued earnings to consumers, akin to ATM withdrawals. Similarly, EWA providers should provide clear disclosures on pricing structures, notice to consumers of the next scheduled debit, as well as clarity on the non-recourse nature of the EWA products they provide.

Earnin supports a regulatory framework for EWA that protects consumers while, at the same time, recognizes the inherent difference between EWA and traditional credit. We welcome the opportunity to work with the Task Force to ensure that there are EWA-specific consumer protection frameworks to ensure fair and equal access.

Thank you for your commitment to consumers and for being thorough in examining the nuances of Earned Wage Access cash flow products. We look forward to collaborating with the Task Force to help achieve our mutual goals of addressing the liquidity gap that impacts the lives of millions of Americans today.

Frequently Asked Questions about Earnin

You really make money from tips? What's the catch?

There is no catch. If customers find our service valuable, they are welcome to leave us a tip, but they can always choose $0. Tipping has no bearing on their ability to access the service, and we do not generate any revenue by selling customer data. About 10% of customers have never tipped and 60% of customers have tipped $0 at least once. The average tip is less than an ATM fee,[12] one tenth the cost of an overdraft fee,[13] and far less than a payday loan fee[14]. We only get paid if we delight our customers enough to want to voluntarily give us their financial support.

Aren't tips deceptive?

[12]The total cost of the average out-of-network ATM withdrawal was $4.59 in 2021. https://www.bankrate.com/banking/checking/checking-account-survey/
[13]The average non-sufficient funds fee was $33.58 https://www.bankrate.com/banking/checking/checking-account-survey/
[14] https://www.consumerfinance.gov/ask-cfpb/what-are-the-costs-and-fees-for-a-payday-loan-en-1589/

Tipping is voluntary and transparent, and ensures we only succeed as a business if our customers find our service valuable enough to reward us with a tip. Our customers tell us they like this flexibility, because it allows them to access the service at a lower, or no, cost if funds are tight, but the ability to tip a higher amount when they have more flexibility and would like to support the service.

Tens of millions of Americans are asked to tip every day when they buy a coffee or beer, food or grocery delivery, or use a variety of services online. Nearly every American has worked for tips in their life or known someone who has. Starbucks, Uber, Lyft, Hilton, Marriott, Red Lobster, DoorDash, Patreon, thousands of other service industry businesses, and even Act Blue rely on tips for their business model; and Earnin is no different. Americans are very familiar with tipping, and understand what it entails and what it does not.

Is selling customer data part of your revenue?
Earnin does not sell customer data. The security of customer information is our top priority. We only use data in accordance with our Privacy Policy[15]. We do share anonymized and or aggregated data with government agencies such as the U.S. Department of the Treasury and California Department of Financial Protection and Innovation, or certain research institutions such as Opportunity Insights to better understand labor markets and how EWA helps our customers.[16]

But what really happens if someone doesn't pay you back?
Earnin simply pauses the Cash Out service for that customer. If they would like to access Cash Outs in the future, they may do so by contacting customer support and paying their unpaid balance. This ensures consumers don't overextend themselves. Rollovers, common in the short term lending context, are not possible. There is no penalty fee if the customer chooses to pay after their service has been paused. Finally, customers' credit is not affected. Our customers tell us the fact that using EWA does not affect your credit score is one reason why they like and trust our service.

Does EWA trap people in a cycle of dependency?
No, families working paycheck to paycheck are currently beholden to the 2-4 week pay cycle when there are real life factors like an unexpected bill that doesn't wait for payday. These unexpected expenses can cause stress and snowball into much bigger expenses. Earnin provides consumers alternative options if they wish to better manage their financial health. It is a potential solution for dependency on payday.

Do providers who debit from accounts cause overdrafts?
Overdraft fees are charged by banks. Earnin does not collect or control overdraft fees. To the contrary, we offer Balance Shield, a service to help people monitor their balances and be notified if overdraft may occur. Any transaction with a merchant can trigger an overdraft fee and consumers remain subject to their banks' ordering of their pending credits and debits. EWA

[15] https://www.earnin.com/privacyandterms
[16] https://opportunityinsights.org/

transactions are no different than any phone or utility bill (or any other ACH transaction), that is paid directly from a bank account.

Isn't it safer to deduct EWA directly from paychecks?
Different providers offer different repayment methods, each has different risks for consumers and for the business. In conjunction with a bank partner, Earnin enables access to a free demand deposit account product called Earnin Express. Through Earnin Express, a consumer can access their full paycheck two days early. This is a separate service from Cash Out, but it is complimentary, as their Cash Outs can be repaid through this account, reducing the chance of an overdraft. This is an FDIC insured account to make sure the consumer is protected. Earnin customers also have the option of their repayments being deducted from their bank account. This gives consumers the ability to cancel or reschedule their repayment if they choose to prioritize other purchases.

Earnin does not take custody of a customer's paycheck, but if a provider utilizes a business model that takes custody of paychecks, they should ensure that there are appropriate safeguards as a fiduciary to ensure that such funds are FDIC insured and are held for benefit of customers in the event of a bankruptcy or liquidation event. Moreover, such services should ensure that customers have the option to receive their full pay, and retain the ability to delay or cancel an EWA repayment, to ensure that the service remains non-recourse.

EWA providers do not assess or benefit from overdraft fees. Overdraft policies are established by banks who determine the order of debits and credits to customer accounts. A customer may deposit funds into an account in the morning but the account may only reflect such credit in the evening if that is the bank's policy.

Should Business to Business and Direct to Consumer Models be regulated differently?
There is robust competition in the EWA space with more than 25 companies offering these services. All business models have slight variations, but they largely fall into two categories of how the users procure the product 1) business to business, where an employer such as Walmart or Amazon would offer EWA as an optional perk to their employees, and where net earnings are estimated based on information from employer payroll systems or 2) direct to consumer, where EWAs are obtained directly by consumers, and net earnings are estimated based on wages deposited into consumers' bank accounts. Earnin is fairly unique in the space, as we provide EWA services directly to consumers and also have partnerships with large employers.

While the procurement method may differ, EWA companies provide largely the same service; they estimate net wages, advance wages to the worker based on those estimates, then get repaid on payday; and they should be treated in a similar manner for regulatory purposes. We don't regulate other industries, like insurance, differently based on whether it is purchased through an employer or directly by a consumer, and EWA is no different.

	Business to Business EWA	**Earnin/Direct to Consumer EWA**
Procurement method:	Employer chooses the EWA provider. Employers may choose what is best for them, not their workers.	Consumers choose the EWA provider based on what is best for their individual situation.
Wage Estimation:	EWA provider estimates net wages based on payroll data.[17] Note this is likely historical data, as the timing of this data transmission varies greatly.	Earnin estimates wages based on past earnings or uploaded time sheets.
Fees paid by customer:	Customer pays fees set by the provider. Employers may choose to pay the fees, or they may pass the fees through to employees.	Customers choose a fee amount (including $0).
Method of funds delivery method:	Customers receive funds on a payroll card, or in their bank account via ACH or Debit.	Customers receive funds in their bank account via ACH or Debit.
Method of funds recovery:	EWA provider is repaid on payday; provider may debit bank account directly; take custody of customer paycheck to repay themselves before transmitting paycheck to worker; or receive a disbursement from employer to EWA provider.	Customers authorize Earnin to debit the amount of the Cash Out + voluntary tip (if any) on their next payday.

Benefits of Direct to Consumer:

- **Portability:** Business to business models are by definition tied to a specific employer. The Direct to Consumer model allows workers to control whether or not they have the access to the service should they choose to switch jobs.
- **Worker privacy:** Workers may not want their employer to know they use EWA, they should have the ability to enter into a transaction that is not subject to potential snooping by employers acting improperly.
- **Competition:** The provider an employer uses for EWA may not be the right one for the consumer. The consumer should have options to choose an EWA provider that works for them. Employers may choose what is in their best interests, and that will not always align with a worker's choice. Employers may choose mandatory fees, because they are not paying those fees. Many of Earnin's customers are employed by companies that offer

[17] Daily Pay uses a "“proprietary”... “Dynamic Income Algorithm” to estimate wages. https://fintechmagazine.com/venture-capital/fintech-profile-dailypay-payroll-game-changer

EWA, but they choose us instead. Legislators should not put their thumb on the scale to benefit one business model. They should allow workers to vote with their pocketbooks and choose the service that is best for them.

- **Flexibility for the worker:** Depending on the business model, some EWA providers allow independent contractors with different income streams to access their income early. This flexibility should be preserved for maximum consumer benefit as work looks different to different people.

Alternatives in the market: What happens if various small dollar liquidity options are not repaid

Liquidity Option	**Cost**	**What happens if you don't pay**
Overdraft	$30-35 per transaction.	Must be repaid when new funds go into account, or the account will be closed. Can generate multiple fees per $100 overdrafted depending on the number of transactions. No negative impact on credit score, but may lose access to your banking account and therefore the banking system.
Payday Loan	$15-25 per $100 borrowed, fees and rollovers can add up to hundreds more.	Depends on state law, but generally can be rolled over a certain number of times, generating additional fees and interest each time. Amount owed could balloon to several times the amount originally owed. Debt can be sold to a collections agency and will likely be reported to credit bureaus damaging your credit score.
Credit Card	No fee if paid at the end of the first month.	If the minimum payment is not paid, large fines will quickly add up, up to $40 plus interest. Credit score will be ruined.
Earnin	There is no mandatory payment to access Earnin. Any payment is voluntary, and the average "tip" is less than an ATM fee.	Cash Out service paused until repayment. Customer still has access to other Earnin services. No late fees, no rollovers or collections, no reports to credit agencies.

Earnin is the clear choice for consumer benefit.
Why our customers choose Earnin in their own words (actual customer reviews):

Alexandrialeeuniverse ★★★★★
I love this app!!
I have horrible credit so I can never get a small loan anywhere with out having to pay so much back but this app helps me !! Best app ever istg
I've been using this app for almost 2 years

Hollywood373777 ★★★★★
Terrific
They are one of the few apps that are able to give you cash right away without doing a credit check

U'nique Childd ★★★★★
Pretty useful if I need some extra cash
I really like this app is better than those cash advance places and it doesn't mess with your credit. 10/10 recommend

Jason Birden ★★★★★
When used wisely, it's a lifesaver for those of us without credit cards.

Joseph Spinelli ★★★★★
You guys have saved my butt on so many occasions and I'm happy to report that my credit went up because of this app! And I learned everything I needed to be more fiscally responsible. Love love love it!

Irmajovens ★★★★★
A helping hand
Using Earnin to get me through some tough spots has helped me better learn to manage debt and credit card usage. Also I have been able to pay down over 4K in debt while on their platform. Thank you guys.

Nespar68 ★★★★★
Amazing
Amazing app. Helps me pay my credit cards earlier and that helps lower my credit. Boom!

Gunitlilmia ★★★★★
Amazing
This app has helped me out many times and has kept me from having OD fees also without having to take out loans and screw my credit up. I love Earnin!

Purrlow ★★★★★
Gratitude!

Discovering this app has saved me from lowering my credit score! Thank you!

Izzy sparxxx ★★★★★
I wish this app existed a decade ago
I would have never used a single credit card. This app is truly a lifesaver especially recovering from the loss of a job and Covid last year. It's help me get back on my feet financially

Anita Kyne ★★★★★
Easy to use. If I need funds sooner than payday, I can get cash instead of using credit.

Tamiamia1210 ★★★★★
Best app ever NO MORE OPENING CREDIT CARDS
This app is the best especially now when we are in quarantine and in need of extra money. This app is fast and it takes the cash back on paycheck day which I think is AWESOME. No more stupid credit cards messing up my credit this app is a lifesaver. Thanks everyone who works at earnin from employees to managers to online chat people to the CEO to literally everyone who makes this experience the best.

Additional Reading on Earned Wage Access:
White Paper on Earned Wage Access Trends (from the Financial Health Network)

Earned Wage Access Services - Legal and Policy Analysis (from Earnin's counsel Paul Hastings, LLP)

Survey Results on Direct to Consumer Earned Wage Access (FTI Consulting, May 2021)

EARNED WAGE ACCESS AND THE END OF PAYDAY LENDING (Jim Hawkins, Boston University Law Review)

Submitted Electronically

Chairman Lynch and Ranking Member Davidson,

We want to thank the Chairman and Ranking Member for allowing us to submit comments to the Task Force on Financial Technology's hearing focused on "Buy Now, Pay More Later? Investigating Risks and Benefits of BNPL and Other Emerging Fintech Cash Flow Products."

We welcome the Task Force interest in earned wage access (EWA) and fintech cash flow products, and wanted to take the opportunity to share Gusto's perspective and how we have designed our product, Gusto Cashout, as a responsible option for small business employees to have early access to funds between paychecks, with an affordable and easy repayment schedule and fully transparent terms and conditions of use.

Background

Gusto is a people platform that helps small businesses onboard, pay, insure and take care of their teams. We serve more than 200,000 Small and Medium Businesses (SMBs) nationwide. In addition to full-service payroll and HR and compliance support we enable benefits for employees such as medical insurance, 401(k)s, and 529 plans. **In 2019, we launched Gusto Cashout, a lending product offered in partnership with Sunrise Banks, N.A., that is fully embedded in the payroll platform for the 1 million+ employees that use Gusto across the country. We selected Sunrise Banks as our bank partner because it is a Community Development Financial Institution (CDFI) and is mission-aligned in offering responsible alternatives to payday loans.** In 2020, we launched a suite of financial tools (Gusto Wallet) to allow small businesses to help support the financial health of their teams with the dual goal of promoting financial inclusion

Our target customers are SMBs with fewer than 100 employees and the accountants and advisors on which these businesses rely. Gusto was founded in 2012.

Gusto Wallet (Cash Accounts and Cashout)

Gusto is well-positioned to provide comprehensive financial services to businesses and their employees quickly, efficiently, and responsibly.

Our consumer centric approach prioritizes transparent and responsible financial products seamlessly integrated into the paycheck. We provide:

- An affordable and fully transparent alternative to high-cost lending allowing consumers to improve their financial health and meet short-term, small dollar needs.
- Transparent terms of agreement to ensure clear and understandable borrowing frameworks.

- Products that operate in a robust state and federal regulatory environment including state licensing, Federal Prudential Regulator and Consumer Financial Protection Bureau oversight, and comprehensive Truth in Lending Act disclosures.
- Gusto Wallet helps improve consumer savings and financial health.

Employees of Gusto customers can access Gusto Wallet, which was designed to put the consumer in control of managing their earnings. Gusto Wallet includes a Cash Account with an associated debit card, and also has separate tools for the consumer to easily set money aside from regular paychecks through individual savings goals. Furthermore, customers can easily transfer money between accounts to meet their spending and emergency needs, and there are no typical fees associated with the bank accounts. We do not charge overdraft fees, monthly maintenance, or minimum balance fees for any of the accounts.

Gusto launched its earned wage access product, Cashout, in August of 2019 in partnership with Sunrise Banks, a CDFI, and intentionally structured it as a loan due to our commitment to transparency. Gusto Cashout is a responsible alternative to payday loans and is a transparent product in the earned wage access market. Gusto Cashout enables consumers to access funds between paydays at low or no cost. Because Cashout is embedded in our payroll system, users can easily request funds within the Gusto platform and their small business employers are able to provide financial benefits along with health benefits and other financial planning tools such as 401(k) and 529 savings accounts. Cashout is based on estimated earned wages and permits consumers to access funds that Gusto has estimated they have already earned, which makes it similar to other earned wage access products. Since Gusto Cashout is structured as a loan, unlike other earned wage access products, it comes with appropriate Truth in Lending Act and other disclosures to ensure that consumers understand the product.

Gusto Cashout Key Facts:

- Gusto Cashout is free if the employee deposits their Cashout into their Gusto Cash Account -- no interest and no fees.
- Cashout is automatically repaid on the borrower's next payday, making it simple to use.
- For those that do not use Gusto Cash Accounts, consumers are able to access Gusto Cashout for a small fee (up to $5 or a 36% APR of the loan amount, whichever is less).
- Gusto is committed to never charging more than a 36% APR for Gusto Cashout.
- Cashout is a direct to consumer loan.
- We have created significant guardrails to ensure that Cashout is responsible credit with a fast and simple repayment schedule -- such as capping the amount that a consumer can access, restricting consumers from having more than one Cashout at a time, and ensuring that consumers can only access Cashout two times per month
- Gusto educates employers about the product, and allows them to opt-out of the product offering for their employees.

Borrower Feedback on Gusto Cashout:

Our surveys of Gusto Cashout users show the positive impact it has had, with 89% of borrowers reporting less financial stress. Another important finding is that the vast majority of customers are using Cashout as a substitute for higher-cost options such as delaying paying a bill or avoiding a bank overdraft. Employers that offer Cashout enjoy a competitive advantage, with 52% of employees saying that having access to Cashout would impact whether they accept a job.

Gusto Cashout user quotes:

- *"It's a nice bonus feature for times when I just need a little extra to get through payday."*
- *"This service has literally saved my life financially for months now. I don't know what I would/could have done without it."*
- *"It's nice to know that the option is available, even though I've used it only once."*

As the Task Force undertakes its important exploration of cash flow products and EWA, Gusto felt it prudent to differentiate how Cashout was intentionally designed to be borrower friendly, transparent, and a better substitute than other forms of high-cost credit intended to promote financial inclusion. We remain committed to treating Cashout as credit and capping fees at 36% APR while offering free alternatives for customers to make the right decisions for their personal needs, and welcome increased scrutiny by Congress and regulators. Once again, thank you for the opportunity to submit comments, and for more information on Cashout or Gusto products please do not hesitate to contact Jeanette Quick (jeanette.quick@gusto.com) or Steve Abbott (steve.abbott@gusto.com).

Sincerely,

Steve Abbott
Public Policy Lead
Gusto

CATO INSTITUTE | Center for Monetary and Financial Alternatives

November 9, 2021

The Honorable Stephen Lynch	The Honorable Warren Davidson
Chair	Ranking Member
Task Force on Financial Technology	Task Force on Financial Technology
U.S. House of Representatives	U.S. House of Representatives
Washington, DC, 20515	Washington, DC, 20515

Dear Chairman Lynch, Ranking Member Davidson, and Members of the Taskforce:

I would like to thank the Financial Services Committee for convening its Task Force on Financial Technology and organizing the hearing titled, "Buy Now, Pay More Later? Investigating Risks and Benefits of BNPL and Other Emerging Fintech Cash Flow Products" on November 2, 2021. I am writing to express my views regarding the topic of that hearing.

My name is Dan Quan and I am an adjunct scholar at the Cato Institute's Center for Monetary and Financial Alternatives. I am also a co-founder and General Partner of Nevcaut Ventures, a venture capital fund that invests in financial technology (fintech) startups. In addition, I provide advisory services through my own firm, Banks Street Advisory, and as a Senior Advisor with McKinsey. Previously, I was Senior Advisor to the Director at the Consumer Financial Protection Bureau (CFPB) and led its fintech initiative, Project Catalyst.

My comments are focused on earned wage access (EWA). In 2013, I began to study this budding industry and have been working on EWA in a variety of capacities ever since: as a regulator, scholar, advisor, and investor. It would be an understatement to say EWA is booming. According to an industry estimate, the transaction volume reached $9.5 billion in 2020, or more than a 50% increase from $6.3 billion in 2019.[1] On November 2, Earnin, a leading EWA provider, announced that it has provided over $10 billion in advances to its customers.[2] There are many reasons contributing to the strong growth of EWA.

First and foremost, there is strong consumer demand for EWA. The availability of EWA benefits consumers across the income spectrum. Surveys have consistently shown that majority of Americans are living paycheck to paycheck.[3] Even more strikingly, 40% of consumers with annual income over $100,000 live paycheck to paycheck, "including 12% struggling to pay their

[1] Leslie Parrish, "Making Ends Meet: On-Demand Pay and Employer-Based Loans," AiteNovarica, February 2021, available at https://aite-novarica.com/report/making-ends-meet-demand-pay-and-employer-based-loans
[2] "Earnin Announces They Have Provided Access to $10 Billion in Earnings for Members," November 2, 2021, available at https://finance.yahoo.com/finance/news/earnin-announces-provided-access-10-170000038.html
[3] Megan Leonhardt, "63% of Americans have been living paycheck to paycheck since Covid hit" *CNBC* December 11, 2020, available at https://www.cnbc.com/2020/12/11/majority-of-americans-are-living-paycheck-to-paycheck-since-covid-hit.html and "Number of Americans Living Paycheck to Paycheck on Decline Despite Pandemic" American Payroll Association September 21, 2020, available at https://www.prnewswire.com/news-releases/number-of-americans-living-paycheck-to-paycheck-on-decline-despite-pandemic-301134207.html

bills."[4] In 2020, 73.3 million, or 55.5% of the workforce, were hourly workers.[5] According to the International Labor Organization, gig workers accounted for 43% of the workforce in 2020 from 34% in 2017.[6] Volatile cash flows as a result of inconsistent and unpredictable income has worsened the financial challenges facing the hourly and gig workers who are generally making less than their salaried peers.

Second, there is growing employer demand for EWA. Financial stress can negatively affect employees' job performance and increase unwanted turnover. This was the main reason that Walmart decided in 2017 to allow its 1.4 million employees in the United States to get paid before payday. According to Walmart, offering EWA was "intended to help workers avoid costly payday loans and other debt traps, and reduce the stress that comes with financial hardship."[7] Indeed, Walmart has been credited for making EWA mainstream. More and more employers, large and small, have followed Walmart by making EWA part of their employee benefits package. In light of the Great Resignation of 2021, EWA has now become an even more important tool to attract and retain talent.

Third, technology is a great enabler that makes it easy for employers and workers to adopt EWA. The wide use of Application Programming Interface (API) has allowed the employer-based (B2B) EWA providers to seamlessly integrate their software with employers' payroll and human resources systems, reducing time and cost to launch the product. The direct to consumer (D2C) EWA providers have all relied on open banking services from data aggregators to gain access to consumers' primary checking accounts to ascertain periodic payroll deposits. Both business models work with payment networks to make real time disbursements to consumers' accounts.

Last but not least, most EWA providers charge much lower fees compared to other short term credit products (e.g., bank overdrafts and payday loans)[8]. What's more, EWA providers generally have no recourse against their customers. There is no debt collection or negative credit reporting when the consumer doesn't pay back the money. Consumers can walk away unscathed.

Many consumer groups view EWA as a new form of predatory lending that can put consumers in perpetual debt cycle. The solution they propose is to treat EWA as an extension of credit and

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[4] LendingClub Corporation, "Nearly 40 Percent of Americans with Annual Incomes over $100,000 Live Paycheck-to-Paycheck LendingClub and PYMNTS Find Majority of Americans live paycheck-to-paycheck" June 15, 2021, available at https://www.prnewswire.com/news-releases/nearly-40-percent-of-americans-with-annual-incomes-over-100-000-live-paycheck-to-paycheck-301312281.html

[5] Bureau of Labor Statistics "Characteristics of minimum wage workers, 2020" February 2021, available at https://www.bls.gov/opub/reports/minimum-wage/2020/home.htm

[6] Nandita Bose, "Labor Secretary supports classifying gig workers as employees," *Reuters* April 29, 2021, available at https://www.reuters.com/world/us/exclusive-us-labor-secretary-says-most-gig-workers-should-be-classified-2021-04-29/

[7] Michael Corkery, "Walmart Will Let Its 1.4 Million Workers Take Their Pay Before Payday" *New York Times* December 13, 2017, available at https://www.nytimes.com/2017/12/13/business/walmart-workers-pay-advances.html

[8] Devina Khanna, Arjun Kaushal, "Earned Wage Access and Direct-to-Consumer Advance Usage Trends," *Financial Health Network*, April 2021, available at https://s3.amazonaws.com/cfsi-innovation-files-2018/wp-content/uploads/2021/04/26190749/EWA_D2C_Advance-_sage_Trends_FINAL.pdf

subject it to federal and state lending laws. Many are especially against the D2C business model, citing evidence that it can cause expensive overdraft fees.[9]

EWA does carry risk, and misusing it could worsen, rather than improve, one's financial wellbeing. But so do any financial services no matter how consumer-friendly they may be. Banning EWA or forcing the existing legal and regulatory framework on it could inadvertently deprive consumers of a lower-cost alternative to help them deal with financial emergencies.

First, any financial product or service may be subject to misuse or abuse but that should not be the reason to ban or restrict their use. Credit cards provide convenience, rewards, and to some, a way to smooth their income. But no one is calling for banning credit cards because irresponsible use of credit cards can result in crushing debt.

Second, EWA's low pricing makes it far more appealing to consumers who experience cash flow constraints. According to a study conducted by the Financial Health Network, consumers who use EWA two times a month pay on average between $60 and $120 per year.[10] The range reflects different EWA fee models. If those consumers use overdraft services instead, they would incur $840 in overdraft fees a year. For the first time, there is a market-based solution that can help consumers effectively manage short term financial shocks.

Third, blaming EWA, especially D2C EWA, for causing overdrafts is inaccurate. EWA does not cause overdrafts. Low-income consumers with scant emergency savings are prone to overdrafting their accounts to meet obligations (e.g., bills). Multiple financial emergencies could lead to multiple overdraft fees in a short period of time. However, EWA offers a way to avoid overdrafts. Many consumers can either actively use EWA to avoid overdrafts or rely on the services offered by some EWA providers that proactively provide advances when the consumer's account balance is in danger of dipping below zero.

Fourth, banning D2C EWA would force many low-income consumers, especially those who are not employed by large companies, to return to the traditional high-cost products. The B2B EWA works well for large and medium-sized businesses due to economies of scale. Sole proprietors and employees of most small businesses would have no access to EWA if the D2C EWA didn't exist. In addition, workers who change jobs would also experience the loss of EWA access as universal EWA via the workplace is not and will unlikely be attainable.

Finally, we should learn the lesson from the disappearance of deposit advance products (DAP) as a result of the imprudent regulatory intervention. DAP fees were generally lower than overdraft fees and DAP was mostly used by consumers who had short term cash flow challenges. In

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[9] "Concern about prior leadership's finding that certain earned wage access products are not "credit" under TILA," National Consumer Law Center & Center for Responsible Lending, October 12, 2021, available at https://www.nclc.org/images/pdf/banking_and_payment_systems/fintech/EWA-letter-to-CFPB_Oct-4-2021.pdf

[10] Devina Khanna, Arjun Kaushal, "Earned Wage Access and Direct-to-Consumer Advance Usage Trends," *Financial Health Network*, April 2021, available at https://s3.amazonaws.com/cfsi-innovation-files-2018/wp-content/uploads/2021/04/26190749/EWA_D2C_Advance-_sage_Trends_FINAL.pdf

November 2013, the OCC[11] and FDIC[12] issued guidance citing safety and soundness as well as reputation concerns about DAP. No bank has offered DAP ever since. According to research by the CFPB, DAP users were made worse off after the product was removed from the market.[13] EWA is similar to DAP in many ways, except that EWA is far more affordable and has no recourse. Killing EWA without adequately studying and understanding its benefits and risks would only harm the most vulnerable consumers.

EWA's strong market traction has attracted attention from federal and state policymakers. It is reasonable to expect that EWA should be subject to both federal and state oversight. At the federal level, most would agree that EWA firms are already under the CFPB's Unfair, Deceptive, or Abusive Acts or Practices (UDAAP) and the FTC's Unfair or Deceptive Acts or Practices (UDAP) authorities. The Gramm-Leach-Bliley Act (GLBA) that governs privacy generally applies as well. Other statutes such as the Equal Credit Opportunity Act (ECOA), Fair Credit Reporting Act (FCRA), and Fair Debt Collection Practices Act (FDCPA) and their implementing regulations are not as relevant for EWA as every consumer (so long as there are accrued and unpaid wages) is eligible and there is no credit reporting or debt collection. In short, there is no need for new federal EWA legislation or regulation. Any unnecessary federal intervention to ban or restrict EWA would impede the vital leadership role states should play.

The real uncertainty is at the state level as most state lending laws generally are awkwardly unfit for EWA. Most EWA providers welcome some form of state oversight. The question is what sort of supervision is required and what kind of consumer protection safeguards should be applied. A number of states have had legislative proposals to establish a new regulatory framework for EWA, but so far none has succeeded.

In California, SB-472 was introduced in 2019 to create regulatory certainty for EWA.[14] It did not pass but it offers a helpful blueprint for other states that are considering EWA legislations.

First, what should be the scope of such state legislation? SB-472 was a good example of trying to be inclusive of every possible business model instead of only allowing B2B EWA. Both B2B and D2C EWAs can play a role competing with each other and with other alternatives.

Second, should there be limits on fees, access frequency, and access amounts? SB-472 imposed caps on all three. Most EWA participants ultimately supported such caps, though some would prefer not to have any restrictions (especially with regard to fees) or less restrictions on access frequency and access amounts. Each state should carefully examine the pros and cons of such limits and make its own decision. For example, if the EWA industry is willing to agree on a fee

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[11] Office of the Comptroller of Currency, "Guidance on Supervisory Concerns and Expectations Regarding Deposit Advance Products," November 2013, available at OCC Bulletin 2013-40, "Deposit Advance Products: Final Supervisory Guidance".

[12] Federal Deposit Insurance Corporation, "Guidance on Supervisory Concerns and Expectations Regarding Deposit Advance Products," November 2013, available at Federal Register/Vol. 78, No. 228/Tuesday, November 26, 2013/Notices

[13] Romeo, Charles J., Estimating the Change in Surplus from the Elimination of Deposit Advance Products February 27, 2018. Consumer Financial Protection Bureau Office of Research Working Paper No. 2018-02, Available at SSRN: https://ssrn.com/abstract=3135496

[14] SB-472 Wage-Based, Work-Based, and Income-Based Advances. https://leginfo.legislature.ca.gov/faces/billTextClient.xhtml?bill_id=201920200SB472

cap that is lower than the competing financial services but still allows them to be profitable, maybe there is no need to limit access frequency and amounts.

Third, should certain practices such as tips and expedite fees be banned? The answer is no. Though, there are some caveats. No provider should advertise its EWA service as free when they make tips mandatory (or quasi-mandatory with strings attached) or charge a fee to expedite the funds. That would be deceptive. If EWA providers are honest about what they charge and consumers are fully informed before using the product, then there is no harm. If policymakers are still uneasy about such practices potentially being manipulative, they can still resort to other measures such as fee caps, which if put in place, would make this debate irrelevant.

EWA has come of age. Consumers are embracing this new service as it can meet their critical needs at a much lower cost than other traditional financial services. Policymakers should keep an open mind and work with both the industry participants and consumer groups to provide regulatory certainty so more consumers can benefit from this innovation.

Respectfully,

Dan Quan
Adjunct Scholar
Center for Monetary and Financial Alternatives
Cato Institute

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November 2, 2021

The Honorable Stephen Lynch
Chairman, Task Force on
Financial Technology
Committee on Financial Services
U.S. House of Representatives
Washington, DC 20515

The Honorable Warren Davidson
Ranking Member, Task Force on
Financial Technology
Committee on Financial Services
U.S. House of Representatives
Washington, DC 20515

Dear Chairman Lynch and Ranking Member Davidson:

On behalf of the Electronic Transactions Association (ETA), we appreciate the opportunity to submit this statement for the record before the Task Force on Financial Technology's hearing, "Buy Now, Pay More Later? Investigating Risks and Benefits of BNPL and Other Emerging Fintech Cash Flow Products."

ETA is the world's leading advocacy and trade association for the payments industry. Our members span the breadth of significant payments and fintech companies, from the largest incumbent players to the emerging disruptors in the U.S and in more than a dozen countries around the world. ETA members make commerce possible by processing more than $21 trillion in purchases worldwide and deploying payments innovation to merchants and consumers.

ETA and its members are dedicated to continuously driving innovation in the payments space – one of those products is called Buy Now, Pay Later (BNPL). BNPL enables consumers to make fixed payments for individual purchases, often repaid in interest-free installments over a short period of time. For certain BNPL products, a consumer can purchase an item without paying the full price upfront at no extra cost if repayments are made on time.

Consumers are demanding more flexibility in how they shop and pay for goods and services. For example, US e-commerce sales have increased 15% each year since 2015, with a 30% spike in growth during the COVID-19 pandemic.[1] To adapt to this shift, most retailers have an online presence and many are using new point-of-sale offerings like BNPL to increase customer exposure, improve customer experience and boost sales.[2]

BNPL is Rapidly Growing

Consumers are looking for new ways to manage and control their own finances. This includes a shift away from traditional credit offerings, embracing greater flexibility in spending patterns and adopting new technologies to help manage their budgets. These trends were particularly evident in 2020, as people relied more on platforms which allowed them to connect, find value and maintain control over their finances throughout the COVID-19 pandemic, and the trend has continued into 2021.

Typically, BNPL allows users to purchase an item without paying the full price upfront and repay the remaining balance in cost-free installments. In other cases, the consumer may pay interest, but only on the principal balance, assuming that the consumer stays current on payments. As a result, BNPL is rapidly becoming a significant component of retail spending. Consumers choose to use BNPL for several

[1] US Census Bureau (2021), Latest Quarterly E-commerce Report
[2] Alexandra Tachalova, Business.com (2018), Make more sales with E-commerce payment options

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reasons – the installment payment model, budgeting support, convenient access to credit, and the ability to shop through online marketplaces offered by BNPL providers.[3]

BNPL Empowering Consumers to Save and Spend Wisely
Those in younger age groups are choosing to use BNPL for a few reasons, including the repayment terms are often far simpler and easier to understand than traditional agreements. In 2021, BNPL users avoided significant costs they might have faced if purchasing with traditional credit offerings, equivalent to hundreds of millions of dollars in credit card fees and interest.[4]

One of the most common banking issues for underserved consumers are unexpected fees. Underserved consumers that successfully repay their BNPL loans avoid recurring debt. By providing easy access to credit, typically with no interest, BNPL loans may help underserved consumers be better prepared for unexpected emergency expenses.

BNPL Products and Robust Regulation
BNPL products are subject to key consumer protection regulations and ETA members are committed to ensuring that consumers use BNPL and all financial/payments products and services responsibly. BNPL is subject to key consumer protection laws and regulations, including anti-money laundering, Equal Credit Opportunity Act, Fair Credit Reporting Act, debt collection, privacy, Unfair, Deceptive, or Abusive Acts or Practices (UDAAP), fair treatment of customers, electronic fund transfers, and in some cases, Regulation Z. They also are subject to similar state consumer protection laws.

BNPL Companies Support American Businesses and Jobs
ETA members are key players in the shift towards faster, more secure, and innovative retail platforms and payment technologies. They understand the needs of its increasingly value conscious user base and empowered its merchant partners to develop offerings that meet these needs. The tens of thousands of US and global merchants enjoy several benefits from using BNPL services, from driving sales to increasing average order values, and attracting new customers. ETA members and their merchant partners engaging in BNPL, have also made a substantial contribution to the US economy, supporting jobs and broader economic growth.

We appreciate the Task Force's leadership on this topic as well as the opportunity to submit this letter for the record. If you have any questions, contact me or ETA's Senior Vice President of Government Affairs, Scott Talbott at stalbott@electran.org.

Sincerely,

Jeff Patchen
Senior Manager of Government Affairs
Electronic Transactions Association

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[3] *Accenture/Afterpay, The Economic Impact of Buy Now, Pay Later in the US* (Sept. 2021), available at https://afterpay-corporate.yourcreative.com.au/wp-content/uploads/2021/10/Economic-Impact-of-BNPL-in-the-USvF.pdf.
[4] *Id.*

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December 10, 2021

Rep. Nikema Williams
Committee on Financial Technology
House Financial Services Committee
Washington, DC 20515

Re: Questions for the Record, Financial Services Task Force on Financial Technology Hearing, "Buy Now, Pay More Later? Investigating Risks and Benefits of BNPL and Other Emerging Fintech Cash Flow Products" (Nov. 2, 2021)

Dear Rep. Williams,

Thank you for your questions for the record in response to my testimony on "Buy Now, Pay More Later? Investigating Risks and Benefits of BNPL and Other Emerging Fintech Cash Flow Products." Here are my responses.

***Question*: I have been that person who needed a couple hundred dollars to pay a bill to make it to payday. I have been that person who could not get a traditional loan when I needed it. I know what it's like for too many people who are working hard but need help just to get by.**

I'm here in Congress now, but it all could have turned out so differently. And it has for too many folks.

Ms. Saunders, what are some of the risks when consumers need to use services like earned wage access and overdraft avoidance on a regular basis just to get by? What long-term impacts can this have on consumers with limited means?

Response:

Earned wage access products and most fintech overdraft avoidance services are balloon-payment loans, with the repayment taken in one full payment from the next paycheck or deposit. The result is that consumers will often find themselves short the next pay period, just pushing the problem down the road and compounding it with fees and charges. Like payday loans, these balloon-payment loans tend to encourage a cycle of chronic reborrowing, with new advances not providing new liquidity but instead just dealing with the shortfalls caused by the previous advance. When these services are used on a regular basis – as most are – they are not helping consumers to get by. Instead, they are adding fees to their budget and leaving them constantly in the hole. The long-term impact can be a drain on sorely needed dollars and more difficulty saving and managing a budget.

Question: ***As I know from personal experience, there's no financial product that can make up for people not making a living wage.***

Ms. Saunders, what impact do you believe raising the minimum wage would have on the demand for Buy Now, Pay Later (BNPL), Earned Wage Access, and overdraft avoidance?

Response:

You are absolutely correct: credit cannot make up for lack of money, which often stems from low, inadequate wages for our essential workers. Raising the minimum wage to a living wage could help people manage on their current paychecks and prevent them from falling into costly debt traps when they borrow just to make ends meet. In particular, employers that are considering tools to enable their workers to borrow from the next paycheck should instead focus on paying a living wage, offering regular hours and predictable schedules, and promoting savings programs.

Please let me know if you have any further questions. Thank you very much.

Yours very truly,

Lauren Saunders
Associate Director

Responses from Marisabel Torres to Representative Nikema Williams' Questions

2. Ms. Torres, have there been any studies or reviews on the demographic characteristics of early wage access and overdraft avoidance users with respect to age, income, gender, race, ethnicity?

Thank you for your question, Representative Williams. As advocates, we are concerned that low-income consumers, who are disproportionately people of color, may be targeted with products for which we do not currently have sufficient data to assess potential harm. We place consumers at risk if we give providers of credit a regulatory free pass from our consumer protection and fair lending laws because they claim to be offering something "innovative." Many of these providers market their products to low-wage workers who may be struggling to make ends meet, and who likely have limited options for traditional forms of credit. These consumers would be better served by affordable and transparent financial products, not by those who seek to evade regulation.

In the case of early wage access (EWA), borrowers are typically hourly, low-wage workers. Research on the employer-based EWA model suggests that Hispanic adults and younger workers are more likely to use EWA than the population as a whole. One study found the adoption rate among the general population was 14%; among Hispanics, it was 25%.[1] This same study found that Hispanic adults had the highest level of requests to access the funds instantly, which they concluded indicated a greater need for them.[2]

Several faux EWA providers who offer their products directly to consumers and not through an employer's payroll, conducted research[3] that attempts to cast the product in a more favorable light, claiming that most users have attained at least some college education (59%) and an average household income of $50,700. However, that same research also states that most users are relying on the service to meet essential needs. The survey reports groceries as the most popular use of EWA funds (52%), followed by avoiding late fees (44%) and paying utility bills (40%), suggesting that, despite their higher incomes, the users of these products are still economically vulnerable. Furthermore, the reliance on these products for essential expenses, as opposed to occasional shortfalls (the survey notes the majority of users access the product every two weeks), among mostly non-white (51%) and women (63%) users makes the industry's attempt to avoid coverage under fair lending laws all the more troubling.

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[1] Michael Moeser, Earned Wage Access: Faster wage payments disrupt the traditional payday, Original research from American Banker and Employee Benefit News (ebn), at 7 (June 2021), https://www.americanbanker.com/research-report/faster-wage-payments-disrupt-the-traditional-payday.

[2] Ibid

[3] FTI Consulting memo, "Direct to Consumer Earned Wage Access User Survey Key Findings," https://www.earnin.com/assets/pdf/FTI-Earned-wage-access-memo.pdf. Given that over half of EWA users (55%) were characterized as Millennials ages between 25-40, it is probably reasonable to assume that student loans may play a considerable role in creating the financial shortfall.

The "overdraft avoidance" market appears to be growing rapidly; one provider of these products reports that they serve 10 million users.[4] These products are also marketed to lower-wage earners, and we can reasonably assume that they are disproportionately people of color who have been historically underserved by mainstream financial services and credit opportunities. This speaks to the need for oversight and regulation to ensure our existing consumer protection and fair lending laws are applied and enforced.

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[4] American Banker, "How neobank Dave hit 10 million users in four years," https://www.americanbanker.com/news/how-neobank-dave-hit-10-million-users-in-four-years