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# Buy Now, Pay Later: The Story So Far

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## Background and introduction

Buy Now, Pay Later – popularly known as BNPL – has globally emerged as a convenient payment method over traditional lending and payment facilities in the last half-decade or so. The growth of the industry was only further accelerated by the COVID-19 pandemic. In the Indian context, even though the amounts disbursed are not as significant, in terms of the number of loans, BNPL is reported to comprise roughly 37 per cent. and 11.91 per cent. of the total loans disbursed by banks and non-banking financial companies (***NBFCs***), respectively. From a 3 per cent. share in 2020, the BNPL industry's share in digital payments is expected to increase to 9 per cent. by 2024, with the sector expected to turn into a roughly USD 40 billion industry by then. The year-on-year growth recorded for BNPL surpasses that of the other popular contestant in the digital space, UPI.

BNPL bridges the wide gap between customers' lower purchasing power and expenses, especially in India where credit card penetration is still significantly lagging in comparison to its western counterparts, supplemented by traditionally strict eligibility criteria to avail formal finance. It remains a separate story that even those with access to formal finance are increasingly drawn to using the BNPL facility given primarily the lure of a faster and easier check out process. The massive advertising spends by BNPL players are also of course paying off. Purchasing goods on credit has anyway traditionally always been a part of the Indian payment ecosystem.

Broadly speaking, a BNPL facility enables customers to make online as well as offline purchases without making the entire payment at that stage and allows them to repay the purchase price at a future date with little to no interest charges. The repayment can either be in lump sum or in the form of equated monthly instalments. The interest free period offered by the BNPL providers typically ranges between 15 to 45 days and the credit limit generally ranges between INR 500 to INR 30,000, with a few players extending credit for up to INR 100,000.

In a typical BNPL structure, the facility is offered by a financial intermediary (known as ***FinTechs***) which in turn partners with: (i) banks and / or NBFCs, for extending short term credit facility to the customers, which is typically loaded on a pre-paid instrument (***PPI***) in the form of a digital wallet and / or card, etc.; and (ii) merchants, who offer the BNPL facility to the customers. At the point of sale, the merchant is paid for the goods or services, albeit post deduction of a fee, thereby settling the transaction for the merchants. The customer then makes the payment for the credit that had been extended on the due date for the BNPL amount. In some cases, FinTechs stand behind the credit line extended by the lender in terms of a "first loss default guarantee" arrangement with the lender. As such, the two key sources of revenue for the FinTechs are the fee that is deducted from the payment made to the merchants, who are OK with paying such fee on the basis that the BNPL facility increases the spending tendencies of the customers which in turn increases sales for the merchants, and the late payment fee, which is charged from the customers in the event of any default in repayment on time. In another model, merchants themselves agree to a delayed payment of the consideration to them, but those are not as popular as the model described above. Customers undergo a basic credit assessment, usually through a combination of soft credit searches and previous repayment history, for availing a BNPL facility.

## Regulatory regime applicable to the BNPL industry (or lacunae thereof, until very recently)

The current regulatory landscape in India applicable to the lending sector, online or otherwise, is geared towards regulating entities which are operating as "financial institutions", such as, banks, NBFCs and other businesses registered to conduct lending operations under special legislations dealing with chit funds, etc. Regulations have also been introduced off late for regulating newer digital payment modes such as PPIs, payment aggregators, UPI, etc., which are involved in handling monies. FinTechs offering BNPL services typically partner with banks or NBFCs to extend credit to the customers which is repaid to them, with the role of the FinTech being limited to a "pure play" technology service provider. Therefore, the general presumption so far has been that they are not required to obtain any specific licenses or registrations. Their business activities are at best governed in their capacity as entities to which certain functions have been outsourced by banks and / or NBFCs in terms of a specific set of outsourcing regulations framed by the Reserve Bank of India (***RBI***, India's central bank) for this purpose. Those regulations, however, also mostly place the onus of compliance on the bank and / or NBFC as opposed to the FinTech.

The first loss default guarantee arrangements extended by FinTechs to banks / NBFCs are also generally not treated as a financial activity, but merely as a commercial guarantee being provided by one party for the debt of another. Notwithstanding the similarity with credit cards, BNPL products have also not been considered to be regulated as such. As the FinTechs identify themselves only as technology providers and not as being involved in the transaction, currently, they do not apply for a registration as a payment system operator either.

In addition, whilst it is mandatory for credit institutions to join one of the credit information companies in India and provide details regarding the credit facilities granted or to be granted to any borrower, in the absence of a statutory definition of the term "credit", the details of BNPL loans are not reported by FinTechs. Since there is no interest charged in the initial period, the lenders do not classify such transactions as credit either and only do so if the repayment is not made in the interest free period. Generally, the lenders do not even have complete visibility of where the funds of the PPI were being used or indeed the end customer details to actually be able to report the loan to a credit institution.

### RBI working group report

Pursuant to a working group report published by the RBI in November 2021 to study the digital lending space, entities engaged in this space were broadly divided into two categories: (i) Balance Sheet Lenders (***BSLs***); and (ii) Lending Service Providers (***LSPs***). BSLs were considered to be entities in the business of lending that carry the credit risk in their balance sheet. LSPs on the other hand, are essentially technology-centric entities which act as both core and ancillary lending service providers such as the FinTechs. An entity can perform the roles of both BSL as well as LSP, as is usually the case of traditional lenders.

The report essentially provided that all credit revolving in the ecosystem should be provided only by BSLs, given those are regulated and are subject to requirements around minimum capitalisation requirements, net worth, etc. LSPs, being unregulated, should not be involved in providing any form of credit or loans including through first loss default guarantee structures. The report further mentioned that to the extent any form of credit exposure is being taken on directly by an LSP / FinTech, it shall be required to obtain prior authorisation to operate from the RBI. It also suggested that BNPL loans should be reported to credit information companies. Setting up of self-regulatory organisations within the wider digital lending space was also recommended.

However, so far, the recommendations of the working group have not been formally given effect to and the BNPL sector, amongst other sectors, continued to function in "vacuum" prior to the RBI circular of June 2022.

## RBI circular of June 2022

The stance of the RBI so far had been that it was evaluating the BNPL sector, including in terms of the recommendations of the working group report, and would come out with an appropriate set of regulations. The Payments Vision 2025 statement issued by the RBI on 17 June 2022 provided that the BNPL method "shall be examined, and issuance of appropriate guidelines on payments involving BNPL shall be explored".

However, through a letter dated 20 June 2022 – seemingly sent almost overnight and within days of the Payments Vision 2025 statement – the RBI clarified that PPIs issued by entities other than banks (which formed a bulk of those being used in the BNPL context) cannot be loaded through credit lines and any such practice shall be stopped immediately. According to the RBI, the regulations dealing with PPIs provided that PPIs can only be loaded through cash, debits to the bank account, and debit or credit card. This hit the model being adopted by almost all BNPL players in the country directly, who have, for now, stopped offering these products. Several representations have been made before the RBI for certain relaxations, particularly an extension of the time period for complying with the circular, but so far nothing has been forthcoming. The BNPL players are in parallel also exploring other models of offering the facility, including potentially through credit cards.

Interestingly, the letter was only sent to PPI issuers other than banks which seemingly meant that where the PPI was issued by a bank then it can still be loaded with credit lines. It is, however, being reported that certain banks had sought a clarification from the RBI in this regard, which then confirmed that the restriction would apply to PPIs issued by banks as well.

## Conclusion

The BNPL industry has certain inherent risks in relation to excessive and unregulated lending, absence of credit history of the customers, abusive recovery tactics, customer data privacy and money laundering. As a result, regulators across the globe are reported to be examining the sector closely to ascertain the form of regulation that is required. The UK plans to publish a consultation on a draft legislation towards the end of this year and would then lay secondary legislation, used to fill in the details of legislation, by mid-2023. After that, the regulators would consult on its rules for the sector. The US government has also been conducting an inquiry into the sector. Whilst the regulators in Australia had earlier indicated that they do not intend to interfere with the BNPL market and the players in the market had put in place an industry code of conduct, they are now looking at examining the code more carefully and introduce regulations to fill any gaps.

The stance of the Indian Government in introducing some form of regulation for the sector is certainly understandable and also in line with the approach being adopted by the regulators globally. However, the question is whether any such regulation should follow a well-planned consultation with the stakeholders akin to what is being done in the other jurisdictions, as opposed to the stakeholders having to halt their business completely and apply for relaxations from a regulation (albeit in the form of a clarification) that is issued without any notice? A million-dollar question to ponder over for Indian regulators!

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