AMERICAN BANKER

CFPB warns of risk from data-hungry payment apps and lenders

By Kate Fitzgerald
August 10, 2022
American Banker

The Consumer Financial Protection Bureau warns in a new report that rapidly evolving buy now/pay later services, embedded commerce and "super apps" could put consumers at risk from a variety of directions.

Consumers are being enticed by free or low-cost payment apps and online services whose operators could monetize users' behavioral and spending data to increase their scale and market power, the report suggests.

Combined with machine learning and algorithmic optimization, these processes could disrupt traditional banking and payments models and potentially victimize consumers, according to "The Convergence of Payments and Commerce," which the CFPB published this month.

In its 19-page report, the CFPB said it's working to determine whether BNPL regulatory interventions are needed. The CFPB last year ordered the fintechs Klarna, Affirm, Afterpay and PayPal to provide details about their business practices, which hinge on giving consumers instant loans at the point of sale. The move came after House Democrats urged the CFPB to examine the booming BNPL industry.

The bureau also said that it plans to begin making rules to protect consumers' personal financial data rights, while it closely monitors the country's gradual shift toward real-time payments, "to mitigate the potential consequences of large technology firms" moving into the space.

"We want to preserve the benefits of real-time payments, while still ensuring that the payments ecosystem in the U.S. is fair, transparent and competitive," the CFPB said.

Payments industry experts said the report raises important issues about how digital technology is creating new ways to shop and pay outside of traditional banking and financial services the CFPB regulates.

"Financial institutions have very clear rules about what they can and cannot do with consumer data, but U.S. privacy laws as a whole are a patchwork of regulations with many unclear areas," said Ariana-Michelle Moore, a retail banking and payments advisor with Aite-Novarica.

By capturing consumer transaction data and coupling it with their online behavior, BNPL firms can get a nearly complete picture of a consumer's life, according to Moore.

"Could the coupling of such personal data with financial products lead to unfair lending practices or discrimination? I think regulators are right to be concerned. How do you reel in these firms now, before they become behemoths?" Moore said.

There is legitimate concern at the CFPB that without traditional underwriting, BNPL loans — which are often marketed to young consumers and those with no credit history — could get people into financial trouble, said Daniela Hawkins, managing principal at the payments and banking consulting firm Capco.

"How many BNPL loans should one individual have and what should be the maximum outstanding debt from these? What's the likelihood of defaulting on these loans?" Hawkins said.

The super apps the CFPB flagged in its report as potential threats — China's WeChat and Alibaba, which concentrate a broad range of shopping, banking, travel and loyalty features within a single app — have no direct analog yet in the U.S.

But Google recently said it's retooling its wallet and working to create direct links between consumers' searches for products and services with the ability to make reservations and payments.

Apple also is poised to add new buying, selling and BNPL financing features to its apps, and PayPal recently wove certain shopping, payments and banking features together within its own multifunction app.

In its report, the CFPB said these big tech companies' apps could potentially be exploited "to take advantage of consumers who aren't fully aware of what it is that they have, and what it is that they agreed to."

The CFPB is also concerned about privacy issues surrounding embedded commerce, where payment capabilities are incorporated within areas of other websites and social media apps.

Embedded commerce is still nascent in the U.S., but retailers like David's Bridal recently began testing "shoppable content" on TikTok.

BNPL loans gained significant traction during the pandemic and by June of 2021 nearly half of U.S. adults had used one of the loans to pay for something, according to a survey of 2,046 consumers Aite-Novarica conducted.

Juniper Research predicts that the global user base of BNPL loans will increase by about 160% over the next five years to more than 900 million, driven by ongoing demand for low-cost credit solutions.

"In their newest incarnations, BNPL providers position themselves not as lending solutions or even payment providers, but as marketing platforms that sell prime placement on their popular apps to merchants who pay affiliate fees to acquire consumers," the CFPB report says.

The prospect of all these evolving services creates an opportunity for retail financial services firms to harness consumer financial and behavioral data for profit, the CFPB's report contends.

"In essence, the customer's information could become a revenue source, a 'lead generator' for the financial institution, and if that organization so chooses, for other companies that can use the data for their own revenue generation activities," the report said.

BNPL fintech Afterpay said the company has built its platform to encourage transparency and responsible spending, and it welcomes the CFPB's efforts, outlined in the report, to ensure appropriate protections for consumers and their data.

Scores of other companies are betting that BNPL lending will continue to expand based on positive market reception.

"Most of these new financial systems have relatively existed for decades and fintechs are merely consolidating data that was sitting in silos into a cohesive experience, so consumers can transact faster and more affordably," said Zaid Rahman, founder and CEO of Flexbase. The 45-person firm is creating a super app that includes installment loans for small businesses.