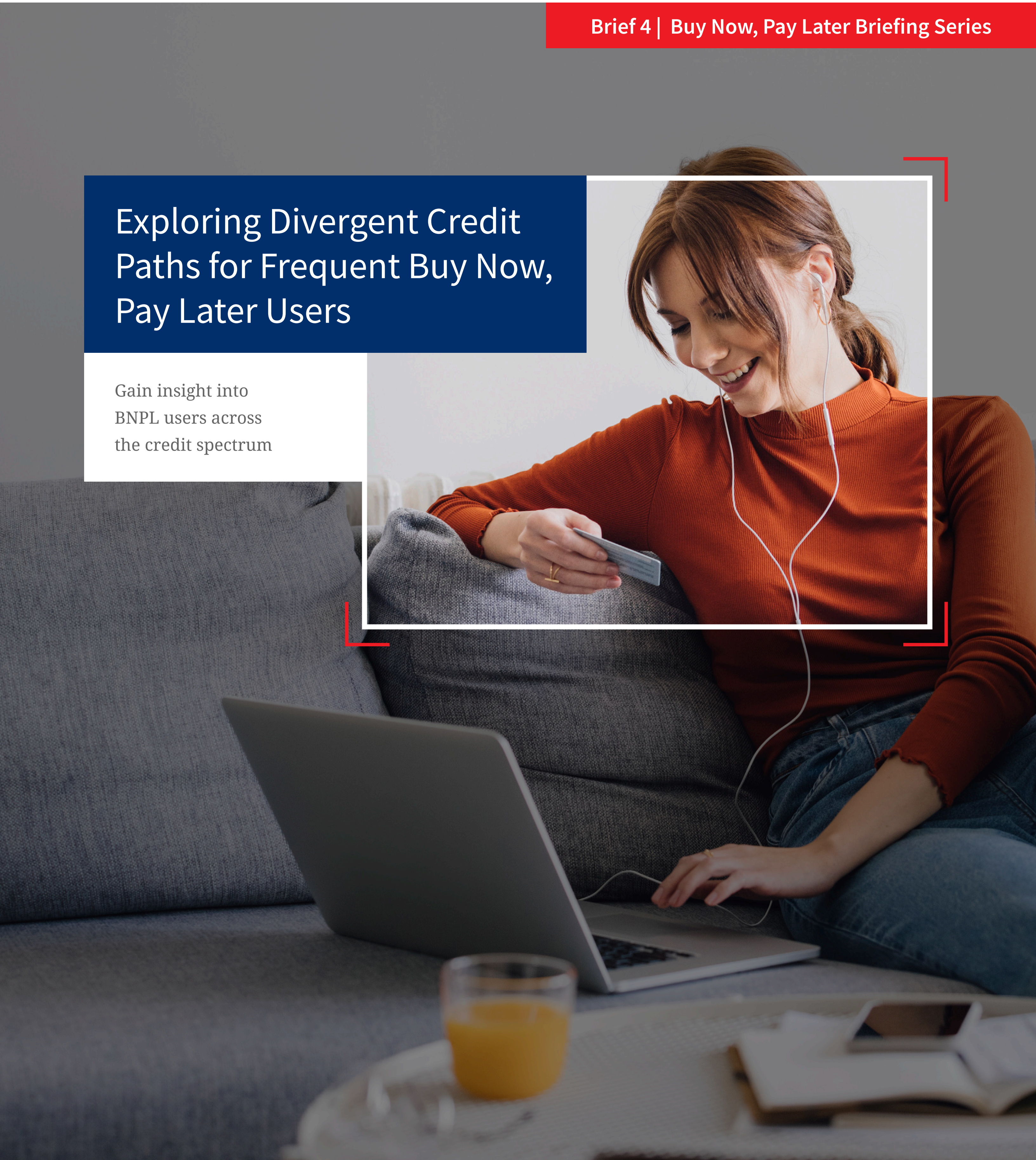
LexisNexis® RISK SOLUTIONS

Brief 4 | Buy Now, Pay Later Briefing Series

Exploring Divergent Credit Paths for Frequent Buy Now, Pay Later Users

Gain insight into BNPL users across the credit spectrum

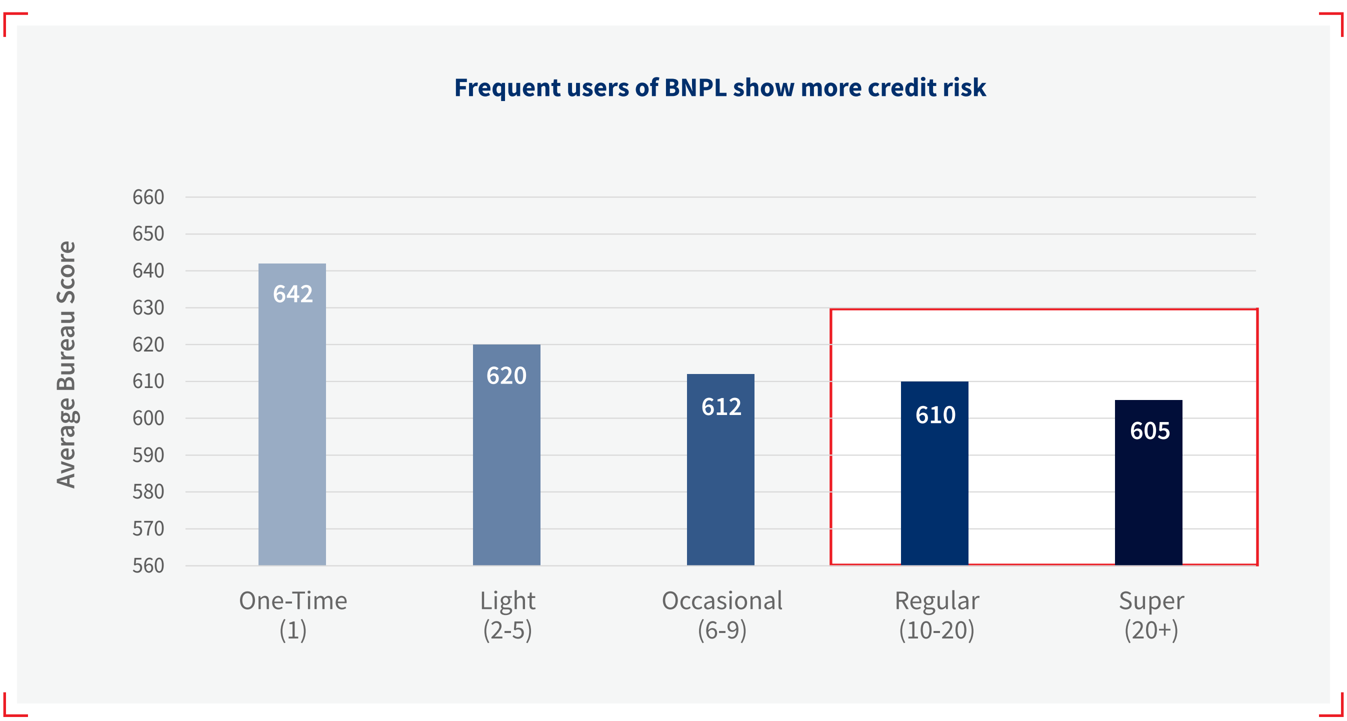


What we know now

In our last research brief, we explored the incremental risk associated with consumers' increasingly frequent applications for BNPL products. We highlighted several types of data that show this relationship such as public record derogatory events, credit utilization and credit delinquencies.

But there could be no clearer sign of impending changes to risk than comparing the tradeline credit scores for frequent BNPL applicants to that of infrequent applicants as shown in Figure 1. On the surface, it appears that consumers who regularly apply for and use BNPL are in some financial distress. But average credit scores mask the volume of consumers that span the credit spectrum from subprime to prime. This research brief will dive into the surprising story of regular BNPL applicants at both ends of the credit spectrum.

Figure 1: The average traditional credit score for each BNPL user profile.



** Regular users of BNPL are considered those that apply for 10 or more BNPL products in a 15-month period.*

Subprime and regular users

Consumers that have low traditional credit scores (below 660) make up 66% of credit-scoreable BNPL users as shown in Figure 2 below. Subsequently, 27% of these subprime BNPL users become regular users. Because subprime consumers typically have struggled to manage traditional credit, our initial hypothesis was that subprime consumers who frequently use BNPL would be prone to over-spending. With that in mind, we tracked how traditional credit scores for this population changed in the 12 months following an initial BNPL application.

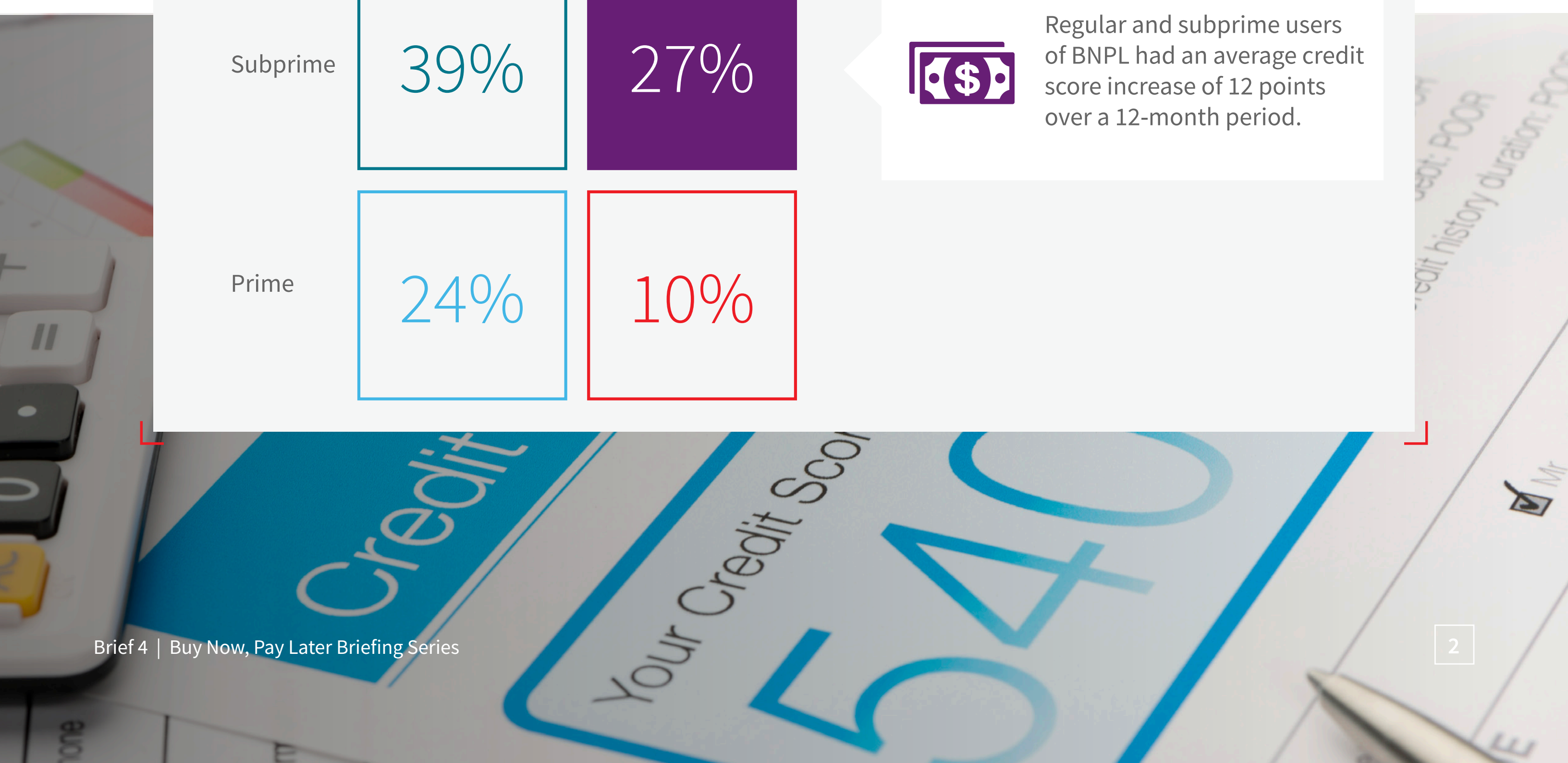
As it turned out, subprime and regular applicants to BNPL show improvement in their credit standing during the period they repeatedly apply for and use BNPL products. This improvement can be seen most directly in the average credit score increasing 12 points over a 12-month period. It is important to note that BNPL activity is not included in the calculation of traditional credit scores, meaning increased scores are more likely an outcome of concurrent changes to traditional tradeline usage shifting to BNPL products.

Figure 2: Percentage of subprime BNPL applicants that fall in the occasional category (1-10 uses) and those that fall into the regular use category (11+ uses)

Traditionally scoreable BNPL applicants

	Occasional BNPL (1-10 uses)	Regular BNPL (11+ uses)
Subprime	39%	27%
Prime	24%	10%

Regular and subprime users of BNPL had an average credit score increase of 12 points over a 12-month period.

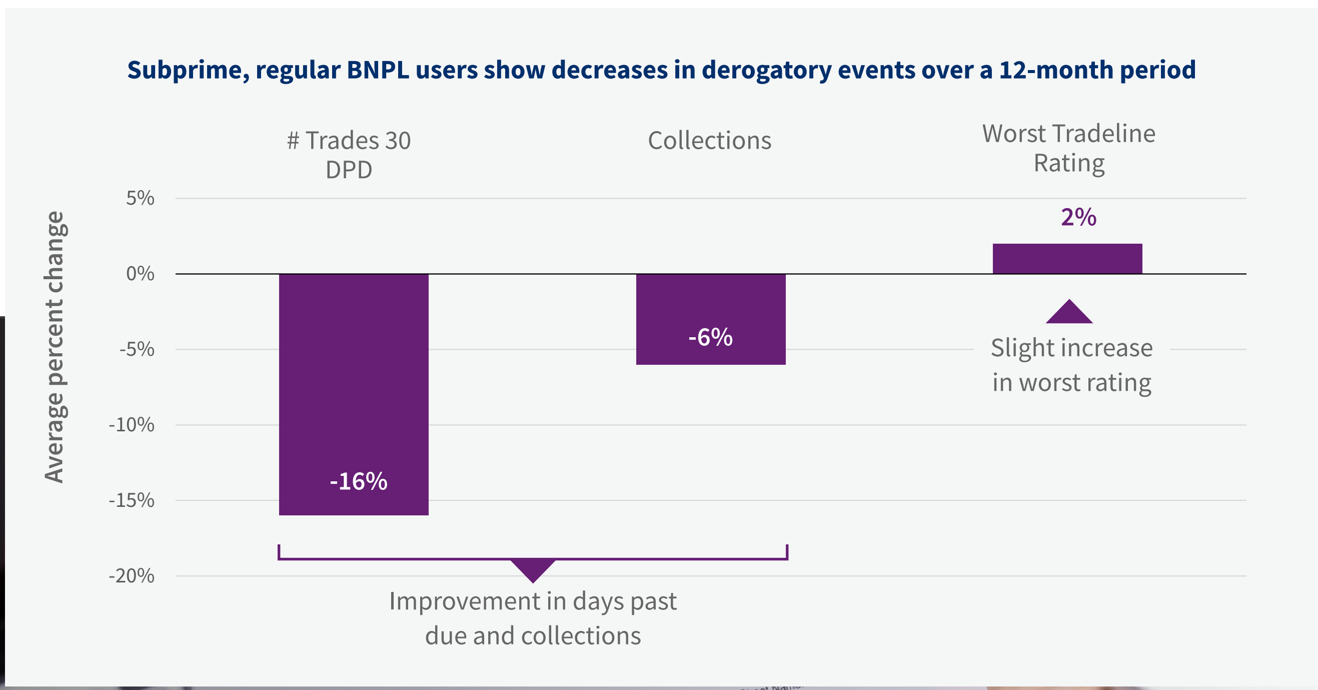


Going beyond credit scores

While it is possible that credit scores increase because migrating from traditional credit to BNPL could hide risk, we see actual changes in credit quality over time in the form of paydown behavior. The proof for improved credit standing can be seen across seven dimensions. Figure 3 highlights the decreases in delinquent tradelines and collections inquiries during the 12 months that coincide with frequent BNPL use. Meanwhile, a measure of the worst rating across tradelines increases a marginal 2% during the same period. These statistics clearly show a net improvement to the delinquency status of subprime consumers during the period they begin to regularly use BNPL.

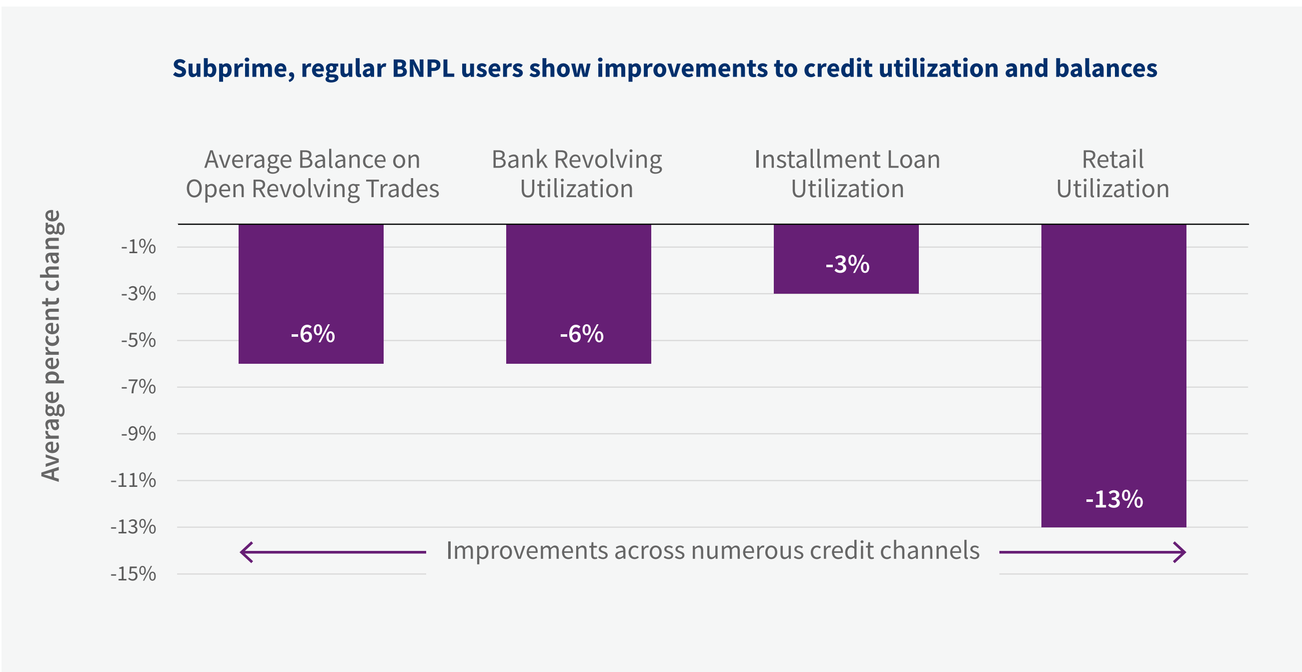
This suggests BNPL alone cannot cause consumers to pay off other traditional debts, but it may be a catalyst for saving money on interest payments and staying current on revolving accounts. In short, usage of BNPL may function as a lifeline to reduce overall credit debt.

Figure 3: Percent change in derogatory tradeline measures during the 12 months following an initial BNPL application by subprime and regular users.



Next, we highlight the measures that show how frequent use of BNPL displaces debts from more traditional sources. Figure 4 provides the percent decreases in balances and utilization for subprime, regular BNPL applicants during the 12-month tracked period. These improvements span several types of credit obligations including revolving tradeline balances and utilization for bankcard, retail card and installment loans. All these factors add up in a credit report to give the appearance of a financially healthier consumer which contributes to higher traditional credit scores.

Figure 4: Percent change in account balance and utilization measures during the 12 months following an initial BNPL application by subprime and regular users.



Are these consumers actually better off financially?

With the advent of BNPL, consumer reporting agencies may no longer have the full picture of a consumer's debt obligations. Some consumers clearly use BNPL enough to alter the view lenders have on their total balances and utilization. But a 12-point credit score increase on average is substantial when we know that 27% of scoreable BNPL users fall into the subprime and regular group.

Additionally, the net improvement in the portion of delinquent accounts over the same period shows that many consumers in this population are actively paying down other debts. There is no causal link between these events, but the volume of data supports the theory that many (not all) subprime consumers who become regular users of BNPL are using this product to improve their money management.

Takeaways from the Subprime and Regular user story

The impacts of regular BNPL use on subprime consumers:

- Reduced burden of traditional credit interest payment and fees
- Positive cycle of lower interest and fees going towards paying down debts and lowering interest further
- More payment flexibility in consumer's financial toolkit

The impacts of consumer migration from traditional credit products to BNPL on lenders:

- Lower balances and utilization on existing lines of credit
- Less activity on existing lines of credit
- Reduced delinquencies among visible tradelines
- Higher credit scores
- BNPL masks true utilization and credit risk

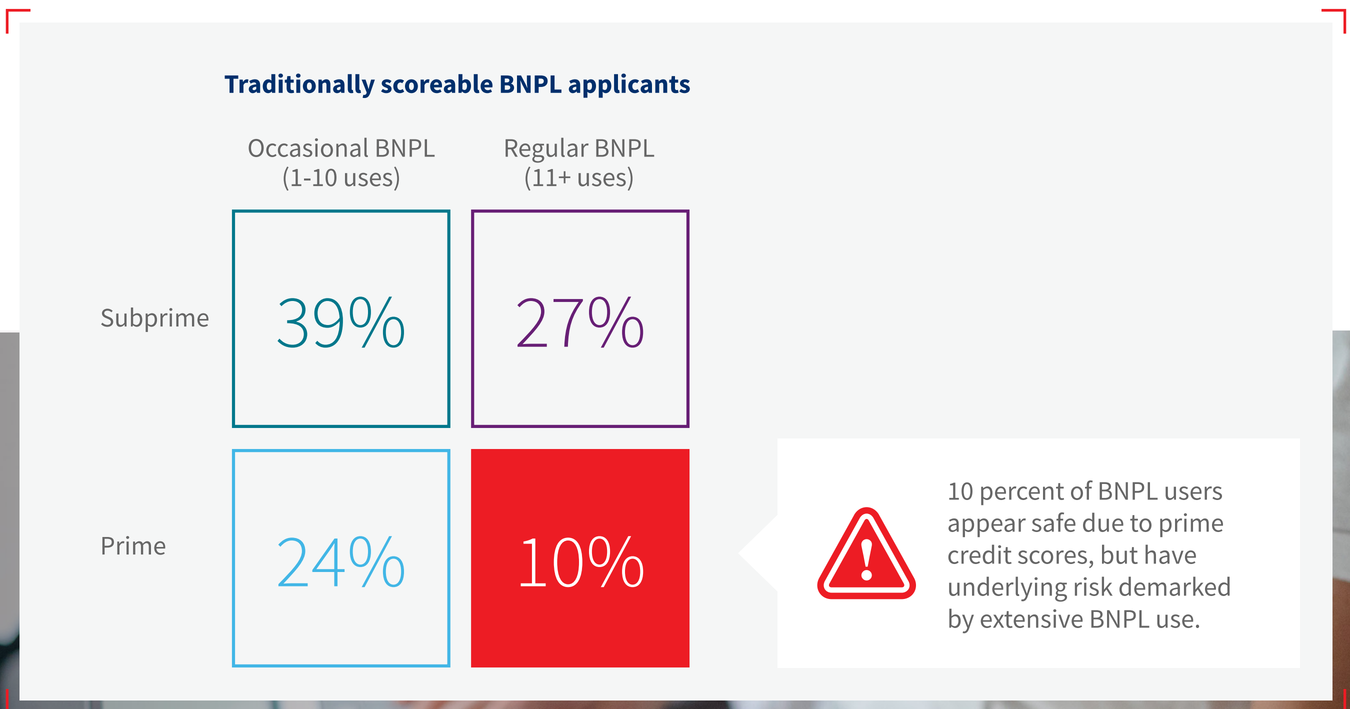
Considering everything above, BNPL products appear to help some subprime consumers with their financial health, but lenders should be aware of hidden risks among BNPL users as credit obligations migrate from reported debts to non-reported debts. We strongly recommend monitoring BNPL usage and behaviors through alternative data sources to track risk migration.

Prime and regular users

Contrary to our assumptions about the BNPL user population, 10 percent of scoreable users have a prime credit score (above 660) and are also regular applicants as shown in Figure 5 below. These consumers are much more likely to have access to affordable credit and rewards programs, and many may not be credit revolvers. It was especially important to research why so many consumers with credit advantages are regularly applying for BNPL products.

During the 12-month study period, the average traditional credit score for prime and regular BNPL applicants dropped by 5 points. An analysis of seven credit score dimensions shows a striking set of changes in the financial health of this group over time. It is important to note that BNPL can be a good credit alternative for financially savvy consumers and not all prime, regular users may be relying on the product as an emergency credit source.

Figure 5: Percentage of prime BNPL applicants that fall in the occasional category (1-10 uses) and those that fall into the regular use category (11+ uses)

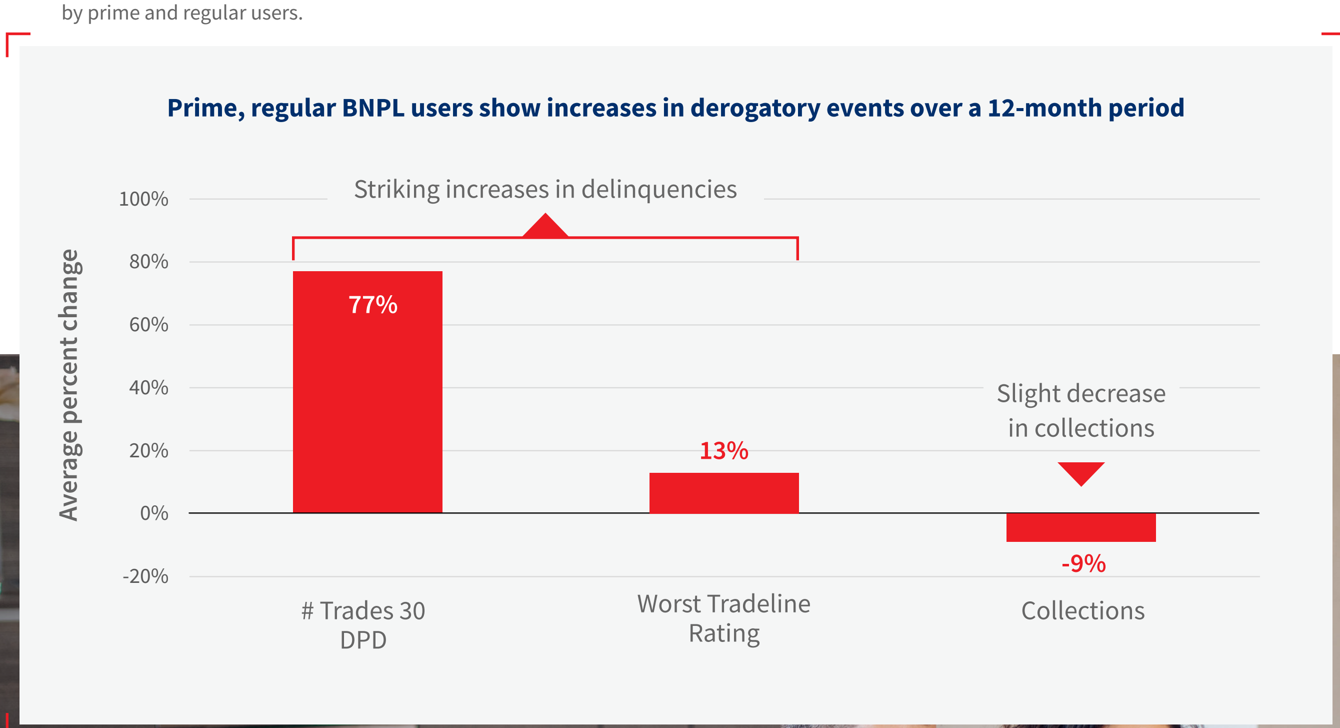


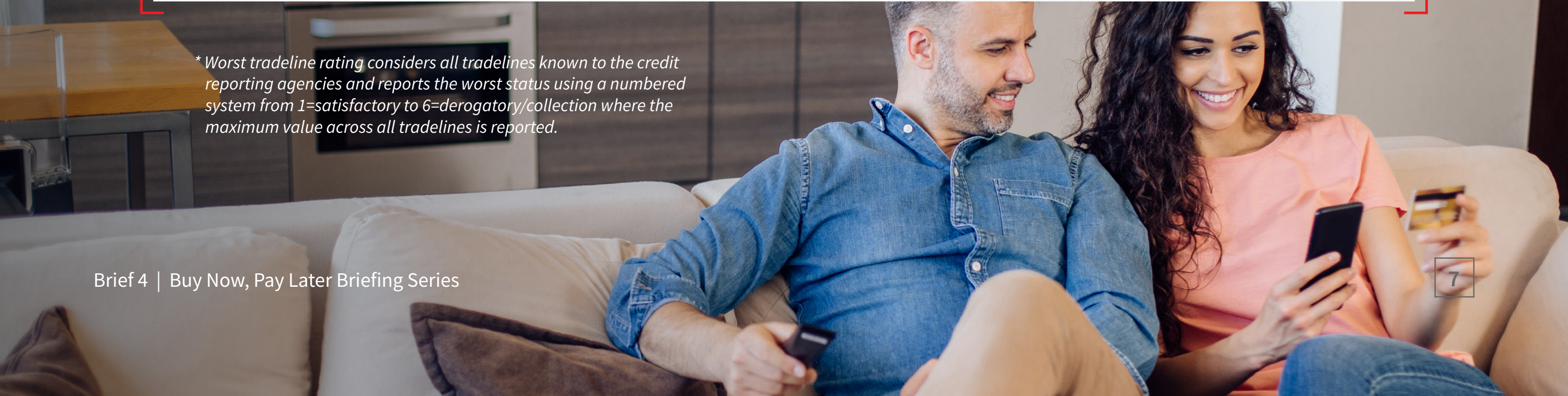
Small credit score decrease, big tradeline changes

The most striking change among prime and regular BNPL users is the 77% increase in the number of tradelines 30 days past due after the initial BNPL application — this can be seen in Figure 6. After beginning to use BNPL frequently, the same consumers a year later are much more likely to have a delinquent tradeline.

There is also a 13% increase in the average rating of the worst tradelines among consumers.* Extreme events like collections inquiries show some declines but do not outweigh the sheer volume of other negative events happening during the same period. These are clear, early signs of financial distress. In other words, prime consumers who start using BNPL products regularly may be showing signs of emerging risks that could be overlooked by traditional credit reporting sources.

Figure 6: Percent change in derogatory tradeline measures during the 12 months following an initial BNPL application by prime and regular users.

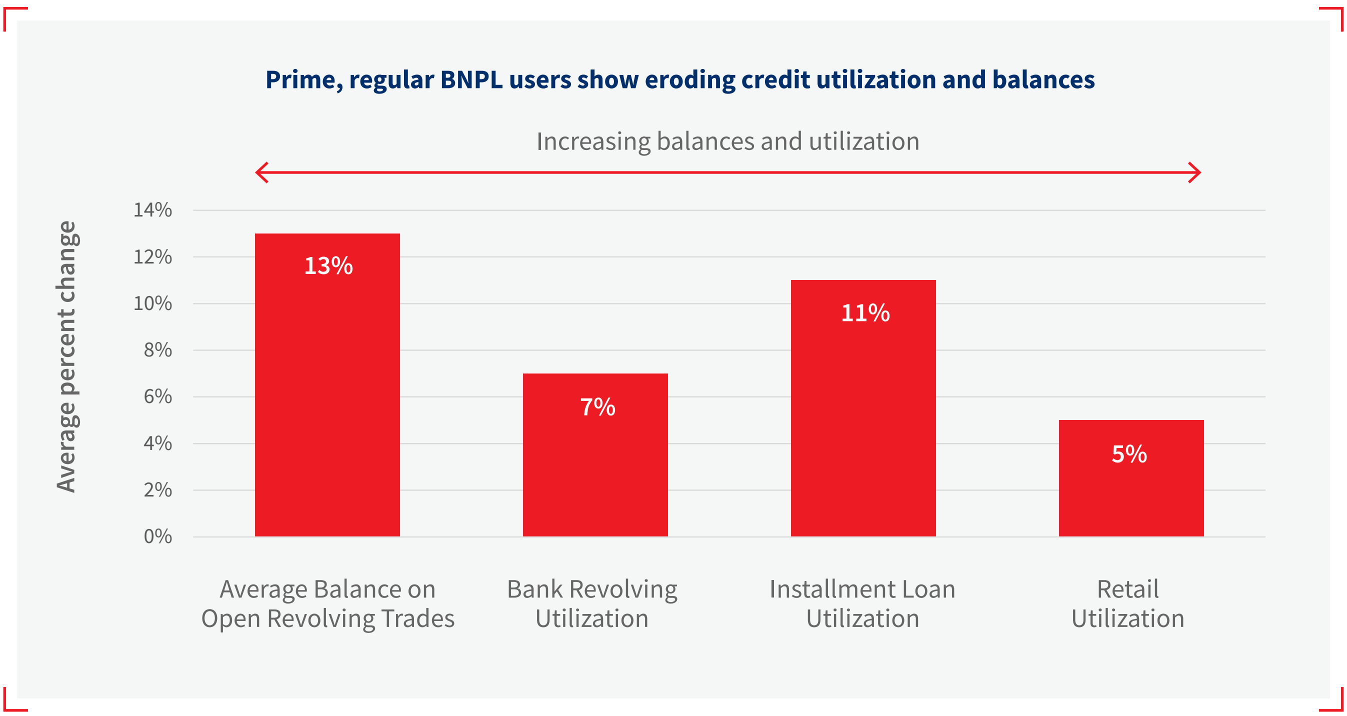




* Worst tradeline rating considers all tradelines known to the credit reporting agencies and reports the worst status using a numbered system from 1=satisfactory to 6=derogatory/collection where the maximum value across all tradelines is reported.

Coinciding with frequent applications to BNPL are substantial increases to their existing tradeline balances and utilization. Figure 7 shows how total revolving balances increase by 13% and utilization ticks upwards by 5-11% depending on the type of debt. With such swift increases in new debt held by prime and regular BNPL users, we can conclude that BNPL inquiries can be a leading indicator of impending financial hardship in the lives of some prime consumers.

Figure 7: Percent change in account balance and utilization measures during the 12 months following an initial BNPL application by prime and regular users.

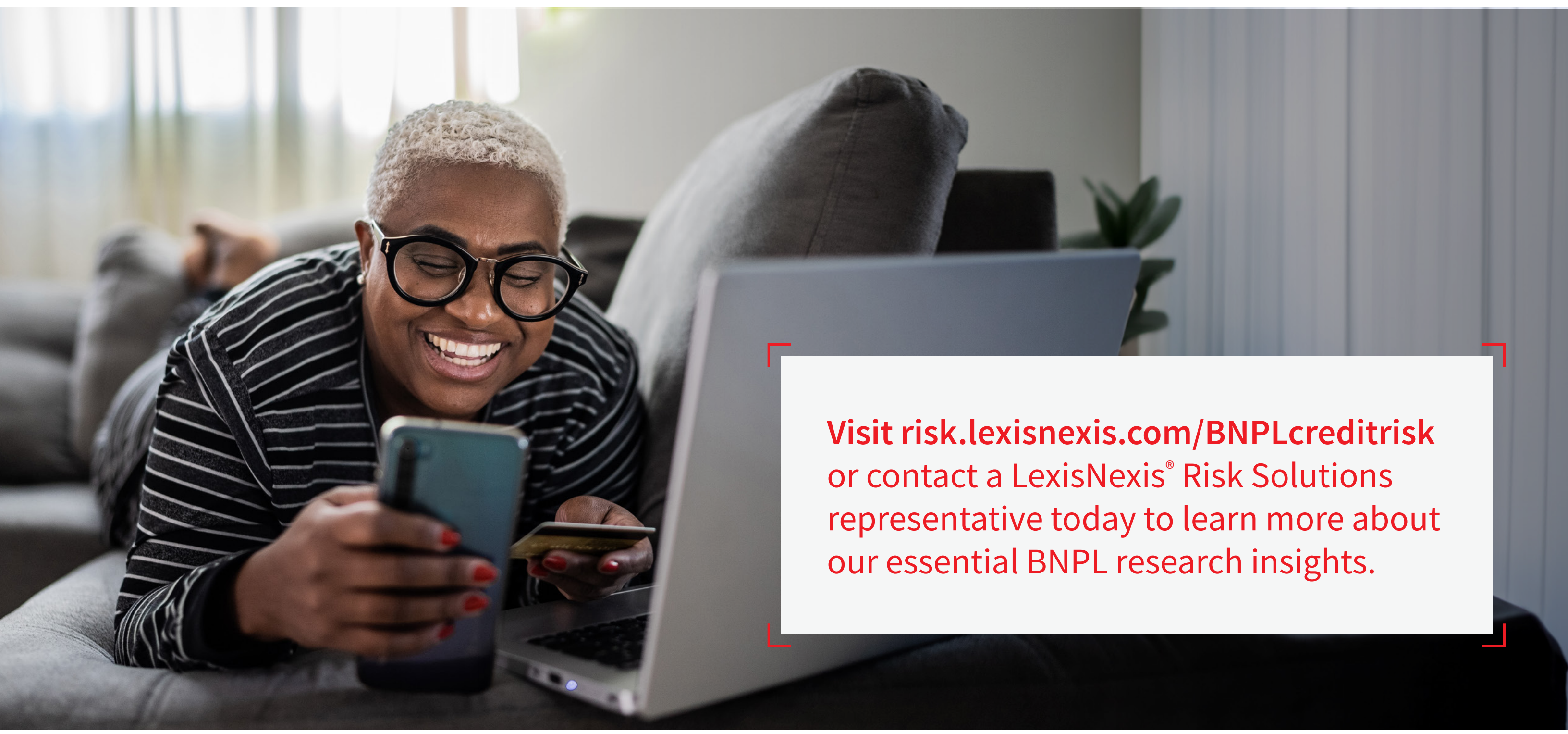


One credit product, many needs from consumers

Prime consumers are unlikely candidates for BNPL, yet one third (34%) of BNPL users are prime and 10% are both prime and regular users. The population we have studied in this section shows a clear need for affordable credit and a willingness to use it when economic stress occurs—irrespective of credit tier. In this regard, BNPL is used by the prime consumer as a remedial tool but to the lending industry, such inquiries can be a leading indicator of financial instability. It appears that subprime consumers are using BNPL as a lifeline for better money management, but prime consumers are using BNPL due to emerging changes in their risk profile.

In closing

We have reported in this research series on the varying degrees of risk that BNPL consumers pose to lenders. By focusing on the riskiest subpopulation (regular users) and pairing that status with traditional credit scores, we get a clearer sense of who this risk is coming from and why. One portion of the risk is characterized by consumers that have struggled with finances in the past, while the other type of risk is captured by those experiencing financial trouble in the present. BNPL provides a potential advantage to consumers that come from a diverse set of backgrounds and are experiencing financial hardship. In the next and final research brief, we will explore the definition of financial inclusion and test whether BNPL is living up to its potential in this area.



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