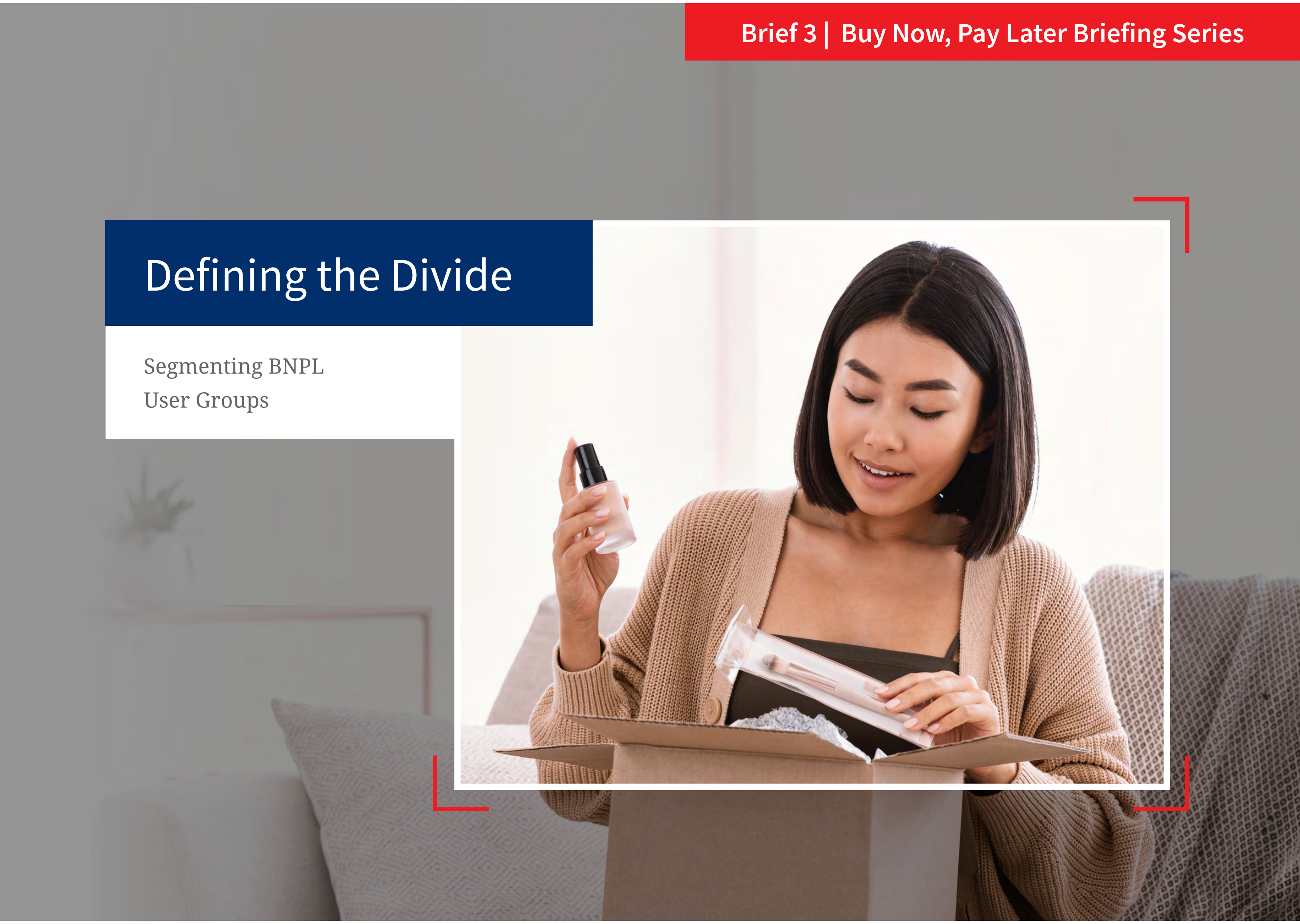
Brief 3 | Buy Now, Pay Later Briefing Series

Defining the Divide

Segmenting BNPL User Groups



The first two research briefs in our series offered a new lens on the types of consumers that use Buy Now, Pay Later (BNPL). We explored the notion that BNPL users are primarily young and credit invisible — instead we found many are older than 35 and credit scoreability is higher than banking applicants. We also found that BNPL users may pose higher risk to lenders after finding greater rates of public record derogatory events in their financial histories. Our research suggested that regular users of BNPL (consumers with 10+ BNPL applications), a subgroup of all BNPL users, drive much of that risk.

In each graphic we show all five types of BNPL users and how risk gradually increases with each "level" of BNPL inquiry. **Our goal is to show how not all BNPL users are quite as risky as others, i.e., the occasional vs. regular user dividing line.**

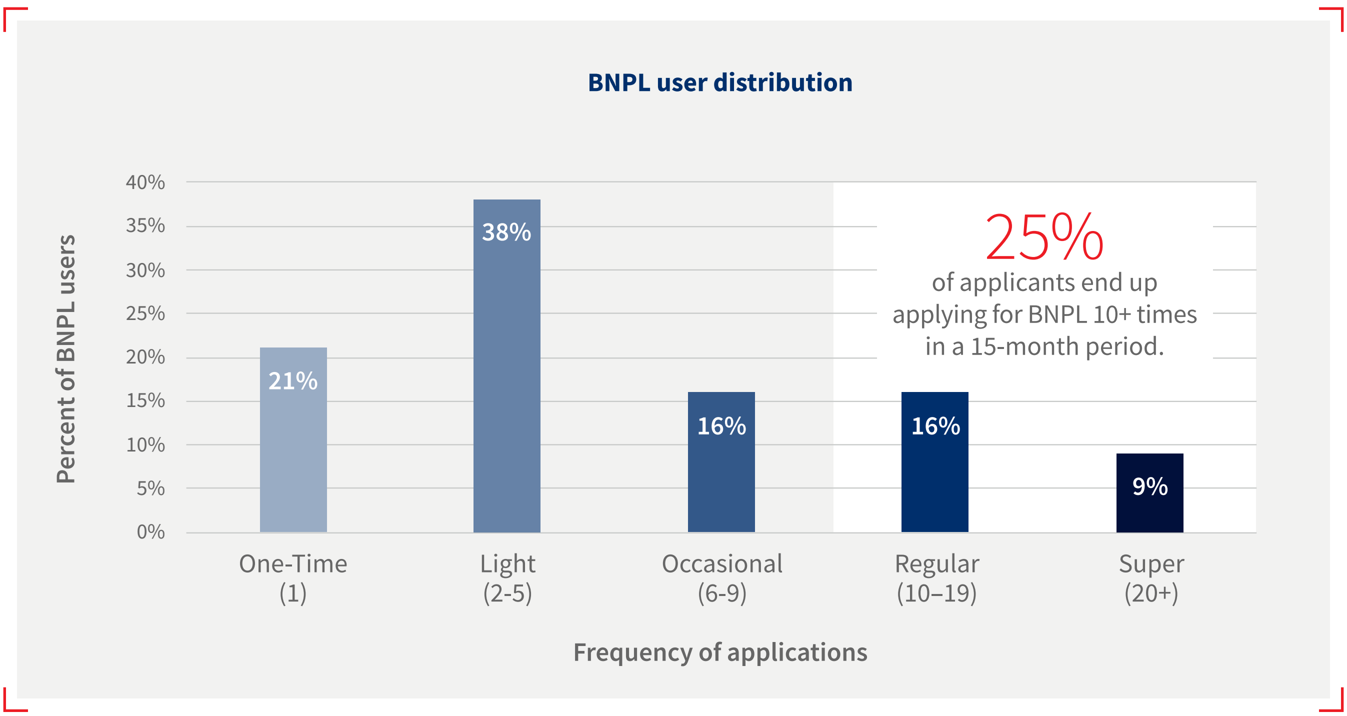
Skewing the picture

We know that credit risk within BNPL is heavily segmented by use-level, but how does the credit behavior of frequent BNPL applicants compare to the profile of an infrequent BNPL user? Equally important — how does the traditional credit profile of frequent users change the longer they use BNPL, and what risks might this present to the overall US lending ecosystem?

The BNPL applicant population can be broken into five groups based on their transaction volume during a 15-month period:

- One-Time
- Light (2–5 applications)
- Occasional (6–9 applications)
- Regular (10–19 applications)
- Super Users (20+ applications)

Figure 1: The five profiles of BNPL use. 25% of applicants end up applying for BNPL 10+ times in a 15-month period.



Dimensions of difference

Looking at the frequency of BNPL use over time provides significant insight to help segment risk among the BNPL applicants. Two measures show this relationship clearly. Figure 2 measures consumer BNPL use from the point they first apply for BNPL and how their usage grows over a 15-month period. Super Users heavily utilize BNPL over this period and are often highly leveraged on existing tradelines. In fact, consumers who eventually become Super Users are 1.8X more likely to be highly leveraged at the outset of their BNPL use than consumers who only end up using BNPL once. This tells us that when consumers are faced with a lack of credit options, they turn to BNPL products at higher rates. Due to current economic volatility, highly leveraged users are likely turning to BNPL as an alternative way to access credit.

Figure 2: The portion of consumers who were using 75% or more of their total available credit at the time of their first BNPL application.

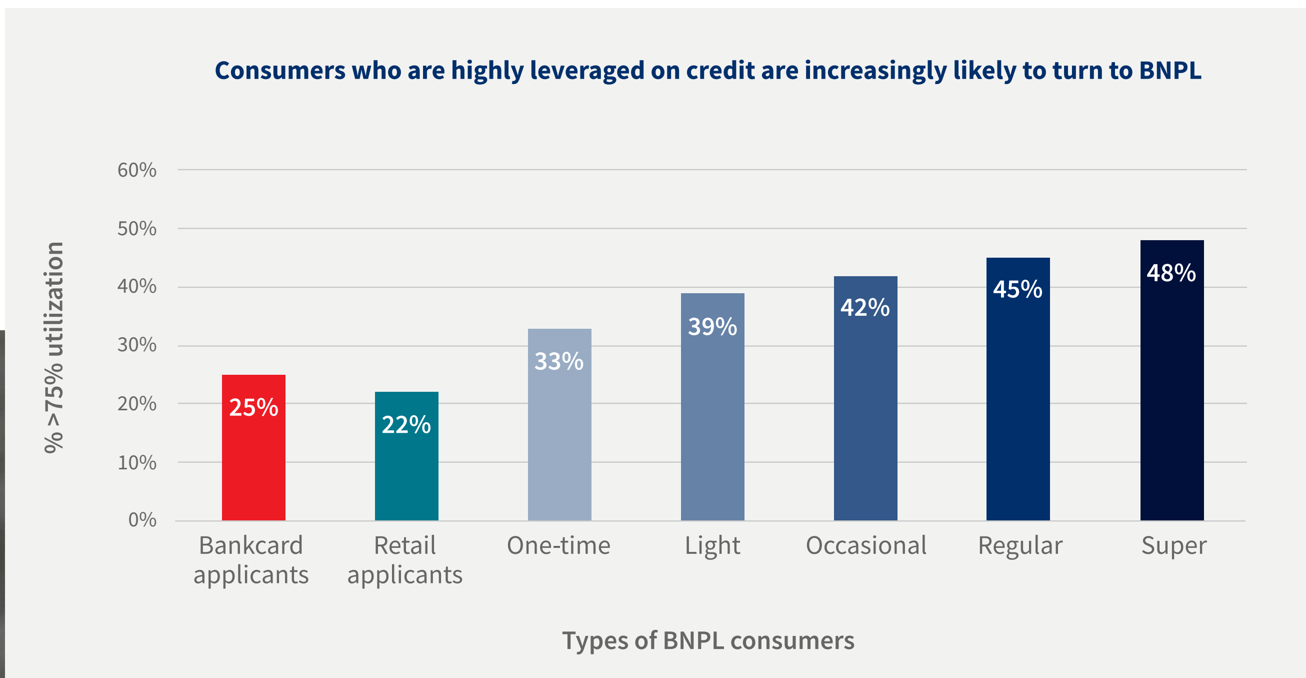
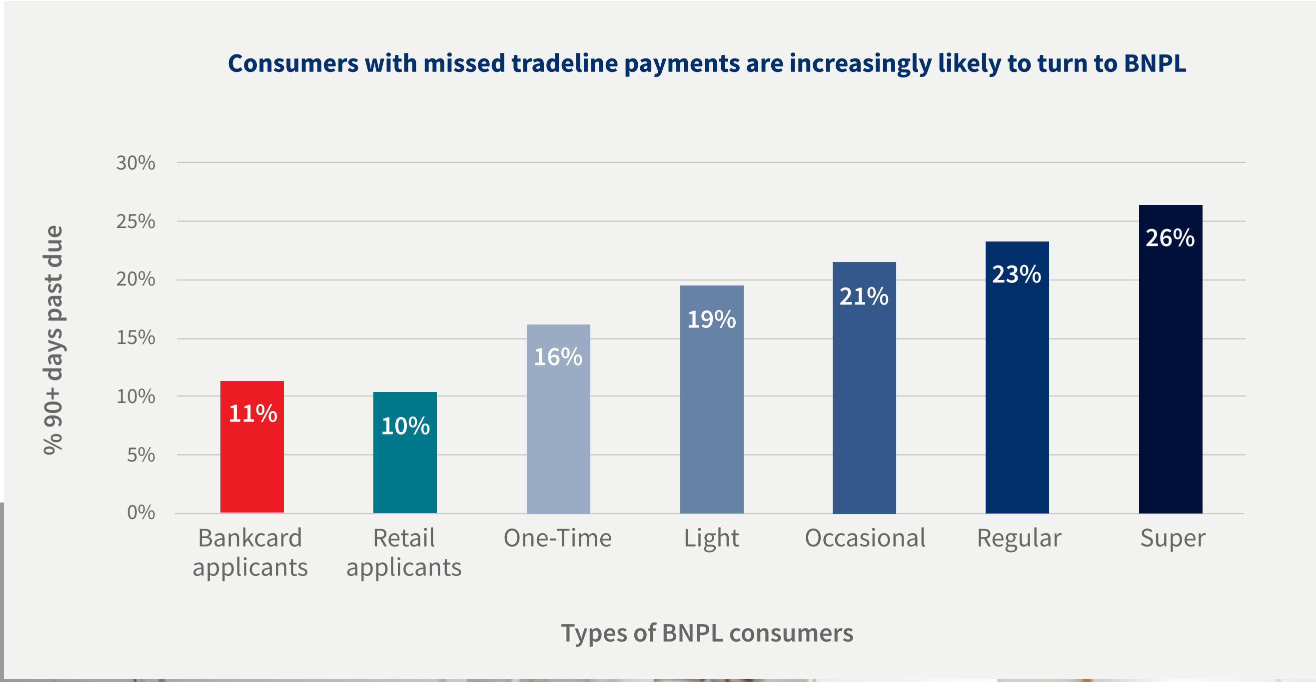


Figure 3 shows that frequent BNPL applicants are also more likely to be delinquent on existing tradelines at the outset of BNPL use compared to infrequent applicants. This means that consumers with severe delinquencies will most likely become regular BNPL users as time goes on. From this relationship, we can see that BNPL acts as a credit backstop for consumers in the most financially stressed situations.

On the flip side, consumers that use BNPL occasionally or less often are notably less risky when it comes to credit utilization, missed payments, and public record derogatory events (see Brief 2). Again, not all BNPL users are as risky as others.

Figure 3: The portion of consumers that had one or more tradelines that were at least 90 days past due or in collections at the time of their first BNPL application.



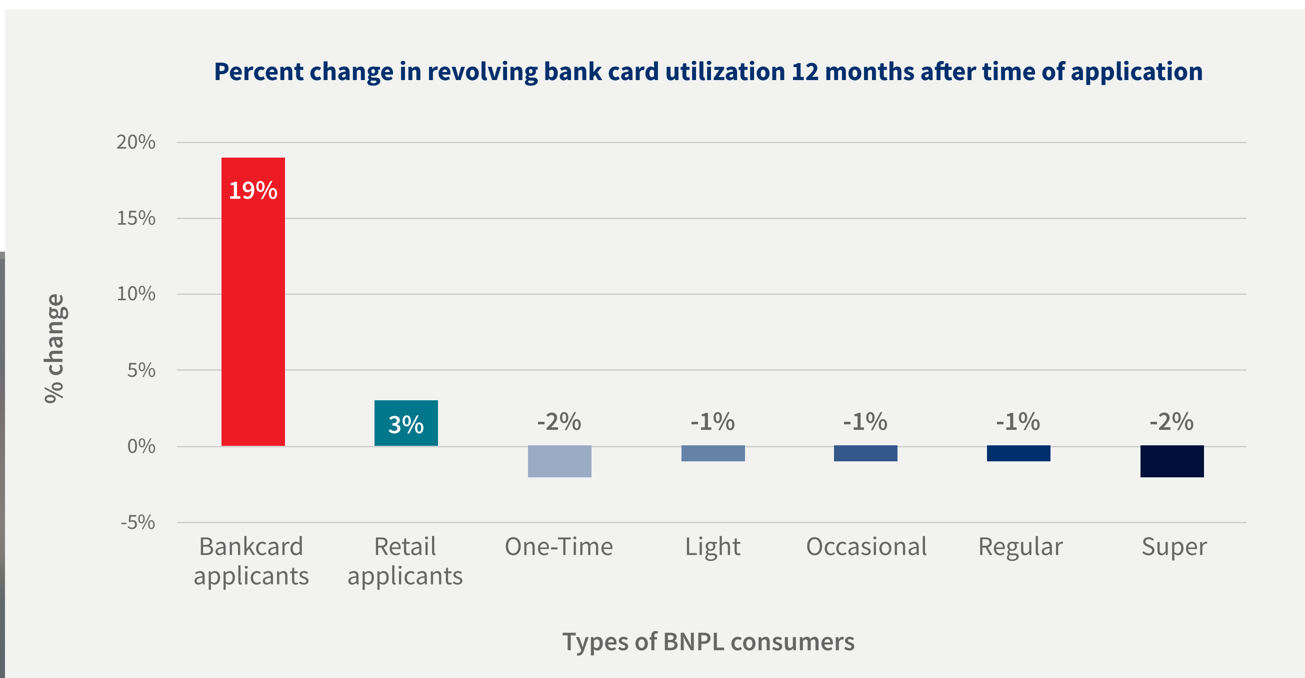
Tracking tradeline health over twelve months

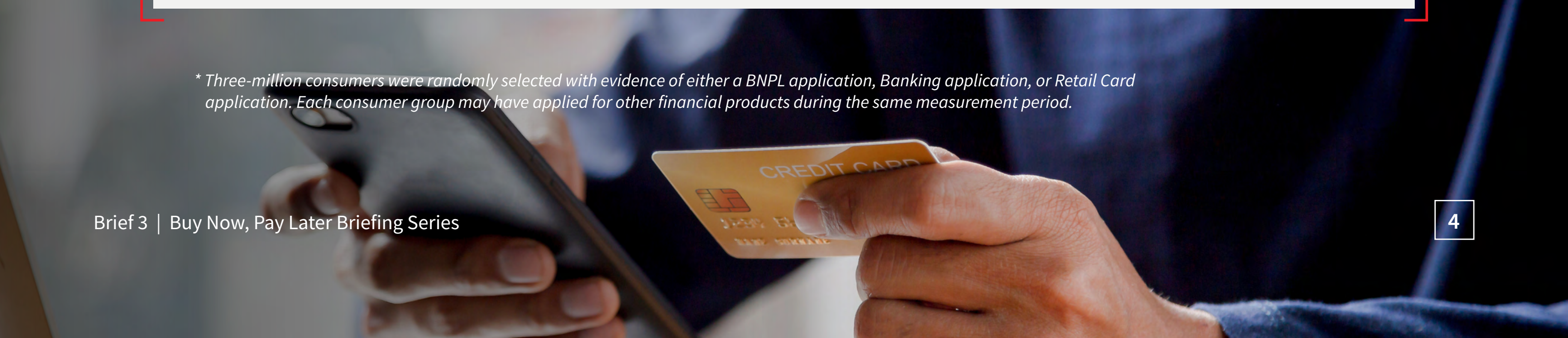
Given the recent surge in BNPL popularity, U.S. consumers are collectively newcomers to this short-term financing option. As a rapidly growing financial product on the market, we wanted to understand how its adoption could change the credit health of a consumer over time.

To do this, we tracked one million unique consumers with evidence of a BNPL application for 12 months and compared them to bankcard and retail card applicants during the same period.* By aging the populations, we found that credit utilization moved in unexpected ways for BNPL applicants.

Figure 4 shows how credit utilization on revolving bankcards changed in the 12 months following a consumer's application for a traditional credit or BNPL product. While bankcard and retail card applicants saw reasonable increases in their bankcard utilization over that time, BNPL applicant profiles *decreased* bankcard utilization during that same time. This finding directly demonstrates how consumers reduce spending on existing tradelines once BNPL is introduced to their financial toolkit.

Figure 4: All BNPL user profiles experience a decrease in bank card credit utilization after applying for and using BNPL.





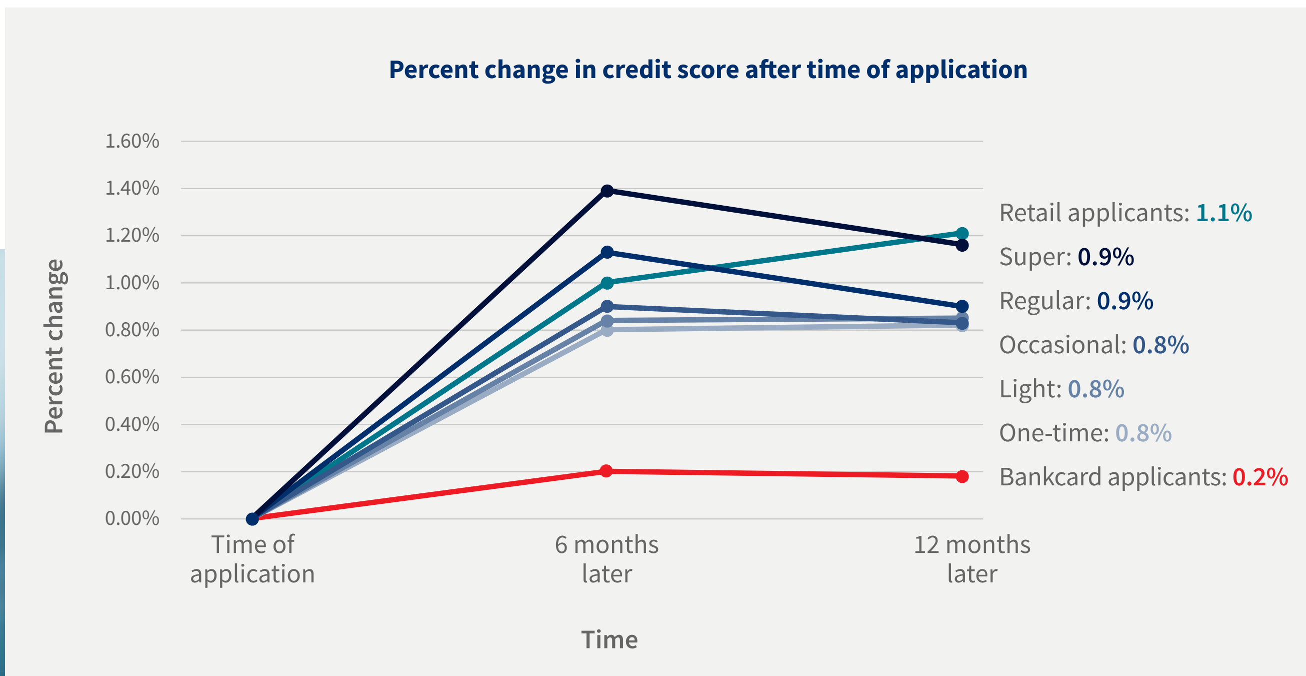
* Three-million consumers were randomly selected with evidence of either a BNPL application, Banking application, or Retail Card application. Each consumer group may have applied for other financial products during the same measurement period.

Unlike a traditional credit product, BNPL loans are not currently reported to the National Consumer Reporting Agencies (NCRAs). The shift in consumer debt away from traditional tradelines to BNPL shows up in credit scores over 12 months.

Figure 5 shows the percent change in credit scores from six months and 12 months after applying for a credit product. The initial consumer data was collected from October 2020 to May 2021 then we tracked those consumers for an additional 12 months ending in May 2022. We observed that all BNPL profiles changed their credit score by 4X-5X more than bankcard applicants during the same period.

Additionally, we found that the more frequently a consumer applies for BNPL, the more their credit score increases in 12 months. From this data, we can conclude that untracked BNPL debt by the NCRAs contributes to potentially inflated credit scores for consumers and potentially hidden risks to lenders. The elevated levels of risk among frequent BNPL applicants and their coincidence with inflated credit scores highlights where BNPL creates a risk blind spot for lenders.

Figure 5: Super users of BNPL tend to experience a 7-pt increase to their credit score.



Parsing the known and unknown risks

At a time when the U.S. lending market is increasingly concerned about credit score inflation, the above analysis highlights the challenges presented to lenders from the Regular and Super user segments. With the lack of visibility into consumer behavior within and across the BNPL market, high-risk credit behaviors might be obscured from traditional credit reporting. This presents significant barriers to both BNPL and traditional lenders in assessing the creditworthiness of applicants accurately. Notably, given the demographics of the BNPL population, this obstacle is perhaps most acutely felt among lenders trying to advance financial inclusion.

On the road to myth busting

While frequent applicants to BNPL may pose unquantifiable risk to traditional lenders, BNPL providers and their own financial health over time — there is more to the story. Our next brief will share the stories of frequent BNPL consumers that fall on either end of the credit spectrum and how BNPL as a credit intervention influenced their creditworthiness over time.

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