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OCC issues guidance on managing risks associated with BNPL lending

On December 6, 2023, the Office of the Comptroller of the Currency (OCC) released Bulletin 2023-37 highlighting their guidance to organizations engaging in buy now, pay later (BNPL) lending.[1] The OCC's Bulletin addresses BNPL loans which are loans payable in four or fewer installments and carry no finance charges. Loans with payment terms greater than four installments or that charge interest or carry other finance charges are treated as traditional installment loans and are therefore not within the scope of this Bulletin.

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5 insights you should know

1. **Safe and sound risk management practices:** The OCC discusses foundational aspects of risk management programs for BNPL products and suggests that BNPL lenders begin reviewing and updating management policies, credit underwriting, relationships with third-party vendors, compliance with current regulations, and consumer disclosures. The Bulletin highlights the downstream product risks the financial industry faces and notes these risks should be incorporated into an organization's compliance management system (CMS). Lastly, the guidance is significant in that BNPL products, and risks, also exist outside of traditional banking.

2. **Unclear disclosure and marketing materials:** The Bulletin identifies the lack of clear disclosure language as a primary risk that could obscure the true nature of the loan. This has the potential for borrowers to overextend their loan repayment obligations and lead to consumer harm or regulatory violations. The result of borrowers overextending on their loan repayment obligations could negatively impact BNPL lenders if they face elevated delinquencies and losses.

3. **Limited credit bureau reporting:** A majority of BNPL applicants are first-time borrowers with limited credit history and BNPL lenders are not required to report their loans balances to the credit bureaus. As a result, BNPL lenders may not have full visibility into applicants' activities on other platforms due to a lack of credit history.

4. **First payment default:** BNPL loan structures may present elevated first payment default risk from intentional fraud or borrower oversight. Since checking account transactions are not settled in real time, the first payment, usually a portion of the loan amount, could fail due to insufficient funds when the transaction settles. As a result, BNPL lenders could be held liable for the loan amount if customers default on their loans. Additionally, customers could face otherwise avoidable fees such as overdraft, non-sufficient funds, and late fees.

5. **Merchant return and dispute:** A common issue with BNPL transactions is when merchandise returns or disputes arise as they often cannot be resolved during the brief term of the loan. A mismatch in timing between customers receiving a credit for returned merchandise and having a BNPL payment automatically taken from their account is a common occurrence. BNPL lenders must have processes for handling merchandise returns (e.g., credits/refunds) and merchant disputes in a way that is fair to consumers.

[1] Office of the Comptroller of the Currency (OCC), "Bulletin 2023-37 'Retail Lending: Risk Management of 'Buy Now, Pay Later' Lending'," Dec. 6, 2023

5 considerations to evaluate

1 **Review impacted risk management programs:** With increased regulatory scrutiny and the nature of these newer processes, lenders should consider evaluating the adequacy of their risk management programs with respect to BNPL processes and risks. Special consideration could be given to BNPL processes related to credit decisioning; monitoring and reporting; oversight of third-party relationships; board and management governance; and key risks such as model risk, credit risk, and operational risk, including third-party risk. Moreover, a strong compliance program to monitor and assess regulatory obligations could also be considered while evaluating current risk management programs.

2 **Assess compliance management system (CMS):** BNPL lenders should give close attention to the delivery method, timing, and appropriateness of marketing, advertising, and consumer disclosures to ensure that they all clearly state the borrower's obligations under the contract and clearly state any fees that may apply. The applicability, spirit, and intent of consumer protection-related laws and regulations such as Equal Credit Opportunity Act (ECOA) and Regulation B; Electronic Fund Transfer Act (EFTA) and Regulation E; Fair Credit Reporting Act (FCRA) and Regulation V; Unfair, Deceptive Acts and Practices (UDAP); and Unfair, Deceptive or Abusive Acts or Practices (UDAAP) should be evaluated and assessed.

3 **Perform credit risk assessment:** BNPL underwriting criteria and repayment assessment methodologies should provide a reasonable assurance that the borrower can repay the debt. Repayment assessment methodologies that are poorly designed could result in elevated delinquencies and losses on top of the adverse consequences for the borrower. BNPL lenders should consider implementing sound charge-off practices and allowances for credit loss (ACL) methodology.

4 **Identify potential fraud risk:** Given the automated and fast-paced nature of BNPL loans, lenders could be at risk for increased levels of fraud. Before offering BNPL loans, management should assess fraud risk and implement controls to mitigate those risks. Assessments should consider common fraud schemes used to circumvent lending systems and controls. Additionally, the structure of BNPL loans presents an elevated first payment default risk from intentional fraud and buyer oversight. BNPL lenders should have procedures and controls in place to identify fraud in a timely manner and take steps to mitigate losses.

5 **Evaluate third-party vendors:** The OCC expects BNPL lenders to have risk management processes to effectively manage the increased operational and compliance risks arising from third-party relationships. A lender that partners with a third party, including a nonbank fintech or merchant, to offer BNPL loans should conduct appropriate due diligence and incorporate that relationship into their third-party risk management processes.

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