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Core Considerations for Out-of-Network Buy Now, Pay Later Payments

*By Evan R. Minsberg and Maria B. Earley**

In this article, the authors address some of the key issues that providers and others in the Buy Now, Pay Later ecosystem should consider in connection with out-of-network transactions.

Much has been written about the Buy Now, Pay Later (BNPL) industry in the recent past. Consumers enjoy the payment flexibility and interest-free features of many BNPL products and frequently use them as a substitute payment method for credit card purchases. The rapid growth of BNPL has attracted the attention of the media and various regulators. The Consumer Financial Protection Bureau (CFPB) released a report¹ on the BNPL industry last fall covering the rise of the industry and consumer protection concerns (among other things), and opened an inquiry² into five BNPL providers in 2021.

The CFPB report largely covers the typical BNPL arrangement where consumers can use the product to make purchases from any merchant in the BNPL provider's network. Although referenced in the CFPB report, use of the product for purchases at merchants outside a BNPL company's existing network has received relatively little attention. These out-of-network transactions make it easier for consumers to use their preferred provider for all purchases but present a unique subset of issues within the BNPL model. This article addresses some of the key issues that providers and others in the BNPL ecosystem should consider in connection with out-of-network transactions.

OUT-OF-NETWORK BNPL PAYMENT STRUCTURE

In a traditional BNPL arrangement, the provider has a preexisting relationship with the merchants from which consumers can make purchases using a BNPL product. These "in-network" arrangements define the amount the provider charges the merchant and how consumer refunds and returns will be handled, among other issues. Notably, they also clarify payment details so the BNPL provider can settle the purchase amount with the merchant (typically by ACH) on a periodic basis, net of the fees charged by the provider.

* The authors, attorneys with Morrison & Foerster LLP, may be contacted at eminsberg@mof.com and mearley@mof.com, respectively.

¹ <https://www.consumerfinance.gov/about-us/newsroom/cfpb-study-details-the-rapid-growth-of-buy-now-pay-later-lending/>.

² <https://www.consumerfinance.gov/about-us/newsroom/consumer-financial-protection-bureau-opens-inquiry-into-buy-now-pay-later-credit/>.

As demand for BNPL products continues to grow, providers continue to explore ways to expand the use of their BNPL offerings to merchants outside their network. While this will allow consumers to have more shopping flexibility with their preferred BNPL provider, the lack of a preexisting relationship with a merchant means that the provider would not have the account information needed to send funds to the merchant by ACH. As a result, BNPL providers have explored the use of commercial card accounts to distribute loan funds to out-of-network merchants. The typical structure works like this:

- The BNPL provider opens a network-enabled commercial prepaid card account directly with an issuing bank or through a non-bank card processor. The card account is funded with the BNPL provider's own funds.
- When a consumer makes a purchase at an out-of-network merchant, the BNPL provider (through the issuing bank or processor) generates and provides to the consumer a virtual card number (VCN) through its app.
- The consumer completes the purchase by providing the VCN to the merchant which, in turn, processes the card payment through its card processing relationships.
- Funds for the purchase are debited from the BNPL provider's commercial prepaid card account and settled through the applicable network with the merchant.

For in-store purchases, some BNPL providers have even arranged for consumers to receive physical cards. But all purchases, whether through a VCN or physical card, are made using a card account issued only to the BNPL provider – not to any consumer.

POTENTIAL CONSUMER PROTECTION CONCERNS

While this process allows consumers to access credit through their preferred BNPL provider at a much greater number of merchants, it also presents a unique set of challenges, including:

- *Merchant Returns and Refunds:* The lack of a formal arrangement between the BNPL provider and merchant means there is no agreed-upon process for facilitating returns and refunds. In fact, the merchant may be completely unaware of the involvement of the BNPL provider. If the merchant initiates a return, those funds will be returned to the BNPL provider's card account, not to the consumer. As the CFPB notes in its report, this situation could leave consumers on the hook for

ongoing payments and unable to return unwanted merchandise.

- *Dispute Resolution Rights:* Federal law provides consumer debit and prepaid cardholders with certain rights under the Electronic Funds Transfer Act and its implementing rules under Regulation E. These rights include disputing errors and unauthorized transactions that are not available for commercial card accounts. Similarly, for credit card holders, the protections from liability for unauthorized use and the right to dispute billing errors afforded under the Truth in Lending Act and Regulation Z would not apply because the consumer does not own the card account and has no direct relationship with the card issuing bank.
- *Card Network Rights:* Similar to the above, the card networks provide rights to the cardholder to dispute or request a chargeback for unauthorized or fraudulent transactions or purchases. Because the consumer is not the cardholder in an out-of-network BNPL transaction, these rights are not available.

MITIGATION STRATEGIES

There are a number of steps that BNPL providers and service providers can take to mitigate the risk of exposure arising from out-of-network merchant payment methods.

- *Clear Disclosures:* BNPL providers should clearly disclose in their terms and conditions, and possibly elsewhere, that any VCNs or physical cards are not associated with a consumer card account and rights typically associated with credit cards may not be available. In particular, if a physical card bears the consumer's name, BNPL participants should carefully consider whether disclosures will be sufficient to resolve potential consumer confusion.
- *Extension of Rights:* To the extent possible, BNPL providers should afford consumers the rights they would otherwise enjoy under payment card laws. This includes the ability to dispute errors, protection from liability for unauthorized transactions, and transaction dispute rights where refunds for unsatisfactory goods and services cannot be obtained from the merchant.
- *Operational Support:* On the operations side, a BNPL provider should have appropriate procedures for managing consumer requests and disputes, resolving issues related to returns and refunds, and processing chargebacks.

CONCLUSION

The consumer demand for out-of-network BNPL products is not likely to subside. To meet that demand, BNPL providers should continue to explore ways to extend their offerings with consumer protection and choice as the guiding principles. A handful of those principles were discussed in this article, but there are other considerations that may be relevant to an out-of-network BNPL offering, including various payment-related rules and restrictions.