

**TO:** Banking and Housing Committee LAs  
**FROM:** Majority Committee Staff  
**DATE:** September 9, 2022  
**RE:** Hearing on “New Consumer Financial Products and the Impacts to Workers”

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On Tuesday, September 13, 2022, at 10:00 a.m. in room 538 of the Senate Dirksen Building, the Committee will hold a hybrid hearing entitled: “**New Consumer Financial Products and the Impacts to Workers.**” The purpose of the hearing is to examine new consumer financial products (including buy now, pay later; earned wage access; training repayment agreement provisions; and other new products), the structure of new consumer financial products, existing regulatory and legal frameworks, and their impact on households.

**The Committee will hear testimony from the following witnesses:**

- **Ms. Rachel Gittleman**, Financial Services Outreach Manager, Consumer Federation of America;
- **Ms. Penny Lee**, CEO, Financial Technology Association;
- **Professor Todd J. Zywicki**, George Mason University Foundation Professor Of Law, George Mason University Antonin Scalia School of Law; and
- **Mr. David H. Seligman**, Executive Director, Towards Justice.

## **SECTION I      BIOGRAPHIC DETAILS OF WITNESSES**

### **Rachel Gittleman, Financial Services Outreach Manager, Consumer Federation of America**

Rachel Gittleman is the Financial Services Outreach Manager for the Consumer Federation of America (CFA). In this role, Ms. Gittleman leads CFA’s advocacy and outreach on high-cost lending, payday loans, and other banking and credit issues. She has successfully led legislative and regulatory campaigns, as well as CFA’s High Cost Lending Summit and Advocacy Weeks. Ms. Gittleman represents CFA on behalf of consumers before the Consumer Financial Protection Bureau, the Office of the Comptroller of the Currency, the Federal Reserve, the Federal Deposit Insurance Corporation, as well as other federal and state financial regulators, Congress, and state legislatures. Ms. Gittleman earned her B.A. in Religious Studies from the University of Chicago.

### **Penny Lee, CEO, Financial Technology Association**

Penny Lee is the CEO of the Financial Technology Association (FTA). She previously served as Chief Strategy Officer of 1776, a technology incubator and accelerator servicing over 1,200 startups in its network. Additionally, she co-founded and chaired a Washington, D.C.-based angel investment group, K Street Capital, which has invested over \$5 million in 45 companies. Ms. Lee previously served as Senior Advisor to Senate Majority Leader Harry Reid (D-NV), Executive Director of the Democratic Governors Association, and Communications Director for Pennsylvania Governor Ed Rendell. Ms. Lee graduated from Baylor University with degrees in political science and journalism.

### **Todd J. Zywicki, George Mason University Foundation Professor Of Law, George Mason University Antonin Scalia School of Law**

Professor Todd J. Zywicki is George Mason University Foundation Professor of Law at George Mason University Antonin Scalia School of Law, Senior Fellow of the Cato Institute, and former Executive Director of the GMU Law and Economics Center. He is an expert in consumer financial services, and has authored more than 130 articles in leading law reviews and peer-reviewed economics journals. Professor Zywicki served as the Chair of the Consumer Financial Protection Bureau Taskforce on Federal Consumer Financial Law. Previously, he served as the Director of the Office of Policy Planning at the Federal Trade Commission. He has held fellowships from and served on the boards of numerous nonprofit and educational institutions. Professor Zywicki clerked for Judge Jerry E. Smith of the U.S. Court of Appeals for the Fifth Circuit. He received an AB from Dartmouth College, an MA in Economics from Clemson University, and a JD from the University of Virginia School of Law.

**David H. Seligman, Executive Director, Towards Justice**

Mr. Seligman has been the Executive Director of Towards Justice since 2018 and previously was Litigation Counsel with the organization. At Towards Justice, Mr. Seligman has litigated several class and collective actions to attack systematic injustices in the labor market. Prior to his work at Towards Justice, Mr. Seligman was a staff attorney at the National Consumer Law Center, working on forced arbitration and predatory auto lending. Mr. Seligman clerked for Chief Judge Patti B. Saris of the District of Massachusetts and Judges Robert D. Sack and Susan L. Carney of the United States Court of Appeals for the Second Circuit. He is a graduate of Williams College and Harvard Law School.

**SECTION II OVERVIEW**

The rapid growth of new consumer financial products being offered by nonbank, financial technology companies—also known as “fintech”—is of great interest to policymakers. Fintech innovations could potentially improve the efficiency of the financial system and financial outcomes for businesses and consumers. However, without strong consumer protections and transparency requirements, the new technology could pose certain risks, potentially leading to unmanageable debt or other harmful outcomes.

Many of the newer consumer financial products, like buy now, pay later (BNPL) and earned wage access (EWA), are short-term credit products, meant to help consumers meet short-term credit needs.

**Buy now, pay later (BNPL)**

BNPL is a form of point-of-sales financing. With BNPL, a consumer can purchase an item now and pay for it later on an agreed upon payment schedule without accruing interest. BNPL is often offered online and has generally been developed by technology-focused, nonbank financial companies, also known as fintech companies. For example, some BNPL services may require four installment payments (Pay in 4) in two-week intervals; other services may have regular

payments over a shorter six-week period. The companies also charge affiliate fees to retailers that advertise on their website or app.<sup>1</sup>

BNPL is meant to help consumers with their short-term credit needs. BNPL may be attractive to thin credit file and younger consumers who may not qualify for traditional credit cards.<sup>2</sup> Consumers may use BNPL through a merchant that embeds it as a payment option in the checkout process or directly on BNPL companies' platforms. BNPL companies determine consumer terms through a soft credit check and a consumer's past performance on the platform.<sup>3</sup>

While BNPL companies generally do not charge interest or fees at time of purchase, they charge a late fee if a customer does not make payment on time. BNPL services earn most of their revenue by charging merchants, who are willing to pay to attract new consumers to their merchandise.

The market for BNPL products has been growing rapidly in recent years. In 2020, reports suggest that BNPL product use may have tripled compared to prior years.<sup>4</sup> A consulting firm reports that BNPL balances grew by 24% from the period 2016 to 2019 and is expected to grow at 20% for the next three years.<sup>5</sup> BNPL accounts for 4% of all ecommerce and is expected to rise to 8.5% by 2025.

Some of the companies operating in the BNPL space include Klarna, Afterpay, Affirm, and Zip. Recently, these business models have been tested due to the shifting economic climate and sentiment, and the potential for bad debt, all of which are reflected in revised market capitalizations and downsizing at firms. For example, in June 2021, Klarna, one of the oldest BNPL companies, was valued at over \$45 billion.<sup>6</sup> After its most recent fundraising in July 2022 it was revalued at \$6.7 billion. Similarly, Square announced plans to purchase Afterpay for an implied value of \$29 billion in August 2021, but was valued at \$13.9 billion according to a Square regulatory filing.<sup>7</sup>

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<sup>1</sup> Consumer Financial Protection Bureau, *The Convergence of Payments and Commerce: Implications for Consumers*, August 2022, pp. 3, 13-14, [https://files.consumerfinance.gov/f/documents/cfpb\\_convergence-payments-commerce-implications-consumers\\_report\\_2022-08.pdf](https://files.consumerfinance.gov/f/documents/cfpb_convergence-payments-commerce-implications-consumers_report_2022-08.pdf).

<sup>2</sup> Puneet Dikshit et al., *Buy Now, Pay Later: Five Business Models to Compete*, McKinsey & Company, July 29, 2021, p. 6, at <https://www.mckinsey.com/industries/financial-services/our-insights/buy-now-pay-later-five-business-models-to-compete>; and Pymnts, "BNPL Expands 'Next Gen' Label; Aims Across Demographics," *Pymnts.com*, April 9, 2021, at <https://www.pymnts.com/buy-now-pay-later/2021/bnpl-expands-next-gen-label-aims-across-demographics/>.

<sup>3</sup> Soft credit checks do not affect a consumer's credit score. For more information on consumer credit reporting and credit scores, see CRS Report R44125, *Consumer Credit Reporting, Credit Bureaus, Credit Scoring, and Related Policy Issues*, by Cheryl R. Cooper and Darryl E. Getter.

<sup>4</sup> According to one provider, spending using BNPL financing more than tripled in 2020 alone. See Accenture for Afterpay, *The Economic Impact of Buy Now Pay Later in the US*, September 2021, at <https://afterpay-corporate.yourcreative.com.au/wp-content/uploads/2021/10/Economic-Impact-of-BNPL-in-the-US-vF.pdf>.

<sup>5</sup> Puneet Dikshit et al., *Buy Now, Pay Later: Five Business Models to Compete*, McKinsey & Company, July 29, 2021.

<sup>6</sup> Supantha Mukherjee, "Klarna Raises \$800 million as Valuation Plunges 85% In a Year," *Reuters*, July 11, 2022, <https://www.reuters.com/business/finance/klarnas-valuation-slumps-67-bln-with-800-mln-raise-2022-07-11/>.

<sup>7</sup> Square, "Square, Inc. Announces Plans to Acquire Afterpay, Strengthening and Enabling Further Integration Between its Seller and Cash App Ecosystems," press release, August 1, 2021, at

In July 2021, the CFPB released a blog post explaining what BNPL is, how it’s structured, and its associated risks.<sup>8</sup> In December 2021, the CFPB issued an inquiry to Afterpay, Klarna, PayPal, and Zip expressing concerns about, “accumulating debt, regulatory arbitrage, and data harvesting in a consumer credit market already quickly changing with technology.” The inquiry asked the BNPL companies to, “submit information so that we can report to the public about industry practices and risks.”<sup>9</sup>

### **Earned Wage Access (EWA)**

EWA products allow workers to access part of their earned but not yet paid income before the end of the conventional pay period. Frequently, workers are paid at regularly-scheduled intervals, typically weekly, every two weeks, twice a month, or monthly.<sup>10</sup> Companies that offer EWA products promote their tools as more attractive, lower-cost alternatives to other types of cash advances or short-term credit products, such as payday loans. EWA products may work directly with employers’ human resources’ time management and payroll software to determine the number of hours an employee worked, and allow individuals to access a portion of that earned income earlier than their employer’s established payday. EWA providers market their product to employers as a benefit to employees that alleviates financial stress, increases satisfaction and productivity, and improves retention.

Other EWA companies, however, do not work directly with employers. Instead they market themselves directly to workers and estimate the amount of earnings the worker has accumulated.

Companies providing EWA products include PayActiv, Earnin, DailyPay, FlexWage, and Instant. Various market studies estimate the number of EWA users at between 45 million<sup>11</sup> and 76.6 million<sup>12</sup> workers. One trade publication report found that at least 14% of employees have used an EWA product.<sup>13</sup> There are reports of large, mostly part-time, shift, or “gig” economy companies such as Walmart, McDonald’s, and Uber that have signed agreements with various EWA companies.

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<https://squareup.com/us/en/press/square-announces-plans-to-acquire-afterpay>; Caitlin Mullen, “Will a swoon in valuations affect Block’s Afterpay?,” *Payments Dive*, August 2, 2022, at <https://www.paymentsdive.com/news/will-blocks-afterpay-bet-pay-off-block-acquisition-buy-now-pay-later/628592/>; and Block, Inc. *Form 10-K*, Securities and Exchange Commission, p. 56, at <https://d18rn0p25nwr6d.cloudfront.net/CIK-0001512673/13386837-50ba-466f-b8ff-81824f066c1e.pdf>. Square changed its name to Block on December 1, 2021.

<sup>8</sup> <https://www.consumerfinance.gov/about-us/blog/should-you-buy-now-and-pay-later/>

<sup>9</sup> <https://www.consumerfinance.gov/about-us/newsroom/consumer-financial-protection-bureau-opens-inquiry-into-buy-now-pay-later-credit/>

<sup>10</sup> U.S. Bureau of Labor Statistics, “Length of Pay Periods in the Current Employment Statistics Survey,” press release, February 2020, at <https://www.bls.gov/ces/publications/length-pay-period.htm>.

<sup>11</sup> Sarah Grotta, *On-Demand Earned Wage Access: U.S Vendor Comparison*, Mercator Advisory Group, April 17, 2020, at <https://www.dailypay.com/wp-content/uploads/mercator-advisory-group-on-demand-earned-wage-access.pdf>.

<sup>12</sup> Michael Moeser, *Earned Wage Access: Faster Wage Payments Disrupt the Traditional Payday*, Arizent, June 9, 2021, at <https://arizent.brightspotcdn.com/7a/4b/e6ab389041148a2b9985c544d66c/ewa-research-report-060921-v2.pdf>.

<sup>13</sup> Michael Moeser, *Earned Wage Access: Faster Wage Payments Disrupt the Traditional Payday*, Arizent, June 9, 2021.

## Training Repayment Agreement Provisions (TRAPs)

TRAPs are agreements between employees and employers “that require workers to repay training costs if they leave the firm,” sometimes before a specific date or given amount of time.<sup>14</sup> The trainings from which these debts arise are routine, part of normal workplace training, or the debt is disproportionate to the cost of training. Employers have been documented using TRAs to try to collect sums as high as \$6,000,<sup>15</sup> \$13,500,<sup>16</sup> \$20,000,<sup>17</sup> or even \$75,000.

TRAPs are regularly used in the healthcare industry sector, with nurses reporting signing TRAPs to compensate hospitals for trainings with little or no practical use, or that are scarcely distinguishable from ordinary workplace orientations.<sup>18</sup> Some workers have filed lawsuits against companies for TRAPs. For example, workers recently filed a suit against PetSmart, alleging the \$5,500 TRAP far exceeds any reasonable value of PetSmart’s Grooming Academy and that PetSmart violated consumer law by saddling groomers with debt under unfair and abusive circumstances in order to pay for an unlicensed post-secondary school.<sup>19</sup>

In a June press release accompanying a Request for Information Regarding Employer-Driven Debt, the CFPB requested info on various areas, including loan terms, loan underwriting, loan disclosure, debt burden, credit reporting, servicing, and the collection of debts.<sup>20</sup>

## SECTION III REGULATORY FRAMEWORK

Generally, many fintech cash flow products, such as BNPL and EWA products, are provided by nonbank financial companies, rather than traditional banking institutions. Consumers who acquire debts through their employment also generally do not obtain these debts through a bank. While these companies generally are not regulated as banks for safety and soundness, they generally need to comply with federal consumer protection and data security laws.

### Truth in Lending Act (TILA)

The new consumer financial products like BNPL, EWA or anything involving a “tips” model may not be subject to similar disclosure requirements as other consumer credit markets. The

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<sup>14</sup> U.S. Department of the Treasury, *The State of Labor Market Competition*, March 7, 2022, p. 7, <https://home.treasury.gov/system/files/136/State-of-Labor-Market-Competition-2022.pdf>; and Evan Weinberger and Rebecca Rainey, “Employers Face CFPB Scrutiny Over Job Training Repayment Demands,” *Bloomberg Law*, April 21, 2022, at <https://news.bloomberglaw.com/banking-law/employers-face-cfpb-scrutiny-over-job-training-repayment-demands>.

<sup>15</sup> Mary Pilon, *This Is the Blue-Collar Student Debt Trap*, BLOOMBERG (Aug. 14, 2017),

<https://www.bloomberg.com/news/articles/2017-08-14/the-blue-collar-student-debt-trap?sref=Hs89ZntT>.

<sup>16</sup> See Complaint, *Boutique Air, Inc. vs. Michael Wade Sticka et al.*, CGS-20-584536 (Ca. Sup. Ct. 2020).

<sup>17</sup> Kevin Krause, *For Nearly Two Dozen Nurses, Leaving Parkland Early Comes at a Cost*, DALLAS MORNING NEWS (Jul. 3, 2020), <https://www.dallasnews.com/business/health-care/2020/07/03/for-nearly-two-dozen-nurses-leaving-parkland-early-comes-at-a-cost/>.

<sup>18</sup> See Comment from National Nurses United, FTC Comment ID FTC-2021-0036-0275 (Sep. 30, 2021), <https://www.regulations.gov/comment/FTC-2021-0036-0275>.

<sup>19</sup> [https://protectborrowers.org/wp-content/uploads/2022/07/PetSmart-complaint\\_file.pdf](https://protectborrowers.org/wp-content/uploads/2022/07/PetSmart-complaint_file.pdf)

<sup>20</sup> The Consumer Financial Protection Bureau, *CFPB Launches Inquiry into Practices that Leave Workers Indebted to Employers*, June 9, 2022, <https://www.consumerfinance.gov/about-us/newsroom/cfpb-launches-inquiry-into-practices-that-leave-workers-indebted-to-employers/>.

Truth in Lending Act (TILA) requires disclosure of credit terms in many consumer credit markets; however, TILA disclosure requirements apply only to consumer credit that is subject to a finance charge or payable in more than four installments.<sup>21</sup> Therefore, these requirements may not apply to many of the newer consumer financial products. TILA is implemented by the CFPB through Regulation Z.<sup>22</sup>

### **Consumer Financial Protection Bureau (CFPB)**

At the federal level, the Consumer Financial Protection Bureau (CFPB) has the authority in nonbank consumer financial markets to write regulations, enforce the law, and supervise companies in certain cases. The Consumer Financial Protection Act also provides the CFPB with authorities to police unfair, deceptive, and abusive acts in consumer financial product or service.<sup>23</sup> Dodd-Frank gives the CFPB authority to enact rules related to UDAAP. The CFPB's UDAAP authority is similar to that of the Federal Trade Commission Act, which prohibits "unfair or deceptive acts or practices (UDAP)."

## **SECTION IV POLICY ISSUES**

While nonbank consumer lending products can provide access to credit or cash-flow flexibility to consumers who might not be able to obtain traditional bank credit at better terms, these products may also introduce consumer protection risks to consumers. In addition, TRAPs may introduce consumer protection issues if consumers do not understand the debt arrangements, do not have the ability to shop for the best credit terms, or negatively impact their future employment opportunities.

### **Unsustainable Debt Risks**

Although many fintech cash flow products have low interest or fees or only accrue charges when repayment is late, some consumers may still face negative consequences due to the use of these products. Often, these types of products do not require credit underwriting, so the lender does not evaluate the consumer's ability to repay before taking out the product. Therefore, some consumers could take on unsustainable debts or face other negative consequences. For example, although many BNPL companies have no initial interest or fees, some consumers may still face negative consequences due to the use of these financing services, such as accruing charges when repayment is late. Some studies suggest a high number of consumers miss BNPL payments; one study found that 38% of consumers have missed a BNPL payment. For consumers who have unpaid BNPL payments, they could be blocked from future purchases or have their debts sent to a debt collector for collection.<sup>24</sup> For wage advance products, a consumer who uses part of their paycheck in advance may not have enough funds at payday for other regular bills.

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<sup>21</sup> 12 C.F.R. §1026. For more information on Regulation Z, see CFPB, "12 CFR Part 1026 – Truth in Lending (Regulation Z)," at <https://www.consumerfinance.gov/policy-compliance/rulemaking/regulations/1026/>.

<sup>22</sup> 12 C.F.R. §1026. For more information on Regulation Z, see CFPB, "12 CFR Part 1026 – Truth in Lending (Regulation Z)," at <https://www.consumerfinance.gov/policy-compliance/rulemaking/regulations/1026/>.

<sup>23</sup> 12 U.S.C. §5531.

<sup>24</sup> Jason Cover, *CFPB Warns Consumers of Risks of Buy-Now-Pay-Later Credit*, Ballard Spahr LLP, Consumer Finance Monitor, July 29, 2021, at <https://www.consumerfinancemonitor.com/2021/07/29/cfpb-warns-consumers->

## Disclosure Risks

For some fintech cash flow products, TILA disclosure requirements may not apply, depending on how the financial product is structured.<sup>25</sup> For example, TILA disclosure requirements apply only to consumer credit that is subject to a finance charge or payable in more than four installments.<sup>26</sup> Therefore, these requirements may not apply to many BNPL. For example, in November 2020, the CFPB gave PayActiv, an EWA product, a safe harbor from liability relating to compliance with TILA, concluding that the product is not considered “credit” under TILA.<sup>27</sup> However, in June 2022, the special regulatory treatment was rescinded.<sup>28</sup> For those products with unclear disclosure regimes, there is a risk that consumers may not understand the terms of these products before they use them. In addition, some of these products might not have consumer protections similar to more traditional financial products. For example, if merchandise is faulty or a scam, a BNPL consumer may still be responsible for paying the merchandise cost in these cases, unlike what may be the case with credit card dispute protections.<sup>29</sup>

## Consumer Credit Reporting

Some fintech cash flow products do not report information regularly to consumer credit bureaus.<sup>30</sup> While some consumers may prefer to exclude these products from their credit reports, others might miss out on the opportunity to build a credit history, particularly those who pay their BNPL financing on time and have limited credit histories<sup>31</sup>. By contrast, consumers are likely to damage their credit scores if they become delinquent because debts in collection can be reported to consumer credit bureaus. For example, one study finds that almost three-quarters of consumers who have missed BNPL payments report credit score declines due to their late payments.<sup>32</sup> Recently, the three nationwide consumer credit bureaus have announced plans to

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of-risks-of-buy-now-pay-later-credit/. For background on the debt collection market, see CRS Report R46477, *The Debt Collection Market and Selected Policy Issues*, by Cheryl R. Cooper.

<sup>25</sup> CFPB, *The Consumer Credit Card Market*, September 2021, p. 165, at [https://files.consumerfinance.gov/f/documents/cfpb\\_consumer-credit-card-market-report\\_2021.pdf](https://files.consumerfinance.gov/f/documents/cfpb_consumer-credit-card-market-report_2021.pdf).

<sup>26</sup> 2 C.F.R. §1026. Comment 2(a)(10).

<sup>27</sup> Consumer Financial Protection Bureau, “Consumer Financial Protection Bureau Issues an Approval Order to Facilitate Employee Access to Earned but Unpaid Wages,” press release, December 30, 2020, at <https://www.consumerfinance.gov/about-us/newsroom/consumer-financial-protection-bureau-issues-an-approval-order-to-facilitate-employee-access-to-earned-but-unpaid-wages/>.

<sup>28</sup> CFPB, “CFPB Rescinds Special Regulatory Treatment for Payactiv: Termination Follows Request by Company in Order to Change its Product,” press release, June 30, 2022, <https://www.consumerfinance.gov/about-us/newsroom/cfpb-rescinds-special-regulatory-treatment-for-payactiv/>.

<sup>29</sup> Nelson Akeredolu et al., *Should You Buy Now and Pay Later?* CFPB, July 6, 2021, at <https://www.consumerfinance.gov/about-us/blog/should-you-buy-now-and-pay-later/>.

<sup>30</sup> For background on the consumer credit reporting system, see CRS Report R44125, *Consumer Credit Reporting, Credit Bureaus, Credit Scoring, and Related Policy Issues*, by Cheryl R. Cooper and Darryl E. Getter.

<sup>31</sup> For more information on limited credit history policy issues, see CRS Report R45979, *Financial Inclusion and Credit Access Policy Issues*, by Cheryl R. Cooper; and CRS In Focus IF11630, *Alternative Data in Financial Services*, by Cheryl R. Cooper.

<sup>32</sup> Gaby Lopera, *72% of Americans Saw Their Credit Scores Drop After Missing a ‘Buy Now, Pay Later’ Payment, Survey Finds*, Credit Karma, February 8, 2021, at <https://www.creditkarma.com/insights/i/buy-now-pay-later-missed-payments>.

accept BNPL payment data, although the CFPB has expressed concerns about inconsistent reporting of this information.<sup>33</sup>

### **Employer-Driven Debt**

TRAPs may have terms that create certain restrictions on employees who are a party to them, potentially impacting their future employment. For instance, the specter of debt from a TRAP may incentivize an employee to stay in a position longer than perhaps is wanted, and may limit an employee's ability to move or accept a position that may better suit the employee's skills or needs. These agreements could subsequently reduce an individual's earning potential or future financial situation if an employee is forced to forego a better opportunity or, alternatively, incur a debt in order to do so. According to the U.S. Department of the Treasury, such agreements may have the effect of decreasing "expected gains" from a worker's job search if they are constrained from looking for new roles that may better suit their skills.<sup>34</sup> In addition, TRAPs may introduce consumer protection issues if consumers do not understand the debt arrangements, and do not have the ability to shop for the best credit terms. Because these agreements may constitute a form of consumer lending, employers may have to comply with TILA requirements and may be subject to the CFPB's 'unfair, deceptive or abusive acts or practices' authority.

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<sup>33</sup> Martin Kleinbard and Laura Udis, *Buy Now, Pay Later and Credit Reporting*, CFPB, June 15, 2022, at <https://www.consumerfinance.gov/about-us/blog/by-now-pay-later-and-credit-reporting/>.

<sup>34</sup> U.S. Department of the Treasury, *The State of Labor Market Competition*, March 7, 2022, p. 7.