HIDDEN IN PLAIN SIGHT: THE RISK DYNAMICS OF BUY NOW PAY LATER LOANS

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INTRODUCTION

Buy now, pay later (BNPL) has rapidly become an important form of consumer financing. This growth has been driven by the expansion of e-commerce and growing consumer demand for flexible alternatives to traditional credit. BNPL allows consumers to obtain goods immediately while spreading the cost over several instalments. Although the sector currently represents a relatively small share of Canadian household credit, its rapid expansion raises important questions about the systemic risks it introduces to FIs and the broader financial system.

The economic dynamics of BNPL help explain both its growth and its potential vulnerabilities. In traditional lending, interest paid by borrowers is typically the primary source of revenue. In contrast, BNPL providers can derive substantial revenue from merchants, who offer BNPL as a payment option to encourage additional sales. Furthermore, BNPL is particularly attractive to consumers with limited access to traditional credit because it offers relatively accessible, low-cost financing. As a result, elevated credit risk is a structural feature of the BNPL business model.

Loan stacking further exacerbates BNPL credit risk, as consumers often hold multiple BNPL loans simultaneously, either with the same provider or across different providers. Higher-risk borrowers are also more likely to engage in loan stacking, increasing the potential for correlated defaults across BNPL loans, both within individual providers' portfolios and across providers.

These exposures are compounded by potential wrong-way risk[i] scenarios in some securitization and funding agreements commonly used by FIs involved in the BNPL space. FIs that provide warehouse financing to BNPL providers often hold BNPL receivables (the outstanding payments owed by consumers on their loans) as collateral. However, if borrowers begin to default, the provider's creditworthiness and the value of the collateral securing the FI's exposure are likely to deteriorate simultaneously. Therefore, the protection that collateral is meant to provide may weaken precisely when it is most needed.

Given its rapid growth, BNPL lending is emerging as a potential systemic risk for the financial sector, raising questions about the adequacy of Canada's existing regulatory framework.

i Wrong-way risk arises when an institution's exposure to a counterparty is adversely correlated with that counterparty's credit quality.

Although BNPL providers are governed by several overlapping regulations, the sector's systemic impact currently remains largely outside the scope of financial regulatory bodies. At the same time, credit bureau reporting by BNPL providers has been inconsistent, creating blind spots for both regulators and lenders. As the sector continues to grow, these blind spots will make it increasingly difficult to assess borrowers' true debt burdens and to identify emerging household credit stress.

This paper examines BNPL through these interconnected dimensions. It begins by assessing the size and structure of the BNPL market and the business models that shape provider incentives. It then explores how BNPL receivables are funded and distributed across the financial system, focusing on borrower credit quality, loan stacking, and risks arising from funding and securitization structures. Next, the report examines Canada's regulatory and credit-reporting framework and how continued BNPL growth could affect the financial sector. Taken together, these risks position BNPL as an emerging risk that warrants closer attention from risk leaders and regulators.

1. THE BNPL MARKET: SIZE, GROWTH, AND PRODUCT STRUCTURES

BNPL loans are a form of short-term, closed-end financing used to fund discrete purchases and are typically embedded directly into the purchase journey. Unlike traditional credit, BNPL approvals are usually granted for discrete purchases in real time and use automated underwriting that draws on limited soft credit inquiries.[i]

The BNPL sector is one of the fastest-growing segments of consumer finance, recording a compound annual growth rate (CAGR) of 18.8% globally between 2022 and 2025. The global BNPL market is projected to reach approximately US $647.4 billion in 2026, measured by gross merchandise volume (GMV).[ii, iii]

Within Canada, the sector has grown at a CAGR of 16.6% between 2022 and 2025 and is valued at $9.31 billion USD in 2026. The sector is expected to continue growing, reaching $15.48 billion USD by 2031 (Figure 1). Growth in the BNPL market has been driven primarily by the rapid expansion of e-commerce and a shift in how younger consumers prefer to finance purchases.

BNPL loans generally follow two primary product structures: (1) the Pay-in-4, Pay-in-6 or Pay-in-8 plans, under which consumers pay for a purchase over a fixed number of interest-free instalments over a period of four, six or eight weeks, and (2) longer-term instalment loans, generally used for higher-value purchases, with repayment periods ranging from six to 36 months and typically carrying explicit interest charges. Under both structures, a consumer purchases and takes ownership of an item or service immediately and a merchant pays a transaction fee that is significantly higher than the average credit card fee.[iv]

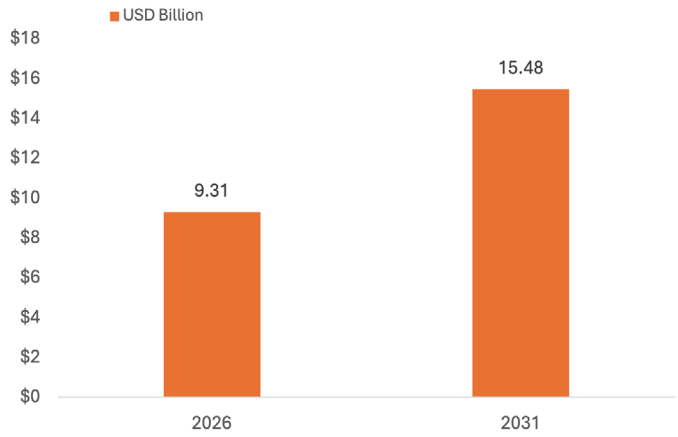
i Congressional Research Service. (2026, February 18). Buy now, pay later: Policy issues and options for Congress

ii Canadian payment methods and trends report 2026

iii As measured by Gross Merchandising Volume (GMV) which is the total value of purchases made using BNPL

iv Congressional Research Service. (2026, February 18). Buy now, pay later: Policy issues and options for Congress

Figure 1: Canada's BNPL market in 2026 as measured by gross merchandise volume (GMV) and forecasted size by 2031



Source: Canadian payment methods and trends report 2026.

2. HOW BNPL WORKS: BUSINESS MODELS AND INCENTIVES

The BNPL business model differs meaningfully from traditional credit. These differences highlight the incentive structures and economic dynamics that contribute to the unique risks associated with this sector. The main differences highlighted in this report revolve around: (1) the economic underpinnings of BNPL originations, (2) how providers generate revenue, and (3) funding and securitization strategies common in the sector.

2.1 The Economics of a BNPL Loan: Merchant-Subsidized Credit

A defining feature of BNPL is that the merchant indirectly bears a portion of the financing cost. By indirectly subsidizing the BNPL loan through the merchant fee, the merchant effectively lowers the product's purchase price for consumers who choose BNPL financing. The subsidized loan is especially attractive to consumers who lack access to cheap credit otherwise. This pricing structure enables merchants with some degree of market power to engage in price discrimination through cross-subsidization, whereby merchants accept higher transaction fees in exchange for generating additional sales and capturing greater incremental margins on those transactions. As shown in Figure 2, the arrangement is profitable for merchants if the increase in margins from additional sales exceeds the extra cost of the BNPL fees.[i]

Empirical evidence supports this claim. When BNPL is introduced relative to a control group, the sales response among customers with lower credit scores is two to three times greater than among customers with higher credit scores. Additionally, merchants that

i Provided creditworthiness and willingness-to-pay are positively correlated, Berg, T., Burg, V., Keil, J., & Puri, M. (2025)

offer BNPL options experience a 14% increase in revenue, as more customers complete their purchases and spend more per transaction.[i]

These findings have important implications for the risk profile of BNPL users and the economic incentives experienced by providers. Because the appeal of BNPL to credit-constrained consumers is a feature of the product's underlying economics, elevated default risk may be a structural feature of the BNPL model. Furthermore, depending on their business model, BNPL firms may be less dependent on revenues generated from the loans themselves and instead rely on merchant fees. This revenue structure can weaken the incentive to ensure that borrowers are able to fully repay the loans they take out.

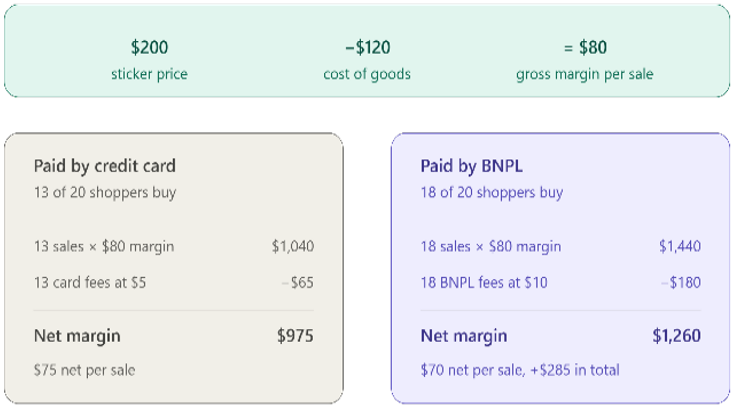
2.2. Sources of Provider Revenue

BNPL providers can generate revenue from merchants, consumers and subsequent securitization of receivables. The relative contribution of these revenue sources varies across providers and depends on factors such as the structure of their BNPL products, the composition of their loan portfolios, and their broader business models.

2.2.1. Merchant Fees

BNPL providers charge merchants a fee for each transaction they facilitate. These fees are often substantially higher than those charged by credit card networks. Providers also generate revenue from fees tied to cards used at merchants other than those directly integrated with the BNPL platform. In some cases, merchants pay BNPL providers to promote their products on the BNPL provider's platform. Altogether, merchant fees account for roughly 30% to 60% of total revenue, depending on the company.[ii] BNPL firms that rely more heavily on merchant fees tend to have loan portfolios consisting primarily of shorter-term, interest-free loans.

Figure 2: Merchant Revenue When Offering BNPL vs Traditional Credit (Example transaction)



i Berg, T., Burg, V., Keil, J., & Puri, M. (2025). The economics of "buy now, pay later": A merchant's perspective

ii In 2024, merchant transaction fees (excluding advertising) accounted for the majority of Klarna's revenue at 57%, while making up smaller but still substantial shares for Affirm at 36% of net revenue and Sezzle at 32%. Afterpay, meanwhile, reported in 2022 that its revenue came largely from active seller fee. See - Sezzle Form 10-K; Affirm Annual Report 2024, p. 102; Klarna Group Form F-1, p. F-54; Eisen et al., "Connecting Cash App and Square Ecosystems," p. 11

2.2.2. Consumer Interest and Late Fees

Providers can also generate revenue by charging interest on installment loans that are repaid over time. This revenue stream is particularly significant for providers whose portfolios include a large portion of longer-term loans. Shorter-term products, such as Pay-in-4 plans, typically do not charge consumers' interest.[i]

Companies also charge fees related to late, deferred, or missed payments. However, late fees have been decreasing both in absolute terms and as a proportion of total loans over time. On average, 4.1% of "Pay in 4" loans incurred late fees, with an average of $9.70 charged and $5.70 collected per fee.[ii]

2.3. BNPL Provider Profitability

Using a simplified microeconomic model,[iii] we illustrate how BNPL providers can remain profitable while extending credit to higher-risk borrowers. The model divides borrowers into higher-credit and lower-credit groups and expresses the provider's break-even condition as a function of the share of lending allocated to lower-credit borrowers and their associated credit loss rate. This relationship defines a break-even frontier, showing the combinations of borrower mix and lower-credit loss rates consistent with profitability, given a specified revenue structure, funding and servicing costs, and higher-credit loss rate.

Additionally, we construct a hypothetical BNPL provider using Klarna's 2025 financials and U.S. BNPL default rates by credit tier reported by the Consumer Financial Protection Bureau (CFPB). The model is then used to examine how default timing and changes in funding and servicing costs affect the break-even borrower mix. Appendix A provides the model assumptions, inputs, and calculations.[iv]

The analysis highlights two key findings:

- **Default timing:** Earlier defaults result in larger credit losses, significantly reducing the share of lower-credit lending a BNPL provider can sustain while remaining profitable. This constraint is particularly pronounced for providers offering short-term, interest-free products, such as pay-in-four loans, whose revenues rely primarily on merchant fees.
- **Sensitivity to costs:** Even modest increases in funding and servicing costs can sharply reduce the share of lower-credit lending a provider can profitably support, particularly when relying exclusively on merchant fee revenue.

These sensitivities are particularly relevant to the funding and securitization structures discussed in section 2.4, as changes in default timing or funding and servicing costs can weaken the profitability of the providers originating the underlying receivables. As

i In 2024, interest income collected from consumers was roughly 52% of Affirm's revenue and 18% of Klarna's revenue. Additionally, for Klarna, adding up to roughly 14% of GMV
By GMV in 2024:
74% of Affirm's loans were interest-bearing installment loans, Affirm, Affirm Annual Report 2024
5% of Klarna's were interest-bearing installment loans. Klarna Group, Form F-1; pp. 121, 131
Sezzle refers consumers to third-party lenders and receives a fee. Sezzle, Form 10K, p. 9; pp. 6, 67

ii Salem, N., & Udis, L. (2025, December). The buy now, pay later market. Consumer Financial Protection Bureau

iii Costa Lima, Rafael and Correia-da-Silva, Joao, The Microeconomics of Buy now, pay later (July 13, 2025)

iv The results are illustrative and should not be interpreted as estimates of Klarna's actual borrower mix or loss rates.

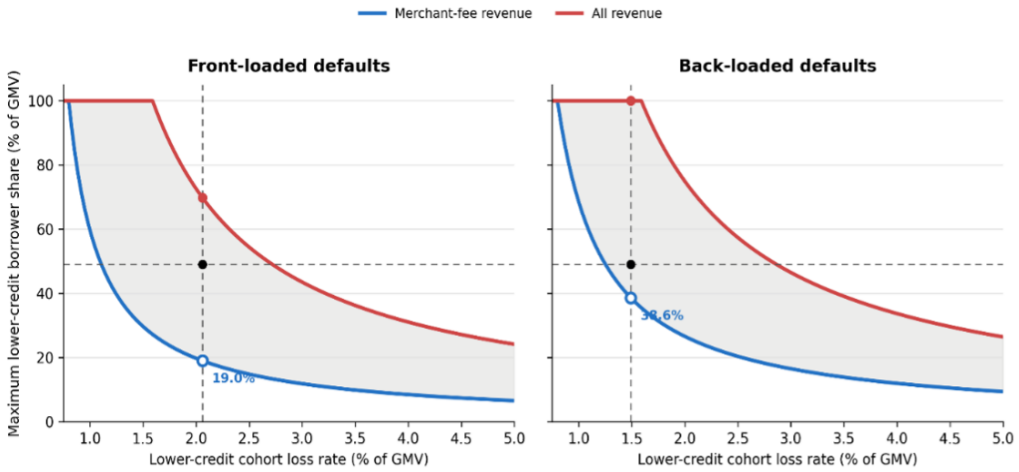
discussed in later sections, lower-credit borrowers account for more than 40% of BNPL originations, underscoring the importance of these sensitivities when assessing provider resilience and the risks borne by financial institutions funding or purchasing BNPL loans.

2.3.1 Default Timing

The timing of default affects the credit losses a BNPL provider incurs and, consequently, the share of lower-credit lending it can profitably support. To account for this, we estimate group losses by multiplying the probability of default by the exposure at default (EAD). To illustrate this, Figure 3 compares two scenarios: front-loaded defaults, where borrowers tend to stop making payments earlier in the repayment schedule, leaving a larger balance unpaid; and back-loaded defaults, in which borrowers tend to stop paying later, after repaying more of the principal. To illustrate a provider's sensitivity to default timing, we hold default rates and all other model inputs constant and vary only the EAD.

When revenue comes solely from merchant fees, the maximum share of lending that can be allocated to lower-credit borrowers is approximately 19.0% under front-loaded defaults, compared with 38.6% under back-loaded defaults. This difference highlights the sensitivity of BNPL profitability to default timing: earlier defaults generate larger losses, leaving less room to accommodate lower-credit borrowers. Providers that rely primarily on merchant fees are particularly vulnerable because they have fewer additional revenue sources to absorb these losses.

Figure 3: Modeled Breakeven Frontier Given Different Distributions of Exposure at Default (EAD)[i]



Source: Author's own calculations, Appendix A

i Blue lines show revenue from merchant fees only, red line shows a mixed revenue including interest charged to consumers and selling of receivables. The dashed vertical and horizontal lines illustrate where our hypothetical BNPL provider falls on the frontier.

2.3.2 Sensitivity to Funding and Servicing Costs

The break-even share is also sensitive to changes in funding costs. We illustrate this sensitivity by varying funding costs by ±0.25 percentage points while holding all other model variables constant. We use the merchant fee revenue model in Figure 4 to show the different break-even frontiers. The resulting curves show how changes in funding costs affect the maximum share of lending that can be extended to lower-credit-quality borrowers while maintaining profitability, across a range of lower-credit loss rates.

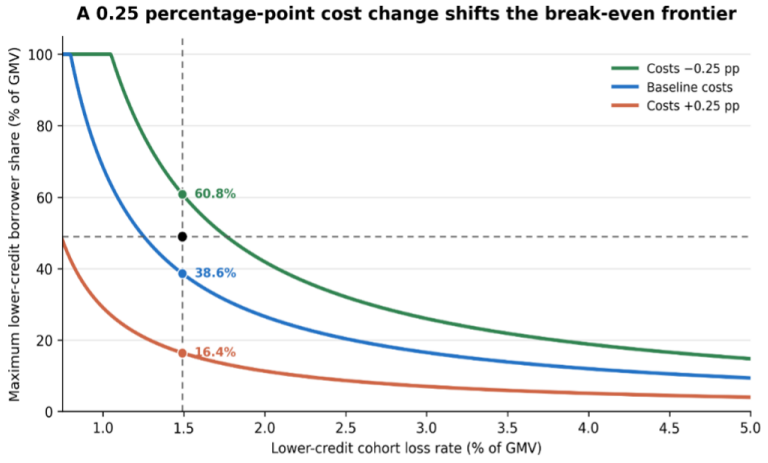
The sensitivity analysis demonstrates how even relatively small increases in funding costs can sharply reduce the share of lending that a BNPL provider can profitably extend to lower-credit-quality borrowers when relying exclusively on merchant fee revenue. An important caveat is that interest-free BNPL loans typically have short repayment periods of four to eight weeks. This gives providers greater flexibility to adjust their lending activity in response to rising funding costs, allowing them to limit their exposure to less profitable loans as funding conditions deteriorate.

2.3.3. Implications for BNPL Sector's Fragility

The analysis illustrates how BNPL providers can profitably serve the higher-risk borrowers their business models tend to attract. Merchant fees generate revenue that can absorb credit losses, creating room for lending to consumers with weaker credit profiles. Although the presence of these borrowers may have significant implications for BNPL receivables, it does not by itself imply that a provider's business model is unprofitable.

However, this headroom is sensitive to both default timing and funding costs. Even when default rates remain unchanged, earlier defaults increase the principal left unpaid and reduce the share of lower-credit lending a provider can sustain. Higher funding costs further constrain this capacity by reducing the revenue available to absorb losses. Providers relying primarily on merchant fees have less additional revenue to cushion these pressures.

Figure 4: Sensitivity of the Merchant-fee Profitability Frontier to Funding Costs[i]



Source: Author's own calculations, Appendix A

i The curve shows the profitability frontier of a firm using only merchant fees and how it shifts as funding costs change.

Taken together, these findings suggest that assessing BNPL provider resilience requires looking beyond default rates alone. Borrower mix, repayment patterns, revenue sources, and funding costs jointly determine whether a portfolio remains profitable. The model's break-even frontiers illustrate how changes in these conditions can make a previously sustainable borrower mix unprofitable, providing a foundation for examining the risks borne by institutions that fund or purchase BNPL receivables.

2.4. How BNPL Is Funded: Connections to the Financial System

The funding architecture underlying BNPL products reveals a layered and interconnected relationship between FIs and BNPL providers. Rather than operating as fully independent lenders, most BNPL companies rely substantially on banks and capital markets to provide the funds used in their lending activities. This section will discuss two primary channels of funding used by BNPL providers: (1) bank deposit partnerships and (2) securitization and post-origination financing.

2.4.1. Bank Partnerships and Deposit Funding

Under this model, the BNPL platform handles customer engagement and transaction processing while a partner bank originates the actual loan. While some providers partner with independent banks, others hold their own banking license. For instance, BNPL provider Klarna holds a banking license in Europe. This allows it to draw funding from European retail deposits to fund its BNPL activity.[i] On the other hand, companies like Affirm originate most of their funding through partnerships with a number of banks.[ii] Bank partnerships are common globally; however, they are not prevalent in Canada. Canadian banks tend to originate their own style of BNPL products discussed in section 4.2.

2.4.2. Post-Origination Funding Structures

A second layer of FI involvement occurs through consolidating BNPL loans into structured financial instruments. The most common financing structures used by FIs in the BNPL space are (1) Warehouse financing and (2) Forward-flow agreements.[iii, iv, v]

1. **Warehouse Financing**
   Warehouse financing is a revolving line of credit that a BNPL provider uses to fund consumer loans. FIs commit a line of credit up to a maximum dollar amount for a fixed term, which the BNPL provider draws against each time it originates a loan. The resulting BNPL receivables serve as collateral for the credit line. Once a sufficient pool of receivables has accumulated, the BNPL provider securitizes them and sells

i Klarna's prospectus outlines its funding strategy. Like other BNPL providers that work with banking partners, Klarna collaborates with WebBank, a Utah-based industrial loan company in the U.S. However, the extent to which Klarna's customer receivables are financed through U.S. deposits via this arrangement is not clearly disclosed - see: Klarna, "Prospectus Filed Pursuant to Rule 424(b)(4)," September 10, 2025, pp. 268

ii Affirm Holdings. (2024). Annual report (Form 10-K). U.S. Securities and Exchange Commission

iii Buy Now, Pay Later: Policy Issues and Options for Congress. (2026, September 29)

iv Klarna Group. (2025, September 8). Registration statement (Form F-1). U.S. Securities and Exchange Commission

v Affirm Holdings. (2025, March 12). Affirm's capital strategy 2.0 - A Silicon Valley approach to building bridges between Wall Street, Main Street, and everywhere in between

the resulting securities to investors. The proceeds from selling the securities are then used to repay the line of credit, freeing up capacity to fund new originations.[i, ii]

2. **Forward Flow Agreements**
   Forward-flow agreements are standing contractual arrangements under which an FI commits in advance to purchase receivables generated by newly originated BNPL loans over a specified term. Rather than borrowing against receivables held on its balance sheet, the BNPL provider sells them outright, transferring the full economic interest in the loans to the purchaser. The purchasing FI funds the receivables directly, meaning the BNPL provider does not need to commit its own capital to fund the loans. This makes forward-flow arrangements particularly attractive for smaller or thinly capitalized BNPL providers.[iii]

3. RISKS EMBEDDED IN BNPL RECEIVABLES

The economics underlying BNPL loan origination discussed in section 2 create several key risk concerns for the receivables they generate and for any subsequent securitization of those receivables. These risks stem primarily from (1) the credit risk profile of the borrowers who tend to use BNPL loans, (2) the phenomenon of "loan stacking" among BNPL consumers, and (3) the wrong-way risk embedded in some funding and securitization arrangements.

3.1. Borrower Credit Quality: A Structural Tilt Toward Subprime Lending

A central risk within the BNPL ecosystem stems from a disconnect between the economics underpinning loan origination and the subsequent treatment of those loans in funding markets. Due to the economic dynamics of BNPL loans, lending is disproportionately concentrated among consumers with relatively low creditworthiness.[iv] As shown in Figure 5A and 5B, although BNPL users and traditional credit users have similar credit footprint sizes, BNPL users are more concentrated at the lower end of the credit quality distribution. Over 50% of BNPL originations go to unscored, subprime and deep subprime borrowers. Furthermore, as shown in Figure 6, BNPL defaults are concentrated in the deep subprime (3.5%) and no score (4.1%) groups. To compensate for the expected credit loss associated with this borrower profile, BNPL providers tend to collect elevated fees from merchants as explained in previous sections. However, the same underwriting rationale that makes BNPL economically attractive within the merchant-provider relationship diminishes the loan's value for the FIs holding these receivables as collateral or investments.

i TAO Solutions. (n.d.). Bank structured finance warehouse facilities.

ii Young, J. (2025, September 17). Warehouse financing explained: Capital raising strategies for lenders. Fortra Law.

iii Hogan Lovells. (2023, June). Going with the flow - The appeal of the forward flow transaction in structured finance.

iv Berg, T., Burg, V., Keil, J., & Puri, M. (2025). The economics of "buy now, pay later": A merchant's perspective.

Figure 5A: Credit footprint and credit worthiness of traditional credit users vs BNPL users

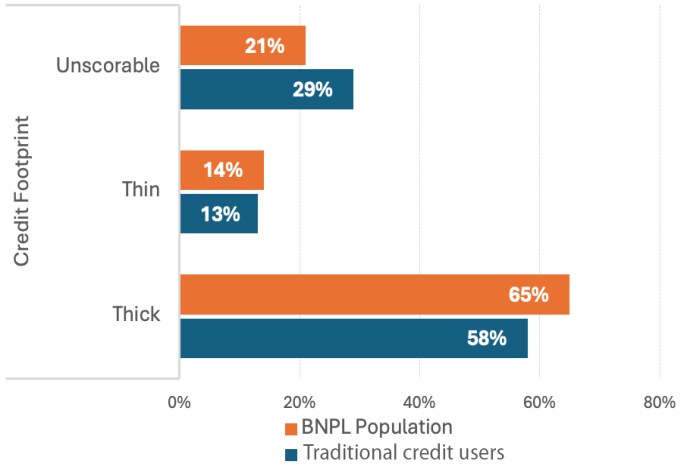
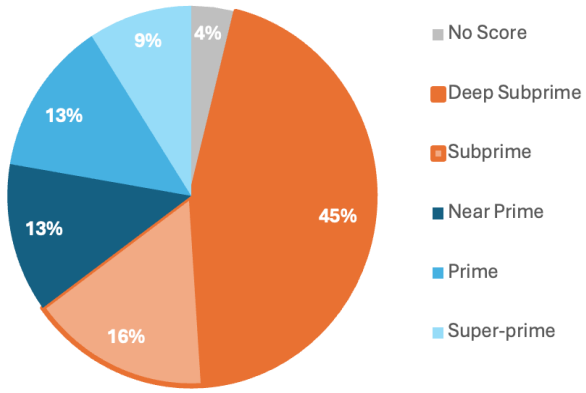
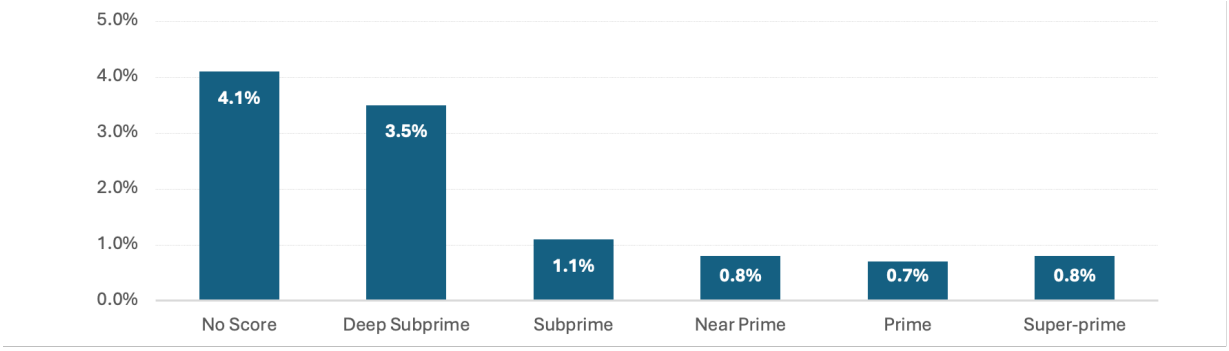


Figure 5B: The share of originations from 2021-2022 across six FICO score categories[i]



Source: LexisNexis Risk Solutions. (n.d.). Buy now pay later credit risk research series, Consumer Financial Protection Bureau. (2025, January). Consumer use of buy now, pay later and other unsecured debt

Figure 6: BNPL default rates across six FICO score categories from 2020-2021[ii]



Source: Consumer Financial Protection Bureau. (2025, January). Consumer use of buy now, pay later and other unsecured debt

i No Score, Deep Subprime (300-579), Subprime (580-619), Near Prime (620-659), Prime (660-719), and Super-prime (720-850)

ii No Score, Deep Subprime (300-579), Subprime (580-619), Near Prime (620-659), Prime (660-719), and Super-prime (720-850)

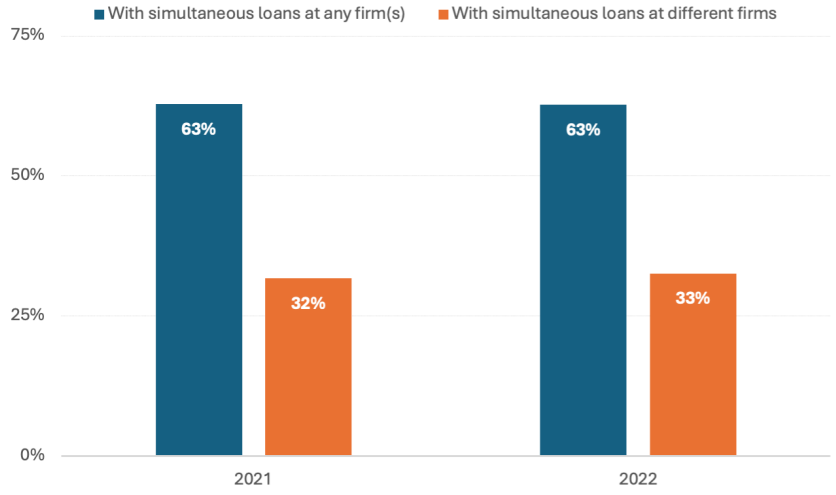
3.2. Loan Stacking and Correlated Defaults

Further exacerbating the potential credit risk associated with BNPL users is the phenomenon of "loan stacking." Loan stacking occurs when consumers hold multiple simultaneous loans with one or more BNPL providers. 63% of BNPL users have reported stacking loans, with 33% doing so across different providers (Figure 7).[i] This may indicate significant correlations within an individual provider's loan book, as well as across BNPL providers. Moreover, consumers who engage in BNPL loan stacking are often those with higher credit risk (Figure 8A and 8B). Consequently, the loans carrying the greatest credit risk may also be more likely to deteriorate simultaneously.

3.3. Wrong-Way Risk in Collateralized Funding

FIs that hold BNPL loans as collateral under funding arrangements, such as warehouse facilities, may be exposed to meaningful wrong-way risk.[ii] Wrong-way risk arises when an institution's exposure to a counterparty is adversely correlated with that counterparty's credit quality. This causes the protection offered by the collateral to weaken precisely when it is most needed. In BNPL funding, this occurs because the creditworthiness of the BNPL provider and the performance of the underlying BNPL receivables used as collateral are fundamentally interconnected as shown in section 2.3.

Figure 7: Percentage of BNPL borrowers holding loans at multiple firms simultaneously



Source: Consumer Financial Protection Bureau. (2025, January). Consumer use of buy now, pay later and other unsecured debt

i Consumer Financial Protection Bureau. (2025, January). Consumer use of buy now, pay later and other unsecured debt

ii Risk.net, Wrong way risk

Figure 8A: Average credit score by usage frequency of BNPL loans

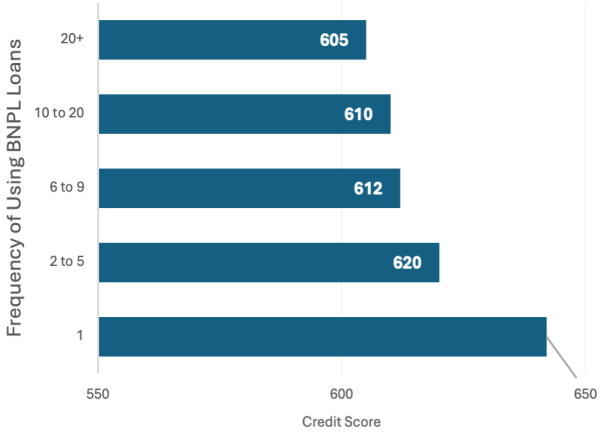
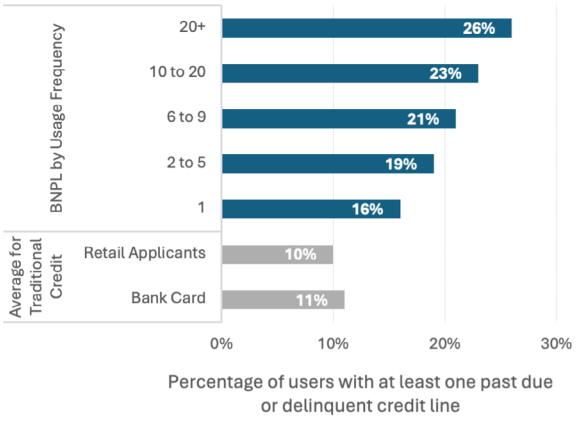


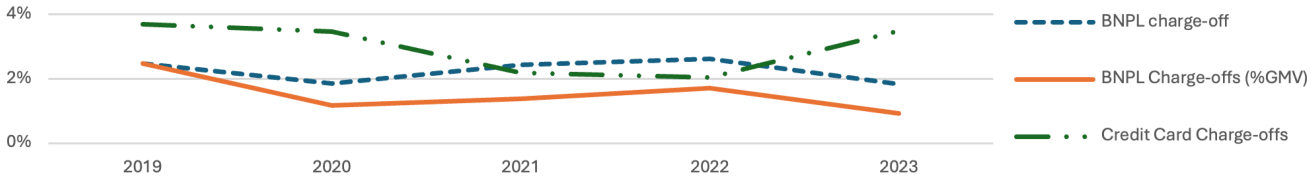
Figure 8B: Percentage of users with at least one credit line 90+ days past due or in collections by user frequency[i]



Source: LexisNexis Risk Solutions. (n.d.). Buy now pay later credit risk research series.

If a BNPL provider experiences financial distress, the deterioration in its financial condition may be driven by the weak performance of its underlying loan book. This scenario is particularly concerning given BNPL borrowers' credit risk profiles and the potential for loan stacking to increase correlated defaults within a provider's portfolio.

Figure 9: BNPL charge-off rates versus credit card charge-off rates at all U.S. commercial banks, 2019–2023. Board of Governors of the Federal Reserve System.



Sources: CFPB, The Buy Now, Pay Later Market (December 2025); Board of Governors of the Federal Reserve System.

i Bank card application is for a general-purpose credit card issued by a bank on a network, retail card application is for store-branded credit issued through a merchant partnership.

3.4. Default Performance to Date

Although formal reporting on BNPL defaults remains sparse, data from the U.S. Consumer CFPB from 2019-2023 can be used to gauge the general level of current defaults in the sector. The CFPB put together a provider-level panel covering six major BNPL providers. As shown in Figure 9, the BNPL charge-off rate declined from 2.47% in 2019 to 1.83% in 2023.[i] The CFPB attributes the low realized losses to structural features such as autopay enrolment, short repayment terms and transaction-level underwriting.[ii]

4. THE CANADIAN REPORTING AND REGULATORY ENVIRONMENT

Canada currently has no dedicated regulatory framework specifically governing the potential systemic risks associated with the BNPL sector.[iii] The Financial Consumer Agency of Canada (FCAC) published a pilot study of the BNPL sector in 2021 but stopped short of recommending any BNPL-specific regulations.[iv] This gap is currently filled through existing consumer protection statutes rather than purpose-built BNPL rules. These statutes regulate the terms and disclosure of individual credit agreements. They do not

Canada's Existing BNPL Regulatory Framework

BNPL providers in Canada operate under several existing regulatory frameworks, depending on their activities and business models. These may include federal requirements under the Retail Payment Activities Act and applicable provincial consumer protection legislation. While these frameworks address aspects of payment services, operational risk and consumer protection, they are not specifically designed to address the broader prudential and systemic risks associated with BNPL lending, including the accumulation of credit exposures and limited visibility into household borrowing.

Sources: Canadian Lenders, Fintech Lawyer: BNPL Regulation and FCAC Pilot Study: Buy Now, Pay Later Services in Canada

i Equifax - A charge-off means a lender or creditor has written the account off as a loss, and the account is closed to future charges

ii Shupe, C., & DeLuca, J. (2025, January). Consumer use of buy now, pay later and other unsecured debt. Consumer Financial Protection Bureau.

iii **Important Note:** BNPL providers in Canada operate under overlapping regulatory frameworks that depend on their structure and activities. The Retail Payment Activities Act (RPAA, a payment regime) requires qualifying providers to register with the Bank of Canada and meet risk management and safeguarding standards. Provincial consumer protection laws apply where BNPL products are considered credit or installment agreements, governing disclosure and consumer rights. At the federal level, obligations may also arise under anti-money laundering, privacy, and fair dealing frameworks. Providers may additionally follow industry codes and international standards that promote transparency and responsible lending practices. See – Canadian Lenders, Fintech Lawyer: BNPL Regulation and FCAC Pilot Study: Buy Now, Pay Later Services in Canada

iv Financial Consumer Agency of Canada. (2023, September). Financial Consumer Agency of Canada business plan 2023–2024 to 2025–2026. Government of Canada.

impose prudential requirements, such as capital or liquidity standards, nor do they help monitor the accumulation of BNPL credit risk across the financial system.

The regulatory gap is particularly evident when comparing BNPL providers to federally regulated financial institutions. Banks and other OSFI-regulated lenders are subject to capital adequacy requirements, stress testing and supervisory review. By contrast, BNPL providers operating in Canada face no comparable prudential oversight. These differences in regulatory treatment may create incentives for credit risk to accumulate outside the traditional prudential framework, potentially reducing visibility into emerging exposures.

4.1. Incentives Shape Credit Bureau Reporting

Concerns also arise from the current credit-reporting structure within the BNPL sector. While banks and other traditional lenders generally report consistently to credit bureaus, reporting among BNPL providers is less consistent. This may reflect differences in business models and economic incentives that do not always align with the benefits of comprehensive credit reporting.[i, ii]

Whether a BNPL provider reports voluntarily or not seems to depend significantly on its revenue structure. For instance, providers that earn most of their income from consumer interest and hold long-term loans benefit directly from a complete view of each borrower's credit risk. Affirm fits this profile, with interest-bearing instalment loans accounting for 74% of its GMV in 2024.[iii]

On the other hand, providers relying on shorter-term interest-free loans face a different set of incentives. For example, interest-bearing instalment loans accounted for just 5% of Klarna's GMV in 2024.[iv] The benefits of improved credit bureau data diminish as repayment periods shorten, and the share of revenue generated from merchant fees increases. Additionally, reporting adds compliance costs and could discourage borrowers from using the product.

Recent reporting decisions by BNPL providers in the United States appear to follow this pattern. In March of 2025, Affirm announced that it would report all BNPL products. Meanwhile, Klarna indicated that it would not report BNPL data to credit bureaus for the time being.[v, vi] Although anecdotal, the contrast at least suggests that BNPL providers' credit reporting decisions are shaped by the extent to which credit bureau reporting aligns with the incentives of their underlying business models and lending structure.

i PYMNTS Intelligence. (2024, June). New data: Defining the new buy now, pay later consumer.

ii Klarna, "Does Klarna Report to Credit Bureaus?"; Affirm, "Affirm Credit Reporting," ; PayPal, "Questions About Pay Monthly Applications,"

iii In 2024, interest income collected from consumers is roughly 52% of Affirm's revenue and 74% of Affirm's loans by GMV were interest-bearing installment loans, Affirm, "Affirm Annual Report 2024."

iv In 2024, interest income collected from consumers is roughly 18% of Klarna's revenue and 5% of Klarna's loans by GMV were interest-bearing installment loans. Klarna Group, Form F-1, pp. 121, 131

v Axios, Buy-now-pay-later companies get cold feet about handing data to credit bureaus, Aug 2025

vi WSJ, Push to Add 'Buy Now, Pay Later' Loans to Credit Scores Hits a Snag, Aug 2025

4.2. Bank Provided BNPL Products

Unlike third-party BNPL providers, banks operate within an established prudential framework and maintain existing relationships with credit bureaus through their conventional lending activities. Therefore, bank-provided instalment plans offer a useful point of comparison for examining how the institutional setting in which BNPL operates shapes its credit reporting practices and lending decisions.

Bank instalment plans allow credit card holders to convert eligible purchases into fixed monthly payments without undergoing a new credit check, opening a new credit line, or changing their existing credit limit. Instalments usually carry a reduced interest rate or a fee and are added to the minimum monthly payment of the credit card. Missed or late payments are reported in the same way as other credit card payment delinquencies.

Unlike third-party BNPL providers, bank instalment plans do not incur merchant fees because they apply to purchases already made with an existing credit card. Instead, banks generate revenue through consumer-paid fees or interest. As OSFI-regulated institutions, banks must also comply with capital, stress-testing, and supervisory requirements.

Due to the way it is structured, access to bank-offered instalment services is limited to consumers who hold an eligible credit card in good standing. Consequently, these plans may exclude credit-constrained consumers, who represent a significant segment of third-party BNPL users.

5. GROWTH AND DECLINING CREDIT VISIBILITY

The Canadian BNPL market is currently valued at approximately $9.31 billion USD, a relatively small amount compared with total Canadian household debt. However, the potential systemic risk posed by the sector stems primarily from its rapid growth and the interaction of its underlying risk factors. Gaps in the sector's regulatory and credit-reporting frameworks could allow the risks associated with BNPL lending to increase disproportionately as the market expands. As discussed in Sections 3 and 4, these gaps can amplify underlying credit vulnerabilities and obscure their accumulation, making BNPL a significant emerging risk for the financial sector.

5.1. Regulatory and credit reporting gaps

The limitation of the current regulatory framework becomes increasingly consequential as the BNPL sector expands. The absence of comprehensive credit reporting can create vulnerabilities that extend beyond the BNPL sector and affect the broader financial system.

Under the current credit-reporting framework, information sharing between BNPL providers and credit bureaus remains limited and inconsistent. Consequently, banks and other lenders assessing applications for credit cards, lines of credit, or mortgages may rely on credit files that do not fully reflect an applicant's existing BNPL obligations. Individual loans may therefore appear appropriately underwritten when assessed in isolation, even when the consumer's aggregate debt burden is understated.

These reporting gaps also reduce system-wide visibility into household borrowing and repayment behaviour. Without comprehensive information on BNPL obligations, lenders and regulators face greater difficulty identifying emerging financial stress, assessing household leverage, and monitoring the accumulation of vulnerabilities across the financial system.

These gaps are likely to persist without changes to sector-wide reporting practices or regulatory requirements. As discussed in Section 4.1, incentives to report to credit bureaus differ across BNPL business models, while some consumers may also prefer products that do not affect their conventional credit records.

The implications of these reporting gaps are particularly significant given the elevated level of household indebtedness in Canada. In the second quarter of 2026, Canadian households held approximately $1.76 in credit market debt for every dollar of disposable income.[i] Faced with rising living expenses and reduced savings buffers, some households may increasingly rely on BNPL financing to manage expenditures. Inconsistent reporting of these obligations limits lenders' and regulators' visibility into the additional debt taken on by already highly leveraged households.

As the BNPL sector grows, these information gaps could become increasingly consequential, weakening the ability of financial institutions and regulators to assess household debt burdens, identify emerging credit deterioration, and respond to vulnerabilities before they spread through the broader financial system.

CONCLUSION

BNPL remains a relatively small segment of Canadian consumer credit, but its rapid growth creates several channels through which risks could become more significant over time. These risks arise from the way BNPL loans are originated, funded, and reported, as well as the interactions between these structures.

The economics of BNPL lending tend to attract consumers with weaker credit profiles. Financial institutions that fund these loans may be exposed to the resulting credit risk without directly benefiting from the merchant-fee revenues that help compensate BNPL providers for originating them. Loan stacking further concentrates credit exposures and increases the potential for correlated defaults. Certain funding arrangements also introduce wrong-way risk, whereby deterioration in a BNPL provider's creditworthiness coincides with a decline in the value of the receivables securing its financing. Finally, inconsistent credit bureau reporting reduces visibility into these exposures, making it more difficult for lenders and regulators to identify emerging vulnerabilities.

The BNPL sector's most pressing emerging systemic concerns stem from the blind spots it creates across the wider financial system. As the sector grows, regulatory gaps and incomplete credit reporting will increasingly limit lenders and regulators' visibility into household debt burdens and interconnected exposures. Furthermore, providers' economic incentives may be insufficient motivation to close these information gaps through voluntary reporting, highlighting the importance of changes to reporting practices or regulatory requirements.

i National balance sheet and financial flow accounts, second quarter 2026

For risk leaders and financial institutions, assessing BNPL exposures requires an understanding of the economics underpinning loan origination, the sensitivity of provider profitability to funding costs, and the effects of borrower repayment and defaults on receivable performance. Although observed BNPL default rates currently compare favourably with credit card defaults, loan stacking creates the potential for correlated defaults within and across providers. Features that currently help contain losses may also create fragility under stress, making recent default performance an incomplete measure of the sector's resilience.

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APPENDIX A: THE MATHEMATICS OF BNPL LOANS

The goal of this analysis is to illustrate the profitability of BNPL providers in terms of loss rates and portion of lending going to users who have low credit scores. We use an adapted microeconomic model to explain how revenue, costs and credit losses affect the economics of BNPL lending.[i]

Furthermore, using Klarna's financial data and CFPB's default data we construct a hypothetical BNPL provider to show how a realistic example of a BNPL provider compares against the profitability frontier we construct.

The Model

A BNPL provider earns revenue from merchants that offer the service at checkout and from any interest or fees charged to consumers. The costs analyzed in this model are payment processing costs, funding costs, and credit losses on unpaid balances. We express each component as a share of gross merchandise value (GMV),

r: Revenue

c: Processing and servicing costs

ϕ: Funding costs

λ : Average credit loss rate across the portfolio

π: Transaction margin

$$\pi = r - c - \phi - \lambda$$

The break-even credit loss rate

The provider breaks even at the transaction level when π = 0. The break-even credit loss rate, λ^* , is therefore the amount of revenue left to absorb losses after processing, servicing and funding costs:

$$\lambda^* = r - c - \phi$$

For a model with merchant revenue m and consumer revenue k, r = m + k.

$$\lambda^* = (m + k) - c - \phi$$

i Costa Lima, Rafael and Correia-da-Silva, Joao, The Microeconomics of Buy now, pay later (July 13, 2025).

Dividing borrowers into two risk groups

We divide the loan portfolio into two groups. The higher-credit group has a loss rate of λ_H and the lower-credit group has a loss rate of λ_L. If lower-credit borrowers account for a share s of GMV, higher-credit borrowers account for $1 - s$. The portfolio's average loss rate is the weighted average of the two:

$$\lambda = (1 - s)\lambda_H \ - \lambda_L$$

Substituting this average into the break-even equation and solving for s gives s^*. This is the maximum share of lower-credit lending the provider can support at the transaction level:

$$s^* = (r - c - \phi - \lambda_H)/(\lambda_L - \lambda_H)$$

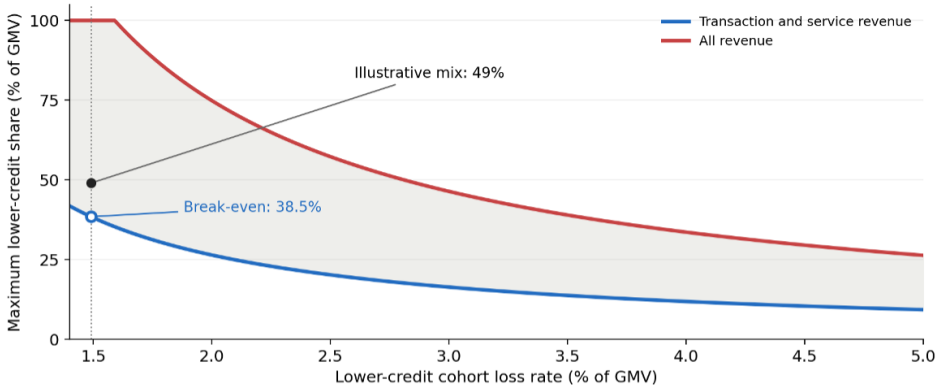
This calculation relies on the following assumptions:

- Processing, servicing and funding costs are the same across the two groups. If costs rise as the lower-credit share grows, this model may overstate the share the provider can support.
- The lower-credit group has a higher loss rate than the higher-credit group: $\lambda_L > \lambda_H$
- Loan duration does not affect default rates.
- Default rates are the same for interest-bearing and non-interest-bearing loans

Realistic Example of a BNPL Provider

To populate the model with realistic data, we use financial data from Klarna's 2025 Annual report and BNPL defaults reported by the CFPB's report as shown below:[i, ii]

Figure 10: Break-even by lower credit loss rate and share of lending under two revenue definitions



Source: Author's calculations

Figure 10 shows how the maximum supportable lower-credit share, s^*, declines as that group's loss rate, λ_L, rises. It uses the back-loaded default scenario in Table 3, with an EAD of 0.42, and holds the higher-credit group's loss rate at 0.37% (calculated using CFPB default data and the assumed EAD). The blue curve uses transaction and service revenue, while the red curve includes all revenue. Portfolios below a curve generate a positive transaction margin under the corresponding revenue definition; portfolios on the curve break even. The shaded area identifies portfolios that meet the break-even condition only when all revenue is included.

i Klarna Group plc, 2025 Annual Report (Form 20-F), Klarna FY2025 Annual Report, pp. 130 and 157. Klarna Group plc, Q3 2025 results announcement, 18 November 2025

ii CFPB, Consumer Use of Buy Now, Pay Later and Other Unsecured Debt (January 2025), CFPB, The Buy Now, Pay Later Market (December 2025)

Table 1: Klarna's financial data

Line item	$ millions USD	% of GMV
GMV	127,862	—
Transaction and service revenue	2,500	1.96%
Gain on sale of consumer receivables	73	0.06%
Interest income	937	0.73%
Total revenue (take rate)	3,509	2.74%
Processing and servicing costs	(809)	0.63%
Provision for credit losses (rate calculated)	(794)	0.62%
Funding costs	(667)	0.52%
Transaction margin	1,238	0.97%

Source: Klarna Group plc, 2025 Annual Report

Table 2: Calculating break-even credit loss rate (λ^*) as a % of GMV

Calculation	All revenue	Transaction and service revenue only
Revenue	$3,509m	$2,500m
Processing and servicing costs	$809m	$809m
Funding costs	$667m	$667m
Available to cover credit losses	$2,033m	$1,024m
Break-even credit loss rate, % of GMV)	1.59%	0.80%

Source: Klarna Group plc, 2025 Annual Report

The provider can absorb credit losses of 1.59% of GMV when all revenue is included. Using only transaction and service revenue lowers that break-even loss rate to 0.80%.

Klarna reported $2,500 million in transaction and service revenue in 2025. Merchant revenue from Pay Later and Pay in Full is the largest component, but this category also includes Klarna card fees, app advertising and Klarna Plus subscriptions. It excludes $937 million in interest income and $73 million in gains on receivables sales. Those two items explain the gap between the transaction and service revenue and the total revenue.

Because transaction and service revenue includes non-merchant income, it is not a direct measure of merchant fees. Klarna does not disclose the split. We therefore use 1.96% as an upper bound on merchant revenue and 0.80% as an upper bound on the losses that merchant fees alone could cover.

Default rates and credit losses

The CFPB's January 2025 report provides BNPL default rates by credit score. For loans originated in 2021 and 2022, it reports rates of 0.8% for super-prime borrowers and 3.5% for deep-subprime borrowers. A default is defined here as a loan becoming at least 120 days past due. Deep-subprime borrowers accounted for 45% of originations (Figures 5 and 6).

A default rate measures how many loans become seriously delinquent. To estimate the amount lost as a share of GMV, we also need the balance still unpaid when default occurs. This is the exposure at default (EAD). Assuming no recoveries, the loss rate is:

$$\lambda = \mathrm{PD} \times \mathrm{EAD}$$

PD is the probability of default. In this illustration, EAD is the unpaid balance at default expressed as a fraction of the original purchase price.

Table 3: Example EAD distributions and respective loss rate calculation (using $\lambda = \mathrm{PD} \times \mathrm{EAD}$)

EAD distribution	Remaining Balance:	100%	75%	50%	25%	EAD	λ_H	λ_L	Maximum lower-credit share (transaction revenue)
Evenly Spread Defaults	Distribution of defaults by remaining balance	0%	33%	33%	33%	0.50	0.44%	1.78%	27.4%
Front Loaded Defaults		0%	50%	33%	17%	0.58	0.50%	2.06%	19.0%
Back Loaded Defaults		0%	17%	33%	50%	0.42	0.37%	1.49%	38.6%

Source: Author's Calculation, CFPB, Consumer Use of Buy Now, Pay Later and Other Unsecured Debt (January 2025), CFPB, The Buy Now, Pay Later Market (December 2025)

We make the following simplifying assumptions:

- Average loan size is similar across credit-score tiers. Each tier's share of loan originations can therefore be treated as its share of GMV.
- EAD is the same across credit-score tiers within each scenario. For a pay-in-four loan, 25% is paid at checkout. If the borrower stops paying before the second instalment, 75% remains unpaid; before the third, 50% remains; and before the final instalment, 25% remains.
- EAD is the same for interest-bearing and non-interest-bearing loans.
- PD is the same for interest-bearing and non-interest-bearing loans.

Reading the break-even curves

Figure 10 shows how the maximum supportable lower-credit share, s^*, changes as that group's loss rate, λ_L, rises. It uses the back-loaded default scenario, with EAD of 0.42, and holds the higher-credit group's loss rate at 0.37% of GMV.

The blue curve uses transaction and service revenue; the red curve includes all revenue. The grey area marks portfolio mixes that meet the break-even condition only with all revenue included. A portfolio at or below a curve meets that condition; one above it does not.