



December 20, 2013

**Via Email**

Sandra Pianalto  
President and CEO  
Federal Reserve Bank of Cleveland  
P.O. Box 834  
Chicago, IL 60690

Re: Payment System Improvement – Public Consultation Paper

Dear Ms. Pianalto:

PayPal, Inc. is pleased to submit this response to The Federal Reserve Banks' Payment System Improvement – Public Consultation Paper, issued September 10, 2013. PayPal, Inc. ("PayPal") is a registered, licensed money transmitter in the United States. PayPal is the faster, safer way to pay and get paid online, via a mobile device and in store. The service gives people simpler ways to send money without sharing financial information, and with the flexibility to pay using their account balances, bank accounts, credit cards or promotional financing. With 137 million active accounts in 193 markets and 26 currencies around the world, PayPal enables global commerce, processing almost 8 million payments every day. Because PayPal helps people transact anytime, anywhere and in any way, the company is a driving force behind the growth of mobile commerce and expects to process \$20 billion in mobile payments in 2013 (up from \$14 billion in 2012). In the U.S., PayPal has over 50 million active, registered users.

PayPal commends the Federal Reserve Banks for setting out their vision to improve the speed and efficiency of the U.S. payments system from end-to-end over the next decade, while maintaining a high level of safety and accessibility. PayPal is committed to working with government leaders to develop new regulatory models that achieve timeless policy goals allowing for innovation, economic growth and consumer



empowerment. PayPal agrees with the Federal Reserve Banks that ubiquitous, open payment networks and/or broadly interoperable networks best serve the public interest. Unfortunately, some recent legislation in the U.S. has moved us further away from these goals, while some other countries have enabled faster payments systems. We believe that our experience with those new systems can provide important insights to the Federal Reserve's current considerations.

PayPal's experience processing payments in the United States is also relevant to the questions and considerations raised by the Federal Reserve Banks. If PayPal were an Originating Depository Financial Institution, the volume of transactions we process would qualify us as one of the top ten ODFIs in the ACH system. PayPal originates more than 90% of the industry's IAT volume, while maintaining a low loss rate. PayPal has made significant investments in fraud and risk modeling, including the acquisition of Fraud Sciences in 2008 for \$170M. This group, now known as Advanced Risk Services, operates within PayPal's broader specialized Risk Management team. Comprised of 130 software engineers, analysts and other skilled technical staff focused on developing science, technology and strategies to aid in detecting and preventing fraud, this group has been instrumental in developing faster payment capabilities for PayPal.

Below are PayPal's responses to selected questions set out at the end of the Federal Reserve Banks' paper. We would be happy to meet with you to further discuss our position.

Q1. PayPal is in general agreement with the payment system gaps and opportunities set out by the Federal Reserve Banks. PayPal urges the Federal Reserve Banks to ensure that the system envisioned can process both debits and credits. It should not be limited to credits. In order to develop a robust yet easy and customer friendly solution, the ability to verify the account and easily authenticate the funds at the depository bank is a key component. Additionally, the ability to process cross-border transactions in a world where commerce is increasingly becoming global is critical and should not be overlooked.

Q2. PayPal is in general agreement with the desired outcomes for payment system improvements over the next 10 years. In addition to the outcomes listed, it is important that the system NOT be limited to financial institutions only. It should be open to non-banks as well as banks. Additionally, the system should be able to accommodate data beyond payment-related remittance data, to encourage and enable information-rich transactions. We believe that the significant time and resources required over the next decade to realize the Federal Reserve Banks' vision can be justified only by a significant improvement to the U.S. Payments System – namely, the creation of a real-time system. Other improvements, short of that goal, can be accomplished within the current environment, through industry innovation. This includes the proposal to increase the number of ACH files processed each day and move to a “near real-time” payments system. We categorize that as an incremental improvement to the current system, not the outcome desired or expected from a 10-year plan.

Q3. In PayPal's experience, although many parties involved in a payments system may seek to change and improve the system, successful change by consensus is rare and takes a long time. If the vision the Federal Reserve Banks outlined is to be attained, PayPal believes that it will require the leadership of the Federal Reserve Banks and a government mandate. With such a mandate, which may have to be issued by Congress, the Federal Reserve Banks can work with other stakeholders to build a system to reach the stated goals. The new system may offer the Federal Reserve Banks a continuing role as an Operator. There is also an important role for the Federal Reserve to play as a government leader with payments expertise to prevent regulation at odds with the stated long-term goal. While the Federal Reserve Banks have laid out their vision for a system that is ubiquitous, near real-time and that does not require the sender to know the bank account number of the recipient, the industry has had to become compliant with the new Remittance Transfer Rule, which requires cancellation periods that can delay payments and knowledge of recipients' bank account and routing numbers.



Q4. PayPal agrees with those industry participants who have stated that implementing a system for real-time payments with the described features will require coordinated action by a public authority or industry group. PayPal is a good example of a real-time payments system, where most transactions are processed immediately and funds generally made available to recipients. However, recent legislation, regulation and rules have not been focused on the same features of a payment system outlined in the Public Consultation Paper. This has had the counterproductive effect of slowing some cross-border payments and requiring senders to know the names, bank account and routing numbers of the recipients. For example, under the Remittance Transfer Rule, implemented as an amendment to Regulation E under Section 1073 of Dodd-Frank, senders must know the recipients' names, account and routing numbers, and be given 30 minutes to cancel certain transactions. The rules relating to processing of cross-border transactions under NACHA's IAT Standard Entry Code require that one payment be screened multiple times, by multiple parties handling the transaction. These requirements penalize cross-border transactions and delay payments. Any potential legislation relating to development of a new payments system should, at a minimum, include a provision that new rules relating to payments should be evaluated against the goals of the new system. That system should prohibit laws and regulations that contradict the stated goals of the new system.

Q5. PayPal is in general agreement with the features that the Federal Reserve Banks list as desirable for a near-real-time payments system. We agree that such a system should allow for ubiquitous participation (including banks and non-banks), provide confirmation of good funds at the initiation of the payment and timely notification to the sender and receiver that the payment has been made. We also agree that the sender should not need to know the bank account number of the recipient. A PayPal sender need not know the bank account number of the recipient; a sender can use the recipient's email address or mobile phone number. It will have to be determined whether such factors can continue to be used in a new system, or whether other identifying information will be used. It would be preferable for a new system to allow for innovation on this front, rather than mandating the use of any particular identifying information.



Q6. The Federal Reserve Banks outline several possible ways to reach the desired goal. PayPal does not believe that creating a separate wire transfer-like system would be an effective solution. Wire transfer systems generally rely on the participation of correspondent banks, which increases the handling time of payments and causes difficulty in confirming receipt of funds at the final destination. Linking together existing limited-participation networks (such as PayPal), so that a sender in one network could make a payment to a receiver in another network seamlessly, holds appeal, but it may be difficult to reach an ubiquitous state, as not all senders and recipients belong to such networks. Similar issues faced the debit card networks, which have done a great job of supporting interoperability between networks. The current ACH system effectively processes a significant portion of U.S. payments. Changes could be made that would allow for faster settlement of some ACH payments (perhaps for an additional fee), but those payments would not be real-time. Unless significant changes were made to NACHA Rules and processes, use of the ACH system would not allow for confirmation of good funds at the initiation of the payment.

Q7. PayPal does not believe that it is necessary to make check payments easier to use. The resources of the Federal Reserve Banks and the industry are best used to modernize electronic payments, including those initiated through mobile devices which are increasingly being used to make payments. The Federal Reserve Banks can support this move by encouraging government agencies to “go green” and initiate electronic payments in lieu of paper checks.

Q8. Real-time payments will affect fraud in several ways. On the one hand, the ability to move funds quickly out of accounts may present additional opportunities for fraud, including from account takeover. On the other hand, if the system provides for real-time validation of accounts and available funds as well as final payments, losses from returns may decline. Ultimately, this is an area where parties will need to invest in new risk model management if they have not already. This should not limit progress in the development of a real-time system, although participants will need to be aware of the implications and be prepared directly or via vendor support to stop fraudsters from taking advantage of the increased speed of funds movement.



Based on PayPal's experience implementing Faster Payments in other countries, we believe it is critical for any real-time or near-real-time payments system to allow participants to identify and reasonably hold payments that appear to be risky for closer review. Our experience shows that it is preferable to allow such payments to be held for delayed processing, rather than be returned unpaid. This allows system participants to build proper models that allow them to evaluate risky transactions and process legitimate payments after mitigating risks. A new, ubiquitous system should accommodate cross-border payments, which should not be returned unpaid or delayed solely because they cross borders.

Q9. Mobile payments are growing. In 2012, PayPal processed approximately \$14 billion in mobile payments. In 2013, we expect to process more than \$20 billion in mobile payments. We expect the growth in mobile payments to continue. A ubiquitous near-real-system would be complementary to mobile payments, encouraging more customers to use mobile for transacting all kinds of payments, including P2P, P2B, etc.

Q10. If neither the Federal Reserve Banks nor industry act to implement faster payments, innovation will continue. This innovation may not be focused to meet the goals set out by the Federal Reserve Banks, and will continue to occur in an environment of inconsistent regulatory requirements. Some of the innovation may create inconsistent experiences, rather than consistent faster, ubiquitous payments.

Q11. PayPal currently simulates a near-real-time payment experience for the majority of our customers, especially as they transfer funds among PayPal customer accounts. PayPal expects to have to make some changes to our systems to ensure alignment with the details of a final system, including adjustments to our anti-fraud models. (See response to Question 8 above.) It is our understanding that there will be a greater need for many banks and solution providers to modernize their core processing and other backend systems to support near-real-time payments. We do not have information on how long that will take, but are



confident we will be able to adapt to a new system, as we currently support solutions of this kind in other countries.

Q12. We are in favor of developments that would enable better customer experiences, such as real-time account verification. A mobile phone registry that is accessible to all participants in the system – including non-banks like PayPal – is one way to enable real-time verification. However, it must be designed to allow for broad access while balancing concerns around privacy and security. We believe that a decentralized directory -- where the data base reflects which entity holds an account is centralized, but the data itself is kept and updated at the institution level – best creates that balance and provides an easier way to manage changes and limit the risk of breach. Such a decentralized model is being created in Australia.

Q13. Although PayPal customers may use Remote Deposit Capture, checks are not a large part of PayPal's business. We do not believe that check usage should be an enduring part of the U.S. payment system. We expect to see continued consumers continue to migrate away from check use. Businesses have not yet moved away from using checks. The migration away from checks can be accelerated by the development of a robust real-time or near-real-time electronic payment system envisioned by the Federal Reserve Banks, especially if those payments can be information-rich, carrying other information along with the payment, which is attractive to business users. We do not believe that it is critical for the Federal Reserve Banks to establish a target for the percentage of noncash payments to be initiated via electronic means, although they could accelerate that transition by encouraging government entities to stop issuing checks for their own payments.

Q15. The key to interoperability is less about the message format and more about creating a regulatory environment that supports processing transactions in an interoperable manner. For instance, in the United States, we are hampered by additional screening requirements by all parties for cross border payments and



the cancellation option under the Remittance Transfer Rule. These rules disadvantage the entities that process U.S. cross-border payments, compared to some of our international ecosystem partners.

Q16. The industry will move toward the desired goals for cross-border payments when a new system has “global reach.” That is, senders in the United States can easily send payments to recipients and destinations in significant global corridors, using a system that is competitive on the factors of price, security, and speed. A pricing structure that allows entities to determine when they want to take advantage of different system options would encourage use.

Q.17. There are risks across the entire spectrum listed (from authentication to security of payment databases to security of devices etc.) All of these must be considered in any new system, but that system should also allow flexibility to encourage continued innovation. A new system of real-time verification of accounts, based on standard messaging, is imperative for better customer experiences, wide adoption, and success of a new system. The Federal Reserve Banks can also help develop new methods for storage of payment credentials. The card industry has seen an increase in data breaches, with hackers stealing payment card and other data. In response, card networks are exploring the use of tokenization – where the merchant stores only a token that references the payment card information. A similar risk exists with bank account- based payment databases with merchants and billers who initiate recurring billing. Similar storage of credentials can be explored for bank payments.

Q18. The industry should study and learn from the experiences in other countries that have adopted faster payment systems, such as Faster Payments in the United Kingdom. The Federal Reserve Banks can create forums for sharing information on emerging threats, vulnerabilities, and appropriate risk mitigation, including the many commercial solutions that exist for managing security issues.



Q19. Guidelines should be provided and minimum standards should be set, but this should be done in a way that allows the industry to adapt and continue to innovate.

Q20. As industry leaders, the Federal Reserve Banks should work to prevent implementation of regulations that do not advance their stated goals for a new payments system and articulate alternative solutions for meeting desired outcomes. It can provide input on pricing, costs and efficiencies of products in a new system. To ensure that a new system is ubiquitous, they should ensure that non-banks can participate and that all transactions (cross-border or not) provide similar customer experiences. Foremost, they must work toward developing a real-time authorization process. That is crucial to the development of the faster payment system the Federal Reserve Banks envision.

Sincerely,

Jeanette Blanco  
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PayPal, Inc.