

Head of Payments Policy Department
Reserve Bank of Australia
GPO Box 3947
Sydney NSW 2001
pysubmissions@rba.gov.au

Executive Summary

The Australian payments landscape is evolving at an unprecedented pace. As a global innovator in online payments, PayPal welcomes the opportunity to share insight and knowledge on both the opportunities and threats facing the payments industry, and to encourage innovation alongside responsible management of growth and change.

Advances in technology, coupled with consumer demand, have led to a period of rapid change and innovation in the Australian payments industry. The next 5 years will bring about more change in the payments sector than we have seen in the last 15 years. With this change comes great responsibility for all participants in the payments industry ecosystem to act in the long term interests of Australian consumers and merchants.

As a facilitator of online commerce, PayPal enables transactions for over 40,000 Australian businesses, from sole proprietors to established large merchants, whilst protecting the personal financial information of its 4 million active user accounts. PayPal is passionate about innovation in payments, and is excited about the myriad of benefits that can be brought to the economy. The RBA's paper has raised a broad range of important issues and PayPal wishes to work closely with the RBA to provide information and access to the deep knowledge it has of the payments industry, and to leverage insights both from Australia and across the world.

Whilst the issues raised in the RBA's paper are varied, PayPal would like to limit its contribution to those areas in which it is best placed to provide comment, particularly being in the areas of mobile and online payments, and the related regulatory environment.

PayPal's response covers five key areas:

(1) The payments industry in Australia is undergoing monumental change

The payments landscape is undergoing rapid change, with consumers and merchants demanding, accepting and embracing new methods of payment. There are several key factors driving this change:

- **eCommerce:** Nearly 9 million Australians are now transacting online¹ with the number growing by around 10% year over year. Consumers are embracing eCommerce due to the additional benefits it brings, such as access to a broader range of goods and services, more competitive pricing and the ability to transact at any time of day
- **Choice:** The number of Australian merchants accepting new and additional forms of payment is rapidly increasing, providing consumers with ever increasing choice. Available payment methods now include BPAY, POLi, payclick, Paymate, Facebook Credits and PayPal, in addition to more traditional methods such as credit cards, debit cards, EFTPOS, store cards, cash and cheque
- **Mobile commerce:** The rapid adoption of smart phones is changing the way consumers transact – Two out of three handsets sold in Australia are now smart phones² and one in eight active PayPal customers have completed a transaction via a mobile device
- **New form factors:** New form factors, such as smart phones, are enabling new technologies including but not limited to NFC chips. This is heavily impacting the way consumers pay and, in time, will lead to an adjustment in the reliance consumers have on traditional payment methods
- **The Digital Wallet:** The emergence of the “digital wallet” is allowing consumers to access their payment methods at anytime and anywhere, by storing them remotely. This concept is a breeding ground for innovation and is propelling a number of new players to enter the market, such as Serve by American Express, payclick by Visa and PayPal

(2) The key driver of payments innovation in the near future will be closer integration of payments with mobile technologies (including other value added services)

Australians are showing a willingness to adopt new technologies. When it comes to the acceptance of mobile payments, Australia is leading the way as one of the most advanced markets in the world. PayPal is already seeing huge volumes of transactions going through mobile devices and expects these volumes to more than triple this year. A range of factors will contribute to the growth in mobile payments:

- **Flexibility:** The “digital wallet” will allow consumers to choose specific funding sources and store essential payment accessories such as receipts and warranties in one place on their mobile device. This will yield huge benefits for both consumers and businesses, streamlining and refining the payment process whilst bringing convenience. In time this will eliminate the need for paper based records, allowing all important payment information to be stored electronically. PayPal has trialed several of these innovations in areas such as mobile ticket purchase and presentment (Event Cinemas and Moshtix) and skip the checkout in-store payments (Pizza Express).
- **Integration with point of sale:** Advances in mobile technologies are enabling the offline and online worlds to blur. Consumers will soon be able to transact from one

¹ Forrester eCommerce Australia Market Size 2011

² GfK, August 2011

device, centrally storing in one place all loyalty cards, gift tokens, special offers etc. The payment process will be simplified for the consumer and will enable retailers to engage consumers more readily with 'easy to manage' value added services

(3) Innovation in payments will be stimulated by equal and fair access to payment platforms and services

Payments innovation will benefit from payment industry participants having equal access to core infrastructure, platforms and services. Some key areas where it will be important for infrastructure to be openly available include:

- Consistent application of regulated interchange rates, recognising that technology evolution, new form factors for payment such as mobile devices, and improvements in fraud management are blurring the boundaries between 'card present' and 'card not present' transactions
- Access to high quality electronic verification databases and products to enable digital payments innovation
- Prevention of incumbent providers from using their market power to block entry by payment innovators

(4) For innovations in payments to be successful they must be flexible and have global relevance

PayPal believes that the most successful payment services provide flexibility around funding choice, are more convenient and have global application. The challenges uncovered with projects such as MAMBO highlight the importance of creating ubiquitous payment methods that do not rely on a narrow set of market participants. In particular, it must be acknowledged that overseas transactions are of increasing importance and it is imperative that payment systems are globally interoperable.

(5) To maintain trust in online services, appropriate consumer protections need to be in place for all participants in the payments sector, including 'non-traditional' organisations that are providing payment services

Innovative digital payments are predicated on the notion of trust, even more so than in the traditional payments world. Technology is enabling many 'non-traditional' organisations to provide payment services such as stored value services and virtual currencies, which are subject to lesser prudential and consumer protection oversight than traditional or established providers. For digital commerce and innovation to thrive, security and regulation across all payment methods must remain central. Both regulation and voluntary codes of conduct, such as the pending introduction of the ePayments code, will be necessary to provide key consumer protections in cases of fraud and unauthorised transactions, as well as ensuring prudential oversight of all businesses carrying on a payments activity. Payments innovation will only flourish where there is trust, so regulatory oversight and industry standards must ensure that the Australian payments ecosystem remains safe for consumers and merchants alike.

The above five key points are discussed in more detail in the following paper and PayPal remains available at any time to provide further written or verbal briefings to RBA personnel on these issues.

Yours sincerely,

A handwritten signature in blue ink, appearing to read 'F. M. Feller', is positioned above the typed name.

Frerk-Malte Feller
Managing Director
PayPal Australia Pty Ltd

Introduction

PayPal welcomes the opportunity to contribute to the Reserve Bank of Australia's (RBA) understanding on the issues raised during consultation with stakeholders as part of its strategic review into innovation in the payments system.

Whilst the issues raised in the RBA's paper are varied, PayPal would like to limit its contribution to those areas in which it is best placed to provide comment, particularly being in the areas of mobile and online payments, and the related regulatory environment.

About PayPal

PayPal is the preferred way for Australians to pay and get paid online, according to independent research by Nielsen³. The service enables any verified individual or business with an email address to send and receive payments online securely and easily using a bank account, credit card, debit card or stored balance. PayPal customers thereby have the flexibility to pay in any way they prefer.

PayPal's business was specifically designed to ensure customers' security when making payments online or on mobile devices. PayPal customers do not have to share financial information with each other (credit card or account numbers), which builds security and privacy into the service. Unlike banks or other payment companies, PayPal has a relationship with both the buyer and seller (or sender and receiver) in any given transaction, which means it has greater insights and control over transactions.

PayPal has more than 100 million active user accounts in more than 190 markets around the world and operates in 24 currencies, enabling global e-commerce. There are more than four million active Australian customer accounts.

More than 40,000 online merchants offer PayPal as a payment option in Australia, including eBay. Other notable merchant relationships include: Big W, Jetstar, Country Road, Dan Murphy's, JB Hi-Fi, Roses Only, Dick Smith Electronics, Hoyts, DealsDirector, Telstra and eBay. PayPal also provides tens of thousands of small businesses the means to accept payments to domestic and overseas customers. Beyond retail, PayPal is also an appropriate payment method for charities, educational institutions and local governments.

The PayPal online payment service is provided to Australian customers by PayPal Australia Pty. Limited ABN 93 111 195 389 ("PayPal") which holds Australian financial services license number 304962. PayPal Australia is regulated by Australian laws, and PayPal is directly regulated by ASIC, APRA, AUSTRAC and the ACCC, amongst other state and federal

³ The Nielsen Company – The Australian Online Consumer Landscape, March 2011

government bodies. PayPal operates in Australia with a board that has a majority of independent directors.

How PayPal works

PayPal's core business process enables two entities, a sender and a receiver, to make an online payment using their existing financial instruments, such as credit cards, debit cards and bank accounts. PayPal adds value to the financial tools that customers already own by providing additional security and ease-of-use, making both domestic and cross-border online payments safer, faster and easier.

PayPal stores the details of a customer's financial instruments (credit card, debit card or bank account) in a secure online PayPal account. The account can only be accessed by a unique username, typically the customer's email address, and a user-selected password.

When completing an online payment with PayPal the sender enters their PayPal username and password, and is given the option of which stored financial instrument they wish to use for that transaction. By using PayPal the sender does not need to enter details of their financial instruments each time they transact, rather they need only enter their PayPal username and password. In addition, PayPal does not share any of the sender's financial details with the receiver, providing further security.



1. The payments industry in Australia is undergoing monumental change

It is clear that the reliance on traditional payment instruments are on the decline. In Australia, the number of monthly cheque payments has declined by over 61 percent to 27.6 million from the beginning of the millennium to 2010. Consumer and business payment preferences are changing and with thousands of payments sent every hour, PayPal has seen an increase of over 30 per cent in its online transactions sent year on year. The fast adoption of mobile payments is further driving this change.

PayPal's Chief Executive Officer, Scott Thompson, recently highlighted this in the US context, charting future evolution of the payments; "As the trend toward digital currency continues to gain momentum, we are focused on delivering solutions that are not just new and different, but better than what is currently the norm today. We believe that by 2015 digital currency will be accepted everywhere in the U.S. – from your local corner store to Walmart. We will no longer need to carry a wallet."

eCommerce

Rapid growth in the eCommerce market in Australia confirms this trend. As more Australians recognise and embrace the benefits of online retail, the e-commerce market reached approximately AU\$27 billion in 2010 and is forecast to reach almost AU\$37 billion by 2013.

Over the last year a number of major Australian retail groups such as Country Road, Big W and Westfield have made major forays into the online space, and retailers are beginning to respond to consumer demand by offering broader ranges online along with transparent transaction, shipping and return policies.

Mobile commerce

More than 50 billion internet-enabled (mostly mobile) devices are expected to come online globally in the next 10 years. Consumers will be able to access their digital wallet no matter which connected device they're using – whether it's mobile phones, gaming consoles, tablets, PCs or any other devices yet to be conceived.

Mobile devices are poised to become a primary form of payment for millions of people around the world. According to Aite Group forecasts, global mobile bill payments will reach US\$214 billion in gross dollar volume in 2015, up from US\$16 billion in 2010, which represents a 68 percent compound annual growth rate.

Australian market research commissioned by PayPal and conducted by Nielsen as recently as March 2011 indicates that half of the Australians who use the Internet have done so from a mobile phone. The ownership of Internet enabled mobile phones is currently at 63% of overall mobile phone ownership, which is an increase of 20% in the last year. PayPal has seen an increase of 25% in mobile payments month over month in the last year.

This same research highlights that the reason people are converting to transacting via mobile is for convenience. 76% of respondents said that they had made a payment transaction via mobile as it was more convenient, however over 50% indicated that the security of this mode of payment was still a major concern.

The success of the first generation of electronic payment solutions came from the facilitation they provided between consumers and merchants: consumers could more easily access their funds and merchants received a more reliable form of tender, enabling growth in commerce. Moving forward, consumers will no longer be satisfied with a defined 'in-store' and 'online' retail experience, but will increasingly demand the ability to buy what they want, when they want, how they want and where they want.

New Form Factors

The smart phone, and the convergence of many technologies into this one device, has enabled many new form factors for payment, credential storage and identity verification. Near field communication (NFC) technology is currently deployed in plastic cards and (in some countries) mobile phones, however it can conceivably be embedded in many objects such as wristbands, watches and key fobs. Products that currently utilise this technology include MasterCard's PayPass, the Melbourne public transport 'myki' and the Brisbane public transport 'go card'. Similarly, with the successful uptake of Radio Frequency ID tags for the payment of tolls in Australia, it is conceivable that this technology and infrastructure could be expanded to include payment for other services.

The Digital Wallet

The term 'digital wallet' has been coined to describe a service that stores all your payment options, transaction history, vouchers, loyalty cards and many other items you may currently carry in a physical wallet. It is conceived that the digital wallet will become standard in the next decade as consumers look to simplify their lives and as new technologies enable this. Services like Google Wallet, currently under trial in the United States, Visa's payclick and PayPal will continue to offer more and more services to streamline the payment experience for consumers whilst offering greater security and fraud protection.

2. The key driver of payments innovation in the near future will be closer integration of payments with mobile technologies (including other value added services)

PayPal has been a leader in secure online payment systems, however this has traditionally been through fixed PC-based home and workplace internet outlets. Whilst growth in this area continues, the most staggering growth in online payments is being experienced through mobile devices, such as smart-phones and tablets.

Recent innovations in the local mobile payment space include integration of payments services with dedicated mobile commerce applications and websites. These can allow customers to link effortlessly and seamlessly with their payments services. Authorisation

can be given with a password or PIN, delivering a payment service that is easier to use and more secure than a traditional credit card payment. The Event Cinema 'Pocket Cinema' iPhone and iPad application exemplifies how integrated third-party payment services can make paying by mobile faster and more secure. Event Cinema customers can purchase a movie ticket whilst on the go as simply as entering a login and password, without the need for sharing sensitive financial data, increasing convenience for the consumer and decreasing fraud and security risk for both the consumer and the merchant.

Other innovations that are currently being trialled by the market could involve the integration of global positioning system (GPS) services or near field communication (NFC) chips that tie an individual to a device and a location. These can offer greater security and surety that a transaction is legitimate and minimise fraud whilst increasing convenience and speed at which cash-less payments can be made whilst on the go.

Australians are seeing mobile transactions as the way of the future, with 68% agreeing that they will be able to use mobile devices for all kinds of purchases, transactions and payments in the near future.⁴

Increasingly, payments are becoming more deeply integrated into the buying experience, allowing merchants to establish deeper relationships and provide Value Added Services (VAS) to the consumer. These Value Added Services will include:

- Demand generation (for example, special offers based on location, time of day, social network parameters and consumer behaviours)
- Instant redemption of special offers at a certain time or physical point of sale
- Instant usage of Loyalty

It is most likely that mobile devices will be the form factor that enables much of this innovation.

These advances and countless others to come highlight how payments and the devices used to make payments will consist of differing form factors, including those which are yet to be conceived. As such, it is of critical importance that government and corporate policy is as technology neutral as possible, encouraging innovation and levelling the playing field, ensuring the same rules apply to all like services, irrespective of form.

⁴ The Nielsen Company – The Australian Online Consumer Landscape, March 2011

3. Innovation in payments will be stimulated by equal and fair access to payment platforms and services

As technology advances, it is important that access to payment platforms and services are equal and fairly priced.

Card not present surcharging

The Australian Payments Clearance Authority's 2011 Credit and Charge Card Fraud data demonstrates that more than 65% of credit card fraud occurs when there is no card present in a transaction, which justifies the greater surcharge applied to merchants when a sale is made in these circumstances to offset the cost of fraud.

As new technologies are introduced into the payments sector, the application of the card not present premium should be examined for its appropriateness against risk factors and actual fraud rates.

In future it is likely that payment services will take many different forms, particularly where mobile commerce is concerned. In the event that a person presents a physical device, such as a mobile device, card or other physical form factor, PayPal believes that these may be appropriately treated in the same way as 'card present' transactions.

Irrespective of form factor, innovation can only truly flourish if there is no cost premium attached to the use of a new payment method, particularly if that premium is not justified through higher risk or cost to the funding source.

Electronic Identity Verification

An area where Australia is at risk of falling behind other comparable economies on the innovation front is in electronic identity verification. Current Australian privacy laws prohibit the disclosure of information such as credit reporting information for the purpose of verifying identity to meet *Anti-Money Laundering and Counter-Terrorism Financing Act 2006 (Cth)* (AML/CTF Act) requirements, whereas in the United States and the United Kingdom this is allowed. Further, there is no regulatory framework supporting access to other sources of high-quality, legitimate and verified identity information for this purpose, such as additional information sources held by the Australian Government, state and territory governments and the corporate sector.

Enabling improved electronic identity verification will promote competition in the payments sector, particularly as this will reduce administrative costs associated with regulatory compliance. It will also increase convenience for new customers. These are essential

ingredients to foster innovation, particularly enabling online providers who don't have access to shopfront facilities.

PayPal supports the provisions of the current draft legislation that is before parliament that will amend the Privacy Act 1988 (Cth) to enable the use and disclosure of credit reporting information for electronic identity verification purposes to satisfy obligations under the AML/CTF Act. PayPal also considers that further sources of verified identity information should also be considered for this purpose.

4. For innovations in payments to be successful they must be flexible and have global relevance

One of the most important outcomes of leveling the regulatory and competition playing field for payment services will be decreased reliance on closed, proprietary systems and those which are only of domestic relevance. The Internet, eCommerce and greater consumer understanding and awareness of the benefits that competition brings has heralded an era where Australians want choice when deciding how they will make payments.

Development of payment systems that have global relevance is becoming increasingly important. Australian consumers are more mobile, and are transacting offshore more than ever. Likewise, Australian merchants are conducting more and more business offshore, making interoperability with global payment systems more important to their business than ever. Of the nearly 40,000 Australian businesses that offer PayPal as a payment option, 17% of their business originates from foreign markets.

The recent challenges faced by the MAMBO system suggests that this proposed domestic solution was not likely to succeed in the new payments environment, but its development highlights that there is a need for more efficient, real-time and secure payment solutions.

5. To maintain trust in online services, appropriate consumer protections need to be in place for all participants in the payments sector, including 'non-traditional' organisations that are providing payments services

PayPal has made significant inroads in the Australian market in online payments, partly through the ease of use but also because it is rapidly establishing a reputation as a trusted and secure provider of financial services in the online space. As more and more cases come to light of customers' financial data being compromised through security breaches of online retailers and service providers' data holdings, secure payment services are becoming more desired by Australian customers and merchants.

An important ingredient in driving innovation is market uptake. In the online environment, as with the offline environment, consumer experience is key to uptake, and trust is a significant part of a positive user experience in this realm.

Maintaining trust in online systems requires a whole of sector approach. High profile failures in security in the online world, like those experienced in recent times at Sony and Dell, could be challenging to the growth of the Australian online economy. A combination of appropriate regulation and voluntary industry codes of conduct, like the ePayments Code (currently under development), will be necessary to provide key consumer protections in cases of fraud and unauthorised transactions. In addition to this, ensuring prudential oversight of all businesses carrying on a payments activity will be a key consumer protection measure for businesses and consumers alike.

Consumer privacy protection

It is becoming increasingly common to hear media reports regarding high-profile information security breaches at companies that hold vast amounts of consumer financial details such as credit card and bank account details. Recent market research commissioned by leading online security firm Symantec revealed that that three out of four (73 percent) Australian organisations experienced at least one data breach in 2010⁵.

The market is a major driving force in ensuring appropriate data protections of consumers' data, however it may be that some market participants have not done enough to secure their customers data under the current regulatory framework. PayPal therefore supports the potential introduction of data breach notification laws as recommended by the ALRC.

APRA oversight

Australia has a robust banking and financial system that is the envy of the world, especially in light of the high-profile failures in this sector in comparable economies since the start of the global financial crisis in 2008. This is in no small part due to the appropriate levels of regulation that the Australian financial sector is subject to under the jurisdiction of the Australian Prudential Regulation Authority (APRA).

PayPal is licensed by APRA as an authorised deposit-taking institution, enabling it to provide purchased payment facilities (PPF). PayPal is currently the only business listed in the PPF category by APRA, but is not the only online business that offers services like these. Currently, exemptions are granted by the RBA under the *Payment Systems (Regulation) Act 1998* to similar services due to their inability to store more than \$10,000.00 per customer or through an exemption granted by category, such as gift card facilities or pre-paid mobile services.

⁵ The Ponemon Institute LLC: 2010 Annual Study: Australian Cost of a Data Breach

Deposit-taking institutions under the Banking Act 1959 must hold Tier 1 capital, the total being the greater of \$5 million or 5% of its total outstanding stored value liabilities. This is a fair and reasonable requirement and an important part of broader consumer protection policy in Australia, and importantly, one that doesn't impact on the ability to innovate, given the obligation scales with liabilities.

PayPal supports this oversight by APRA and acknowledges it as appropriate given (a) recent high-profile failures of international organisations that provided financial services and (b) the volatile state of the economy. Innovation needs the support of market uptake, and market uptake in the payments arena is predicated on trust and safety. Australia must ensure that the community maintains trust in all kinds of online payment services by setting the bar at a level that keeps rogue or negligent operators out of this space through the imposition of capital holding regulations. As such, PayPal believes that the current exemptions granted by the RBA may need further consideration given the proliferation of purchased payment and stored-value facilities online.