

Federal Reserve Forum on Consumer Research & Testing: Tools for Evidence-based
Policymaking in Financial Services
Panel Three: Exploring key consumer issues

Rene Pelegero:

Good afternoon everyone. Good afternoon. Hi. As the speaker of the panel right after lunch those going for a cup of coffee sounds about just right now. I'm gonna try to make this as entertaining and as engaging as possible. My name is Rene Pelegero. I work for PayPal. I am not a statistician. I am not an economist. I am not an educator so what the heck am I doing here. Hopefully some of the experiences that I've seen with PayPal and prior to joining PayPal, I consulted for Google for about 3 years and I also run payments for Amazon.com, might come in a little handy in terms of what consumers think or what consumers struggle with whenever we're talking about payment issues, primarily as it relates in the eCommerce Space. I'm going to limit my remarks to the eCommerce Space and to payments in particular.

If you think about it, payments not only is an important source of income for financial institutions, it's also something that we do every day. I don't know about you folks but every time that I get my paycheck I'm not a very good saver but only a very small percentage of my money I keep to save, the rest I spend. Whether it is a mortgage payment or whether it's a gas and groceries or whether it is book on Amazon.com. I'm making payments all day long, everyday. And so it is a very, very important aspect and attribute. So nowadays eCommerce—and ePayments are becoming an integral part of our lives. eCommerce is growing at a rate 2 or 3 times the rate of physical commerce. Just as a show of hands, can I see--can I see a show of hands? So who has bought anything online in the last year? Thank you, point proven. And so what I like to do today is to talk a little bit about some of the issues associated with payments and how will that impact research and policy making? Because it is our contention that not only the issues that have been brought up by the last 3 speakers are really, really relevant in terms of education, in terms of some of the players that are out there and some of the research that needs to be done. We also have a significant challenge in terms of even in speaking the same language and even meaning the same things when we're saying the same things. So what I like to share with you all today is, you know, kind of a framework for discussion of how payments are actually related because if you think about it, payment is nothing more than an exchange of value. And in many cases we tend to confuse where the value is from what the vehicle to access the value is. And I'll explain that to you in a second. And to make matters worse of course, new entrance like my company seem to be creating all levels of confusions. For example, out of--my friends over at Visa and MasterCard get tremendously cross everyday when they hear a consumer says that they have paid with PayPal. When underneath that there is a bank card, there is a Visa or a MasterCard but they get really, really upset about that. And so again, the consumer's perception is the vehicle sometimes relates to the--where the funds or where the value is being kept and that's something that we need to sort our way out of it. And I will also try to spend a little bit of time sharing with you what our view within that framework, the view

of payment for the future will be. And I'll try to inject a little bit of some of the things that are also happening outside of the US because I gotta share this with you folks, the US payments environment is quite different from the environments in many other countries primarily like in Europe or even in some of the emerging markets.

Alright, so here's the framework or the beginning of the framework that I'm--that I wanted to share with you guys today. As I said, payment is nothing more than an exchange of value. Most people tend to have value in the form of cash or money, and in most cases some of that cash or money is kept at a bank account. But some people are walking around with cash and that's value that can be used to make a payment. In some cases, I do have funds in my current or checking account and that tends to sit at a bank in a bank account or a current account. Or I may have a credit line. Or in some cases there are other forms of value that people are already beginning to use to trade. I'm sure you have all received in the mail offers to trade your frequent flyer miles for magazines. Well in Africa, in Kenya to be exact, there is a company called Empesa, which is actually using mobile minutes as currency because most people there are unbanked and people are actually using mobile minutes as a quasi currency because getting to the branch and opening a bank account is very difficult. So that's just--just another form of value.

So I have this layer called the value layer. And in most cases, financial institution tends to be the ones who dominate or who hold most of the value, whether it is a credit line or whether it is a checking account. Sitting atop that is the network layer. These are the organizations that manage to get the messages from what I will get to in a second the vehicles into the value layer. And this relates to networks such as Visa, MasterCard or American Express in the case of credit cards. Or the ESP or debit networks like the Star Network or the NICE Network and the likes, ACH across the world, in online banking and we'll get to spend a little bit of time about online banking and the importance, the emergent importance to the payments as seen that online banking is providing. And finally, at the top, we have what I call the vehicle layer. The vehicle layer is the things that we are carrying around, it's our check books, it's our credit cards, it's our debit cards and even the numbers that we may have memorized. Although I'll challenge that--none of you have memorized your routing transit number and ABA Bank account number--that is actually a vehicle that allows you to access through the services of a network, access to your funds, and access to the value.

So one of the things for example that I was rather intrigued when I was hearing the case of prepaid cards, who's holding the value? Is it financial institutions? Is it a quasi financial institution? You know that becomes some of the biggest consumers don't understand the difference between who's holding the value because to them the value is in the card. And you and I know that that's not quite correct. There's certainly an illusion of that.

So what is happening in the world? Okay, over the last few years with the entrance of new players there have been a significant number of challenges, there are interesting challenges related to the existing model. One of the challenges is of course that there is such a silo approach

to all of this. By that I mean that credit cards go through Visa or MasterCard to access a credit line. And debit cards go through EFT or ATM network to access your checking account. It is kind of hard to have a credit card going through Visa MasterCard to access your debit account and that just doesn't happen or to have a check in your check book accessing a credit line. Again, those systems and those environments and those payment schemes were never defined to do that. The networks of course had become rather large and cumbersome. The question that was asked a few seconds ago, why couldn't a consumer be told "Hey, if you do this transaction you're going to overdraft, would you like to proceed, yes or no?" Reason for that is that these guys have huge infrastructures in place that requires tons and tons of development in a lot of thousands of financial institutions to agree to make a change. And remember in my days at Amazon we used to complain about the fact the credit card descriptor is only 22 bytes long, 22 characters, to put everything that you could possibly put in there and merchants want to avoid all kinds of dispute by putting as much information as possible. We brought the issue up to Visa and MasterCard and they said, "We've got to get 10,000 banks to agree to make this change, rather unlikely". And that's one of the difficulties that has come about because these data polls have become big and unwieldy. And of course, there is confusion as to who is doing what, as I mentioned in the case of the prepaid cards.

Consumers on the other hand have this desire to use their funds, to use their value anytime, anywhere, for fundamentally at no cost whatsoever. They want to have it easy, they want to have it fast and nowadays they also want to have it secure. And of course, they don't want to have it fragmented either. That was an interesting tidbit of learning that I picked up from what was being said earlier on, that maybe because younger adults haven't accumulated enough value to kind of realize they are okay--seems to be okay fragmenting their value across. But as people tend to get older, certainly I'm a proponent of that, I like to have all my money in the same place. I'm the same as you. I don't like to preload money other than to my Starbucks card. By the way, did you see the report that Starbucks alone has loaded 1.5 billion dollars to their prepaid cards? That's a lot of money. At any rate--but we do it because there are some benefits. But in general we tend to want to have all of our funds in a consolidated place. But some of this new players, some of these new entrance into the market place seem to be forcing us to fragment our finances and that's not necessarily a cool thing to do.

So we have a--as I said, a whole bunch of players, new entrants, all of whom are creating what is essentially a new layer which I'm calling the delivery layer. And these layers come in flavors such as wallets. My PR group gets absolutely ticked off when I say that PayPal is a wallet. Well we are kind of like a wallet. We do a lot more. But we do store all their payment information which is the traditional definition of a wallet. We have gateways, we have prepaid cards, we have things like web mashing, which I'll talk about in a second, mobile and any other kinds of payments. As a matter of fact, the world of payments is becoming so dynamic that now a mobile number and your mobile phone is now becoming a vehicle, which means that a telco is now becoming a network which then leads to the question, who's holding the funds?

So most of the competition you will see that some of the traditional players, the old suspects remain at the value layer. Some of the still same suspects reside at the network layer and of course we are all familiar with our different debits and credit cards and so forth. Most of the stuff that is taking place in terms of new, creative, innovative ideas is been at the delivery layer. That's where you have players like PayPal in Amazon.com payments, and let's see who else, Visa and MasterCard have just announced that they are also introducing wallets of their own. Did you guys know that Wal-Mart also now is trying to push a wallet, trying to leverage all of those credit cards that they have stored overtime? They're getting into the fray as well. Gateways are companies that allow retailers and consumers to access other countries and other places and other currencies by providing through the internet an easy way to make payments and buying from merchants in other locations.

We have spent quite a bit of time on the prepaid space so I'm not gonna go there, web mashing. This is the capability to allow a consumer, and this actually happens in places like in Australia and in Canada, a consumer to share his banking credentials with a retailer. And the retailer in turn uses those banking credentials through web mashing technology. In the old days they used to be called screen scraping by the way that allows the software for the retailer to go and log on to the consumer's online banking application into initiate a payment. The consumer doesn't see anything, all he sees is he enters user ID, password, he presses Enter the next thing he sees is the payment has been concluded. But behind the scenes what has been taking place is the software logs on goes to the bill payment page or to the transfer page and initiates a payment from the consumer's account to the retailer or to the processor account. So there are companies for example like--this guys over here, Software [inaudible] I can never say the name--it's a very long German word or POLi in Australia, Mazuma in the US. So these are companies who are out there offering those kinds of service in which begs the question, if we have online bill payment and online banking over here, on this side of the equation which is defined and created from the internet, why to do eCommerce? Are we still using the old cards, NACHS [phonetic] why aren't we using online banking to do for payments what some people have done in places like in the Scandinavian countries for example. Ideal is an example of a gateway in the Dutch marketplace where consumers get to authenticate themselves directly to the bank and create an online transaction, somewhat similar for those of you who follow the space to secure of all payments that [inaudible] has been pushing over the last couple of years.

At any rate the thing about it, the point that I'm trying to make in here is that there is a lot of competition up there, there is a lot of people who are masking all of the verticality of the inefficiencies of all of the stuff that has been created over time by these different layers and giving consumers what they want which is easy access, secure access, access when you need it, no 9 to 5 hours, access anytime, anyplace, anywhere which then leads us to the question as to where are we gonna go with all of this. Well, there are 2 lines of thoughts. There are some banks who are creative enough and as I said, I will put in that category some of the Dutch and the Scandinavian banks who have gone from not only being the holders of the value but also

getting into participating to the network and delivering fairly good and creative and very user friendly applications where consumers can actually use their online banking to make payments for goods and services in the eCommerce Space. And so the first question is will banks and financial institutions really start moving and growing up to be able to provide and offer those kinds of services? That's question one or alternative one. Alternative 2 of course says, are any of these guys, and is already happening unfortunately for the financial institutions, can any of these guys really start penetrating and moving down to be the holders of value? I don't have an answer, nobody does. But the question is those are the dynamics that we're playing in the marketplace today. So that for example, again, as we're talking about prepaid cards who's holding that money? In the case of a Starbucks, a Starbucks is a fairly large corporation and pretty well off corporation but they're holding 1.5 billion dollars of my money, your money, his money, Mike's money as well. So, you know, there were a couple of us, the financial crisis began so many things have happened since that probably people have forgotten. There were a number of prepaid card programs that actually went under. And they actually left consumers holding, oh, I forget what the actual number is, several hundred million dollars of useless and worthless plastic. So who's protecting the consumer for that?

So as we move forward, one of the things that we believe and this is again, speaking from a PayPal perspective is not only those consumers have to--consumers have to be educated. And the level of financial education amongst consumers especially the emerging adults, I like that phrase as well, but not only do they have to be educated but we also have to have a consistent taxonomy, a consistent lexicon that allows us to understand so that when a consumer said hey, I pay with PayPal, no you didn't. You actually paid either with your checking account or with a credit line. That's where the sources of funds where--that's where the money came from. That will allow truly consumers to differentiate the different products and understand the value that each of the different layers have. Maybe it's just me being a little too idealistic that we're going to get that kind of education to the mass of consumers but that's where--that's where we have to aim.

We need research constantly, values from our perspective needs to keep pace with evolution and the pace of development. There are so many new players. There are so many new ways and that's why we try to abstract it to very simple terms like who's holding the value and what is the vehicle that you've been given to access that value to extrapolate over the things like mobile or some of the newer things coming on, television, and again things like what is happening in Africa with Empesa.

And finally, from a policy making perspective, one of the things that we as one of the new players that are very much interested in is to make sure that the proper consumer protections are maintained but without arresting and without impeding innovation. Okay, that's one of the things that I constantly get asked when I'm--I attend a number of banking conferences is about the only time that I get to wear a suit when I'm at banking conferences, and constantly said that, you know, you guys at PayPal are unregulated and because of that you are competing fairly with

us. And my standard answer is that nothing of what we do is prevented by any regulation for any financial institution to actually do and compete with us. We have nothing to do with you know the regulatory framework preventing a bank from actually creating and competing with PayPal in the same kind of a space. So it's a different mindset. It's a different way of looking at world. It's a different way of thinking about how to satisfy consumer needs. And so we do need to maintain that innovation but at the same--and maintain consumer protection but not to hamper the innovation of consumers. And of course, at the end of the day to ensure that those pipes to whoever is holding the value, and I do expect that financial institutions will remain the holders of value for a long time, we need to ensure that those pipes do remain open and are not constrained and are not limited because by doing so that's kind of tantamount to also arresting innovation.

So in summary the challenge that folks that are doing their research, folks that are doing the policy making as it relates to consumer payments have to take all of these things into account and, at least from a PayPal perspective, we're ready to help out in any way that we can possibly can. Thank you very much.