

PayPal Pay Later Maintains Consumer Privacy

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PayPal's new transaction-financing service does not require consumers to divulge their full Social Security Numbers. The financial services industry can learn from this innovative privacy-protection practice.

NEWS ANALYSIS

Event

On 2 August 2007, the online payment provider PayPal announced that it will offer a new service, PayPal Pay Later, which will enable online merchants to offer transactional financing. Consumers can defer payments for purchases on participating merchants' Web sites. The PayPal Pay Later service will be issued and underwritten through GE Money Bank, a unit of General Electric that provides various credit services.

Analysis

PayPal's Pay Later provides consumers with transaction financing without requiring disclosure of full Social Security numbers (SSNs). Consumers who use the service need only supply the last four digits of their SSNs and their dates of birth (DOBs). PayPal mitigates its risk and keeps its underwriting fees down by capping the transaction amount eligible for financing at \$1,500. PayPal does not charge merchants any incremental fees for the first iteration of Pay Later, for which no payments are required for 90 days. PayPal has not yet set merchant fees for other financing options, but Gartner expects them to be 150 basis points or higher.

PayPal's requirement that consumers disclose only the last four digits of their SSNs and their DOBs to obtain "store credit" or transaction financing is akin to requirements set by I4 Commerce's Bill Me Later, an alternative payment option launched in 2003. Bill Me Later has enjoyed triple-digit growth during the past two years and currently serves about 450 merchants. Bill Me Later does not put a cap on financed amounts (which would place constraints on some of I4 Commerce's large clients, such as Apple, Frontgate and JetBlue) and charges merchants fees ranging from 1.5% to 3%, depending on the financing options used. These merchant rates are generally more favorable than traditional card fees. I4 Commerce maintains that its transaction fraud rate is typically in the single-digit-basis point range (compared with an industry average for card-not-present transaction fraud of about 60 basis points). PayPal's transaction rates are about 34 basis points — which is below the industry average, even though the firm is under constant criminal attack.

PayPal Pay Later's and Bill Me Later's data collection processes for credit issuance stand in stark contrast to the financial service industry's argument that capture of the consumer's full SSN is imperative for granting credit and preventing fraud. The industry is spending a great deal of time and money attempting to convince the U.S. Congress and the Federal Trade Commission (FTC) that detection of criminal activity and prevention of fraud requires maintaining old processes that rely on SSNs. We believe the industry can learn from the innovations implemented by Internet payment companies, which face even greater risks because of their business environment. It's too early to conclude that this new credit issuance practice is risk-neutral, but it does suggest that alternatives to full SSN disclosure are worth serious evaluation.

RECOMMENDATIONS

Enterprises that accept e-payments:

- Consider integrating transaction-financing methods into your e-commerce sites. They are proven methods of promoting bigger-ticket sales and customer loyalty.

- Evaluate PayPal Pay Later for purchases of smaller-ticket items, especially if you already accept PayPal payments. Expect PayPal to eventually raise the transaction cap and charge higher fees to merchants.
- Evaluate i4 Commerce's Bill Me Later, especially for large-ticket items (those priced above \$1,500). The firm has more experience with merchant marketing and promotional services.

RECOMMENDED READING

- "SSNs Should be Phased Out as Authenticators in Private Sector" — The U.S. government should understand several ground rules before crafting legislation that would phase out widespread use and storage of SSNs within the private sector. **By Avivah Litan**
- "PayPal and Google Checkout Show the Way for Banks' Payment Operations" — PayPal and Google are showing the way for the evolution of banks' payment operations as well as affecting them through competitive pricing models. **By Christophe Uzureau and Alistair Newton**

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