When PayPal's Fraud Detection Glitched, Europe’s Banks Hit The Panic Button

The owner of a small Berlin shop watched her PayPal account balance stay frozen for three days last week. She had shipped hundreds of orders but not a single dollar was deposited into her account.

Her shop was one of thousands caught in a financial jam that began with a glitch in fraud detection systems.

PayPal's fraud detection systems had stopped working last weekend due to an internal error at PayPal. Without those automatic checks, millions of payment requests that should have been blocked for review instead flooded into European banks alarming fraud analyst of the spike.

A Wave Of Unauthorized Transactions, Was PayPal Hacked? Many Wondered.

Banks in Europe began to experience a wave of suspicious transactions starting on Monday morning, August 25th. Within hours, Germany's largest banks including Bayerische Landesbank and DZ Bank, took an extraordinary step: they froze all PayPal transactions.

Many had wondered at the time of PayPal had been hacked because they had never seen a wave of so much fraud, so suddenly.

By the time banks lifted their blocks two days later, they had halted payments worth 10 billion euros, or about $11 billion.

The German Savings Banks Association, representing more than 300 local banks, called it a "significant impact on payment transactions throughout Europe."

The Fraud Filters At PayPal Stopped Working

PayPal processes millions of transactions daily through an automated system that checks for fraud before money moves between accounts. These are called their fraud filters.

Those fraud checks disappeared completely over the weekend of August 22nd.

PayPal later described it as a "temporary service interruption," but the technical failure meant that every transaction, legitimate or not, went straight through to banks without screening.

From the banks perspective, they suddenly received payment requests that looked like very suspicious fraud attempts.

On Monday morning, bank security teams across Germany noticed the pattern. The volume of suspicious PayPal debits was unlike anything they had seen leaving many wondering if the whole continent was under a fraud attack.

A Freeze Across Europe Starting In Germany

German banks moved first. By Monday afternoon, many banks had suspended PayPal withdrawals from customer accounts.

The disruption hit Germany hardest because PayPal handles nearly 29 percent of the country's online purchases. What started as a defensive move by banks turned into a massive headache for businesses.

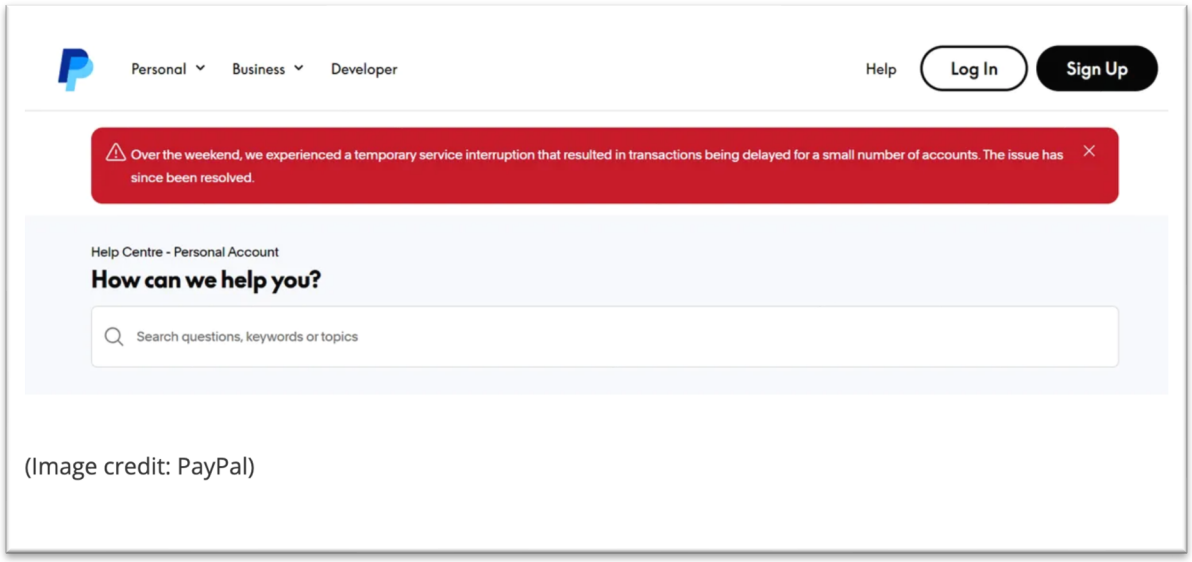
Small businesses felt the impact almost right away. Industry analysts calculated that shops typically receiving 5,000 euros daily through PayPal suddenly were processing virtually nothing.

"Merchants had delayed payouts," according to payment industry reports. Many online sellers faced a cash flow crisis that lasted until midweek.

PayPal Raced To Fix The Fraud Software Glitch. They Said It Was Limited To A “Small Number Of Accounts”

PayPal engineers worked through Monday to identify and fix the problem. By Tuesday morning, August 26th, the company announced its fraud detection was back online.

"We quickly identified the cause," a PayPal spokesperson said. The company posted a red banner alert on its help page describing a "temporary service interruption that resulted in transactions being delayed for a small number of accounts."



(Image credit: PayPal)

But the description of "a small number" seemed to minimize what banks called millions of suspicious direct debits. Banks began releasing the frozen transactions, though insiders said sorting through the backlog would take days.

The Fraud Glitch Strained The Entire Payment System

Germany's financial regulator BaFin launched an inquiry into the incident, with some officials indicating that the event might lead to stricter oversight of payment platforms.

The PayPal glitch lasted only days but revealed how much the global economy depends on a handful of payment processors. A single point of failure at one company forced banks across a continent into emergency mode