

AFP[®] Annual Conference



November 7-10, 2010 | San Antonio

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INFORMATION



Turn Trends into Actions: Effective Payments Solutions for the Emerging Payments Landscape

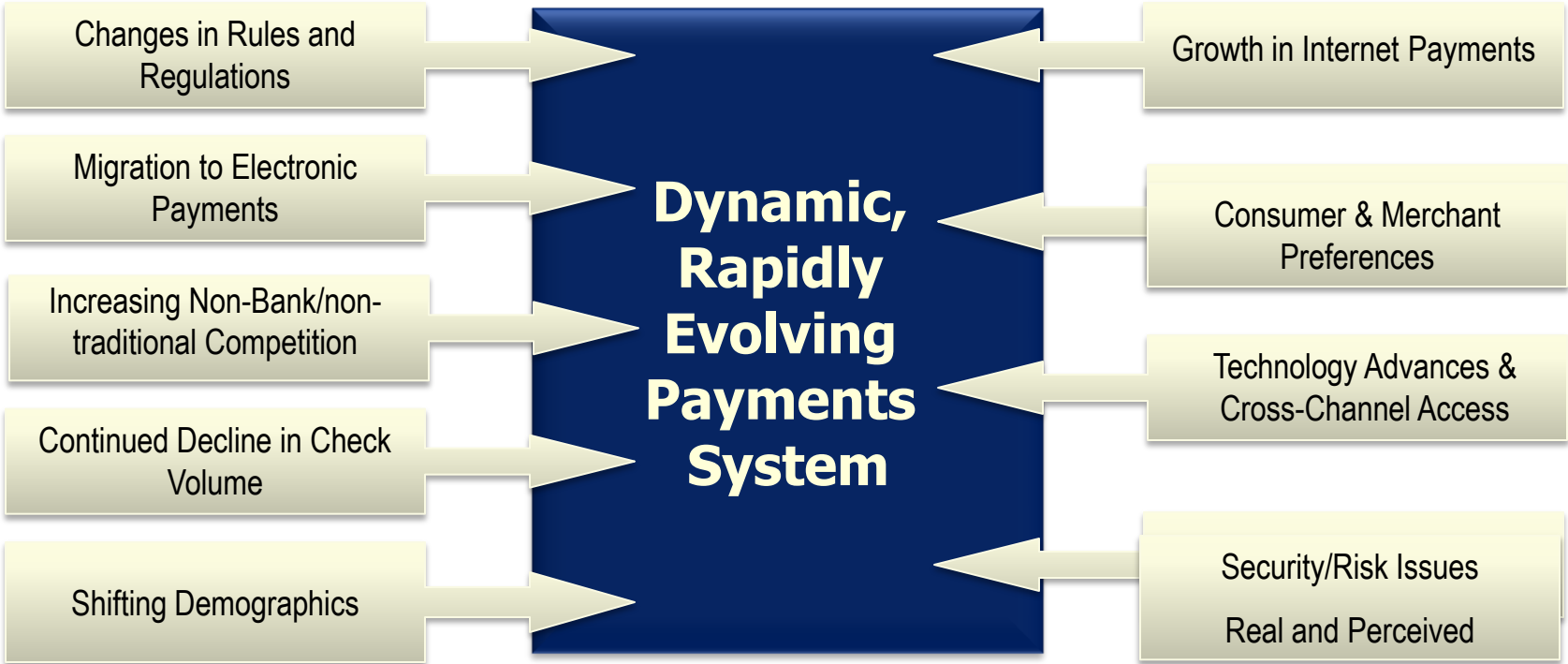
Today's Payment Environment



Agenda

- Introductions
- Trends
- Then Comments & Actions at PHI
- Your Reactions
- Summary
- The “Handout Lite” is a summary with selected slides.
Need/want a complete copy?
 - AFP conference website (see your registration materials)
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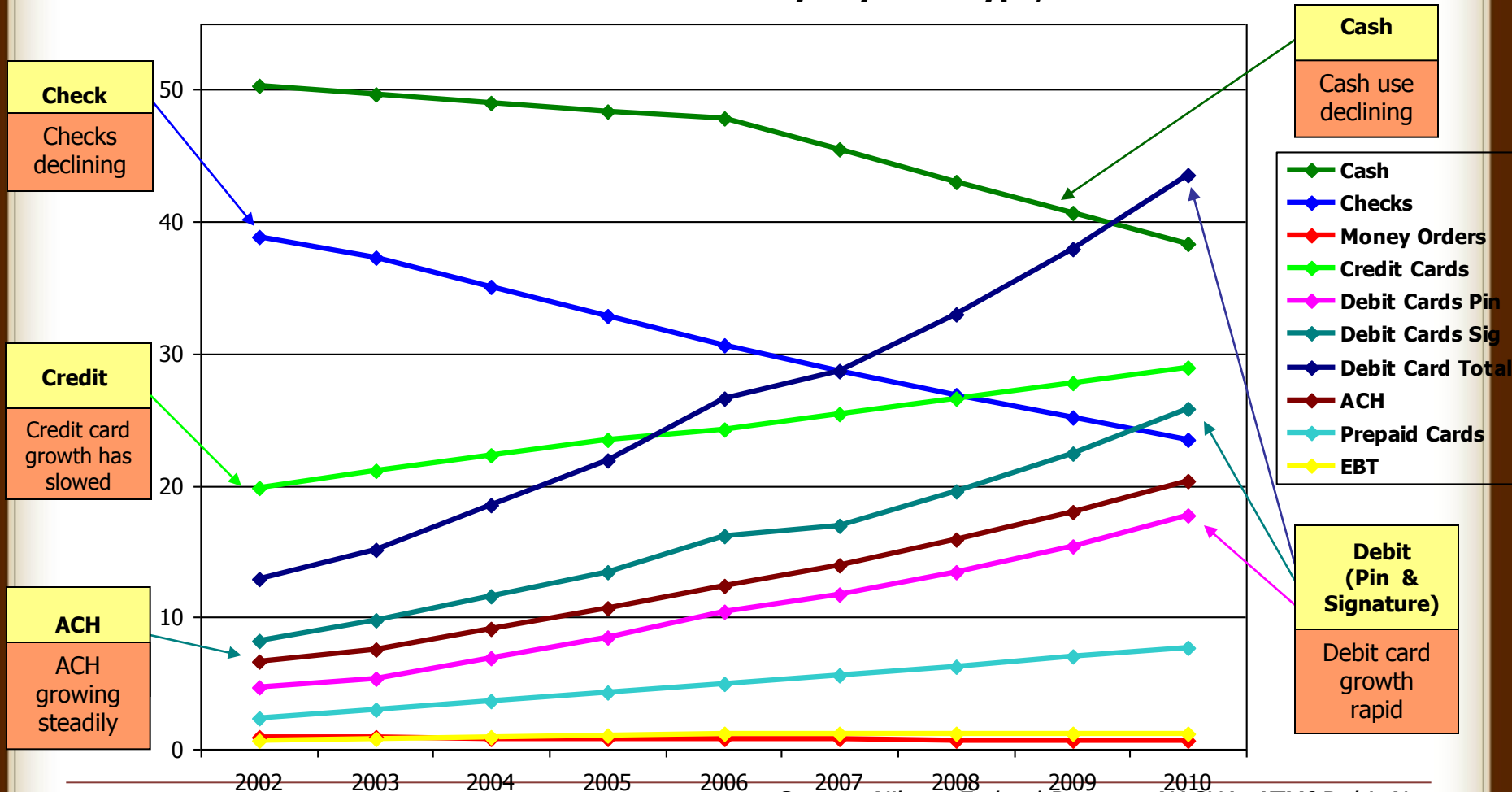
Today's Payment System is Dynamic Many Factors are in Play



Trends in the US Payments Market...

Paper-based, Electronics-based, aggregators, specialists

Estimated Total Number of Transactions by Payment Type, In Billions



Source: Nilson, Federal Reserve, NACHA, ATM&Debit News

Some Disturbing Trends are emerging with platforms & aggregators in payments

- **Churn is at an all time high in the payments marketplace.** Payors want multiple channels and platforms of their own.
- **Companies have embarked on outsourcing contracts -- only to stop or pull them off the table.**
- **Banks are seeing transaction income as the only stable revenue stream in the current economic crisis.** This has prompted many new entrants, prompted others to heavily discount to protect market share/base, and prompted others to “win” business via pricing.
- A decided strategy in those offering “disruptive” technology (“disruptive technology” is a technical term – disruptive can be a good thing, as it advances sustaining technology) **is for the vendors to grow such businesses and then sell off to the larger providers of payments services** – as these larger providers seek to grow their market share via organic growth or acquisitive growth. This means many current, small interface payment vendors, for example single channel providers, will not be around in one to three years.

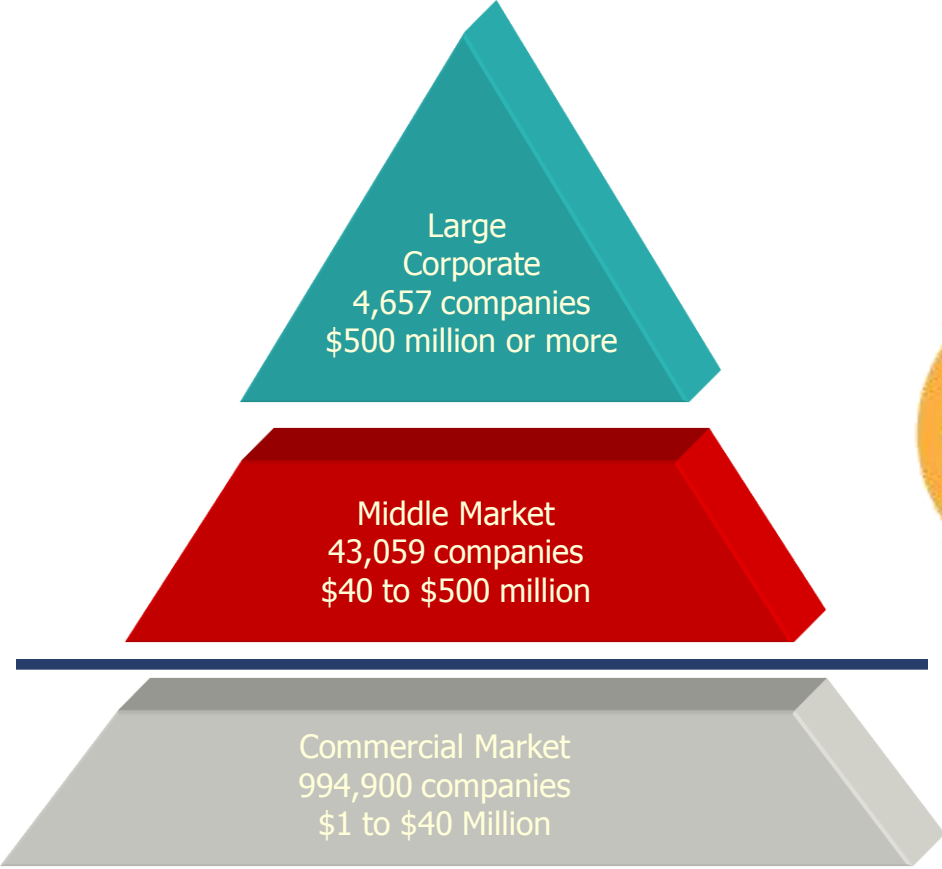
Some Facts & Trends in Payments

- **Payments in the US, despite the economy, are GROWING at a CAGR (compounded annual growth rate) of 4.9%** (grew only by one-half that, however in 2009). Likely due to more cash payments turning into another payment channels, and cash-only payors paying bills at agencies and other aggregators.
- The ENTIRE payments business is a multi-billion dollar industry. **What banks do in handling the money of payments, and their services, is only 1/3rd of the payments revenue** generated by the payments industry.
- **Expect greater adoption of standardized, “Net-native” services** (for example, web apps premised on SaaS –these are “mini-platforms” and sold as an “interface” to companies like PHI [e.g., Usablenet]); these “native to the web” interface services are easier to implement quickly, can be done so in incremental components, and done over a time horizon of the company’s choosing. However – they are one more interface to manage. Check-Free Web, when introduced, is yet another example of “Net-native” interface offerings.
- **A decisive payment platform strategy, and who administers it, will be essential to future payments success.** Some of the largest receivers of payments, who continue to fail to adapt and offer the platforms & channels of payments or move with payor behaviors in the channels, will struggle in managing both their costs and their working capital management.

Trend: Banking Relationships

- Relationship consolidation continues, despite the credit tightening
- BTW.....we WILL see a thaw in credit, beginning in 1Q 2011. Will this change the trend?

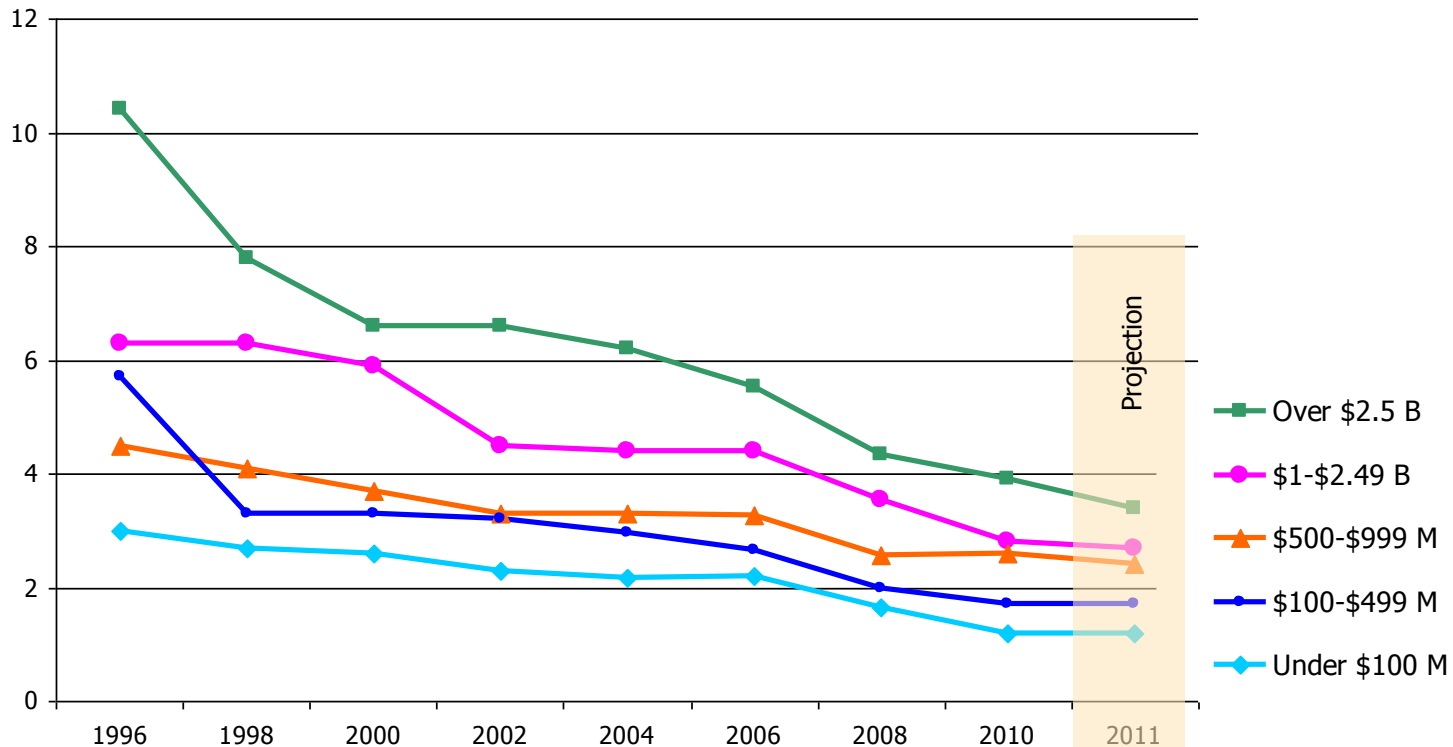
Measurable Dimensions of Treasury Management Relationships and Services



Courtesy: Phoenix-Hecht

Treasury Management Relationship Consolidation

Average Number of Treasury Management Relationships

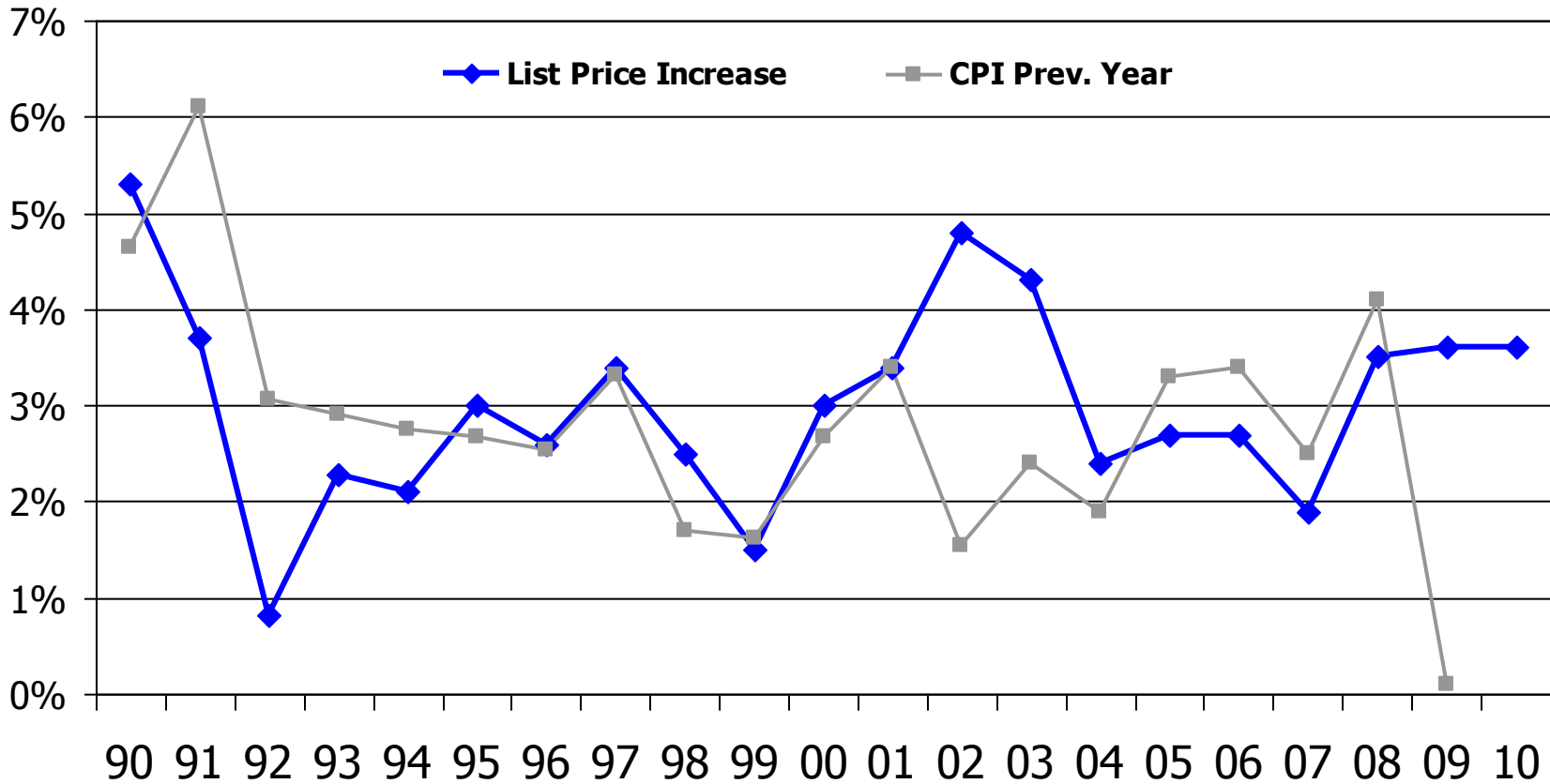


Source: Treasury Management Monitor™

Trend: Payment Pricing

- The dynamics of payment pricing are generally “counter-intuitive” – EXCEPT...
- Legacy payment products (e.g., remit) are seen as commodities
- Electronic products have an interesting margin dynamic
- Cards.....lower prices ARE coming...but there will be a host of ancillary fees

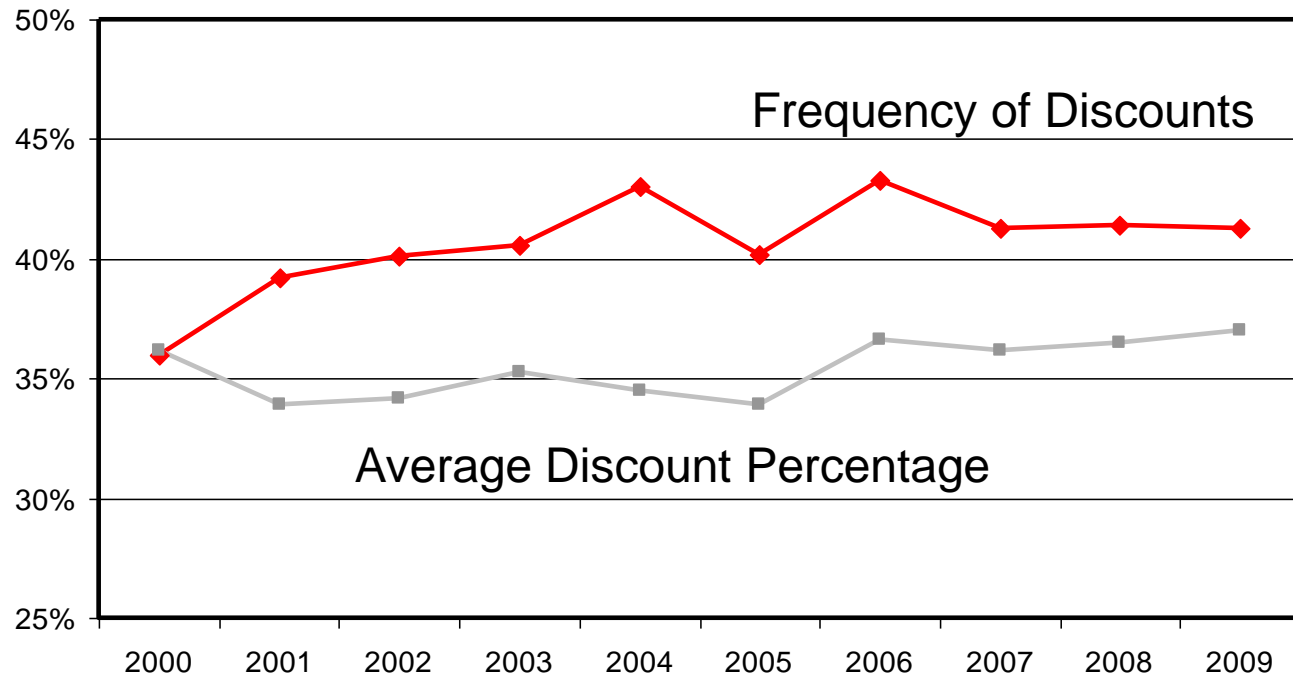
List Price Increase versus Previous Year CPI Increase



Source: 2009-2010 Blue Book of Bank Prices™

Discount Trends

There ARE discounts out there...



Influencers....

- The volume purchased
- The total monthly fees paid to the bank
- The geographic region of the customer

Source: 2009-2010 Blue Book of Bank Prices™

“Upside Down” Metrics....

Some specific examples

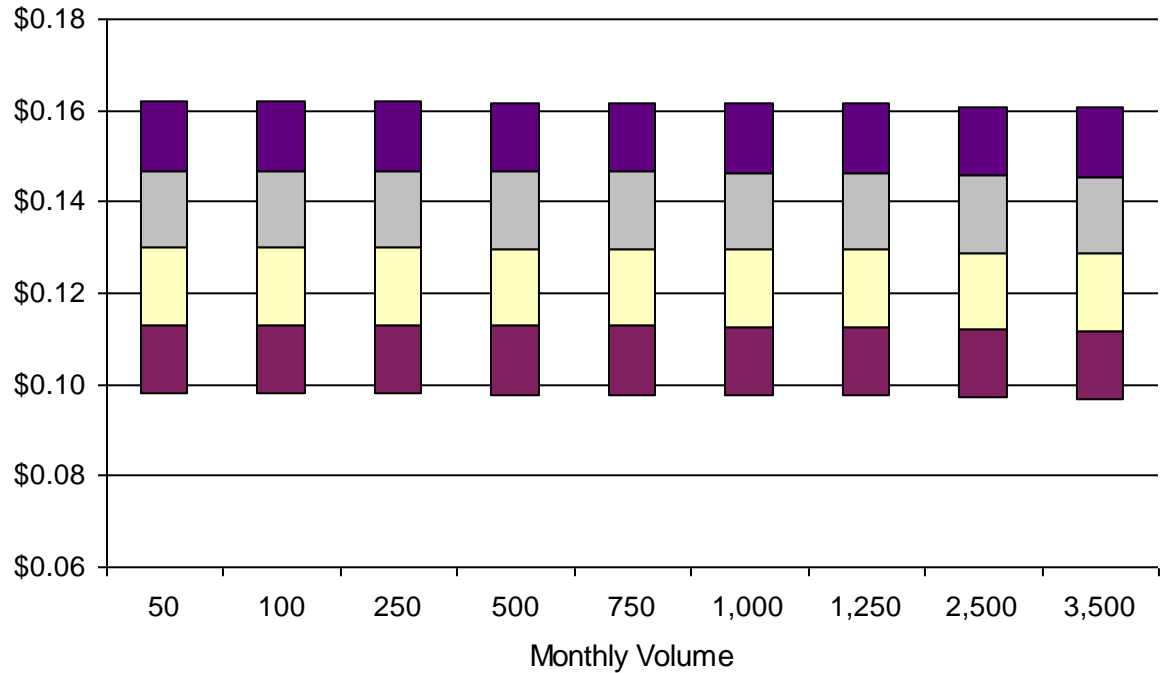
- Certain products are “more equal” than others
- There’s inverse correlations with the migration of paper and electronics
- Perceptions of quality....are all about the perceptions

Example: Remote Deposit Item

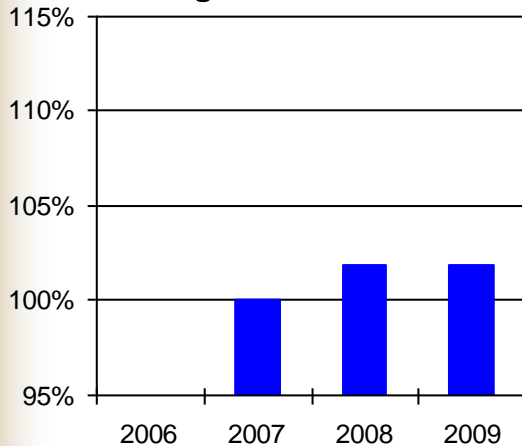
Expected Price Quartiles by Volume

Average List Price	\$0.14
Average List Price Increase	0.0%
Discount Frequency	30.5%
Discount Percentage	36.7%
Median Price Paid	\$0.150

Price per Unit

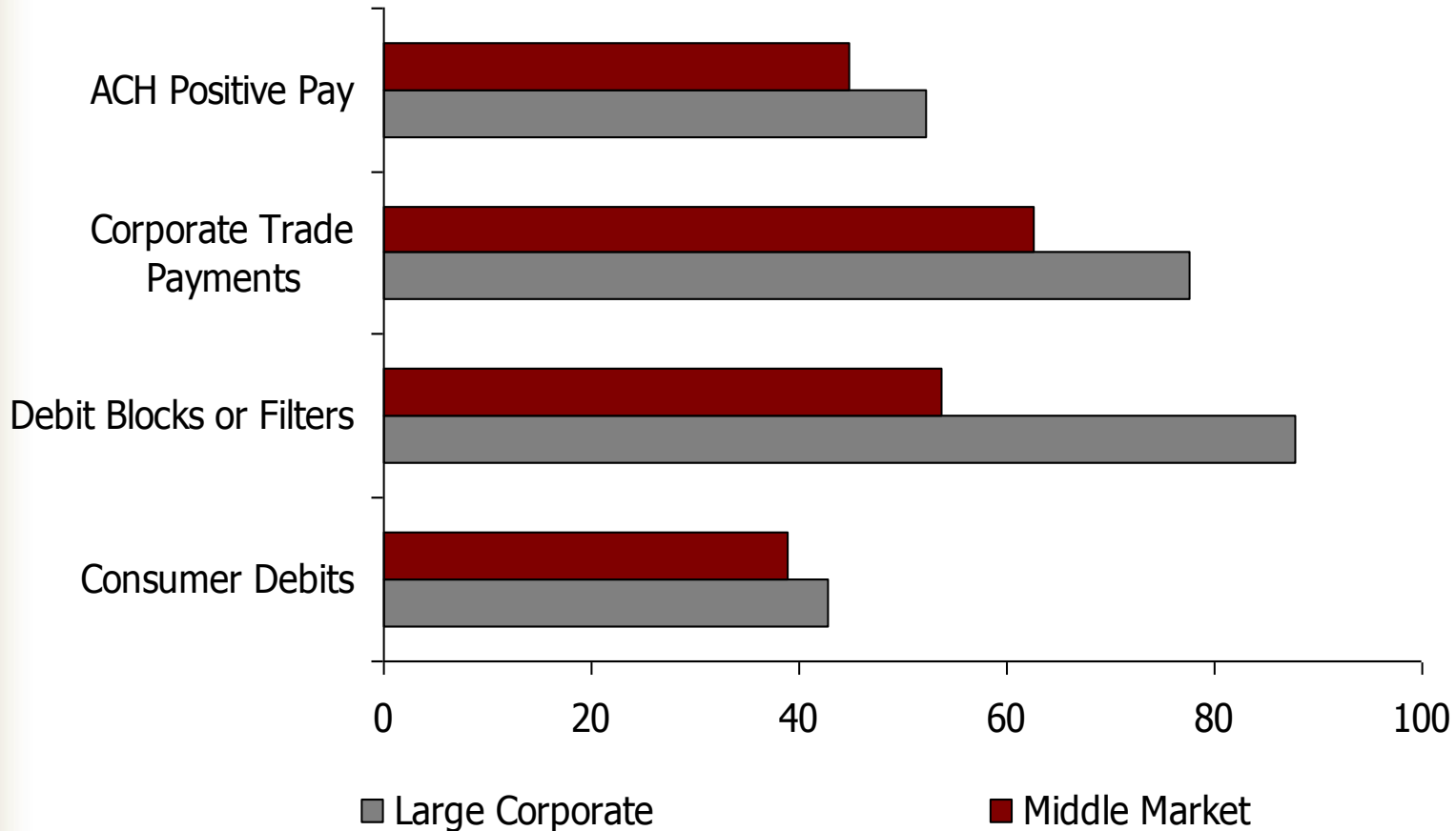


Average List Price Index



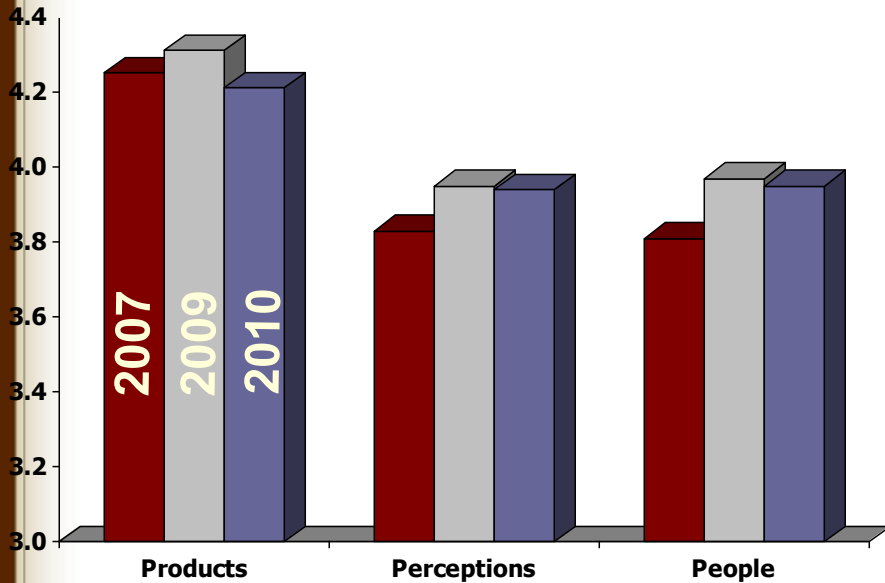
EXPECTED PRICE BY VOLUME		50TH PERCENTILE							
Volume	50	100	250	500	750	1,000	1,250	2,500	3,500
Price	\$0.130	\$0.130	\$0.130	\$0.130	\$0.130	\$0.130	\$0.129	\$0.129	\$0.129

Percentage of Corporations Using ACH Product Features and Transaction Types

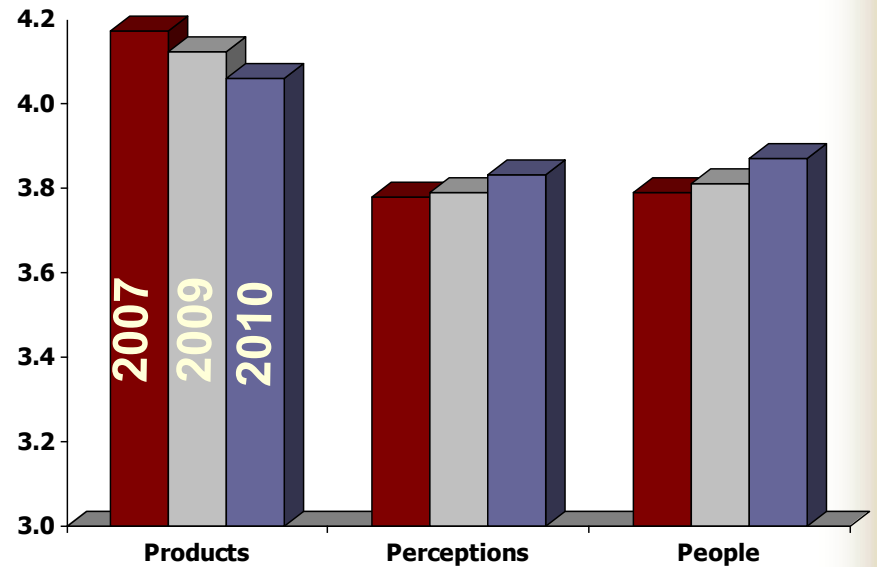


Average Quality Ratings

Middle Market Quality Index™



Large Corporate Quality Index™



Overall Perceptions	2007	2009	2010
Improved	21.5%	22.0%	17.6%
Worsened	11.2%	11.6%	17.6%

Overall Perceptions	2007	2009	2010
Improved	18.8%	17.1%	17.2%
Worsened	10.3%	10.1%	13.1%

Importance of Bank's Commitment

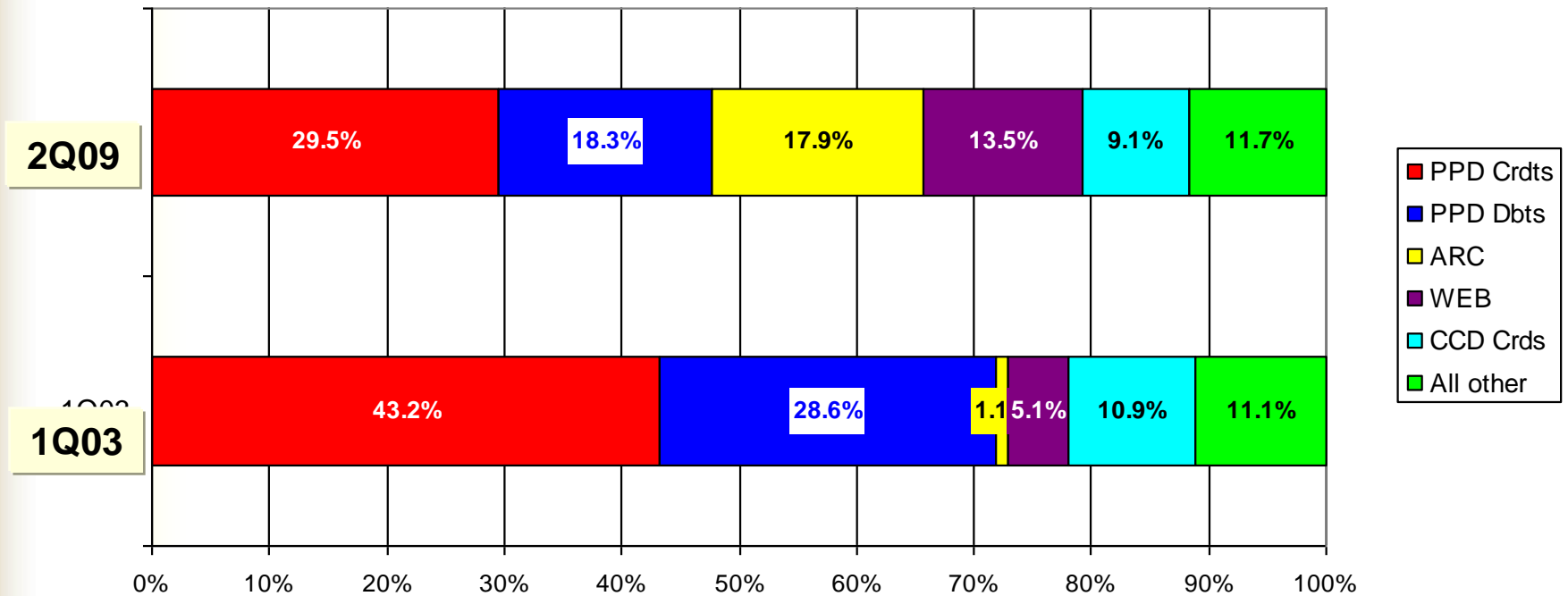
Middle Market (Scale 1 to 5 with 5= Very Important)	2009	2010	Diff
Problem resolution response	4.63	4.70	.07*
Credit availability	4.14	4.33	.19*
Proactive in introducing new services	3.79	3.77	(.02)
Calling officer stability	3.94	4.06	.12*
Length of relationship	3.94	4.00	.06
Frequency of calling officer visits	3.18	3.25	.07*

Large Corporate	2009	2010	Diff
Problem resolution response	4.68	4.71	.03
Credit availability	3.99	4.34	.35*
Proactive in introducing new services	3.94	4.01	.07
Calling officer stability	3.83	4.01	.18*
Length of relationship	3.65	3.86	.21*
Frequency of calling officer visits	3.11	3.32	.21*

*Statistically significant

ACH: Remit Payments are driving the growth, and change in ACH....e.g., ARC & WEB

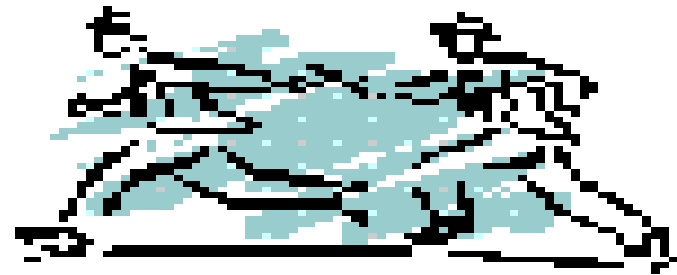
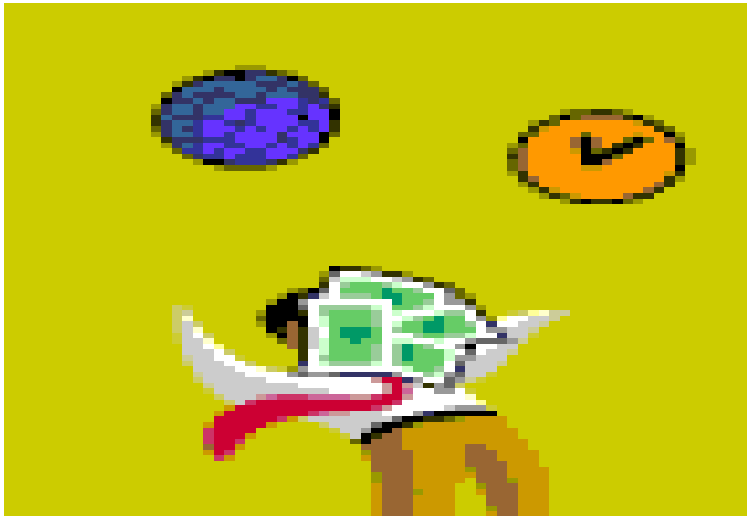
Top Five SEC Codes by Transaction Volume 1Q03 vs 2Q09



N = (interbank volume only):
1Q03: 1.77 billion txns
2Q09 3.74 billion txns

Copyright 2009 National Automated Clearing House Association

Trends – Risks – Challenges to Consider

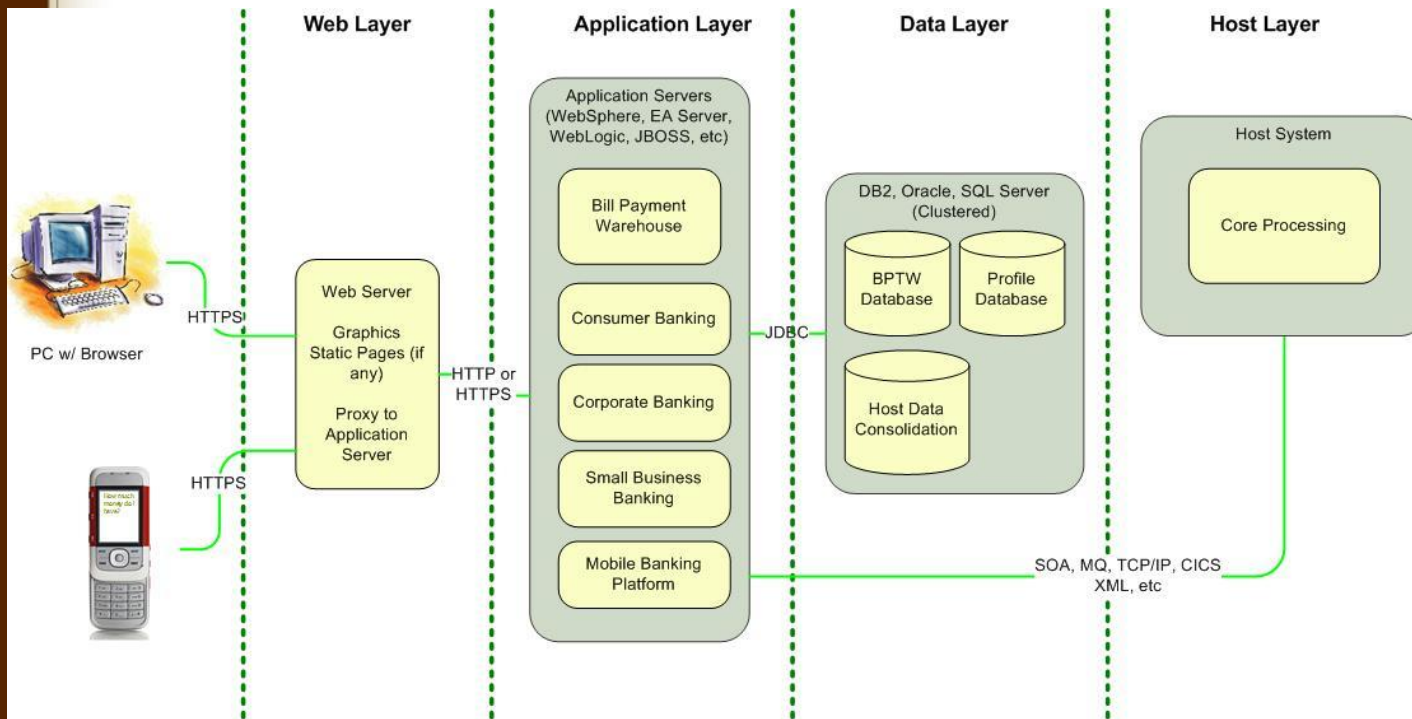


Online and Mobile Communications...

Technology continues to favor web applications

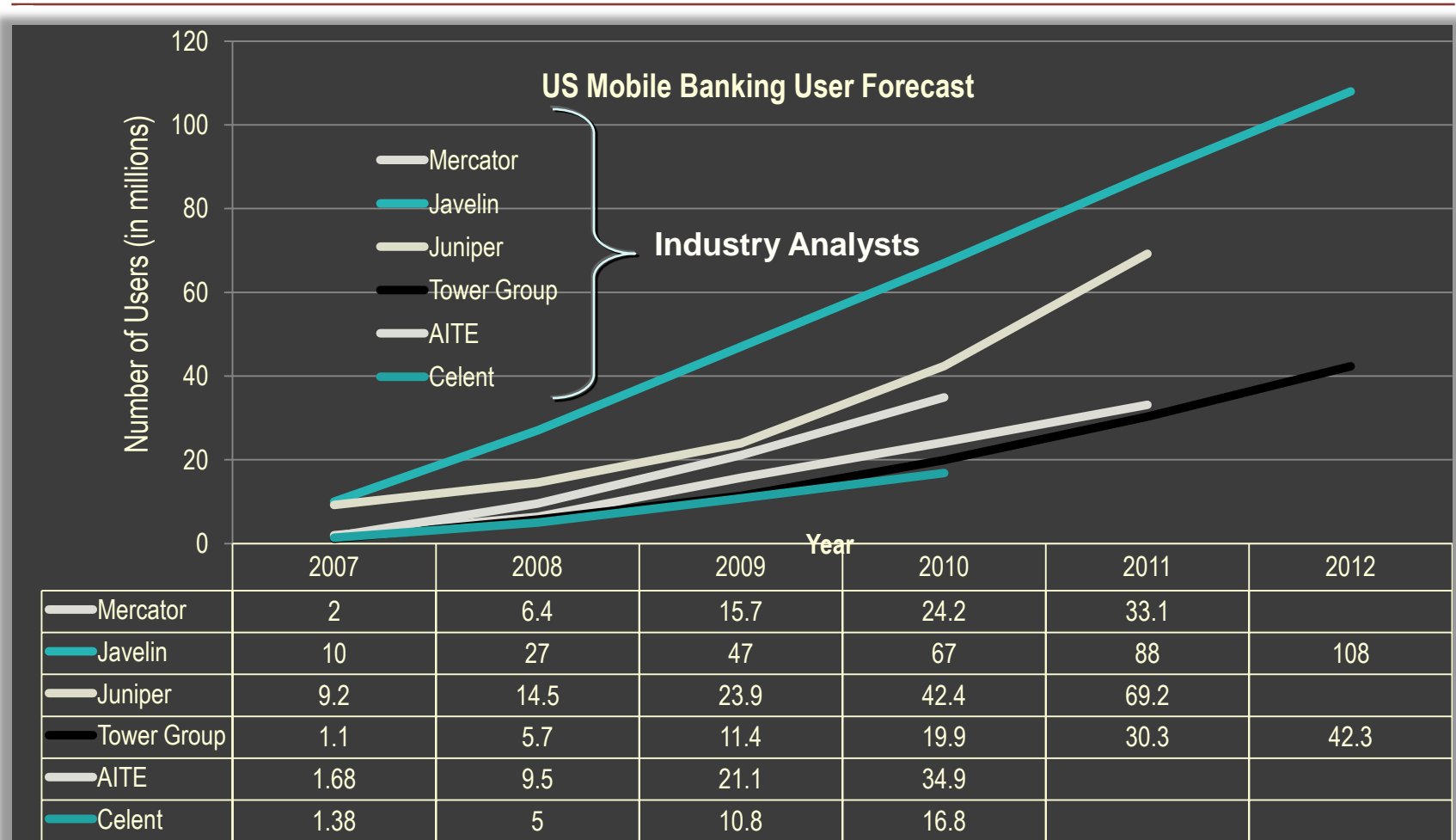
The PC and Mobile Browser

UseableNet is an example, a model, of this architecture

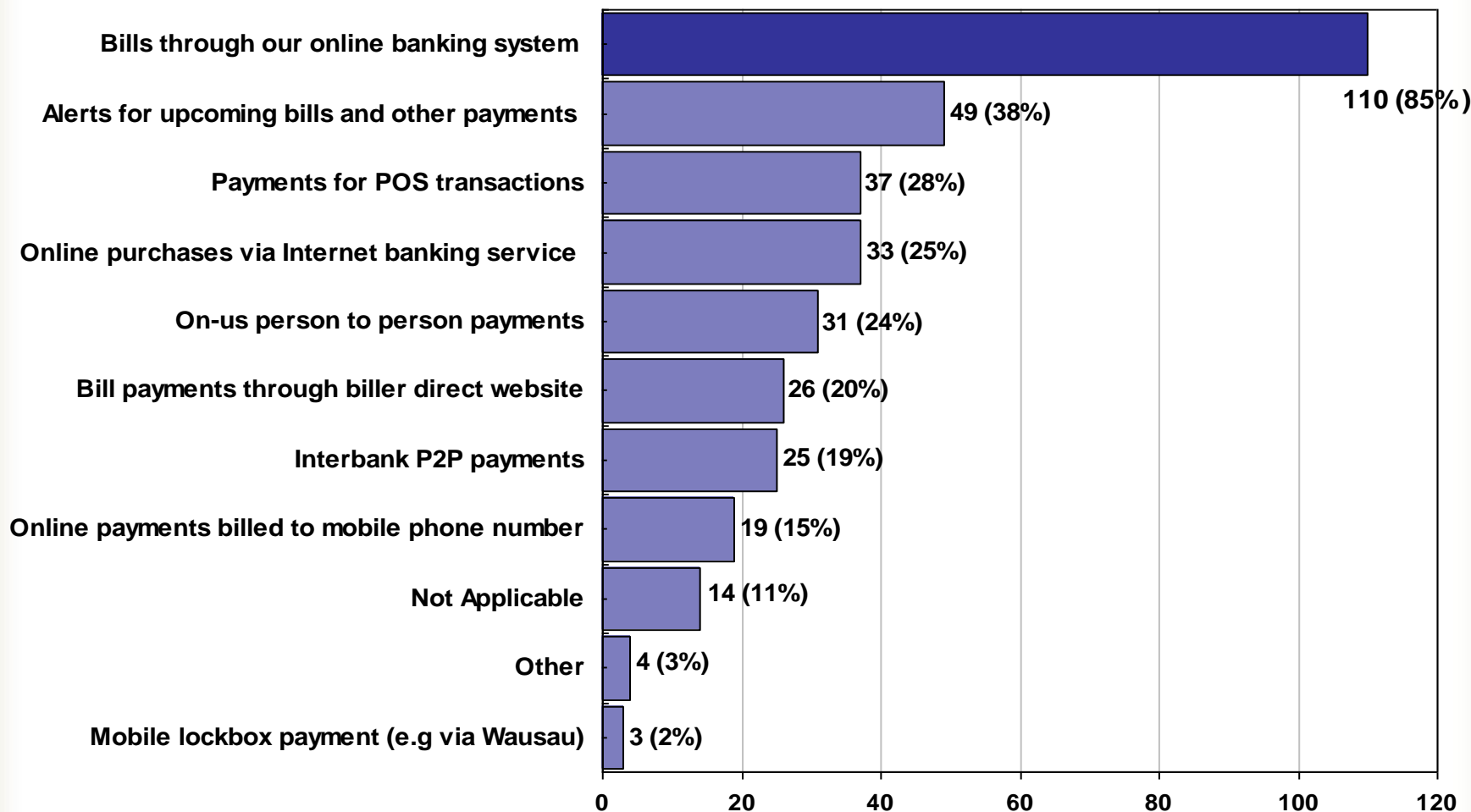


- PC Browsers and Browsers on WAP 2.0 Devices are Functionally Identical from a Security Perspective
- Browsers use 128-bit SSL Communications
- Identifying Data is not Stored on the Device

Mobile Banking Forecasts

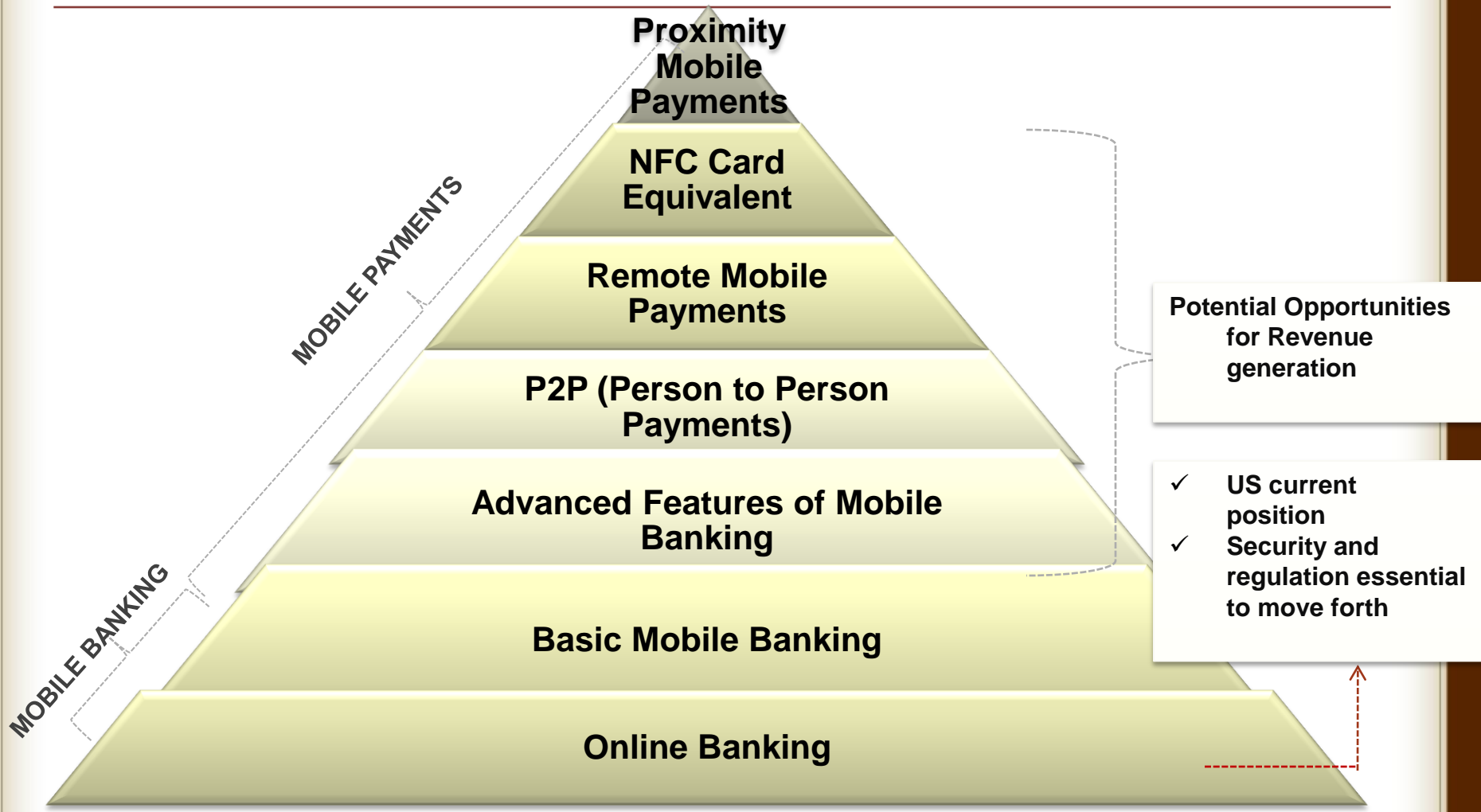


Most Planned Mobile Payment Services at Banks Are Bill-Pay Related



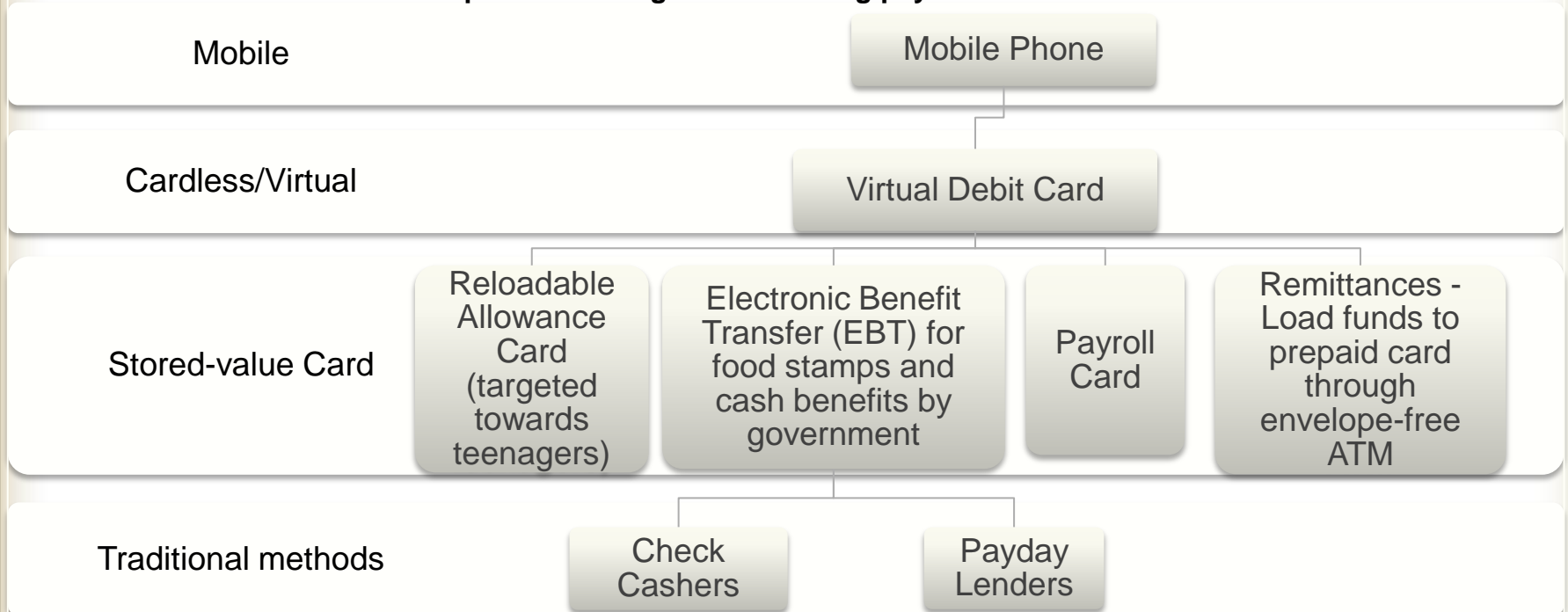
Q - If you offer mobile payment services, please select all features that your FI is considering? N = 150

Evolution of Mobile Banking and Payments



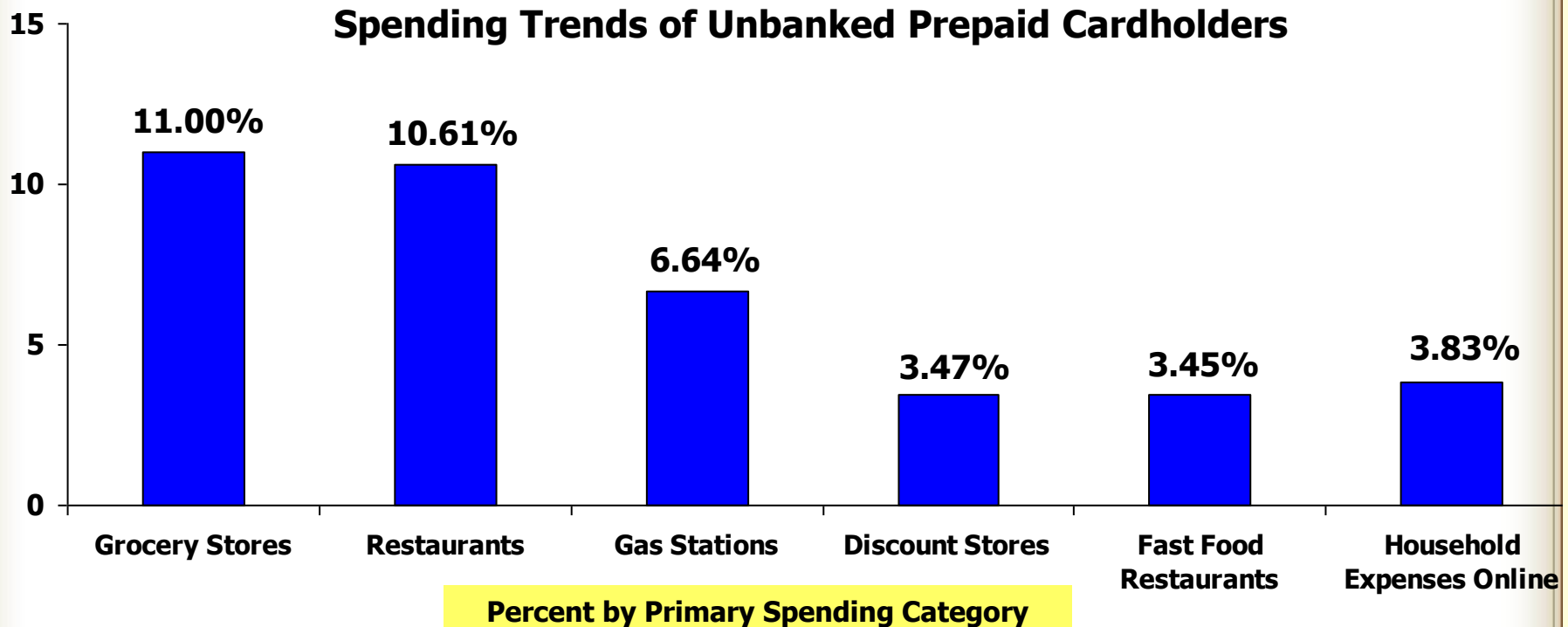
Unbanked in the US – Channels & Platforms in payments benefits them

As the “unbanked” (many are minimum wage workers/poor...but this is changing) are presented with card options to receive payroll, benefit and other payments, the traditional methods are being replaced with higher functioning payment channels.



Pre-paid Cards for Unbanked Customers

- More & more “unbanked” have wages credited directly to cards and are using cards much like a bank account
- Unbanked cardholders use payroll cards for everyday purchases



Source: eCount Prepaid Index, Banked vs. Unbanked Cardholders, July 2009

Challenges in Mitigating Risk in the Payments System

Issues, and the reasoning, underneath each issue....

Scope of non-bank competition is increasing

More commercial firms play a role in the payments processing model

The playing field is not level

Non-banks are not subject to many of the regulations banks must comply with

Access to payment systems is broad

Need consistency and diligence from banks that provide third-party access

Increase in WEB and TEL transactions in the ACH network

Spontaneous, one-time transactions between previously unknown parties increases the level of risk

Vulnerabilities of “e-access”

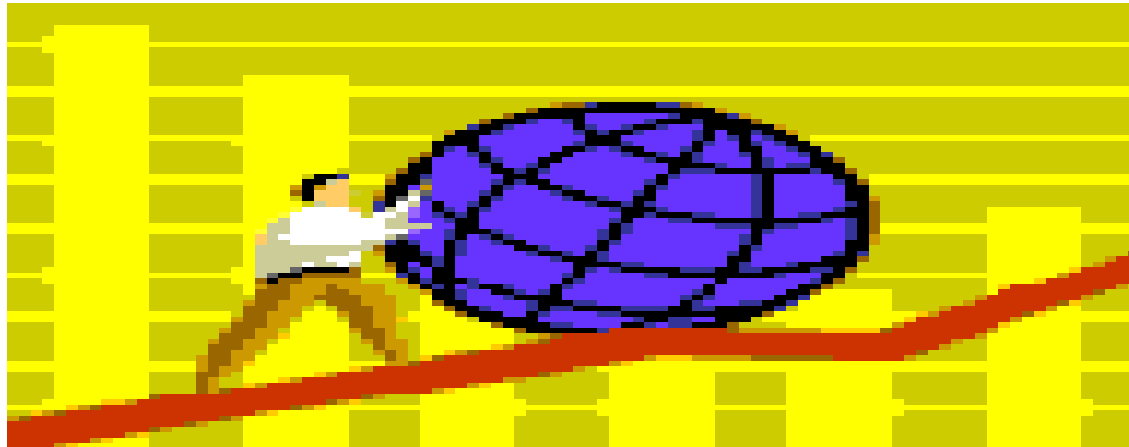
Environment must leave little or no economic incentive for fraudsters to attack payments channels

Non-bank Competition.... Risks & Rewards

- **Growth of electronic payments is creating more opportunities for non-banks to become part of the payment process**
- **This creates opportunities for both large and small companies**
 - **They are willing to get involved in non-core payment activities and often move faster than banks**
- **Therefore, the industry needs a “eyes-wide-open” approach to risk**
 - **Assess risks being created with greater participation by commercial firms in the payments process**
 - **Make adjustments which balance facilitation of commerce with appropriate risk measures**

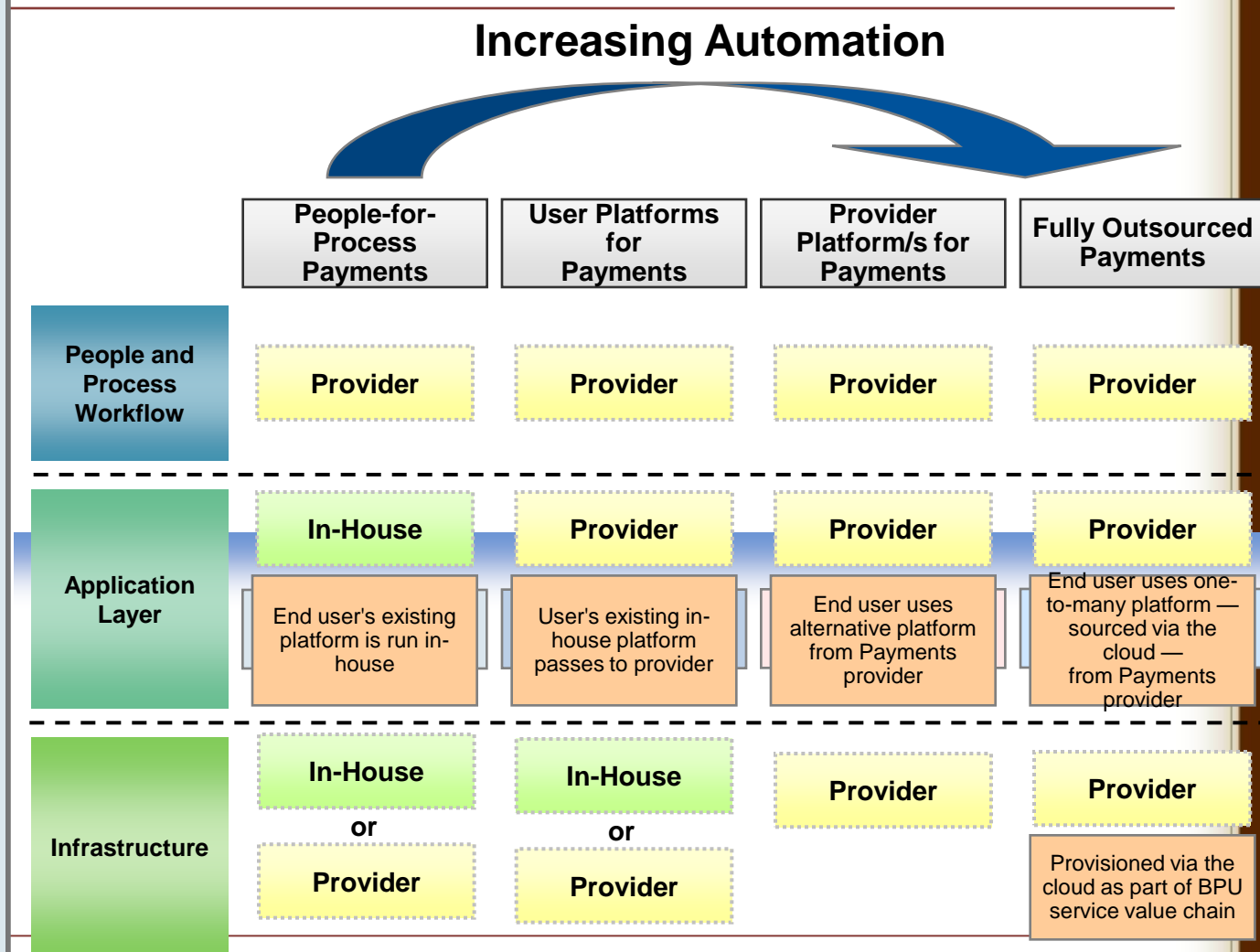


Payment Channels – Now and In the Future



Delivery Architectures Are Crucial to the Efficiency & Effectiveness of Payments Platform/s.

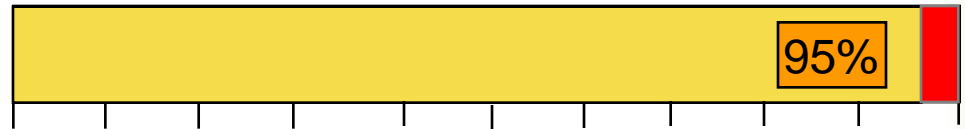
- Payments encompasses people, process and technology
- Much of Payments today is "partial outsourcing" — the people-for-process delivery architecture
- Process automation is crucial to further improve efficiencies and cut labor costs
- Therefore, outsourced channel management is the "ultimate" delivery architecture!



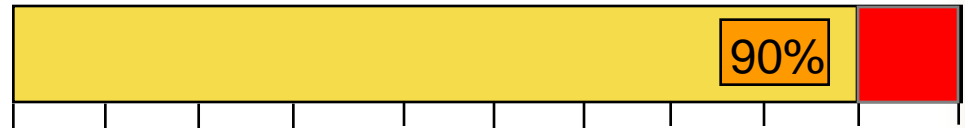
The Growth of Payments Will See Companies Want “Packages” rather than “customized” processes, as a way to reduce costs

Customization

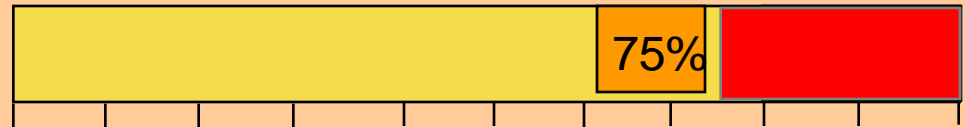
Ten Years Ago: 1999



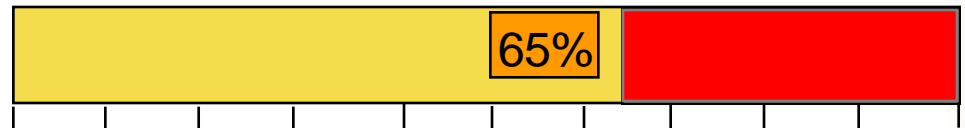
Five Years Ago: 2005



Now: 2009-2010



Five Years from Now: 2015



Ten Years From Now: 2020

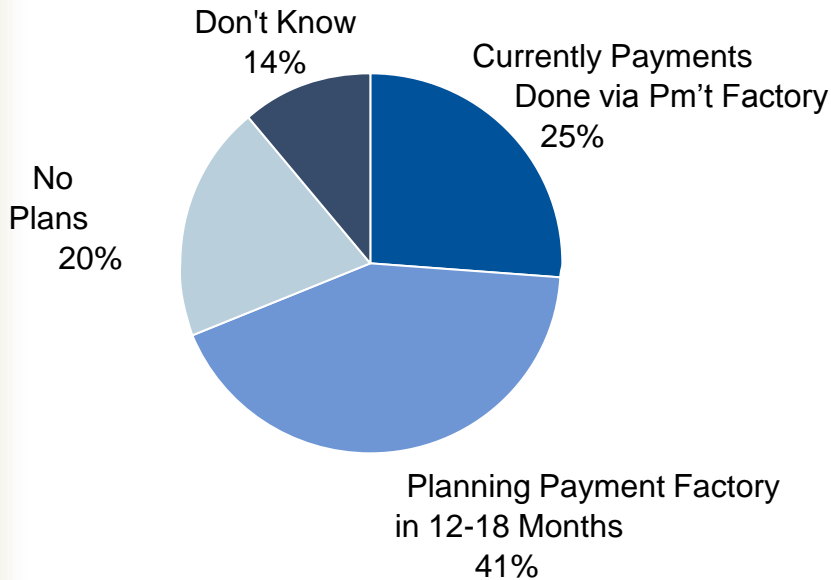


Customization will be expensive, and thus the last resort, not the first resort

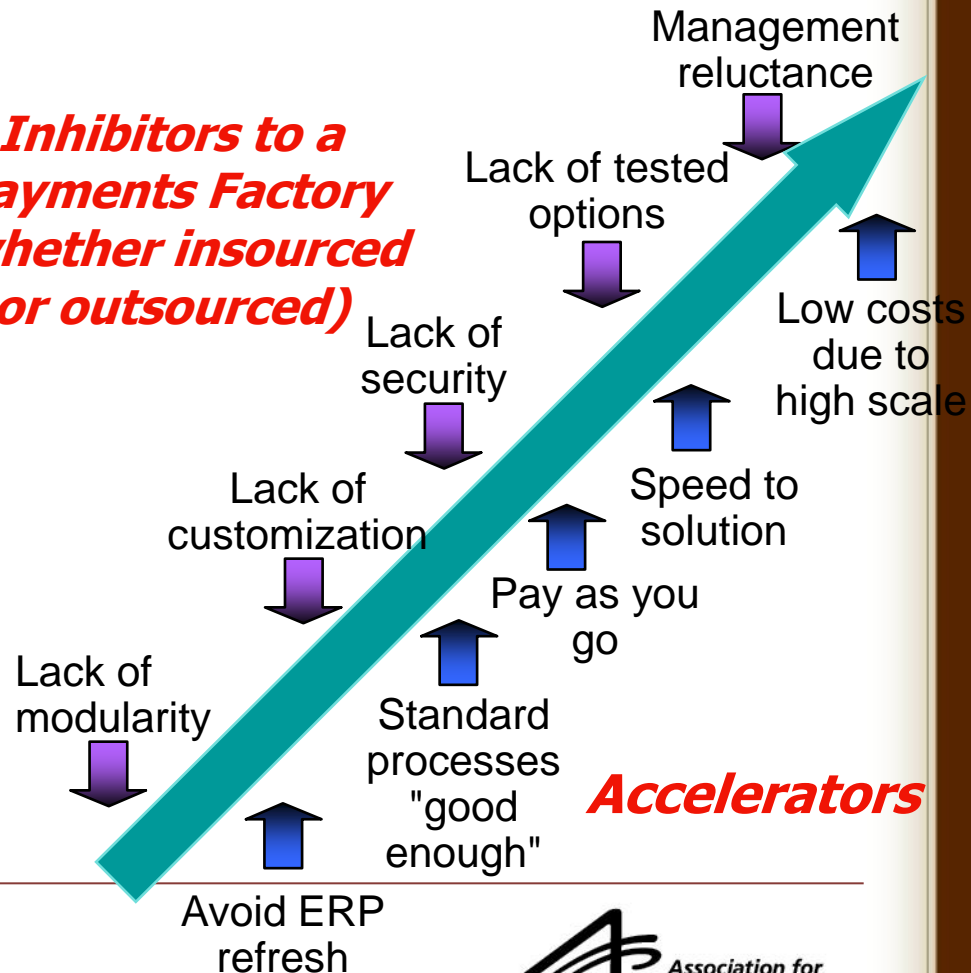
Platforms of the Future for Payments: Strong Evidence for an adoption of a Payment Factory

A Payment Factory....

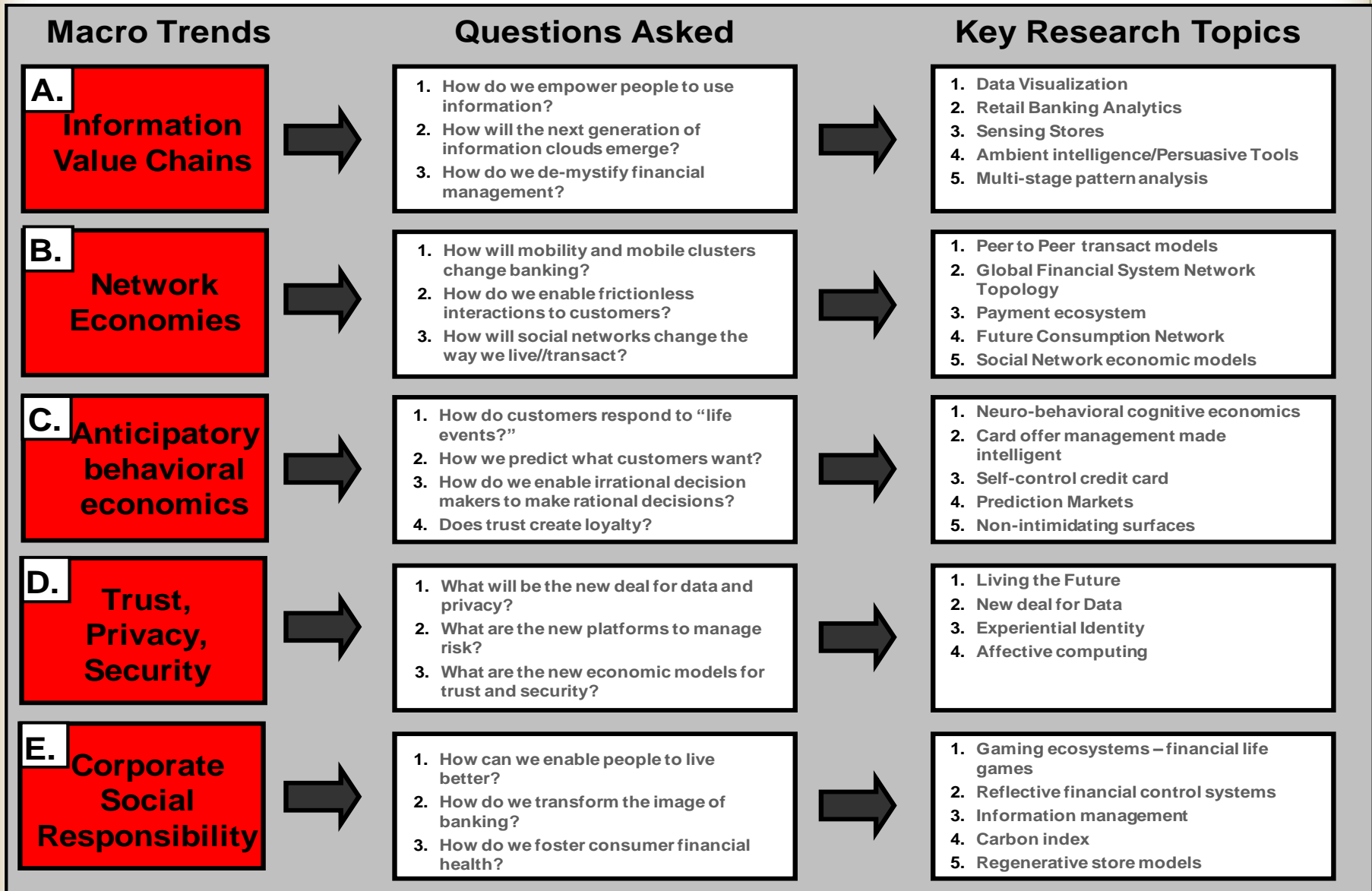
Question: Which of the following most accurately describes your organization's use of a business process utility for payments?










Inhibitors to a Payments Factory (whether insourced or outsourced)



Research Agenda in Assessing Providers:



Conditions Driving Adoption, by Industries

Process Domain Categories	BPU (Business Process Utilities) Market Conditions/Drivers	5-yr. Growth Rate	CPSS Potential
Industry Operations: Education	The forces of budgetary cuts, and the need to do more with fewer resources will give rise to BPU adoption among educators, both in administrative functions as well as front-line processes such as distance learning.	28.3%	
Industry Operations: Financial Services	Use of BPU among financial services companies will be driven more by cost than a desire to standardize — but to date, adoption of BPU has been minimal as a percentage of all financial services operations services Payments.	23.4%	
Industry Operations: Healthcare	So far, countries such as the U.K. and Israel are furthest ahead, yet we the U.S. will change given increased government focus. Look for areas such as medical transcription and coding to show strong BPU growth potential.	52.3%	
Industry Operations: Government	Although concerns regarding security will limit broad adoption of public Internet platforms, the necessity for outreach services to taxpayers and communities will draw government entities increasingly onto the Web. BPU services for a broad range of processes including tax collection and records management will develop out of early-stage SaaS-type applications.	56.3%	
Industry Operations: Retail	Given the embrace of the Internet as a retail platform over the last 10 years and the increasing growth in this area, it is logical to expect that BPU services will become more prevalent in worldwide retail markets.	19.8%	
Industry Operations: Transportation	Outsourced transport related services are in many ways already BPU-like. Gartner expects to see more outsourcing in global transportation markets offered on a BPU basis.	24.8%	
Industry Operations: Utilities	Utilities are among the enterprises that appear to have a clear understanding of the difference between activities that could be considered "core" (such as mission-critical and offering competitive advantage) and those that are "context" (such as important, but not offering competitive advantage). This makes them prime candidates for greater adoption of BPU services.	48.6%	

Summary

Guide to Characteristics of a World-Class Payments Provider

- 1. General clarity and timeliness of response to RFI or RFP**
 - 2. Cultural ability to support and enhance the understanding of clients' internal team (assessed via visits to their delivery centers)**
 - 3. Positive feedback from clients (rating on these strengths)**
 - 4. Ability to clearly explain current and future pricing options**
 - 5. Investment in workflow tools and in technology partnerships for processes**
 - 6. Demonstrable transition strategy and ongoing delivery support**
 - 7. Global rollout experience in broad "footprint" of countries**
 - 8. Appetite for risk and flexibility in contracting styles**
 - 9. Specific industry experience**
 - 10. Ability to manage attrition**
 - 11. Suitable location of delivery centers and flexibility of work movement**
-

Best Practices in Payments & Platforms

ACTIVITY	BEST PRACTICE/VISION
Payments Accountability	Single, accountable party for payments and banking relationships as related to payments
Payments “Architecture”	As few payment streams as possible, aggregating channels and employing a targeted use of aggregators and other vendors. Quick integration of best-of-breed providers.
Bank Pricing	Single depository bank unless risk far exceeds benefits. Achieve top quartile performance in bank prices paid (lowest)
Payments Channel	Recognize and adopt payments channel/s commensurate to consumer preferences and trends, while keeping cost & risk focus
Payments Aggregation	Single, or as few as possible, channels into the organization – realizing multiple channels of payments are handled by one aggregator

Biographies

Michael J Alfonsi, CTP, CRM, WPT

Michael is Managing Director of BancTec's Finance Transformation Services and is the accountable party for timely project completion and client satisfaction. He leverages his leadership expertise to drive change and produce dynamic gains in revenue, profit and performance in client companies. Passionate about Benchmarking and Performance Improvement set in a team oriented approach, Michael has been engaged to assist over 140 organizations in just the last four years alone in benchmarking and performance management, payments, and process improvement. He holds an M.A., magna cum laude, from LaSalle University in Philadelphia, PA, and earned a certificate in Cash Management from Duke University's Fuqua School of Business. He is a frequent speaker at regional events and is the content co-coordinator for the Treasury Executive Series at the University of North Carolina/Chapel Hill.

Michael E Seibert, CPA

Mike is a Finance Manager in the Treasurer's Department at PEPCO Holdings, Inc. in Washington, D.C. and is responsible for special project work and internal controls. Prior to his employment at PEPCO. Prior to Mike's employment at PEPCO, he was Treasury Manager for United States Fidelity and Guaranty Company (USF&G) in Baltimore, Maryland. Mike received a MBA in Finance from Loyola College in Baltimore, Maryland and a BA in Sociology from Lock Haven University of Pennsylvania. Mike is a Certified Public Accountant (CPA), past President and current Board of Director for the Greater Washington DC Association for Financial Professionals, and a frequent speaker at regional and University of North Carolina Treasury educational events.