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Annual Conference

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ORIGINAL → ESSENTIAL → UNBIASED → **INFORMATION**

How Image Exchange & Electronic Payment Channels Have Changed ARC's Value Proposition

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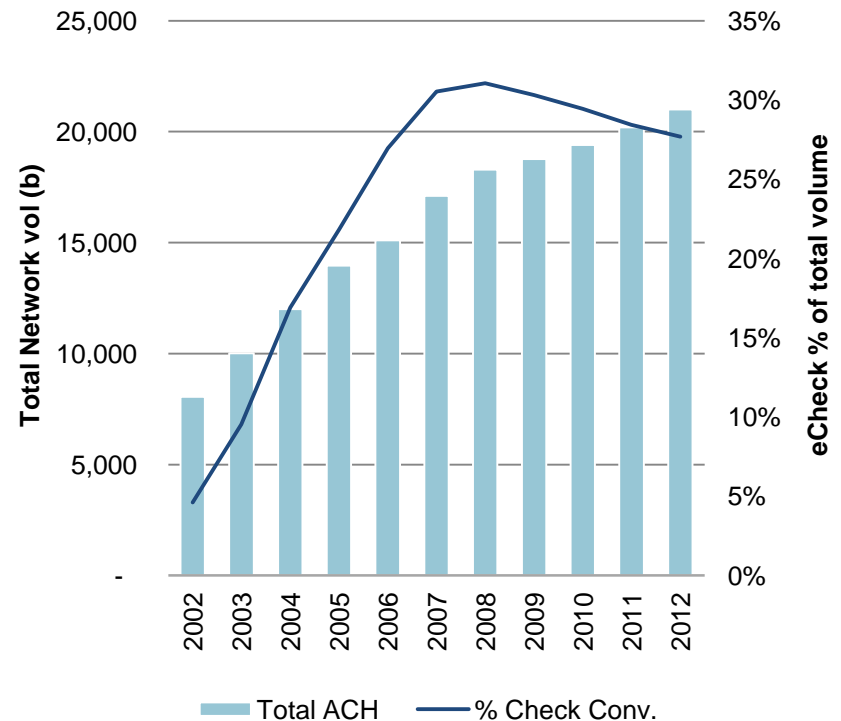
For today...

- **A (very) short check conversion history**
- **The changing ARC business case**
- **PPL Corporation's perspective**
- **A banker's perspective**
- **Discussing the future of ARC, ACH & ICL**

Check conversion was the ACH growth engine

- Check conversion SECs grew from less than 5% of network volume in 2002 to over 30% in 2008
- But, has slowly declined since then (28% in 2012)
- For a decade, ACH network volume growth was largely a result of converting paper checks

eCheck's contribution to ACH volume

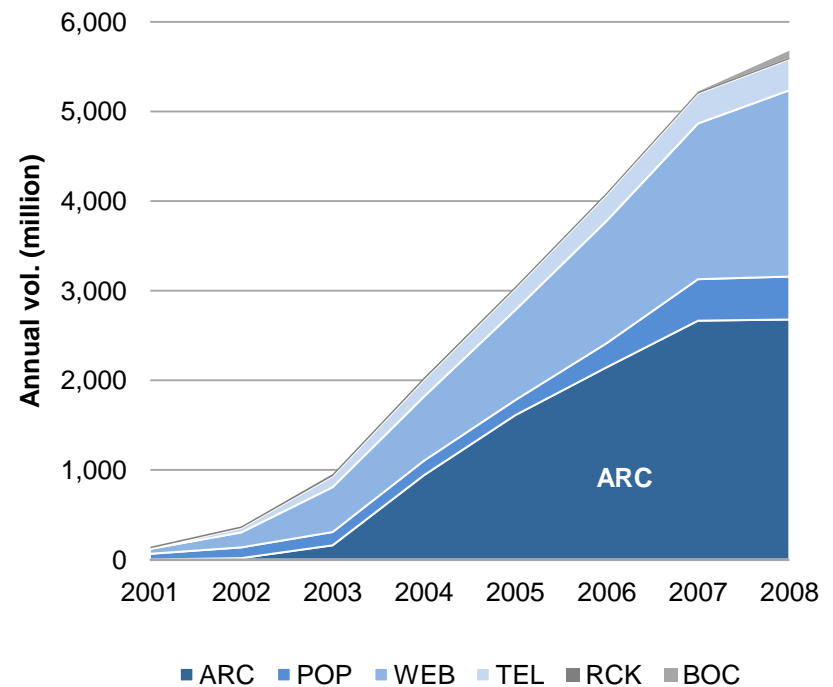


Source: NACHA, Celent analysis

And, ARC was the king of check conversion

- **ARC (2002), enjoyed a 3-digit CAGR for many years**
- **Surpassed WEB volume in 2004 and held the #1 spot until 2009**
- **For most of the decade, ACH network volume growth came through check conversion e.g.**
 - ARC
 - BOC
 - POP

ACH check conversion volume mix

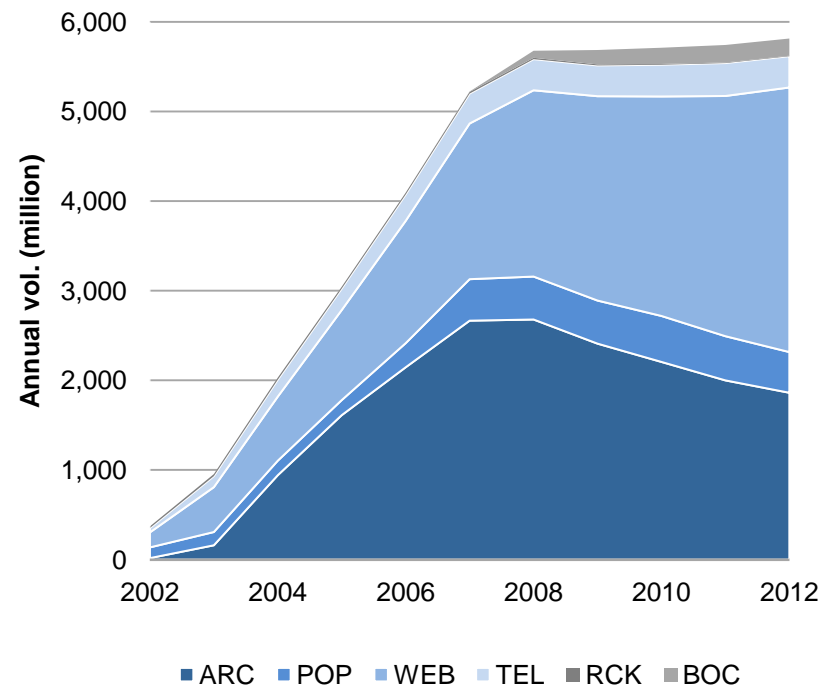


Source: NACHA, Celent analysis

But, was toppled in 2010 by growth in bill pay

- **WEB is the new ARC**
 - #1 check conversion SEC
 - Growing steadily since 2010
- **Apart from the WEB & ARC drama, there's not much happening**
 - BOC has been a yawner
 - POP and TEL have flat lined

ACH check conversion volume mix

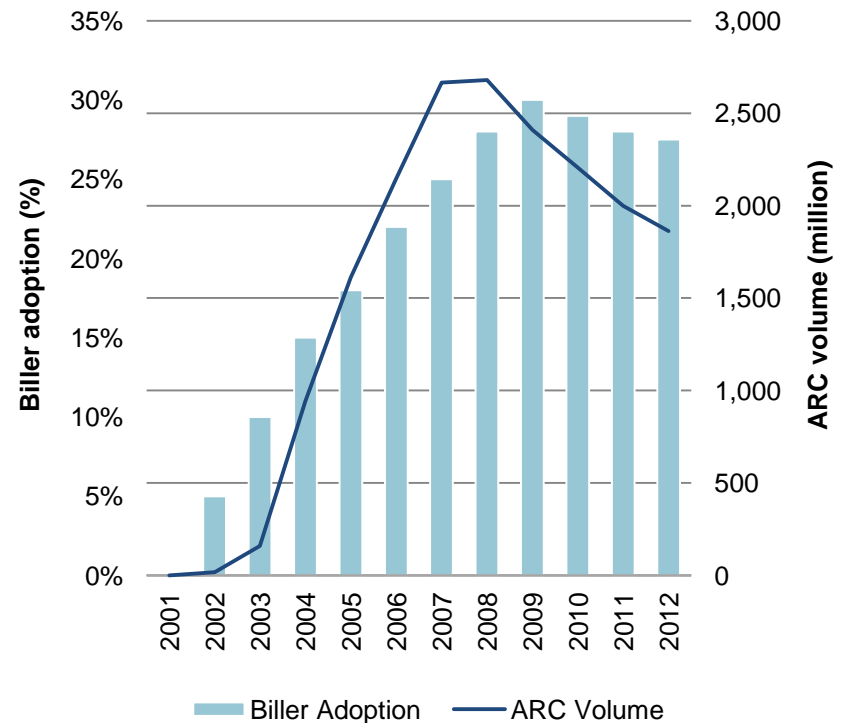


Source: NACHA, Celent analysis

ARC's rapid ascent was driven by biller adoption

- **Less than a third of (in-house) billers ever adopted ARC**
- **Most of them came online in the first several years**
 - Led by large billers
- **Ideal ARC candidates**
 - Nat'l footprint
 - High dollar items
 - High % eligible
- **ARC's volume decline (-35% since 2009) has been driven by continued growth of bill pay**

ARC adoption dynamics

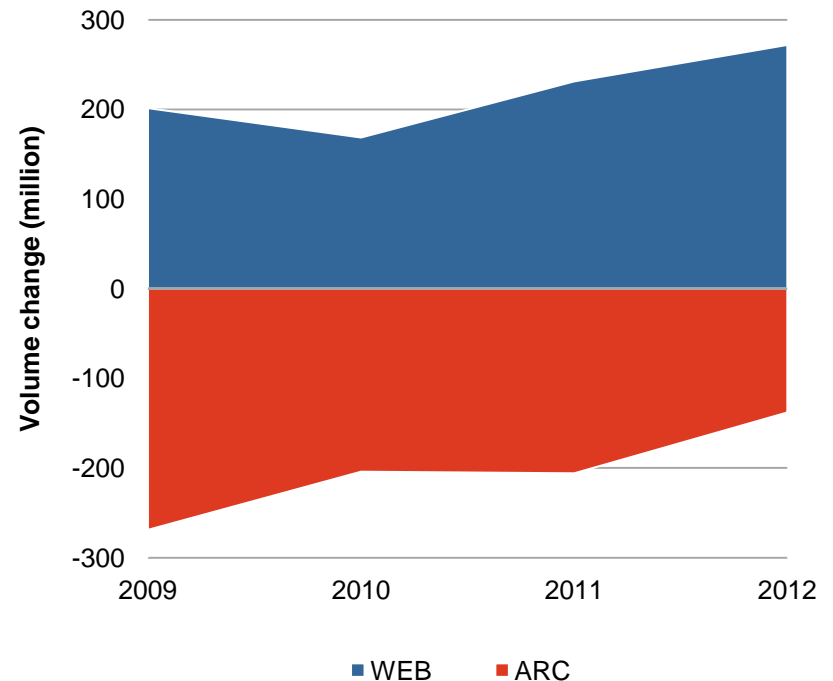


Since 2009, WEB's gain has been ARC's loss

- Growth in WEB and decline in ARC have been mirror images
- Further declines in ARC volume will be driven by
 - Growth in electronic bill payment
 - Further adoption in ICL

Will billers stick with ARC?

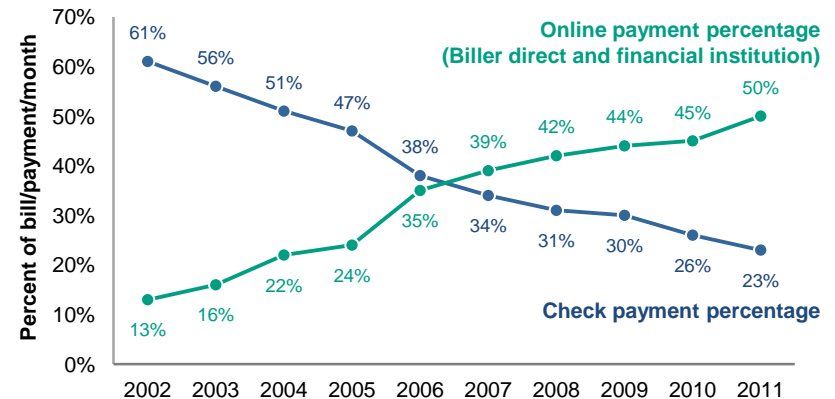
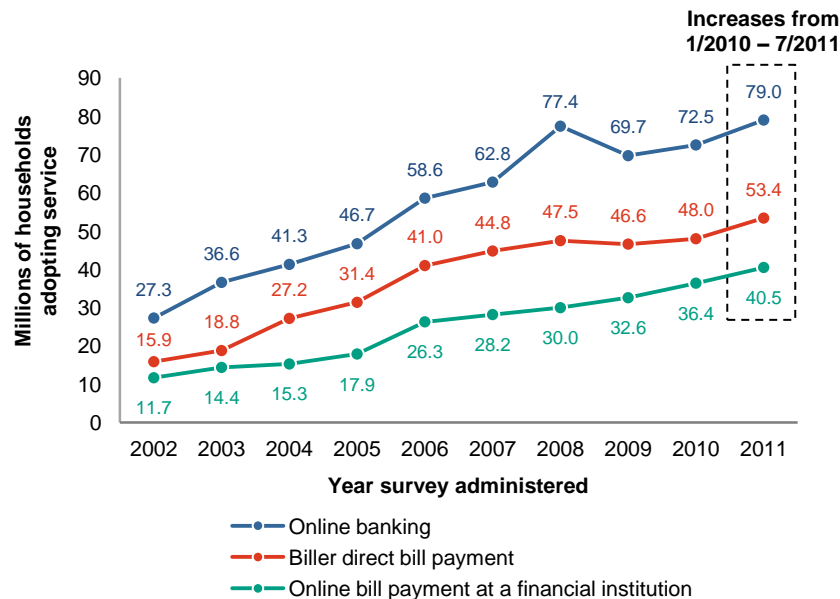
Transaction volume (annual change)



Much has changed since ARC's genesis

- Online banking usage up 3x
- Biller direct bill payment up 3x
- FI online bill payment up 4x

Share of checks declined over 60%



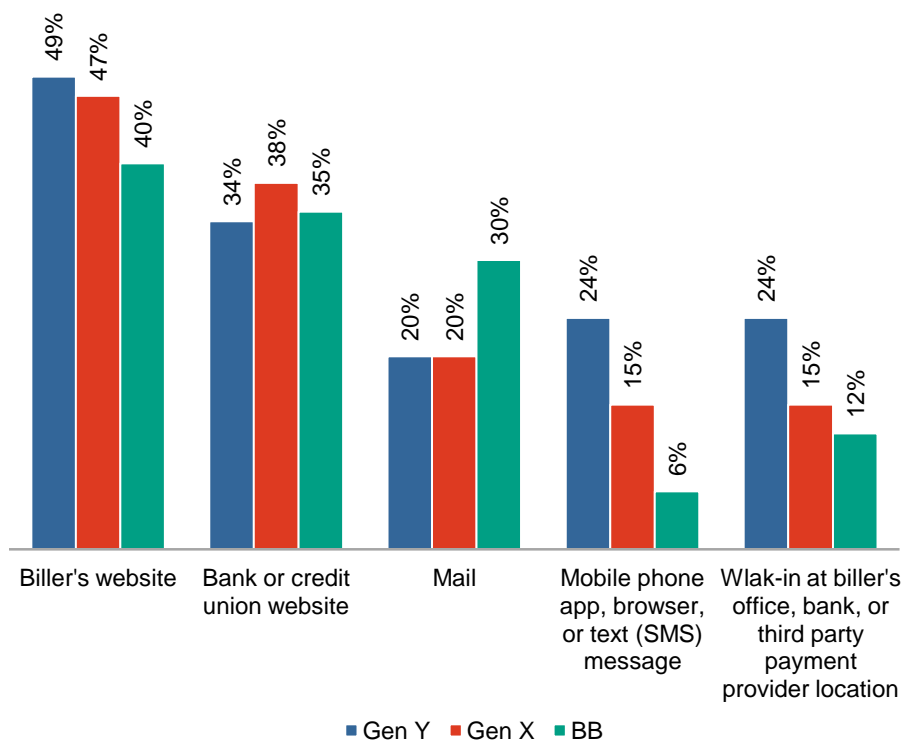
Source: 2011 Consumer Trends Survey, Fiserv Inc., August 2011

Source: 2011 Consumer Trends Survey, Fiserv Inc., August 2011

Bill payments have become multichannel







- **76% of consumers use more than one method to pay bills**
 - 36% of consumers use three or more channels to pay monthly bills
 - 38% use three or more payment methods
- **18% of multi-method payers and 27% of multi-channel payers used a mobile phone to pay at least one bill per month**

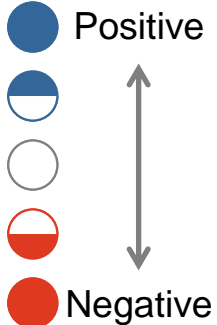
How consumers prefer to make bill payments by generation








Source: The Western Union® Bill Payments Money Mindset Index, March, 2013








Early benefits of ARC were manifest

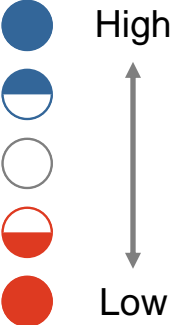
| Considerations | Compared to checks | |
|--|---|--------------------------------|
| Return rate |  | ~30% reduction |
| Predictability of returns |  | Settlement +2 vs. 3-5 days |
| Clearing fees |  | [need metrics] |
| Float |  | Depends on geography |
| Cost of returns processing |  | Full automation of ACH returns |
| Potential consolidation of processing sites and bank relationships |  | Depends on geography |



 Positive



 Negative













Offset by some negatives

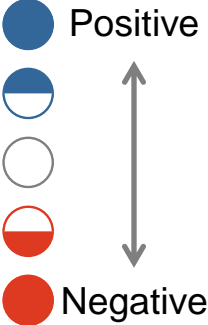
| Considerations | Relative influence |
|--|---|
| Ineligible items (bus. checks, demand drafts, c. card, money orders, etc.) |  |
| Administrative returns |  |
| Opt-out provisions |  |
| Notification requirement |  |
| 60-day consumer right of return provision |  |
| Dual workflow (statements, return, posting, reconciliation) |  |
| Increased check clearing costs |  |








High
↑
↓
Low

My, how things have changed!

| Considerations | Then | Now* |
|--|---|---|
| Fewer returns |  |  |
| Predictable returns |  |  |
| Reduced clearing fees |  |  |
| Float gains |  |  |
| Reduced cost of returns processing |  |  |
| Potential consolidation of processing sites and bank relationships |  |  |



 Positive



 Negative

* 100% ICL environment

Is ARC Dead?

- **“Yes”** in terms of new adoption
- **“No”** in terms of continued usage among ARC adopters
 - For many billers, the benefits of 100% ICL likely won't justify the effort

For most billers...

“If it ain't broke, don't fix it.”

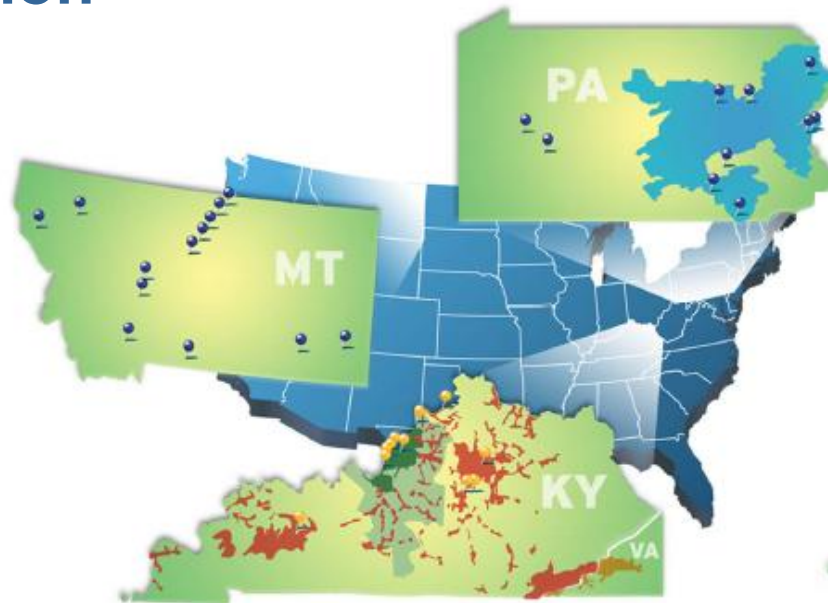
PPL Corporation

U.S. Delivery Territories:

- PPL Electric Utilities
- **Kentucky Utilities**
- Louisville Gas and Electric

Generation Assets:

- Competitive power plants
- Regulated power plants



U.K. Delivery Territories:

- WPD (South Wales)
- WPD (South West)
- WPD (West Midlands)
- WPD (East Midlands)



- One of the largest investor-owned companies in the U.S. utility sector
- 10 Million customers in the United States and the United Kingdom
- 19,000 Megawatts of generation capacity
- More than 30 power plants and more than 500,000 miles of power lines
- PPL has evolved from a small, regional Pennsylvania utility to a diverse, international energy company.
- 17,000 employees are focused on satisfying customers, delivering value for shareowners and personifying the concept of continuous improvement. 17 JDPower awards

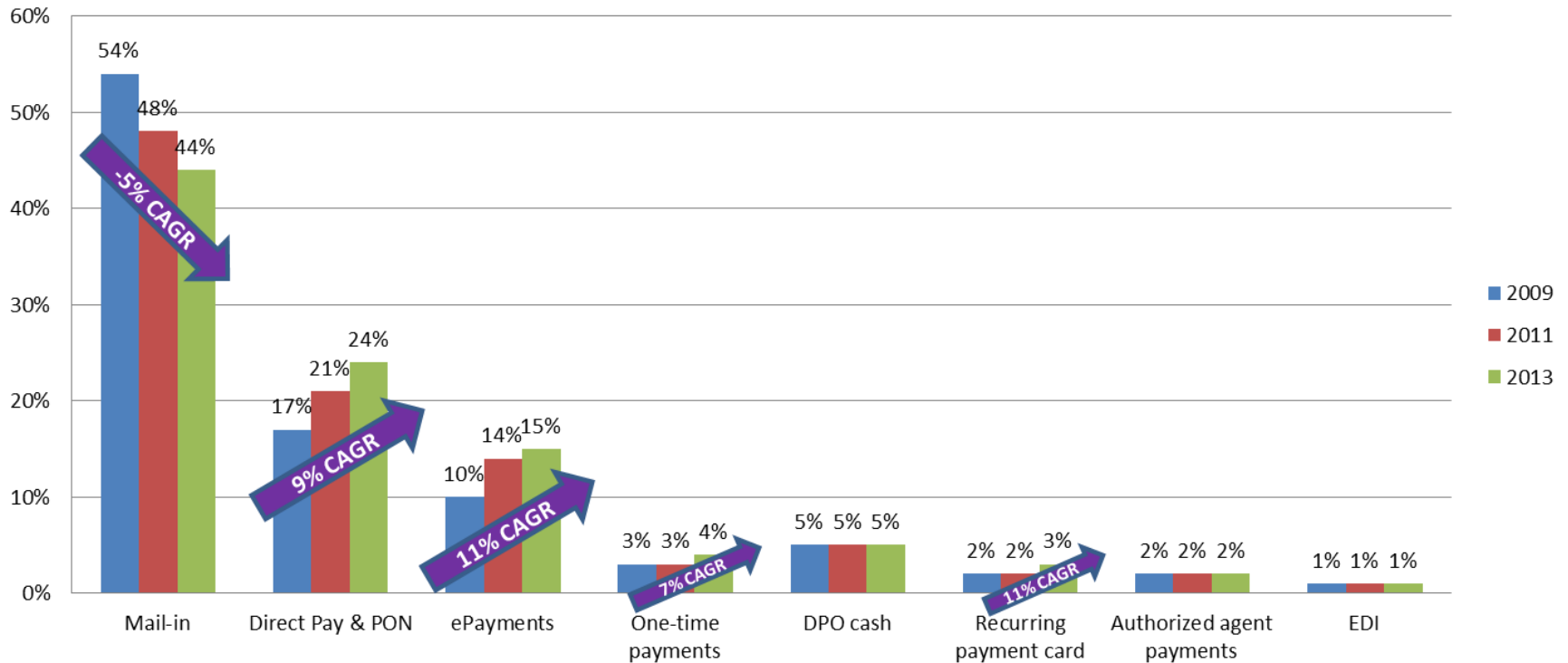
PPL Electric Utilities

- Serving 1.4 million customers in 29 central and eastern Pennsylvania counties.
- Employing nearly 2,300 people
- Maintaining 50,000 miles of power lines — enough to circle the globe twice.



Remittance Processing Overview

PPL Customer Payments Growth by Type: 2009-2013



Decision to go all Image

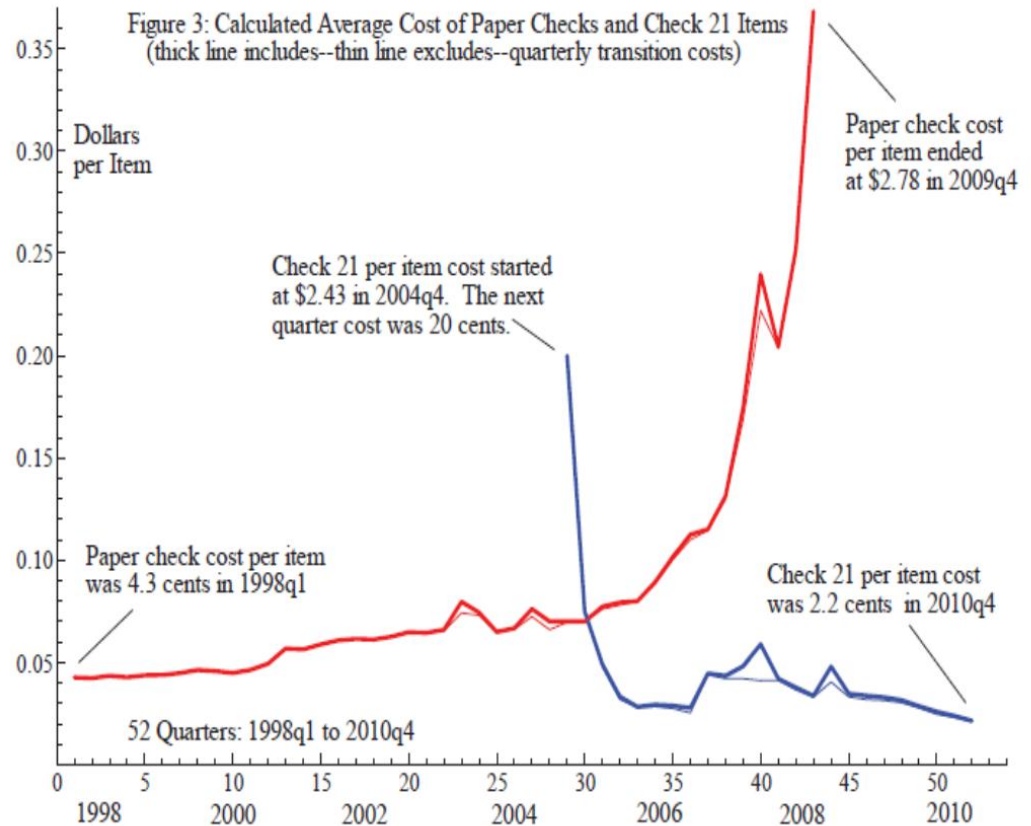
- **2011 evaluated ARC or ICL for all mail-in check payments**
- **ICL proved to be the better decision**
 - Funds are available same day (ARC provided next day availability)
 - PPL processes various types of payments which are not acceptable in the ARC process requiring two payment processing streams.
 - PPL processes in excess of 100,000 money orders per year. These are not acceptable in the ARC process.
 - In addition to residential customers PPL also services C & I customers who remit business checks which are sometimes over the threshold of \$25K which cannot be processed in ARC.
 - Our remittance processing area also processes payments for other business lines within PPL which service large C & I customers.
- **ARC's Opt-Out / Notification requirements**
 - We would have had to set up a process on our statements to notify the customer.
- **Cost associated with increased customer service inquiries**

The shifting sands of costs

- Prior to ARC, ACH processing costs were lower than check
- ARC provided economies of scale driving ACH costs even lower
- Check 21 initially caused an overall increase in check processing costs
- Full implementation of check imaging (2010) ushered in dramatic cost reductions in check processing
- ACH costs have been on the rise primarily due to credit, regulatory and compliance costs
- Shift of ACH from ARC to WEB also attributed to compliance costs

The promises of Check 21 are being realized

- Over 70% reduction in per unit check costs
- \$1.2 Billion in direct cost reductions annually since 2010 to the payment system
- \$1.37 Billion in annual savings for business
- \$.64 Billion in annual savings for consumers

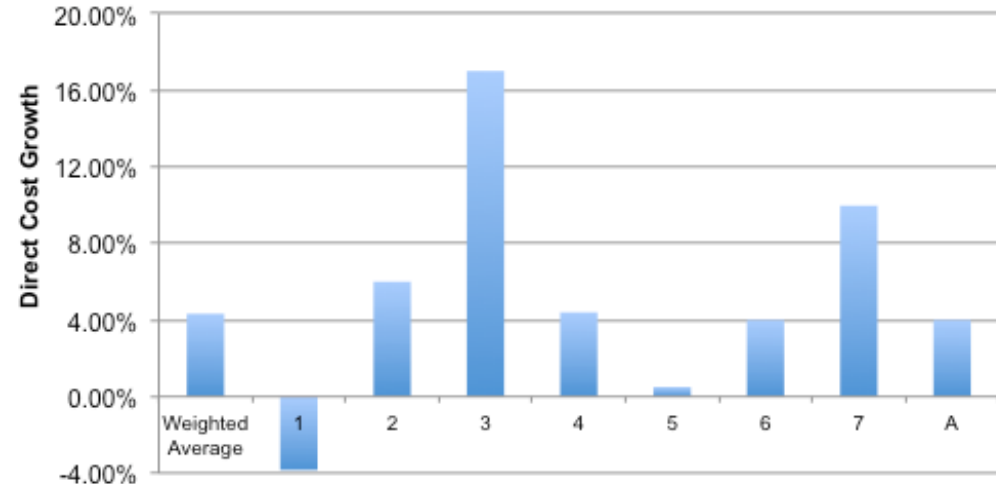


SOURCE: Philadelphia Federal Reserve, May 2012, Working Paper No. 12-12, Getting Rid Of Paper: Savings From Check 21

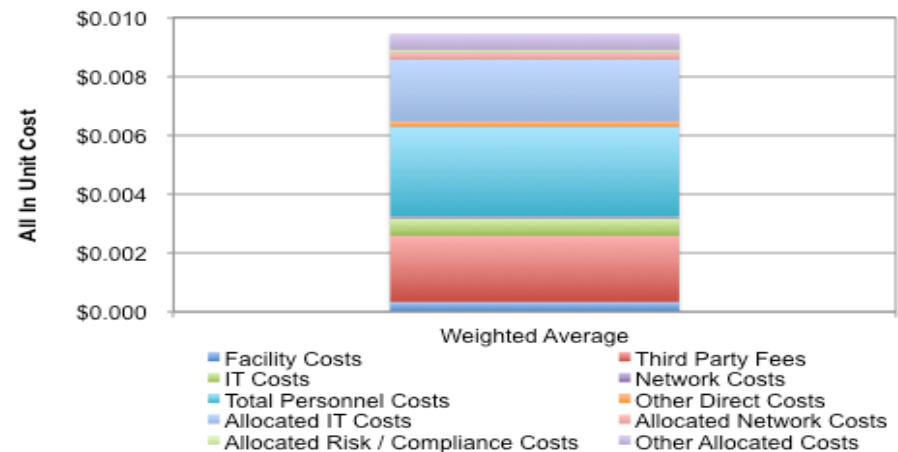
ACH costs low, but rising

- Average CAGR of 5.1% direct cost growth across tier 1 and tier 2 banks
- IT and personnel costs comprise the largest portion of fixed costs.
- Risk and compliance are receiving increased attention across banks:
 - ACH staff dedicated to compliance, OFAC, Reg E claims, returns and exceptions.
 - Across banks, the consumer claims process is typically managed within ACH operations, with a few banks managing the process in consumer or DDA fraud groups.

Year Over Year Direct Cost Growth



Composition of All In Unit Cost



SOURCE: Treasury Strategies, August 2012, ACH Cost Benchmark Study

Impact to pricing

- ACH pricing has remained flat for over 10 years – Phoenix-Hecht Blue Book average list for Originated Debits is \$.13 with an average discount of 39% in 2002 and 58% in 2012
- Image check clearing pricing has come down significantly in recent years. Phoenix-Hecht Blue Book average list for Image Clearing is \$.073 in 2007 with average 12% discount and \$.05 in 2012 with average discount of 20%
- We are seeing pricing for large retail lockbox ICL applications around \$.008 and \$.02
- Market pricing for ACH debits ranging from \$.004 to \$.03

Update your facts

- Verify that your current pricing is based on current cost environments
- Analyze the impact of controllable float
- Review original business case operational components - were they favorable toward the move to ARC or not favorable? If not favorable, has the operational environment changed in any way?
- How are other payment channels impacting your per unit check costs?