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

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

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

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

0 500 1,000 1,500 2,000 2,500 3,000
0% 5% 10% 15% 20% 25% 30% 35%


Biller adoption (%)

ARC volume (million)

Biller Adoption  ARC Volume

AFP® Annual Conference
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?
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%

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

<table>
<thead>
<tr>
<th>Considerations</th>
<th>Compared to checks</th>
</tr>
</thead>
<tbody>
<tr>
<td>Return rate</td>
<td>~30% reduction</td>
</tr>
<tr>
<td>Predictability of returns</td>
<td>Settlement +2 vs. 3-5 days</td>
</tr>
<tr>
<td>Clearing fees</td>
<td>[need metrics]</td>
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<tr>
<td>Float</td>
<td>Depends on geography</td>
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<tr>
<td>Cost of returns processing</td>
<td>Full automation of ACH returns</td>
</tr>
<tr>
<td>Potential consolidation of processing sites and bank relationships</td>
<td>Depends on geography</td>
</tr>
</tbody>
</table>
### Offset by some negatives

<table>
<thead>
<tr>
<th>Considerations</th>
<th>Relative influence</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Ineligible items</strong> (bus. checks, demand drafts, c. card, money orders, etc.)</td>
<td>![High]</td>
</tr>
<tr>
<td>Administrative returns</td>
<td>![Low]</td>
</tr>
<tr>
<td>Opt-out provisions</td>
<td>![High]</td>
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<tr>
<td>Notification requirement</td>
<td>![High]</td>
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<tr>
<td>60-day consumer right of return provision</td>
<td>![Low]</td>
</tr>
<tr>
<td>Dual workflow (statements, return, posting, reconciliation)</td>
<td>![High]</td>
</tr>
<tr>
<td>Increased check clearing costs</td>
<td>![Low]</td>
</tr>
</tbody>
</table>
My, how things have changed!

<table>
<thead>
<tr>
<th>Considerations</th>
<th>Then</th>
<th>Now*</th>
</tr>
</thead>
<tbody>
<tr>
<td>Fewer returns</td>
<td>☺</td>
<td>☀</td>
</tr>
<tr>
<td>Predictable returns</td>
<td>☻</td>
<td>☀</td>
</tr>
<tr>
<td>Reduced clearing fees</td>
<td>☻</td>
<td>☀</td>
</tr>
<tr>
<td>Float gains</td>
<td>☀</td>
<td>☺</td>
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<tr>
<td>Reduced cost of returns processing</td>
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</tbody>
</table>

* 100% ICL environment

![Positive](image.png) ![Negative](image.png)
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

• 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

- Mail-in: 54%, 48%, 44% (9% CAGR)
- Direct Pay & PON: 21%, 21%, 17% (9% CAGR)
- ePayments: 14%, 15%, 10% (11% CAGR)
- One-time payments: 3%, 3%, 4% (7% CAGR)
- DPO cash: 5%, 5%, 5%
- Recurring payment card: 2%, 2%, 3% (11% CAGR)
- Authorized agent payments: 2%, 2%, 2%
- EDI: 1%, 1%, 1%
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

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.

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?