

As Paper Dies...

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Since 2003, the number of electronic transactions in the United States has surpassed those made by paper check, with more than 18 billion electronic payments being made in 2007, a 12.6 percent increase over 2006.* And, there's no going back as electronic payment volume continues to double every five years.*

At face value, this is good news, indicating that the U.S. payments industry is moving toward a state of increased efficiency and cost effectiveness inherent in electrification. But what does it mean to cash management banks whose businesses have traditionally been heavily entrenched in the world of paper payments or to banks hoping to diversify revenue by introducing cash management services?

According to industry consultants at Treasury Strategies, Inc., (TSI), much depends on how these banks react to the current environment. Those that cling to the status quo in terms of the scope and delivery methods that support their treasury solutions may struggle to justify a cash management business line to their senior management. However, those nimble enough to “reinvent” themselves will be better able to survive and, in fact, may actually thrive in the long term.

As a bank's business strategy evolves, many see outsourcing as an increasingly attractive option for initially penetrating the cash management business or for fortifying their current position.

Current Providers Feel the Pinch

With healthy revenue rates that hovered between 6 and 7 percent for more than a decade, cash management was the firm favorite of many banks. They invested heavily in the prerequisite technology, expertise and infrastructure needed to support their check and remittance processing capabilities, using demonstrable ROI figures as justification. Then, things changed rather

suddenly as growth dipped into zero-to-negative territory somewhere around 2003.

After several lean years, the US cash management business appears to be experiencing a solid recovery, with reported revenue growth of 6% in 2006. This rate was double the 3% increase recorded for 2005.**

Still, banks don't want to exit the business. They clearly recognize that customer demand for cash management services is still high and even growing within some areas. Driven by increased regulatory oversight surrounding financial reporting, growing concerns about fraud control and an appetite to save money by using electronic services, companies are still eager to work with a bank that can help them address these issues — and suggest new innovative solutions that penetrate deeper into the realm of working capital management.

Banks with traditional business models are, however, clearly feeling the pinch — and facing some difficult decisions. Out of necessity, most have set high standards for their cash management business lines. In the world of paper payments, as cost per item is rising, so are the expenses associated with the associated technology that is now a “given” in most customers' minds. And, feeding the machine isn't quite as easy as it used to be. The continuous and often sizeable expenditures needed to support top quality cash management services are harder to justify as fewer paper items enter the payment stream. As a result, core service offerings that center on paper payments — such as lockbox, disbursements, check processing, check issuance and positive pay/payee — may no longer be delivering the attractive margins that banks have come to rely on to bolster their income statements.

Banks that offer remittance processing services face some particularly challenging issues. Infrastructure and technology investments are particularly steep in the collections arena and business customers have come to rely on efficiency-boosting enhancements such as Intelligent Character Recognition (ICR), Optical Character Recognition (OCR) and image as givens. Likewise, on the disbursements side of the business, companies expect their providers to continue to invest in areas such as fraud prevention to keep pace with the ever-increasing and ever-changing problem of check and electronic payment fraud.

With business customers hungry for ongoing enhancements that will assist them in their efforts to reduce costs, support risk mitigation, and boost efficiency, bank executives are looking for new strategies that will enable them to continue to offer quality services while also maintaining profitability. In the words of TSI, they seek to “reinvent.”

Reinventing the Cash Management Business

A leading cash management provider, The Bank of New York Mellon Treasury Services has taken an innovative approach to fortify its position in the industry — and in the process is also assisting dozens of other banks in their efforts to weather the storm.

In addition to pursuing a traditional business model where it offers a full suite of cash management services to its corporate and institutional customers, The Bank of New York Mellon Treasury Services also operates a private-label outsourcing business through its BNY Mellon Enterprise Cash Management group (Enterprise). Via Enterprise, other financial institutions can supplement cash management offerings by drawing on The Bank of New York Mellon's expertise, product suite, technology and infrastructure — but with little investment required.

Michael Cross, Director of Marketing for The Bank of New York Mellon Treasury Services, says that today's environment means the time is right for outsourcing. Cross asserts that, “The state of the cash management industry is challenging for financial institutions of all sizes. Many times, those that have already invested

heavily in their cash management businesses are having a hard time justifying ongoing expenditures to their management. Enterprise's private-label solution may help by significantly reducing the need for expenditures on technology and enables these banks to expand their geography and/or their suite of services. It also provides the marketplace transparency that many banks seek if they want to maintain or build their own reputations.”

Banks Seeking a New Revenue Stream Have Affordable Options

Like their larger counterparts, small to midsized banks that have been considering entry into the cash management marketplace may be somewhat reluctant to follow through on their plans given current market conditions. But not having a cash management solution in place can be an issue. Business customers routinely need such services — and may like the convenience of consolidating relationships. So for these banks, private-label outsourcing presents a viable solution from both a proactive and defensive perspective.

According to Cross, “Banks that aren't currently in the business may perceive a variety of obstacles. Upfront investments in technology, overcoming the learning curve to establish required expertise, the expense of marketing their new services — all of these things can seem formidable to financial services providers who struggle to expand their capabilities while demonstrating ROI. Again, Enterprise has alleviated many of these concerns for our bank customers. We operate much like a shared service center where we spread the cost for our cash management services and technology across our entire client base. Banks don't have to make huge upfront investments and can maintain reasonable costs based on their business customers' usage ongoing.”

Expenses specifically related to marketing, for instance, may be daunting to a bank just starting out. To address this concern, Enterprise offers a wide range of assistance in the form of ready-made brochures and presentations that its bank customers can access online and appropriately brand to support their sales efforts. Training materials are also available to help bank employees increase their knowledge of the new products and services in their portfolios.

Overcoming Perceived Show Stoppers

In The Bank of New York Mellon's experience, there are a handful of issues that routinely surface when banks evaluate impediments to outsourcing. One is confidentiality — especially since The Bank of New York Mellon is itself a provider of cash management services. For this reason, Enterprise is operated as a separate business unit within the organization. While it draws on The Bank of New York Mellon's technology, operating sites and set of products/services, it also has its own Product Management, Sales and Client Support organizations and has established processes to segregate customer information from the corporate side of its business.

Second, some banks are often reluctant to disclose that they are enlisting support and resources from a competitor through an outsourcing arrangement. Again, Enterprise responds to these concerns through the “private label” aspect of its outsourcing solution, which gives its bank customers the option to rebrand its services for their own marketplace and to keep its relationship with The Bank of New York Mellon behind the scenes. The best example of this measure is apparent in Enterprise's EnternetBank® Web-based information reporting and transaction initiation service, where screens can be customized to reflect the corporate identity of the bank customer.

Finally, some banks fear loss of control over the cash management services provided to their customers and associated confidentiality. In Enterprise's case, these concerns are addressed through a combination of close ongoing communication and the development of Service Level Agreements that outline performance expectations upfront. Strict project management guidelines and standard procedures are used to control the flow of customer information, and frequent communication between the outsourcing bank and its provider is also important to both parties.

Conclusions

In an era where declining revenue rates and diminished paper transaction volumes weigh heavy on the minds of many bank executives, business customers still expect their banks to offer top quality cash management services. Banks don't want to lose business — but at the

same time, they struggle to justify the significant ongoing investments needed just to maintain their cash management businesses at their current levels, let alone expand and improve them.

If your bank is currently in the cash management business or considering entering the cash management business, private-label outsourcing may be one alternative you want to investigate in your efforts to “reinvent” your business. Through private-label outsourcing, many banks have already discovered a way to derive new or invigorate existing sources of fee-based revenue and balances.

Why Outsource Cash Management?

Declining volumes of paper payments and the rising cost of technology are combining to drive up cost-per-item in the typical check processing environment. Outsourcing cash management is a viable remedy to this undesirable situation for many reasons:

- It eliminates the need for ongoing investments in technology while giving banks access to current functionality.
- Cost-per-item is reduced because the outsourcer is able to price its processing based on the combined volume it attains from all of its banks' business customers.
- The need for other investments in infrastructure (e.g., processing facilities) is eliminated.
- Marketing expenses can be greatly reduced if the outsourcer provides standard off-the-shelf materials that can be customized to reflect a bank's own identity standards.
- Staffing is handled by the outsourcing provider, who is in a position to adjust for peak/slow periods.
- Banks can expand their territories or range of services without experiencing the complexities or long-term commitment inherent in an acquisition.

About BNY Mellon Enterprise Cash Management

BNY Mellon Enterprise Cash Management is a business unit of The Bank of New York Mellon Treasury Services. For nearly two decades, Enterprise has provided cash management services to financial institutions of all sizes under a convenient private-label arrangement that provides access to leading B2B/B2C receivables, disbursement, information reporting and data exchange services.

Enterprise's goal is to help your bank implement and/or expand its cash management offerings to:

- strengthen relationships with your business customers;
- increase fee-based revenues; and
- diversify income through the collection of referral and transaction fees.

At your discretion, you can choose to actively market the cash management expertise, resources and capabilities you gain via your Enterprise relationship. Or you can take full advantage of our private-label capabilities through an arrangement that is transparent to the marketplace.

In either case, Enterprise's leading treasury capabilities are supplemented by a full range of support services, including training, marketing support and skilled implementation management services.

Unlike other outsourcing providers that are not affiliated with a financial services provider, Enterprise combines the strength, reputation and resources of industry leader, The Bank of New York Mellon, with the hands-on outsourcing expertise we have provided to banks of all sizes and located worldwide.

Find out more about BNY Mellon Enterprise Cash Management at www.bnymellon.com/ecm or by calling **1 800 424 3004** (Option 2).

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*NACHA — The Electronic Payments Association, May 2008.

**24th Annual Ernst & Young Cash Management Survey, 2007 Participant Report.

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