4th ANNUAL

ALABAMA TREASURY MANAGEMENT ASSOCIATION SUMMIT

SUMMIT 2014

atma

Reaching New Heights

SEPTEMBER 25

NOTHING IS PERMANENT EXCEPT CHANGE

Mark Bourn

Senior Vice President, Hancock Bank

Agenda

- A look back at how cash management services and practices evolved, changed, and then changed again
- A look forward to how cash management services and practices might continue to evolve and change
- Discussion – What do YOU think?

Once Upon a Time

I would like to start using ACH.

ACH? What is it? How do you spell it?

Business Customer

Banker

Then...

I would like to start using ACH.

What have you been waiting for? We have PLENTY of ACH!

Business Customer

Banker

Now

I would like to start using ACH.

Well, I don't know … We're going to need financials.

. . . and the title to your building.

. . . and a blood sample.

Business Customer

Banker

What Happened?

- A generation ago, ACH was an unknown to the banker.
- Usage was not widespread until Social Security adopted ACH as their preferred distribution method.
- But even then, adoption of ACH Origination among companies was slow.
- The technology of the time was cumbersome, and mysterious to the banker in the field.

What Changed?

- **Understanding increased about the benefits of ACH – efficiency, convenience, cost savings**
- **Technology improved and became simpler.**
- **The development of Software-as-a-Service (SaaS) for banking systems enabled banks of all sizes to become providers.**

What Changed?

- **Massive education and marketing initiatives by NACHA, the Fed, and the Banks heightened awareness.**
- **Banks developed Treasury Management teams as subject matter experts to assist bankers in communicating about "complex" services such as ACH to clients.**

Why Did It Cool?

- **Well, "cool" might not be the right term.**
  - ACH Origination is still an efficient and cost effective payment method.
  - Your bank wants you to use it.
  - There are compelling reasons to settle many types of payments by this method.
- **But you've probably noticed your bank has become more cautious. Let's look at the reasons why.**

Why Did It Cool?

- **Losses started to occur, focusing banks' attention on the credit risks inherent in ACH Origination.**
  - If you issue payroll checks and your account is insufficient, your bank can dishonor those checks.
  - But when ACH payroll credits settle, your bank is already on the hook for the funds.
- **For years, banks did not recognize this risk.**
  - ACH Origination could be offered only to the very largest companies, and the prospect of insufficient funds hardly seemed real.
  - As the user base broadened, the NSF risk became very apparent and banks had to start considering the impact of losses within the economic model for ACH.

Why Did It Cool?

- **ACH users became a target of fraud.**
  - Phishing schemes tricked users into revealing their login credentials
  - Keyboard Logging viruses revealed login credentials through automated means.
  - High quality Spoofing of legitimate websites harvested login credentials in live sessions.
  - Man-in-the-Middle attacks thwart even strong authentication methods.
- **Assessing a company's commitment to security best practices became a part of evaluating each potential ACH user.**

Why Did It Cool?

- **The review of customer approval procedures and the setting of exposure limits became topics of greater scrutiny by bank examiners.**

Now What?

- The benefits of ACH to corporate users, consumers, and banks remain compelling.
- Over 21 billion ACH transactions settle each year, representing over $37 TRILLION in value.
- There's no turning back.

Now What?

- **But . . .**

- **Banks are required by regulation and ever tightening policies to continually evaluate the financial viability and operating practices of their ACH Originators.**

- **Due diligence to ensure integrity, privacy, and security has entered the equation at a healthier level than in the past, and will remain there.**

- **Your bank will continue to be all up in your business more than you want and more than they want.**

Oh, and about Remote Deposit . . .

- **OK, so we're all up in your business about ACH.**
- **But at least there is settlement risk and credit risk there.**
- **Why do we pester you as much – or more – about Remote Deposit?**

A Brief History About Remote Deposit . . .

- Remote Deposit came about because of the Check Clearing for the 21st Century Act (“Check 21”).
- Check 21 came about because of 9/11. When the planes stopped flying, the checks stopped clearing.
- Everyone – even Congress – was able to figure out that even a short interruption in airline traffic represented a big risk to the interbank settlement of checks and a huge potential for economic disruption.
- So now your checks clear electronically.

It Was a Win/Win. . .

I would like to start using Remote Deposit.

GREAT! You won't have to drive to the bank, you'll have a later cutoff and a permanent record of your deposits, and everything clears in a day.

Business Customer

Banker

But Then. . .

I would like to start using Remote Deposit.

Where did you get the checks? Are you storing them securely?

You know, we can't just let you go around putting money in our bank.

Can I see?

Business Customer

Banker

What Happened?

- **Why did banks get mean about such a simple and beneficial process?**
- **In a word . . . Regulation.**
- **In two words . . . Overzealous Regulation.**

Washington Is Turning Bankers into Busybodies: ICBA's Cam Fine

SEPTEMBER 11, 2014

The head of the Independent Community Bankers of America says the government has gone too far demanding banks act like law enforcement.

What Happened?

- **What are the regulators afraid of?**
  - If you deposit more than is "normal," they think you might be running an illegal shadow business on the side.
  - They think someone in your company will find the checks and steal confidential information off of them.
  - They think you will deposit the checks electronically and then take them to the bank and deposit them physically.

SUMMIT 2014 atma Reaching New Heights

What Happened?

- **What do the regulators want your bank to do?**
  - They want your bank to establish a limit for how much you can deposit.
  - They want your bank to audit you or survey you to determine:
    - Do you store the captured checks securely and ultimately destroy them completely?
    - Do you limit the number of people who can operate the scanner?
    - Do you follow security best practices over your computers?
  - They want your bank to monitor your account for disproportionate return item activity.

What Now?

- For now, the regulatory arc still has an uphill slope – we probably won't see a return to reason in the near future.
- Your bank will be as non-invasive as possible, but if you use Remote Deposit – AND YOU SHOULD – you can expect to hear from them from time to time to take a look at that part of your relationship.

Once Upon a Time…

Let me tell you about Lockbox

Banker

Get Lost!

Business Customer

- That’s something banks force on weak credits.
- I don’t want my customers thinking I can’t pay my bills.
- That’s not my address!

Then…

Let me tell you about Lockbox

I love You!

Business Customer

Banker

- Look how quickly I get my money!
- This reduces my workload!
- I don’t have to hire extra people to achieve separation of duties.

Then…

Let me tell you about Lockbox

Get Lost!

Business Customer

- Checks are going away.
- It’s eCommerce all the way for me, buddy.
- Lockbox is on it’s last legs.

Banker

Then…

Let me tell you about Lockbox

I love You!

Business Customer

- You mean I can review my payments same day?
- And post them from data instead of manual entry?
- Ooooo, pictures!

Banker

What Now?

- **Will Lockbox be a viable cash management tool in the future?**
- **To determine that, you have to examine the reasons why its future is in question.**
- **Start with the fake reason:**
  - **Interest rates declined to the point where accelerated cash flow lost much of its value.**

What Now?

- **Why is it false to believe that a decline in the time value of money could kill Lockbox?**
  - Well first – remember Heraclitus? Nothing is permanent except change, and rates will change again.
  - And second, time value of money is not the only benefit of Lockbox.
    - You still get segregation of duties.
    - You still get workload reduction.
    - You still get to restore availability on working capital lines of credit by accelerating payment.
    - You still get a facilitated Accounts Receivable posting process.

What Now?

- **So what are the REAL reasons to question the future of Lockbox?**
  - **First, you receive a lot of checks, but you're also receiving payments through electronic and card channels.**
  - **Second, traditional Lockboxes have narrowly focused on just two components of the Accounts Receivable process.**

What Now?

Let me tell you about ~~Lockbox~~ Receivables Management

Banker

- So, no. Traditional lockbox won’t remain viable.
- EXCEPT . . . As a component of a comprehensive approach to Receivables Management.
- This approach must recognize and accommodate your receipt of payments through multiple channels and in multiple formats.

Where Do We Go From Here?

Billing → Alternative Payments → Mailed Payments → Stranded Payments → Posting

Billing
- Traditional delivery
- EBPP

Alternative Payments
- ACH
- Wire Transfer
- Internet
- Card

Stranded Payments
- Street Address Receipt
- Lockbox Rejects

Where Do We Go From Here?

Billing

A
P

Stranded Payments

Posting

1. You Getting Paid

Once Upon a Time…

- You took it as given your bank was safe and sound.
- You liked your bank, and didn't have to click on anything to do so. 
- You chose your banks by logic –
  - Do they have the services I need and perform them well?
  - Are they responsive?
  - Are they reasonably priced?
  - Are they convenient?
- You didn't ask, "Are they going to fail?"

What Happened?

2008 Happened. Remember the headlines?

The New York Times

Bank Losses Predicted to top $700 Billion

The Washington Post

Bank Failures Higher Than During Great Depression

What Happened?

THE WALL STREET JOURNAL.

Capital Erosion at Largest Banks Called Catastrophic

NATIONAL ENQUIRER

Bat-Faced Boy Terrorizes Neighborhood

Where Do We Go From Here?

- **Safety and Soundness cannot be assumed – They have to be actively sought.**
- **Banks have a #1 Rule**
  - Know Your Customer
- **Customers Need a #1 Rule, too.**
  - Know Your Bank

Where Do We Go From Here?

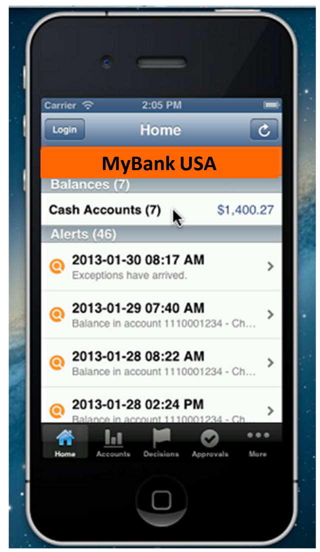
- **Safe banks all have one thing in common – They behave safely, in ways that can be observed or verified.**
  - Is your bank well capitalized?
  - Does your bank have a strong credit rating?
  - Does your bank appear to be doing business in a normal way?
  - Is your bank involved in the community?
  - Does your bank have an effective Business Continuity Plan?
  - Is there a lot of turnover at the bank?
  - Does your bank update its product offering from time to time?
  - Does your bank over-concentrate its lending in a single market segment?
  - Does your bank provide speakers for Treasury Management functions?

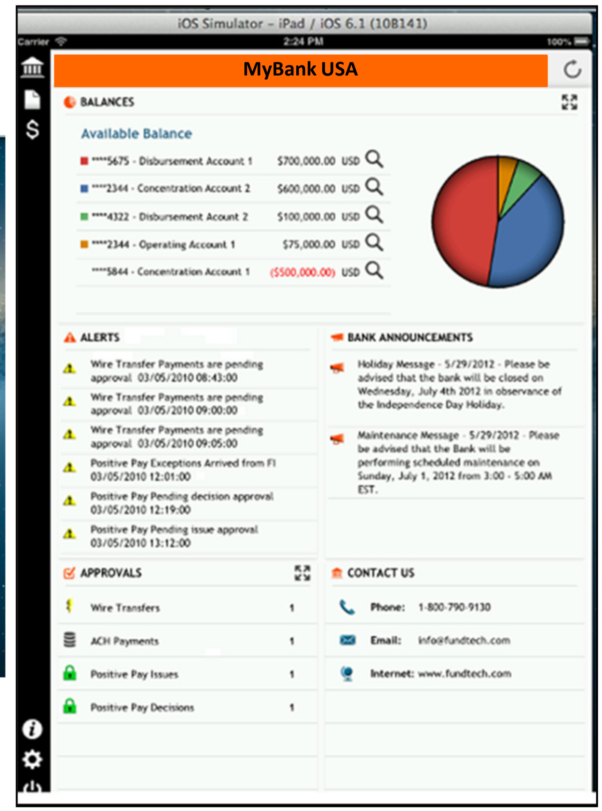
Enough of Once Upon a Time

What does the future look like?

You're Going Mobile, If You Haven't Already

- **Online banking tools will be extended to your smart phones and tablets.**
- **You will be able to monitor account activity, approve wire transfers and ACH batches, and conduct other important business functions wherever you are.**
- **. . . Further eroding your vacation time and driving a wedge between you and your family.**





You're Going to Be a Target of Crime

- Attempts to steal money from companies using online banking applications continue to grow. These are well funded initiatives by organized crime syndicates in all parts of the world.

- Yet most financial fraud does not occur through online banking. According to the Association for Financial Professionals, in 2013 57% of fraud losses came through check fraud.

You're Going to Be a Target of Crime

- Do those things your bank has always asked you to do:
  - Use Positive Pay.
  - Use ACH blocking or filtering.
  - Set up online banking alerts to notify you about outbound wire or ACH activity.
  - If your Administrator is also a User, establish different login credentials for each role.
  - Use strong passwords.
  - Use the multifactor authentication method offered by your bank, be it a token, out of band authentication, or other methods.
  - Beware of unexpected email that prompts you to click on a hyperlink.
  - Monitor account activity promptly and report unexpected transactions to your bank immediately.
  - Buy financial fraud insurance.
  - Establish dual control over transaction functions such as wire transfer and ACH.
  - Limit internet access to business purposes.

You’re Going to Be a Target of Crime

- But those things won’t be enough. So look into new protective techniques and deploy the ones that work in your business environment.
  - Secure browsers that allow navigation only to pre-approved sites.
  - Software specifically designed to detect and remove malware that bears the characteristics of financial fraud malware.
  - Virtual keyboard applications to prevent key-logging.
  - Dedicated computers for financial applications, with no email or general internet browsing allowed. Fraud is expensive; Computers are cheap.

You're Going to Change the Way You Make Payments

- You're going to hear a session later today on new methods for processing payments, so for now let it suffice to say that the way you've always done it is too expensive for you.
- The manual exchange of invoices and payments is a hindrance, and methods to automate and improve these processes are available.
- So stay tuned.

Remember Regulation Q?

- **The regulatory restriction against paying interest on corporate demand deposits was repealed last year.**
  - Nothing happened.
  - Does that mean it was a non-event?
- **No.**
  - Repeal occurred at a strange time, during historically low interest rates.
  - Your banks are ready with interest bearing corporate products, but so far there is not enough earnings potential to catch your eye.
  - Most analysts believe interest rates will begin to rise by this time next year and continue on a slow upward trajectory over several quarters.
  - Delivering monetary value through earned interest will be revived as one of the many ways in which your corporate treasury function provides benefits to your company.

Are Sweep Services Going Away?

- **Probably not, although they will certainly change.**
- **You'll probably see less focus on Repurchase Agreements.**
  - During the economic downturn of which banking was so much a part, there were actually banks that had gains in their investment portfolios that would have helped them weather the storm better. But they often could not harvest those gains because the securities were locked into Repo Sweeps.
  - All banks have investments as a component of a well-balanced asset base, but some banks will find that maintaining a larger portfolio than they normally would to support Repo Sweeps is not a workable business model.
  - Besides, we've already established you are going to seek out only the safest banks, right?
- **You'll probably see less focus on offshore deposits.**
  - That was always artificial, driven primarily by the need to navigate around Reg Q.
  - Expect sweeps to swing toward domestic interest-bearing accounts.

Are Sweep Services Going Away?

- **You'll probably see more focus on Line of Credit Sweeps.**
  - You'll drive this – Remember that a rising rate environment impacts your borrowing cost and not just your interest earning opportunity.
  - Automating the management of the line will serve to reduce the impact of rising rates.
- **Let's go back to the depository side . . . Why sweep at all?**
  - Logically, with Reg Q gone, banks wouldn't. They would just pay interest on your account. But some banks will maintain the Sweep process as a control mechanism.
  - You guys are not walk-in customers. You were actively pursued by your bank, and the rest of us would like to steal you.
  - Your bank needs a way to make sure you don't become a rack-rate customer, and for some banks maintaining the structure of a sweep process will facilitate that.
  - The sweep process also contains a target-balance control, which will be important for those of you who prefer to pay for services with balances.

I Have Just One Word for You: Plastics

- **Cards will continue their march toward a higher and better use than T&E and incidental expenses.**
- **The potential for gains in efficiency by both the buyer and seller suggest a substantial role for cards in an Accounts Payable setting.**
  - Buyers assume their suppliers will not agree to be paid for substantial purchases via a card because of the expense.
  - However, sellers have traditionally demonstrated that prompt and sure payment is worth paying for. The traditional trade term “2/10, net 30” is essentially saying “I’m willing to incur a cost of funds equal to 36.4% per annum to be paid 20 days sooner.”
  - It’s difficult to believe there isn’t enough wiggle room in the trade relationship to make card settlement mutually beneficial.

Recapping the Future

- Mobile business tools
- Cyber Crime – Here to Stay
- More automated workflows for managing Payables
- The ability for Treasury to be a revenue provider through interest on balances will be restored for the first time in over 6 years – probably through some kind of sweep mechanism
- Corporate Cards/Purchasing Cards will become more prominent in the Payments space

Discussion: Where do our views differ?

Discussion: What would you add?

Thank You