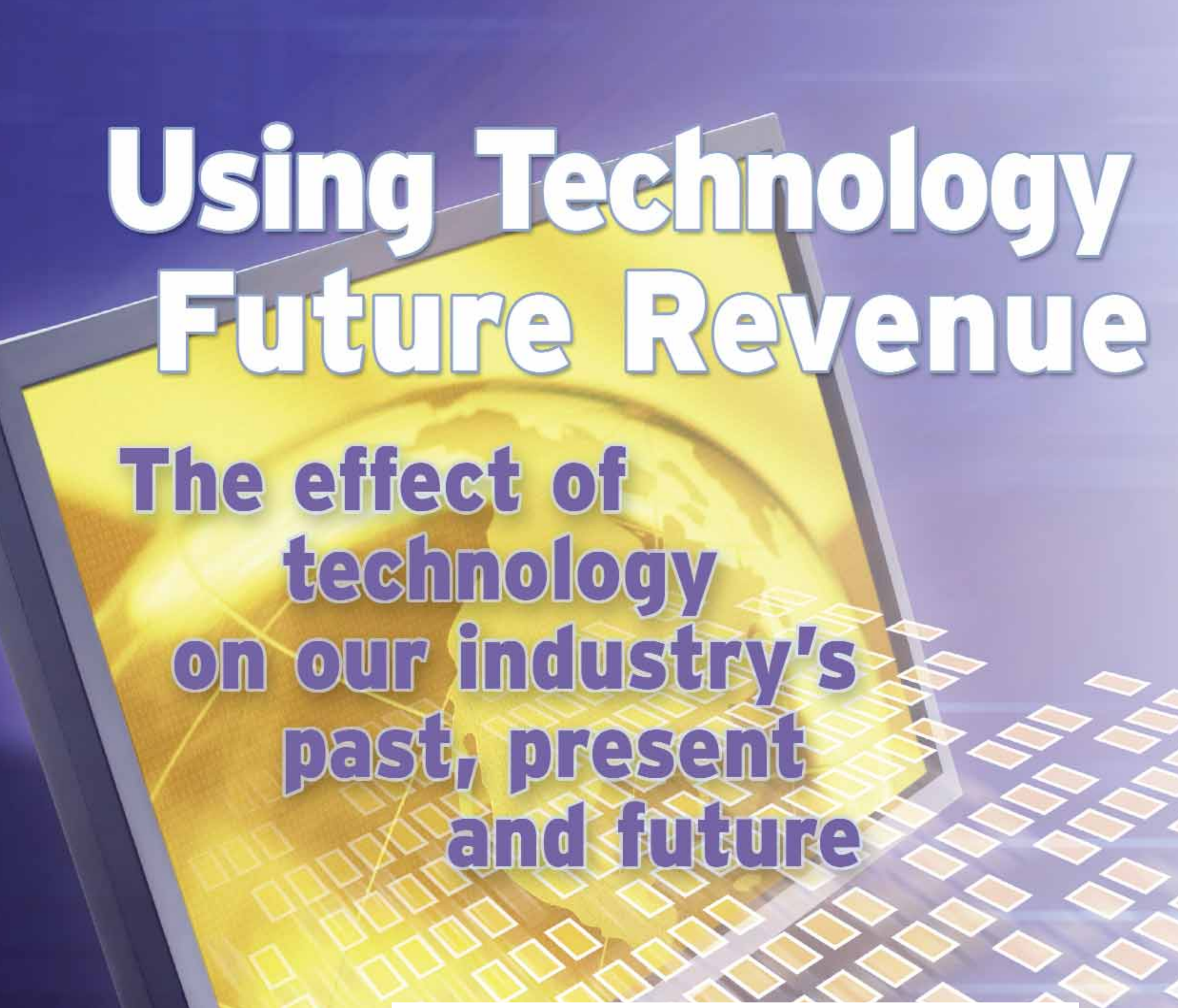
Using Technology Future Revenue

The effect of technology on our industry's past, present and future



Using the words "technology" and "future" in the same sentence brings to mind a great and intriguing unknown. We have always been fascinated by the possibilities of what it might contain, and have been limited only by our imagination when pondering the thought. No matter how old you are, you have experienced firsthand the impact of technological advances that have changed the "normal" way of going about life's business both professionally and personally.

to Develop Streams

BY CYNTHIA VEGA

And what about the financial service center industry? It has outlasted, outlived and outfoxed the "experts" who foretold our imminent demise – many years ago. Keeping this history in mind, we explore the effect of technology on the financial service center industry's past, present and future. We sought the opinions of industry experts who experienced these changes firsthand. We asked our panel to take us through where the business has been, and where it is likely to go, in terms of technology.

A BRIEF LOOK BACK

Our first step is to look at how the operations of a typical Financial Service Center, then known as a check casher, have changed over the past 10 to 20 years due to advances in technology. First, we asked Aggie Clark, President & CEO of Moneytree, Inc. about the biggest changes she had observed.

"When I started, we didn't have Internet access, we didn't have a point-of-sale computer system, we called in all of our Western Union transactions, we handwrote the transactions on the customer signature cards, and we printed our own money orders. You verified funds in most cases by talking to a person rather than listening to a machine, and most people were paid by check. ATMs weren't as popular or plentiful as they are today, and in most cases, you turned paper into cash."

Michael Hans, Director of Operations for My Checkexpress recalls, "When I started in the business, we had a few computers, a couple of printers and no Internet connection. Now there is a PC at each window, multiple printers, DVR security systems, ID scanners, and high-speed Internet connections – the list goes on and on. Check 21 and check electrification has been another big change."

And Steve Harfield, Partner at Illinois-based Community Financial Service Centers, notes, "Technology has vastly changed our ability to process bill payments. We used to have to batch, handwrite, and log them; now the system is doing it. What used to take a week now takes three to five days, and with some billers and software companies, what used to take three to five days is now instant or within a day. We're still handling the money, but the payments are going through more quickly."

"Now, in addition to turning paper into money, we turn plastic into cash, we turn cash into plastic, we turn plastic into paper, or paper into plastic (checks to debit card funds), and we electronically move funds through our wire transfer or bill-pay systems," comments Aggie Clark.

FSCS GOT ON THE INFORMATION SUPERHIGHWAY – DRIVEN BY NEED

"When I entered the financial services industry in 1998, we were just getting up and running with dial-up Internet connections at our locations," says Michael Hans. "It soon became obvious that a high-speed Internet connection would be necessary, in order to quickly and efficiently utilize the connection in our operations. We began to see many government and private entities converting existing programs to Internet-based systems. In order to continue to participate in those programs, we needed that high-speed connection at all times. From there, we had access to many products and services and could deal with vendors from around the country in order to leverage the best deal."

In addition, while the Internet has enabled operators to expand their horizons well beyond their own locale, it has also brought operators, vendors, and partners closer than ever before, explains Aggie Clark. "The Internet makes the financial services world a lot smaller than it used to be. You can research check makers from around the country with a simple Google search. You can communicate electronically to your internal teams and your external customers. It opens up marketing opportunities, new product opportunities and new delivery systems."

Technology has also expanded and enhanced customer service. As Steve Wolf of The Pay-O-Matic Corporation notes, "Another effect of technology is that most check cashers these days use teller automation, which allows the teller to spend more time serving the customer and less time doing basic bookkeeping tasks." Adds Ray Mustafa, Steve's longtime partner at Pay-O-Matic, "It also reduces their training time because of the common database used to check for bad checks."

Steve Harfield highlighted another benefit to operators; "Technology will help us recognize customers better and faster, whether it's through a thumbprint or keeping their history from the operational side."

FUTURE VISION: INNOVATIVE PRODUCTS + INNOVATIVE DISTRIBUTION CHANNELS = OPPORTUNITY FOR FSCS

And how do our experts see the industry evolving over the next ten years?

Aggie Clark proposes the idea that FSCs, who have based their past success in large part on convenience, will have to go back to that well to stay competitive. "I think our industry will need to find more ways to offer convenient financial services to our customers. Does that mean longer hours, or Internet access, or other types of virtual products? What I do know is that with a variety of payment options that people have, we have a niche in helping people turn one form of funds into another." To this she adds, "I think the

continued on page 20

Using Technology, continued from page 19

Internet is a tool that our industry will be using over the next ten years in ways we haven't even thought of yet."

While all agree that technology opens up possibilities for convenience, speed and increased product offerings, one challenge for FSCs will be to continue to offer personal and friendly service in tandem with providing the electronic options to customers. Along those lines, and given the growth of virtual banking, we asked if brick and mortar stores would become less important for the FSC industry. It all comes down to consumer preference, asserts Clark. "Brick and mortar stores didn't become less important for the banking industry, or other industries, for that matter. There are just so many more options for people. Banking is now a 24-hour per day industry. Some people prefer conducting business in person; some prefer to conduct it in a virtual setting. The challenge will be to reach customers in their most preferred method. I'm still trying to figure out a way to cash checks from around the country over the Internet."

Harfield adds, "I still believe that you've got to have that face-to-face interaction with people. I know that the industry is moving toward plastic, even including direct deposit, but with both of those products, people still want to know and trust that the money is still in their hands."

CONDITIONS ARE MOST FAVORABLE FOR FSCS TO OFFER NEW PREPAID PRODUCTS AND SERVICES, AND TO PURSUE NEW AND DIFFERENT PARTNERSHIPS TO DO SO.

Partnerships will play a large role in the future of the industry. "I see our already comprehensive menu of services expanding, and new relationships being forged with both the government and private sectors," offers Michael Hans.

According to Steve Wolf, "I think our proper role will be much more in partnership with banks, as opposed to being an alternative service to banks. We are going to provide a seamless on-ramp to traditional financial services. And, I think we will provide outreach for traditional financial institutions into neighborhoods where they might not otherwise have a brick and mortar presence. This is the single biggest area of growth for the industry."

Aggie Clark challenged FSCs to think out of the box on this concept. "New business models are exciting. They can create new opportunities, new innovations for our consumers. Banks want to reach our customers, although many of our customers are also bank customers. If they can transact more of their financial services at one time, it creates value in convenience. I'd like to turn the tables on this concept. With this type of partnership, how can we reach their customers with convenient, transaction-based financial services?"

THE WONDERFUL NEW WORLD OF PREPAID

A deeper look into their crystal balls revealed our panelists' visions of the new "technology-enhanced" products that will be offered in the near future.

Michael Hans had a very clear read. "Two products come to mind. The first is plastic (i.e., prepaid debit cards) and the second is prepaid cell phones. Prepaid debit cards have been steadily gaining in popularity and are now a very well-known product. The potential for both these products is tremendous, both in terms of revenue for an FSC and in respect to the ability to add features to the cards."

Steve Harfield saw increased opportunities for customers to pay their bills on time via debit cards and the ability to load money on cell phones and pay bills from them as well. From a consumer perspective, he too cited the increased importance of prepaid products. "You'll see customers wanting and using more of the ability to prepay products, like cellular phone service and even prepaid Internet, which is now available."

Our panel endorsed the plastic prepaid card and the prepaid market in general, both from the standpoint of current products as well as the potential offered by all things prepaid in the future. Researchers have been pointing to the tremendous growth of this market as well.

WHO'S DRIVING PREPAID GROWTH?

Consumers with weak or nonexistent banking relationships will load approximately $200 billion onto prepaid cards in 2011, a 583% jump from the amount they were projected to load in 2007, according to a report

continued on page 22

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Using Technology, continued from page 20

issued last August by Packaged Facts, a Maryland-based research firm. The report estimated that unbanked and underbanked U.S. consumers would load $29.3 billion onto prepaid debit cards in 2007, representing a 49% increase over 2006 activity. The report predicted that much of the growth would come from “significant shifts” in the financial behavior of these consumers from traditional financial services, such as money orders, payday lenders, and paper paychecks cashed at check-cashing centers, to prepaid cards.

In an interview in *Prepaid Trends* last May, prepaid expert T. Jack Williams, President of eCommLink, was asked how companies could remain competitive in this sector with the playing field growing more crowded by the day. In response, he offered up this same consumer segment. “On the bank side, it’s going to be making the decision to go after the underbanked. A lot of merchants and third parties are going after them…but the Holy Grail of this will be communication and cardholder acquisition. In this unbanked space there are new cardholders. How do you reach them? It’s going to take nontraditional means to reach them. Mail is not going to be the panacea as it is for credit. I think it’s going to take outdoor billboards, radio and Internet. One of the fallacies that people believe is that unbanked consumers have no Internet access. That’s not really true. And it may not be a bank that wins this game because a lot of these individuals don’t trust banks.”

It goes without saying that FSCs know how to reach them, providing a valuable distribution channel to potential new vendors and partners.

Williams was also asked what he saw as the greatest area for growth in prepaid. He stated that in the open-loop card arena, the greatest opportunity would be in financial services, and in providing a wide array of cards, such as payroll cards, disbursement cards, travel cards or teen cards.

When asked about the key to a successful prepaid card program, Williams replied, “Breadth of offering – being able to provide innovative offerings and being able to find the niche of the card. So, if you provide a travel card, it’s being able to provide travel-related services. If it’s a general spend card, it’s being able to provide services that a bank has. Niche marketing of services that are unique to that genre of card is going to be what drives it. What will not work in the future is a one-stop-shop, one-size-fits-all approach.”

One innovative new product that exemplifies much of the above is the On Time prepaid Visa debit card, introduced in March by Sekurus Inc., a company that offers asset-protection devices to auto lenders. The new debit card links to the On Time “starter interrupt” system. The way it works is that monthly car payments will be automatically deducted from the balance on the borrower’s prepaid debit card. If there are insufficient funds, the device will freeze the vehicle’s starter; once the customer adds funds to the prepaid balance, he will automatically get a text message delivered to his mobile phone with a code to unlock the On Time device. Market testing showed reception from both dealers and consumers to be positive. Nik Thomas, the stored value consultant for Sekurus, said, “The subprime automotive financial space is the last opportunity for a company to really make an impact in the stored-value card business. We’re first targeting the unbanked, then the underbanked, then any customer who has a device in his car.” The opportunity for FSCs here is to become reload sites for the card, like ACE Cash Express stores have already done.

The appeal of prepaid goes well beyond the card product. As Steve Harfield noted earlier, prepaid cellular products have proven to be a significant addition to the product line in his stores as well

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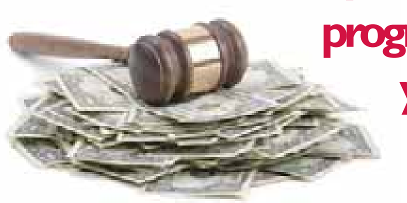

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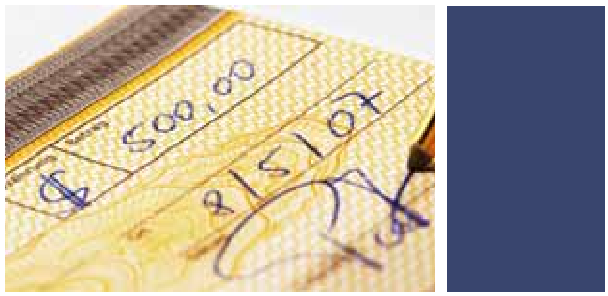

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as others. Their partner, Nationwide Cellular, LLC, based in Northbrook, IL, provides prepaid cellular services across the U.S. and says its goal is "to provide affordable cellular service to a broad customer base that might otherwise be unable to obtain quality cellular products." And now, Steve can provide the phones themselves to his customers, and support their reloads as well.

MOBILE PAYMENTS

Depending on whom you talk to, mobile payments are right around the corner – or still a long way off – from becoming an everyday consumer tool in the United States. No one debates that it will come, it's just a matter of when, and what roadblocks currently stand in the way.

For example, new research from TowerGroup suggests U.S. banks are recognizing that offering mobile banking services can help them reach new customer segments, such as the youth market and the unbanked, both of which have a strong affinity for mobility. TowerGroup believes that in 2008, mobile banking will finally emerge as a basic, necessary service for U.S. banks and therefore a "must have" in the solutions arsenals of core banking vendors.

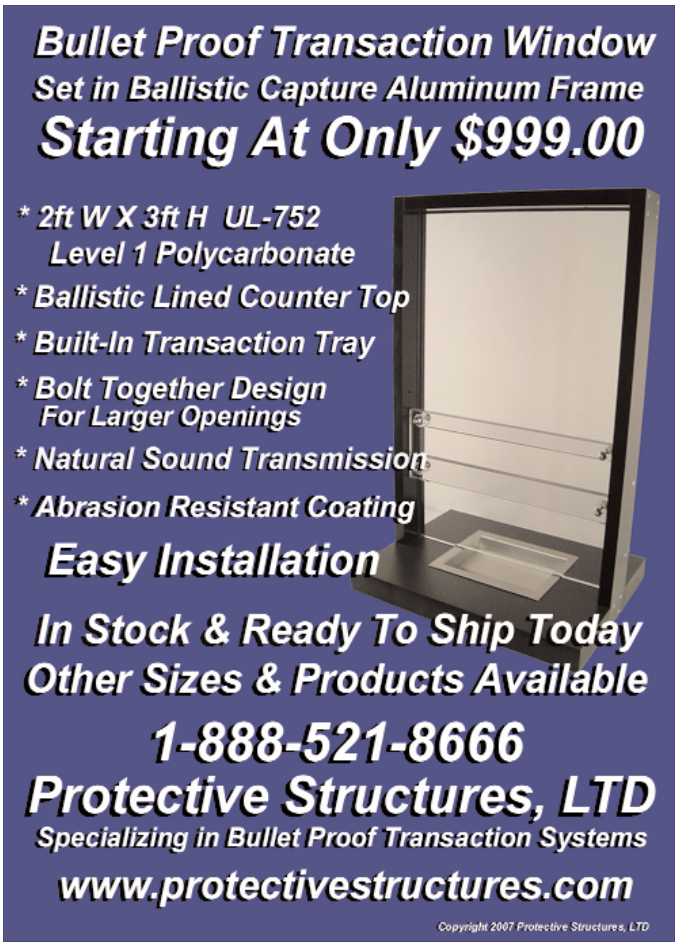
According to Boston-based consultancy Celent LLC, today only 3% of U.S. households that bank online currently also bank using mobile phones. In a recent report, Celent estimates that by 2010, some 30% of U.S. households that use online banking will also conduct some banking functions using their mobile phones, accounting for approximately 17 million households. Red Gillen, Senior Analyst at Celent asserts that before mobile payments can take off, consumers will need to grow accustomed to mobile banking.

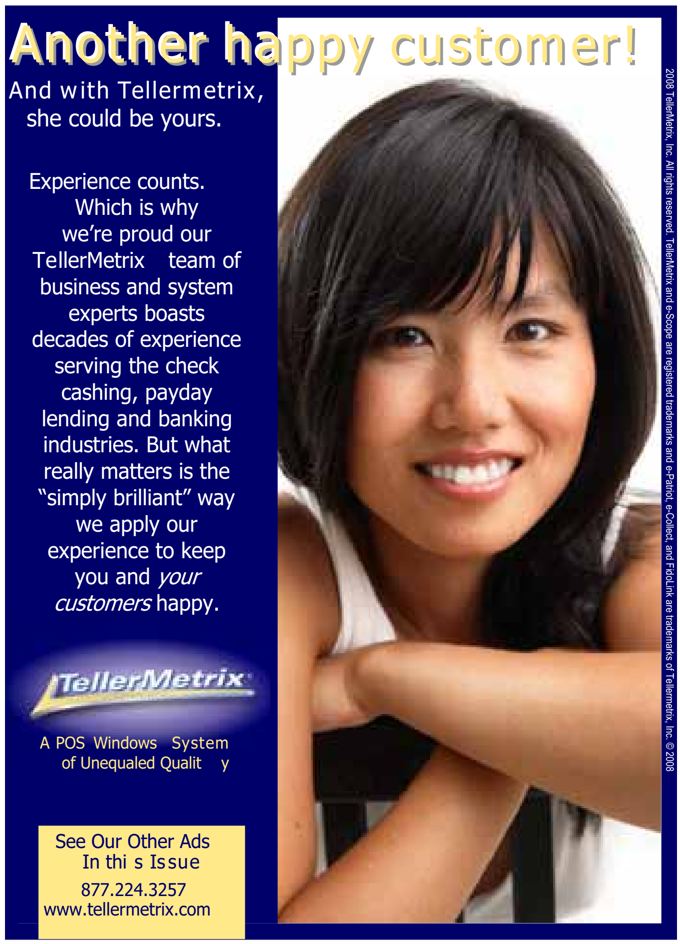
Mobile phone payment company Obopay of Redwood, CA, and their partner, Citigroup, are betting on this predicted growth. The Obopay service, which went live in 2006, lets customers initiate transfers to one another through their phones. Originally set up as a prepaid service, Obopay now allows users to send money to, and from, bank accounts instead of requiring them to maintain a separate prepaid account. Obopay sends account holders prepaid, reloadable MasterCards to tap Obopay funds for free at any merchant or U.S. ATM that accepts MasterCard or the Cirrus brand. And as of this writing, Obopay had just announced their first foray into international remittances via new transfer service to India.

In other late-breaking news, Western Union announced their own new mobile payment service offered through prepaid cell phones, which can be purchased at RadioShack stores. Customers can load up to $200 on their phones for transfer via Western Union, either within the U.S. or internationally. This nationwide rollout will be aimed at Latin Americans working in the U.S. The revenue ramifications of this have yet to be determined. But FSCs who are Western Union agents could potentially be reloading these phones, and perhaps even selling them in the future.

However, even as numerous financial companies ambitiously promote mobile banking services and lay the groundwork for mobile payments within the U.S., one well-known payment company has publicly taken the opposite stance. PayPal Inc. says the U.S. market is not ready to use phones to initiate transactions. In 2006, PayPal launched a mobile person-to-person payment and shopping service; but by and large, the only interested takers seem to be those paying for online auctions. Scott Thompson, President of the San Jose–based company, believes that phones have a bright future when it comes to purchases and payments, but that this future could be years

continued on page 24





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Using Technology, *continued from page 23*

away here in the U.S. In an interview with *American Banker* on March 25, he explained that while PayPal's users are not ready for mobile payments now, he is planning for the time when they will be, and the company is continuing to invest in its systems. "We believe at some point – and I can't tell you whether it's three years, five years, or 10 years – but at some point, this will be a big method of payment for consumers around the world," he said.

One hypothesis given for why mobile payments will be slow to catch on in the United States is that the infrastructure here remains inadequate to support the features that will make such services easy to use. The browsers typically available on phones today are not comparable to those on computers – a gap that could limit payment capabilities now, but that could close within the next two to three years. Ray Mustafa agrees that the U.S. is not the technology leader in this particular area today. "I think there is a lot of technology that still needs to be developed and used by our customers before the use of cell phones to manage money becomes commonplace."

Additional theories may offer additional clues. "In other countries, people are making purchases with stored value right on the cell phone. In Europe and Asia, all the differences in currencies can contribute to the pressure to move away from currency itself. In the U.S., we don't have that same problem," says Steve Wolf. And, according to the U.S. State Department, globally, there are less than 1 billion bank accounts, but approximately 3 billion cell phones. In developing countries, which are often cash-based, such as South Asia, Latin America, and Africa, mobile communications proliferate. With encouragement from the banking authorities, cell phones are now being used to provide cashless payments, remittances and financial services for the unbanked. The unbanked individuals in these countries are bypassing a brick and mortar system altogether. Thus, these consumers are also bypassing the discomfort associated with making a switch from a highly ingrained financial behavior built on a longstanding relationship of trust with either a bank or an FSC.

CONSUMERS WEIGH IN

While most U.S. consumers want high-speed financial transactions, only one in ten is willing to adopt mobile person-to-person payment services, according to a report from Javelin Strategy & Research released in March. In an online survey of 2,192 consumers, speed and convenience were deemed primary incentives for adopting mobile person-to-person (P2P) payment services. However, security concerns remain the leading deterrent, as 63% of consumers said enhanced security would encourage them to use mobile P2P payments. Javelin found that even "tech savvy" consumers, while interested in mobile P2P payments, strongly fear the loss of personal information (62%) and fraudulent transfers (52%). The report also outlines two key consumer segments that remain largely untapped; unbanked consumers and consumers who send remittances. Some 60% of unbanked consumers would be willing to move away from money lenders toward banks to have the ability to conduct mobile P2P payments, which may be explained by an existing comfort with the mobile channel. The 38 million migrants currently living in the U.S. represent another key market for mobile P2P payment services. FSC customers clearly represent these two prime target segments, and the Western Union and Obopay services will serve to show if they will be ahead of the curve in adopting this new technology.

THE GOVERNMENT POINT OF VIEW

A significant hurdle ahead for the industry may be the actions of the U.S. Government. They are not fans of this new technology application. On March 18, 2008, the U.S. Bureau of International Narcotics and Law Enforcement Affairs cautioned that criminals are likely to use mobile payment systems (m-payment systems) to launder money and finance terrorism. This warning is taken from the 2008 edition of the U.S. government agency's International Narcotics Control Strategy Report. According to the report, there are already signs that money launderers and terrorism financiers will take advantage of the new m-payment systems.

One way in which criminals can exploit mobile commerce technology is "digital value smurfing," the report says. In traditional money laundering, "smurfs" deposit small amounts of illicit money into banks in ways that do not trigger financial transparency reporting requirements. Today, digital

continued on page 38

Using Technology, *continued from page 24*

smurfs are able to bypass regulated banks and exchange dirty money for digital value in the form of prepaid cards or m-payment credits.

Proceeds of crime or contributions to terrorist organizations can now be transferred via cell phones, the report says. With these transfers, criminals avoid the risk of physical cash movement, bypass financial transparency reporting requirements, and rapidly send digital value across a country, or internationally.

It is likely that while U.S. financial industry sectors lay the groundwork for offering mobile payment capability to consumers who may or may not be ready for it, the government is laying the groundwork for the issuance of compliance regulations and other restrictions that will make this a far tougher arena for businesses to enter. Expect to hear more about this shortly, now that U.S.–based companies are demonstrating the ability to offer mobile money transfers to those overseas.

In conclusion, the takeaway on using technology to develop future revenue streams can be described as follows:

For prepaid products outside of mobile payments, jump right in. The water is fine, and conditions are most favorable for FSCs to offer new prepaid products and services, and to pursue new and different partnerships to do so.

For mobile payments, watch and wait – for now. Predictions based on the hype of the day don't always pan out, so look before you leap! ■

Cynthia Vega is FiSCA's Communications Manager.