

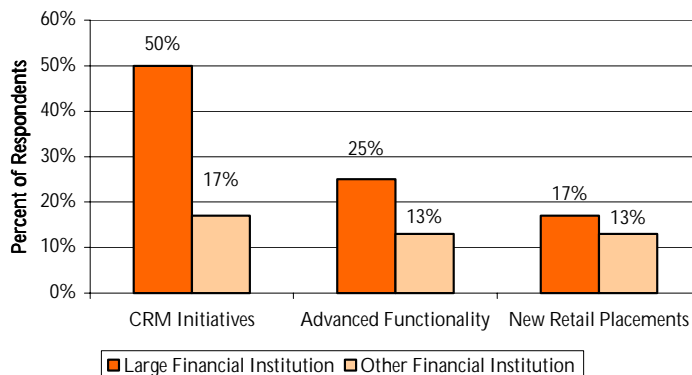


Exploiting the Opportunities Created by Triple DES and ADA Compliance

PIN encryption requirements for all ATMs will change on April 1, 2005. As of this date, all ATMs will be required to become compliant with the new triple DES encryption provisions for PIN entry security. There is also new legislation coming from the Americans with Disabilities Act (ADA), which may require all ATMs to be equipped with voice-guided technology in order to serve visually impaired customers. Many financial institutions are upset with the new requirements because they believe they are forced to invest considerable capital to upgrade their ATM networks without a positive financial return. In the center of these decisions, forward thinking financial institutions are taking a more strategic look at ATM deployment and future capital needs beyond the scope of mandated changes. These institutions are viewing ADA and triple DES compliance as an opportunity to:

- rethink advanced ATM functionality,
- integrate the ATM channel as part of an overall self-service delivery strategy, and
- optimize ATM locations in an effort to streamline their networks and increase profitability.

Customer service is returning as the primary objective for the ATM network at many financial institutions. This trend is reflected in the business opportunities identified by ATM deployers as potential areas for capital investment. A STAR Network study found that 25 percent of large financial institutions and 13 percent of other financial institutions see advanced functionality as an opportunity to improve customer service, while 17 percent of large financial institutions and 13 percent of other financial institutions find opportunity for better customer service through increased retail deployment. Financial



Source: STAR Network

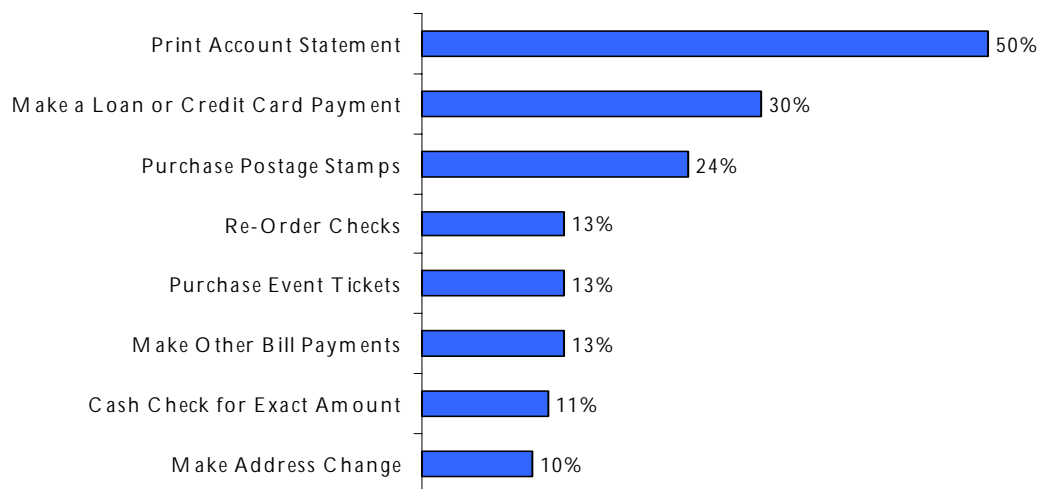
institutions also see opportunities for customer retention and acquisition in their ATM networks through leveraging the ATM channel as a customer relationship management (CRM) tool, and by adding advanced functionality to promote transaction migration away from the teller line. CRM initiatives and transaction migration add value to the

ATM network through the contribution each makes to institution profitability, and advanced functionality and CRM software can easily be included with a triple DES upgrade. Prior to embarking on ATM network upgrades, financial institutions need to consider the following key issues:

- 1) What role does the ATM network play in the overall delivery network today and in the future? Is the ATM channel a revenue source, or an avenue to generate efficiency or productivity gains (teller migration), or a key part of overall self-service channel offering?
- 2) What value does the customer/user have for the ATM channel? Is it pure convenience and access, an alternative to a teller, or a way to reduce transaction costs?
- 3) How profitable is the ATM network overall and at the individual machine level, and where are there opportunities to increase profitability?
- 4) What role does the ATM play in branch transformation, redesign, or new branches?
- 5) What future functionality is most valued by the customer base and market in order to increase channel value and gain competitive distinctiveness?
- 6) How are the Triple DES and ADA requirements justified in the organization?

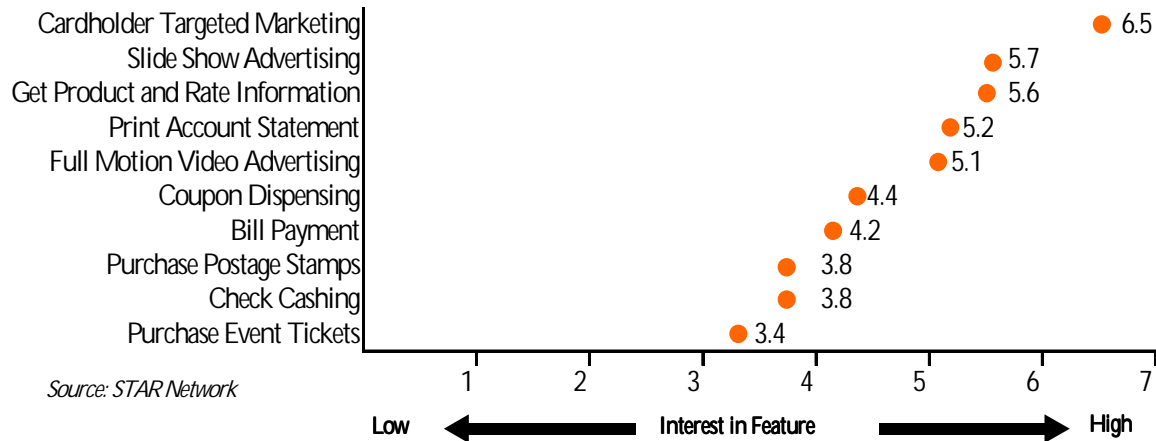
Advanced Functionality

Deployment of limited-function ATMs, which serve as little more than cash dispensers and deposit takers remains popular among financial institutions. However, many institutions are upgrading their ATMs to take advantage of opportunities for additional fee income and increased customer convenience afforded by enhanced ATM functionality. Verdi & Company surveyed 72 financial institutions regarding their current ATM network functionality. The results of the survey, which are depicted below, indicate the portion of financial institutions surveyed who offer various advanced functions.



Source: Verdi & Company research

Financial institution interest in adding advanced functionality is apparent. Functionality trends point to advanced marketing features as an area where financial institutions are paying considerable attention. There is high interest in leveraging CRM investments to include cardholder targeted marketing, slide show advertising, and full motion advertising as new features at ATMs. By promoting other bank products, financial institutions can deepen existing relationships through cross selling, or acquire new customers. Advertising adds an additional revenue stream to the ATM channel.



ATM Channel Integration with Self-Service Delivery Channel Offerings

The ATM channel is more than a source of revenue and improved customer service. ATMs serve as cost reduction tools for migrating customers away from the teller line by providing an efficient and convenient alternative to attended transactions. National averages show that the cost of a teller transaction is \$1.37 compared with the cost of an ATM transaction at \$.53, a difference of \$.84 per transaction. A branch migration strategy seeks to move routine transactions (deposits, withdrawals, transfers) away from the teller line and towards low cost, self-service channels. The ATM is a critical component to an integrated self-service delivery strategy, which includes PC, VRU, and attended telephone channels, due to the ATMs ability to handle cash transactions. Basic functionality allows for deposits and cash withdrawals while advanced functionality offers bill payment (includes loan and credit card), re-ordering checks, and check cashing, all of which can be migrated from branch to ATM. Check cashing functionality is being advanced by technology that creates a digital image of a check, including the MICR line so that the actual check is not required for presentation.

Site Optimization

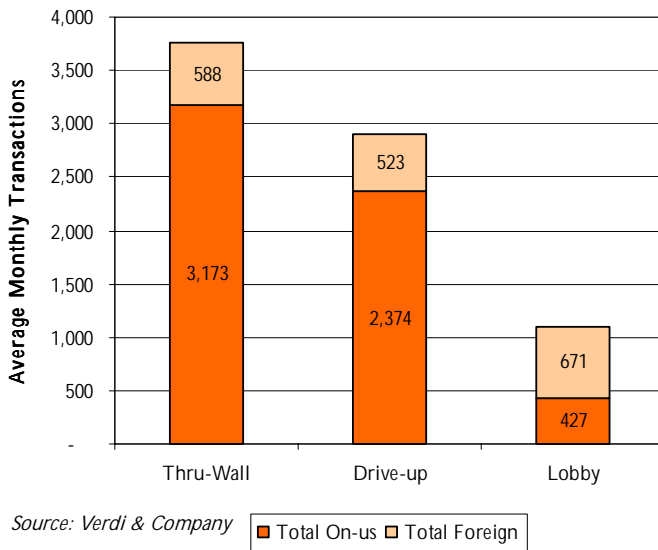
If financial institutions must spend capital dollars on upgrading ATMs due to Triple DES and other legislative changes, then it is important to examine the ATM network and

decide on optimizing placement of current sites. Financial institutions need to understand the profitability structure of the ATM network, and transaction patterns at individual machines, in order to determine:

- which machines are adequate,
- which need replacing or upgrading,
- which need to be relocated or repositioned, and
- which are suitable candidates for advanced functionality.

As the ATM market is relatively saturated, site placement is an extremely important consideration because ATM upgrades are uneconomical for unprofitable machines, or ATMs that have low transaction volumes.

Site placement decisions affect ATMs located at branches, off-premises, and in combination as part of a cluster of touch-points within markets. The strategic decision to place ATMs at off-premises locations is an important consideration that financial institutions are making today. The primary reason to place an ATM at a non-branch location, in addition to customer convenience, is to capture additional surcharge revenue. Off-premises ATMs can also fill gaps in market coverage, be positioned to gain a foothold in new markets, or build brand recognition in existing markets. On-premises



ATMs, on the other hand, are more than just sources of revenue. They serve as a key transaction point at the branch by providing customers an efficient and convenient alternative to attended transactions. Placement of ATMs on-premises is driven by branch spacing concerns and transaction volumes. Among the three types of placement locations (thru-wall, drive-up, lobby), Verdi and Company research found that thru-wall units have the highest monthly volume and the highest percentage of on-us transactions, indicating the greatest level of convenience for customers.

The future of on-premises ATM placement is in the form of the “electronic wall”. This concept, located at the entrance of the branch, features alternative delivery channels such as ATMs, telephone kiosks, and PC banking. The traditional teller line is replaced with remote teller terminals which offer customers efficient processing of routine transactions, and also reduce customers perceived wait time. A manned functional service counter serves as the focal point for the branch, guiding and educating customers on services available at the various delivery channels (including ATM functionality). As the photo on the following page shows, the electronic wall features an ATM and telephone kiosk

which share space with product and rate information in an eye-catching display that draws the customer away from the teller line.



A research study by the STAR networks shows that ATM profitability is different across network types. On average, a large bank will make \$11 profit per month at an on-premises ATM and will make \$301 profit per month at an off-premises ATM. Smaller banks have an average monthly profit of \$119 per month at on-premises locations and lose an average of \$211 per month at off-premises locations. One of the major drivers of ATM profitability is site placement. If an ATM is placed at a location with high traffic and draws a high volume of foreign transactions, it more than likely will turn a profit depending on the expense base. Knowing how to strategically place ATMs in the network and removing under-performing machines will have a positive overall impact on the bottom line of the financial institution.

ATM Network Analysis

In order to assist financial institutions in evaluating their ATM network and overall delivery strategy in the context of ADA and triple DES requirements, Verdi & Company has recently developed an ATM network diagnostic tool. This analytic tool will give financial institutions a detailed overview of their network in order to help prioritize ATM deployment decisions, and assist them in strategic planning decisions. After the analysis is completed, the financial institution will gain the following insights:

- The ability to identify high transaction patterns within the network
- An understanding of advanced functionality among competitors as well as customer reach and utility in order to identify where a competitive advantage can be gained
- The ability to identify high growth / high potential markets
- The identification of gaps in network coverage
- An understanding of where current customers are transacting when not using a proprietary ATM

- The profitability of the overall network and at the individual machine level to help identify which machines are under performing and should be removed from the network
- An understanding of ATM user patterns which can aide in migration and CRM decisions

Included with each ATM network analysis is an overall set of recommendations for current ATM locations and potential expansion opportunities as well as key findings that will help the client optimize their network. Specific machine level recommendations are provided along with the rationale used to justify the recommendations. A comparison of market coverage is then presented in order to quantify the improvements of the recommended actions.

The Critical Questions

ATM network managers faced with upcoming triple DES and ADA upgrades need to ask themselves the following questions concerning their ATM networks:

- **Network Locations and Markets** – Does your ATM network complement your existing branch network? Does your ATM network cover gaps in your branch trade area?
- **Network Transactions** – Do you know which competitors’ machines your customers are transacting at?
- **Per Unit Financials/Network Profitability** – How can you maximize your surcharge income? Which machines in the network are losing money?
- **Network Functionality** – How can you use your ATM network to bring in new streams of revenue? Which advanced functions do your customers prefer?
- **Customer Profitability & Channel/ATM Use** – How can you increase customer use of self-service channels?
- **Priorities** – What are the priorities of your institution - ease of adding functions; ease of service; open software support; flexible, scalable design, and/or transaction speed?

Difficulty answering these questions, or answers that lead to more questions signal the need for an ATM network optimization. Verdi and Company can provide this type of analysis for networks of all sizes and locations. Verdi & Company consultants are available to assist all financial institutions in developing their strategic ATM decisions, with the goal of adding value to the ATM network and increasing ATM performance.

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