Module 3:

Retail Banking Operations

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Module 3: Retail Banking Operations

Importance

Retail banking has become one of the bank priorities throughout the world as business has migrated from corporate to retail. Therefore, it has become essential to improve the type and quality of retail banking services to match the growing retail customer needs. Enabling participants to understand the true value added of retail banking as per the new banking concept / approach for retail banking aiming to achieve customer satisfaction, generate profit, stand the increasing competition and run a successful retail operation business.

Learning Objectives

- Define the retail banking
- List retail products and services
- Explain retail business activities
- Explain retail risk activities

I. Introduction to Retail Banking

A. Retail Banking Definition

The common definition of any commercial bank is “a type of bank that provides services such as accepting deposits, making business loans, and offering basic investment products”
Commercial bank can also refer to a bank or a division of a bank that mostly deals with deposits and loans from corporations or large businesses, as opposed to individual members of the public, as the main banking sectors of any commercial bank might be divided as follow:

- Corporate Banking.
- Retail Banking.
- Investment Banking.

In this module, we’re going to have an overview about the retail banking and all related activities.

Retail banking as one of the major current bank’s functions might be defined from different perspectives as follow:

- From function perspective, retail banking refers to the division of a bank that deals directly with retail customers. Also known as consumer banking or personal banking, retail banking is the visible face of banking to the general public, with bank branches located in abundance in most major cities. Banks that focus purely on retail clientele are relatively few, and most retail banking is conducted by separate divisions of banks, large and small. Customer deposits garnered by retail banking represent an extremely important source of funding for most banks, mainly for those banks that willing to finance retail business.

- From market perspective, it is a typical mass-market banking in which individual customers use local branches of larger commercial banks. Services offered include savings and checking accounts, mortgages, personal loans, debit/credit cards and certificates of deposit (CDs).

- From customer perspective, “When bank addresses individual customers’ needs which normally are smaller amounts compared to those that are dealt with in case of corporate customers. Such type of business is called retail business. It is normally for massive number of customers with smaller amounts. Retail banking aims to be the one-stop shop for as many financial services as possible on behalf of retail clients. Some retail banks have even made a push into investment services such as wealth management, brokerage accounts, private banking and retirement planning. While some of these ancillary services are outsourced to third parties (often for regulatory reasons), they often intertwine with core retail banking accounts like checking and savings to allow for easier transfers and maintenance.

- From service offered perspective, Retail banking is the direct execution of transactions between a bank and its consumers, rather than with corporations or other banks. Services offered include savings and transactional accounts, mortgages, personal loans, debit cards, and credit cards. The term is generally used to distinguish these banking services from investment banking, commercial banking or wholesale banking. It may also be used to refer to a division of a bank dealing with retail customers and can also be termed as Personal Banking services. The Banks retail products and service are designed to be used as is for mass users, customer can't ask for tailoring or customizing. It is a readymade product.

B. Why Retail Banking

Retail banking, which is sometimes known as personal financial services, is what most people think of as high street banking; it concerns providing financial products and services, such as bank and saving accounts, insurance and mortgages, to individuals. Some reasons were a rushing force towards the change of focus towards The Retail Banking such as:

- The globalization effects on the banking industry, especially with the continuous increase in the multinational mega banks. While the indigenous banks would lose part of their market share.
- The hard competition between banks had eroded the margin of commercial lending, therefore the fee based services became of a greater value.
- The flashing changes in the technology, has resulted in changing the way banks' look at their services especially in retail banking.
- The need to segment the retail accounts with the view to isolating special group of customers particularly suited to specific products and services.
- The proven experience that retail products are of low cost and high returns.
- The change in the distributions of the geographical market share due to change in the banking technology and delivery channels using electronic media, plastic cards, automatic tellers machines, telephones and internet.

When we are talking about the reasons behinds banks direction to such business, the advantages of working in retail banking must be highlighted as follow:

- Higher Profitability (Interest & Commissions) compared with commercial lending.
- Less Risk (within the overall portfolio) due to sharing the portfolio assigned to this line of business to a maximum number of borrowers.
- Great potential for growth & market penetration.
- Greater opportunities of cross selling.
- Retail banking increases the subsidiary business of the banks by opening doors for other Income (Insurance, Commissions on sales …etc).
- Improves lifestyle and fulfills aspirations of the people through affordable credit products.

I. Exercise

Choose the correct answer:

1. From function perspective, retail banking refers to the division of a bank that deals directly with:----------------

   a. Corporate customers.
   b. Retail customers.
   c. Elite customers.

2. One of the main advantages that leads banks to retail business is --------------------

   a. High risk.
   b. High profitability.
   c. a & b

II. Retail Banking Products

Retail banking by definition as explained previously, enforce the bank to come up with products that meet their customer's individual needs. These retail products are classified into two main categories as follow:

A. Liabilities Products:

Commercial banks offer a variety of "liability products" to consumers. These products are known as "liability products" because they represent liabilities of the bank. Consumers generally know them as "deposit" products. Typically, liability products include current and savings accounts, time deposit and certificates of deposit (CDs). Bank liability products are useful to consumers since they provide a safe place to keep their funds and give them the opportunity to earn interest on cash that they may not immediately need. Liability products also give consumers access to cash via checks and ATMs, they allow consumers to earn interest on their deposits. Such type of products represents the source of fund that banks use in financing their lending products portfolio.

(Liabilities products were already explained in Module 2.)

B. Assets Products:

Bank assets consist mainly of various kinds of loans and marketable securities and of reserves of base money, which may be held either as actual central bank notes and coins or in the form of a credit (deposit) balance at the central bank. The bank's main liabilities are its capital (including cash reserves and, often, subordinated debt) and deposits. The latter may be from domestic or foreign sources (corporations and firms, private individuals, other banks, and even governments). They may be repayable on demand (sight deposits or current accounts) or after a period of time (time, term, or fixed deposits and, occasionally, savings deposits). The bank's assets include cash; investments or securities; loans and advances made to customers of all kinds, though primarily to corporations (including term loans and mortgages).

The general definition of the loan is "the act of giving money, property or other material goods to another party in exchange for future repayment of the principal amount along with interest or other finance charges. A loan may be for a specific, one-time amount or can be available as open-ended credit up to a specified ceiling amount.

But when we talk specifically about retail banking, the retail assets products that known as consumer credit is basically defined as the amount of credit used by consumers to purchase non-investment goods or services that are consumed and whose value depreciates quickly, this includes most of retail assets products, but excludes debts taken out to purchase real estate.

Assets Products Classification:

There are two main classifications for retail assets products as follow:

1- In terms of loan purpose:
   a) Loans or facilities for non-specific purpose:
      - Cash / Personal Loan
      - Secured overdraft
      - Unsecured overdraft
      - Salary in advance.
      - Credit Card

   b) Loans or facilities for specific purpose:
      - Auto Loan.
      - Mortgage/Real-estate loan.
      - Durable Goods Loan.
      - Micro Finance
      - Educational Loan.
      - Others …

2- In terms of loan / facility schedule:
   a) Term Loan:
      Which is a monetary loan that is repaid in regular payments over a set period of time? Term loans usually last between one and ten years, but may last as long as 30 years in some cases. A term loan usually involves an unfixed interest rate that will add additional balance to be repaid; *it includes all types of loans.*

   b) Revolving Credit:
      Revolving credit can be defined as follow:
      - Credit limit that is automatically renewed once the debts are paid off.
      - A line of credit where the customer pays a commitment fee and is then allowed to use the funds when they are needed. It is usually used for operating purposes, fluctuating each month depending on the customer's current cash flow needs.
      - In basic terms, revolving credit is a specific type of line of credit. A line of credit and revolving credit is financial arrangements made between the lending

institution and a business or an individual. The lender provides access to funds that you can use at your discretion to make purchases.

- Revolving credit is a type of credit that does not have a fixed number of payments
  Revolving credit includes credit cards and all types of overdrafts.

Term Loans Structure:

All retail loans have almost the same structure / features that should be mentioned in loan application and the agreement form that will be signed from the customer & the bank / financial institution, as follow:

1- Loan amount:

The approved amount that specified in the loan contract that the borrower agrees to pay back.
Based on capability/resources of monthly payment, Credit scoring, Bank's Credit Policies, a minimum & Maximum amount.
We can differentiate between the following terms of loan amount:

- Maximum loan amount for the product.
- Maximum loan amount per customer, which refers to the maximum loan value that the customer can be granted based on his income & capability of repayment.

2- Loan tenor:

The amount of time left for the repayment of a loan or contract or the initial term length of a loan. Tenor can be expressed in years, months or days. Each loan product has minimum & maximum loan tenor.

Tenor is sometimes used interchangeably with "maturity", although tenor is not often used to describe the terms of fixed-income instruments such as government bonds and corporate bonds. Instead, non-standardized contracts like insurance policies and bank loans tend to be described in terms of tenor.

3- Interest rate:

The interest rate is defined as, a rate which is charged or paid for the use of money. An interest rate is often expressed as an annual percentage of the principal. It is calculated by dividing the amount of interest by the amount of principal.

Interest rates often change as a result of inflation. and Central Bank of Egypt policies. For example, if a lender (such as a bank) charges a customer \$90 in a year on a loan of \$1000, then the interest rate would be 90/1000 *100% = 9%.

It is the proportion of a loan that is charged as interest to the borrower, typically expressed as an annual percentage of the loan outstanding.

It is also known as the rate at which interest is paid by borrowers (debtors) for the use of money that they borrow from lenders (creditors). Specifically, the interest rate is a percentage of principal paid a certain number of times per period for all periods during the total term of the loan or credit.

4- Installment amount:

Installment amount is defined as a fixed payment amount made by a borrower to a lender at a specified date each calendar month The monthly installments are used to pay off both interest and principal each month, so that over a specified number of years, the loan is paid off in full.

Installment types:

a) The most common Installment type are either fixed installment or changing installment based on reducing scale according to monthly, quarterly or yearly payment.

b) Are there Balloon payment installment?

c) Is it Reducing.. Floating..

d) Are there "Grace Periods"..

5- Installment frequency:

The installment frequency / regularity might be monthly, quarterly, half yearly or annually based on the product features.

6- Installment Date:

Installment date refers to a specific day of the month where the loan installment is due.

7- Disbursement Date:

Disbursement / booking date refers to the date that the loan approval is executed, by crediting loan value to customer account.

8- Maturity Date:

Maturity date refers to the due date on which last installment loan must be paid in full, and the loan is totally due.
It also refers to the principal amount of a note, draft, acceptance bond or other debt instrument becomes due and is repaid to the investor and interest payments stop.

1) <u>Cash / Personal Loan</u>

<u>Definition:</u>

The personal loan is defined as:
- An amount of money lent to an individual for personal purposes; it usually unsecured and based on borrower's integrity and ability to pay
- A secured or unsecured loan with fixed terms issued by a bank or financing company that may be used for any purpose but is typically tied to the purchase of a specific item. Unsecured loans are issued based on the creditworthiness of the borrower while secured loans are collateralized by cash guarantee.
- A loan from a bank for a specific amount that has a specified repayment schedule and a floating interest rate. Term loans almost always mature between one and 5 years.

<u>Documentation:</u>

This part refers to the required documents need to be fulfilled according to product terms & conditions.
The most common documents required for such kind of loans are:
- Application form.
- Authorization to investigate customer's status.
- National ID or Passport for foreigners.
- Recent Utility Bill (Electricity, Gas, Telephone)
- Source of income proof (HR letter)
- Loan agreement.
- Promissory Notes or bank cheques as collaterals.

2) Secured Overdraft

Definition:

A bank overdraft is a credit limit of borrowing on a bank current account, where the customer can withdraw up to the approved limit and pay the outstanding amount with no fixed schedule. With an overdraft the amount of borrowing may vary on a daily basis.
This kind of secured credit limit is usually granted up to one year, against time deposits & certificate of deposits.

Documentation:

- Application form.
- Authorization to investigate customer's status.
- National ID or Passport for foreigners.
- Recent Utility Bill (Electricity, Gas, Telephone)
- Pledge form, which gives the bank a right to block the time deposit or certificate of deposit.
- Overdraft agreement.

3) Salary in advance

Definition:

It refers to kind of bank overdraft, where the credit limit is granted against salary transfer for only one month with a value of one month salary.
Employers with payroll agreements are the target segment customer for such product.

Documentation:

- Application form.
- Authorization to investigate customer's status.
- National ID or Passport for foreigners.
- Recent Utility Bill (Electricity, Gas, Telephone)
- Recent account statement showing last 3 salaries credited to the account.
- Overdraft agreement.

4) Auto Loans

Definition:

The auto loan is a personal loan granted to a specific purpose, which is purchasing a brand new / used car.

Documentation:

- Application form.
- Authorization to investigate customer's status.
- National ID or Passport for foreigners.
- Recent Utility Bill (Electricity, Gas, Telephone)
- Source of income proof (HR letter / bank statement)
- Loan agreement.
- Promissory Notes or bank cheques as collaterals.
- Car price quotation from an approved car dealer.
- Car insurance policy
- Car license with lien marking in favor of the bank.

5) Mortgage Finance

Definition:

- A term loan secured by the collateral of specified real estate property, that the borrower is obliged to pay back with a predetermined set of payments.
- A loan used to buy real estate. A mortgage is secured by the property that used to purchase. The customer must make monthly payments, and there's a set of terms before full payments is due.
  It's always granted over 10 to 20 years. Some mortgages have fixed interest rates, while others have variable interest rates. If the customer defaults on his payments, the bank may take possession of the real estate and sell it to recover its investment.
- A mortgage loan, also referred to as a mortgage, is used by purchasers of real property to raise money to buy the property to be purchased or by existing property owners to raise funds for any purpose. The loan is "secured" on the borrower's property. This means that a legal mechanism is put in place which allows the lender to take possession and sell the secured property ("foreclosure" or "repossession") to pay off the loan in the event that the borrower defaults on the loan or otherwise fails to abide by its terms.

Documentation:

- Application form.
- Authorization to investigate customer's status.
- National ID or Passport for foreigners.
- Recent Utility Bill (Electricity, Gas, Telephone)
- Source of income proof (HR letter / bank statement)
- Loan agreement.
- Promissory Notes or bank cheques as collaterals.
- Fully executed copy of the purchase agreement. If it is a new construction loan, you may need to provide copies of plans and specifications.
- Legal description of the property being purchased. This may be obtained by your real estate agent.
- A document to proof that the real estate can be legally registered.

6) Micro Finance

Definition:

- Microfinance is a source of financial services for entrepreneurs and small businesses lacking access to banking and related services. The main mechanism for the delivery of financial services to such clients is relationship-based banking for individual entrepreneurs and small businesses.

- A type of banking service that is provided to unemployed or low-income individuals who would otherwise have no other means of gaining financial services. Ultimately, the goal of microfinance is to give low income people an opportunity to become self-sufficient by providing a means of saving money, borrowing money and insurance.

- Micro financing is not a new concept. Small microcredit operations have existed since the mid 1700s. Although most modern microfinance institutions operate in developing countries.

- In some regions, for example Southern Africa, microfinance is used to describe the supply of financial services to low-income employees, which is closer to the retail finance model prevalent in mainstream banking.

- For some, microfinance is a movement whose object is "a world in which as many poor and near-poor households as possible have permanent access to an appropriate range of high quality financial services.

- Many of those who promote microfinance generally believe that such access will help poor people out of poverty. For others, microfinance is a way to promote economic development, employment and growth through the support of micro-entrepreneurs and small businesses.

- The World Bank estimates that there are more than 500 million people who have directly or indirectly benefited from microfinance-related operations.

Documentation:

- Application form.
- Authorization to investigate customer's status.
- National ID or Passport for foreigners.
- Recent Utility Bill (Electricity, Gas, Telephone)
- External investigation report to describe the small business status that the bank will finance.
- Loan agreement.
- Promissory Notes or bank cheques as collaterals.

7) Durable Goods Loan

Definition:

Consumer durables are a category of consumer products that do not have to be purchased frequently because they are made to last for an extended period of time (typically more than three years). They are also called durable goods or durables. Banks used to offer loans to finance purchasing such type of goods.

Documentation:

- Application form.
- Authorization to investigate customer's status.
- National ID or Passport for foreigners.
- Recent Utility Bill (Electricity, Gas, Telephone)
- Source of income proof (HR letter / bank statement)
- Loan agreement.
- Promissory Notes or bank cheques as collaterals.
- Durable goods price quotation from an approved vendor.

8) Educational Loan

Definition:

- A student loan is designed to help students pay for university tuition, books, and living expenses. It may differ from other types of loans in that the interest rate may be substantially lower and the repayment schedule may be deferred while the student is still in school.

- This kind of loans may be granted for students or their parents to finance their universities or schools tuitions.

Documentation:

- Application form.
- Authorization to investigate customer’s status.
- National ID or Passport for foreigners.
- Recent Utility Bill (Electricity, Gas, Telephone)
- University / school tuition fees statement.
- Source of income proof (HR letter / bank statement)
- Loan agreement.
- Promissory Notes or bank cheques as collaterals.
- Durable goods price quotation from an approved vendor.

Plastic Cards

Definition & Advantages:

- The plastic card is defined as a payment card issued by banks that can be used as an alternative to cash. Each card carries the name and account number of its owner.

- Around the world shop, dine, travel and manage their money, enabling transactions that drive global commerce and improve peoples' lives. Today, payment cards offer more security, convenience, flexibility and control than any other payment method.

- Convenience:
  Consumers can use payment cards to access their bank accounts or credit lines any time of the day or night, from just about anywhere in the world. Payment cards are the fastest, simplest and safest way to make purchases, whether at the point of sale, on the Internet, or by mail or telephone. Automatic bill payments save time and hassle by replacing checks for utilities, fitness clubs, subscriptions and others.

- Flexibility:
  The broad variety of cards available today means consumers have greater choice over how and when they pay for goods and services. Payment cards are accepted nearly everywhere in the world, providing consumers with secure and convenient access to their funds and their credit lines whenever and wherever they choose.

- Control:
  Payment cards make it easy to track and manage expenses by offering instant online access to information about recent transactions, as well as detailed monthly statements. Many cards also provide consumers with annual statements that categorize all the previous year's expenses. By offering access to a line of credit, credit cards make it possible for consumers to meet emergency or other extraordinary expenses and to pay for them on a timetable that suits their needs and budgets. Credit cards also help consumers build and maintain a credit record that can help them get jobs, rent homes, or qualify for mortgages or vehicle loans.

- Security:
  Payment cards are safer than carrying cash or using checks. If a credit or debit card is lost or stolen, it can be replaced quickly and easily. An increasing number of prepaid cards can be registered so that they, too, can be replaced if lost or stolen, a particular advantage for consumers traveling abroad. Moreover, payment card issuers continually invest in state-of-the-art security technology

that can detect and prevent many fraudulent transactions before they occur. Using credit, debit or prepaid cards to pay bills – either with automatic bill payment or individual online payments– reduces the likelihood of criminals intercepting mailed statements or payments. Payroll cards eliminate the risk that unbanked employees will be robbed after cashing their payroll checks.

Types:

- Cards types as a payment tool:
    - Credit cards
    - Prepaid cards
    - Debit cards
    - Charge cards

- Physical Card types:
    - Magnetic strip cards.
    - Chip cards (smart cards)
    - Virtual cards.

1. Cards types as a payment tool:

a. Credit Cards:

- Credit cards are plastic cards that enable consumers to make purchases and pay for them at a later date by accessing a line of credit. Credit cards are alternatives to cash or checks and often used for routine purchases at the point of sale (POS), ATM's, Internet, or via telephone.
- A credit card is a payment card issued to users as a system of payment. It allows the cardholder to pay for goods and services based on the holder's promise to pay for them. The issuer of the card creates a revolving account and grants a line of credit to the consumer (or the user) from which the user can borrow money for payment to a merchant or as a cash advance to the user.
- The main feature of the credit card is that it represents a retail assets product with a credit line, which requires a credit study by the bank for the customer's income & his / her source of payment.
- The credit cards might be issued as primary card for the account owner, or as supplementary card, which is a card that is issued upon request of the card holder to issue other card (supplementary) that is a supplement of such original card. Therefore the supplementary card is issued on the bases and credibility and responsibility of the original card holder / account owner.

The uses of such card are for a wife or husband, son or daughter, brother or sister etc.
The supplementary card carries same limit of the main card or sub-limit as part of the original limit, with full legal & credit responsibility on the main card holder.

Credit Cards Operation side:

- Credit cards operate somewhat like a portable loan system. When your bank issued a credit card for you, your bank assigns you a credit limit, or a maximum value that you can spend with your card. Credit limits are determined by a credit scoring system that takes into account facts such as your age, banking history, annual income and spending history.
- Once you have a credit card, you can simply present it at stores and to service providers to make purchases with your card instead of cash. Your purchases are recorded and-immediately paid by your bank. At the end of each month, the bank sends you a statement listing your purchases. You then have a set amount of time (usually between 45 and 55 days) within which you can pay back the bank.
- If you pay back the full amount claimed in your statement within this period, you pay no interest. If, on the other hand, you pay only a portion of the statement (a minimum of 5-10% depending on the bank), then you must pay interest on the remaining balance (just as you would for a loan)

b. Charge Cards:

- It is a deferred payment card and known as charge card. When the total spent in a given period is reflected on a claimed statement sent to the applicant / client asking for payment within a given time limit normally a month or less from the claimed statement date.

- It is a card that charges no interest but requires the user to pay his/her balance in full upon receipt of the statement, usually on a monthly basis. While it is similar to a credit card, the major benefit offered by a charge card is that it has much higher, often unlimited, spending limits.

- A charge card is a specific kind of credit card. The balance on a charge card account is payable in full when the statement is received and cannot be rolled over from one billing cycle to the next.

c. Prepaid Cards:

- A prepaid card is a payment card where you can load it with a set amount of money to allow you or other consumer that hold it to make purchases or cash withdrawals.

- A card issued by a financial institution that is preloaded with funds and is used like a normal credit card. A prepaid card works in the opposite way of a normal credit card, because instead of buying something with borrowed funds (through credit), you buy things with funds that have already been paid.

- The prepaid card might be used as:

  - Gift Card
    - It's cash wrapped in a thoughtful card.
    - It comes in a variety of designs and patterns to suit all occasions.
    - It's just perfect for all your gift-giving occasions, all year round.

  - Teen Card
    - Manages your day-to-day budget conveniently.
    - Makes it easier to plan and budget, Safer than cash.
    - Maximizes security, since the cash withdrawal option is activated only upon request.

  - Household Card
    - Ideal to keep your household spending separate from your personal finances.
    - Safe and convenient to use.

  - Virtual Internet Card
    - Maximize your security and privacy by separating your virtual spending from your other spending.

  - Travel Card
    - Manages your travel spending safely and conveniently.
    - Keeps your holiday spending separate from your other finances.

d. Debit Cards:

- Enable consumers to make purchases and pay for them immediately by accessing the funds in their bank accounts, also called demand deposit accounts (DDAs). Debit cards can be used to make purchases at POS, on the Internet, or via telephone or mail order, or they can be used to withdraw cash at automated teller machines (ATMs). Many consumers use debit as an alternative to cash or checks for their everyday purchases.

- The debit card is the most widely issued payment card around the world. A quarter of the world's adult population use debit cards, bringing convenience, security and peace of mind to their users.

- Debit cards, like credit cards, are plastic cards bearing their owner's name and bank account number, and are used to make cashless payments. The difference between the two types, however, can be found in the name: while "credit" means to loan, "debit" means to deduct. Basically, credit cards allow you to pay later, while with debit cards you pay now.

- Debit cards are linked directly to a user's bank account and it is directly debits the linked accounts to the card (in which the cost of a purchase is deducted from the bank account immediately).

- The debit card is a payment card for everyone, it can be safely offered to anyone of legal age, regardless of his or her banking history or credit status. Students, lower income groups and people without regular monthly incomes can all enjoy the benefits that come with debit.

2. <u>Physical plastic card types:</u>

a. Magnetic Stripe Cards:

A magnetic stripe card is a type of card capable of storing data by modifying the magnetism of tiny iron-based magnetic particles on a band of magnetic material on the card. The magnetic stripe, sometimes called swipe card or magistrate, is read by swiping past a magnetic reading head.

b. Chip / Smart Cards:

It is a plastic card containing a microchip like a computer; the chip contains files and store data as well as performs processing functions. The chips are more secured than the magnetic stripe even if it is used Offline. Additionally it supports add-on services.
Security features and Memory capacity would lead smart cards to play vital role in future.

Benefits of using chip / smart card, can be summarized as follow:

- Greatly Increased Information Capacity:

Chip technology allows payment and non-payment applications to be combined on a single card, so providing cardholders with added convenience. This means that, in addition to storing your name and account number, cards can carry additional information including identification, loyalty programmers such as user points, frequent flyer miles, cardholder insurance information.

- Safety:
  Smart cards contain enhanced security features such as data encryption to prevent unauthorized use. As such, they are less vulnerable to fraud or counterfeit, they are also protected via a personal identity number (PIN) known only by the cardholder.

- Speed:
  Due to these inbuilt security features, many transactions can be authorized offline without the need to call the bank -meaning faster transactions and better customer service for you.
  The migration to smart cards is a gradual process, and until such time when all payment cards worldwide have been converted to chip and Points of Sale (POS) are chip-enabled, the original magnetic stripe will continue to feature on the back of your card in addition to the chip added on the front.
  While there is no doubt that magnetic stripe technology has brought the convenience of electronic payment to consumers all over the world, chip technology will bring many more exciting opportunities to consumers.

c. Virtual Cards:

- A technology that allows a user to set up a new credit account with a bank on the Internet and then use this account number to purchase goods, also on the Internet, without physically receiving any plastic card.

- Virtual cards are online cards that are not physically issued by the credit card provider. It is usually a free service provided by the original card issuer to their customers who want to perform an online payment with the help of their credit cards. Virtual credit cards include a one-time-use credit card number created by the respective credit card provider.

3. <u>ATM’s</u>

- ATM stands for “Automatic Teller Machine” that allows the card holder (the bank customer) to operate his account without the need to visit the bank counter.
- Main ATM’s functions might be listed as follow:
  - Fast Cash (certain amounts pre-set to quickly withdraw).

- Cash withdrawal that is a selected amount of cash required by the customer. However such amount is based on the account balance with a minimum and a maximum amount according to each bank's policy and machine capacity.
- Balance inquiry: to get the recent account balances.
- Statement Account: Mini statement or request for full statement.
- Cash Deposit.
- Check Deposit.
- Pin Change.
- Account to account transfer.
- Check book request.
- Many other transactions might be customized.

- When Visa and MasterCard lifted their surcharge bans in 1996, the door opened for independent sales organizations and retailers to add ATMs in the off-premises space. But not every location is a financial drop in the bucket, which is why retailers must carefully consider their ATM placements. Regulatory changes also are making retail ATMs more cumbersome to deploy; however, with the right partnerships and information, exceptional opportunities exists ATM placements, like the ATM industry as a whole, have evolved over the past 10 years. In the United States in 2005, 68 percent of the country's nearly 400,000 ATMs were in retail or off-premises locations, according to the American Bankers Association. And some industry insiders expect that number to increase as new sites for ATMs crop up over the next five years.
- With 10.5 billion ATM transactions conducted in the United States in 2005, according to ABA, opportunity exists for retailers, ISOs and FIs to have pieces of the ATM-revenue pie. But how profitable a retail ATM is depends on its business model and location. It's no secret that a customer will spend between 20 percent and 25 percent more in a retail location when she uses a location's ATM. But if a location doesn't generate the right amount of foot traffic or facilitate a need for cash, the ATM may not be as profitable.
- According to ABA, more than half of all adults use ATMs regularly, with 40 percent of them visiting ATMs at least 10 times a month.
- For retailers, revenue opportunities also exist from interchange rates, surcharge fees and branding deals.

4. <u>POS</u>

- POS stands for "Point Of Sale" It is the machine that is maintained by a merchant to allow customers to use their plastic cards within that machine to affect purchases. Such machine (POS) is given by the banks (Acquiring banks) to the merchant and connected through a normal telephone line (land line or Mobile line). The old style Zip Zap is on the going phase to be replaced by the electronic POS's.

- It refers to the time and place where a retail transaction is completed. It is the point at which a customer makes a payment to the merchant in exchange for goods or after provision of a service.

5. The involved parties of cards operations:

- The consumer which is the cardholder who wishes to buy something with his/her payment card.

- The consumer's bank, which is the issuing bank which issues the payment card to the consumer.

- The merchant, which is the store or service company that accepts card payments.

- The merchant's bank, which is the acquirer bank which provides the retail acceptance tools to merchants and holds the merchant's bank account.

- The Portal Organization such as Visa, MasterCard, Euro Card or Diners.

II. Exercise

Choose the right answer:

1. The higher commission & fees among retail products is ……………..
    a. Personal loan
    b. Credit card
    c. Educational loan
    d. Auto Loan

2. Which of the following cards represent a line of credit:
    a. Debit card
    b. Prepaid card
    c. Chip card
    d. Credit card

III. Retail Business Activities

In terms of bank organization chart, retail banking has two main sides, retail business & retail risk. In the coming few lines, we are going to describe briefly the role of retail business team.

Retail business team / division consist of the following main areas:

- Product development
- Marketing
- Sales & branch network.

A. Product Development:

- Product development is the process of designing, creating and marketing new products or services to benefit customers. Sometimes referred to as new product development, the discipline is focused on developing systematic methods for guiding all the processes involved in getting a new product to market.

- The creation of products with new or different characteristics that offer new or additional benefits to the customer. Product development may involve modification of an existing product or its presentation, or formulation of an entirely new product that satisfies a newly defined customer want or market niche.

- Product development team in the bank is responsible for creating new product / service, or amending the existing products / services in an effective way that leads to grow the business.

- The first step for this team to do such job, is to identify the bank customer's needs, then the market should be scanned correctly, to come up with the gaps in these customer's needs that the bank can offer in a form of new product / service.

B. Marketing:

- Marketing as a function is defined as the action or business of promoting and selling products or services, including market research and advertising.

- It is the management process through which goods and services move from concept to the customer.

For example, new Apple products are developed to include improved applications and systems, are set at different prices depending on how much capability the customer desires, and are sold in places where other Apple products are sold. In order to promote the device, the company featured its debut at tech events and is highly advertised on the web and on television.

- Marketing differs from selling, because selling concerns itself with the tricks and techniques of getting people to exchange their cash for your product. It is not concerned with the values that the exchange is all about. And it does not, as marketing invariable does, view the entire business process as consisting of a tightly integrated effort to discover, create, arouse and satisfy customer needs." In other words, marketing has less to do with getting customers to pay for your product as it does developing a demand for that product and fulfilling the customer's needs.

- The activities of a company associated with buying and selling a product or service. It includes advertising, selling and delivering products to people. People who work in marketing departments of companies try to get the attention of target audiences by using slogans, packaging design, celebrity endorsements and general media exposure.

- Marketing is everything a bank does to acquire customers and maintain a relationship with them. The ultimate goal of marketing is to match a bank’s products and services to the people who need and want them, thereby ensure profitability.

C. Sales & branch network

- Once the new bank product / service is designed from product development team and marketing department does their role correctly, the sales team & branch officers start their role in selling the product / service to their customers.
- Usually this area in each bank is formed as follow:
    - Sales team department.
    - Branch network department, which is divided into geographical regions, under each region a group of branches.

Transition to a Customer Service-oriented:

Retail banks learned how their organization can increase sales effectiveness by motivating & providing their employees with relevant real-time customer information to enable them up-sell and cross-sell opportunities and to convert them into sales, capture new leads by targeting personalized offers to customers and automatically generating referrals based on customer response and improve customer retention and loyalty by enabling employees to understand customer needs with on-demand intelligence and action alerts.

Cross Sell Technique

A Cross Sell Technique would require the following:

- The bank should have a product mix that enable customer to get all that he needs from one bank, one source.
- The marketing material for each product / service is very essential for both customer and banker to understand full information about the product / service. The marketing material help customer to remember all details, refer to a missing point or tell a friend.
- Untrained employee would not be able to cross sell unless he has obtained proper training on all different products & services. Also after training any changes should be circulated in an informative way to all involved staff is the selling process.
- The availability of customer details data base is an essential tool for the selling team that is involved in cross selling process. Programs like "CRM" would add to such requirement.
- The need to motivate the selling teams would be required to introduce "staff incentive schemes" that boost & motivate staff to cross sell bank's product & services.
- It is also important to introduce "Customer incentive schemes" that has very positive reaction on customer's desire & decision to enlarge his bundle of needs from the bank as well as introducing other customers to the bank.

Cross sell & Combined Exposure with Other Retail Products:

The Customer may have more than one or two or three … banking products (such as Car loan, personal loan, Credit Cards, Prepaid Cards). However this is an issue that is reflected by internal bank's policies such as:

- The promptness in payment for 6 or 12 months ahead to new credit application.
- No bad records in credit cards.
- The customer's debt burden including the new loan / credit matches the debt burden ratio as per bank's policies.
- Use the available data base regarding customer information / investigation to analyze the credibility of the borrower.
- Check the CBE consolidated investigation report as well as the credit bureau.
- Make sure that customer is not in the negative list.
- If the customer had previous defaults, you may refer to collection department to get feedback about the customer.

III. Exercise

Choose the correct answer.

1. A Cross Sell Technique would require:
    a. Product mix
    b. Proper training
    c. Incentive plan
    d. All above.

2. Which of the following areas is responsible for achieving sales target:
    a. Product development
    b. Sales & branch network
    c. Marketing
    d. Communications

IV. Retail Risk Activities

A. Retail Risk Definition:

- Risk Management is theoretically defined as the process of identification, analysis and either acceptance or mitigation of uncertainty in investment decision-making.
- Retail Risk / Consumer Credit Risk can be simply defined as the risk of loss due to a customer's monthly obligation non re-payment (default) on a credit product, such as a mortgage, unsecured personal loan, credit card, overdraft etc.
- Recently & due to the aggressive competition between banks in retail business, some major activities were added to the retail risk definition to be more comprehensive.

B. Where's "Retail Risk" in the bank organization chart?

- Banks in Egypt used to handle risk issues through business divisions till end of 2005.
- According to Central Bank of Egypt regulations & its circular in May'05, some banks started to establish their own risk management units. As the previous scenario was a clear conflict of interests.
- Some banks shifted their risk activities from business authority to Operations Division, as a trial to comply with CBE.
- Other banks followed the ideal module, where all risk management areas are gathered under the Chief Risk Officer.

C. Retail Risk Main Functions

1. Retail Credit:

This department is responsible for managing the approval process for all retail customers applications, starting from the channels stage (branches, DS, call center,…) then the underwriting stage, till the booking.

Risk Assessment & Credit Scoring:

Retail Credit department proceeds in assessing the customers applications through scoring modules. Different Credit Scoring Modules will consider major applicants' information which to be categorized under the following characteristics:

- Financial Characteristics.
- Employment Characteristics.
- Personal Characteristics.
- Payment History.

Credit Limit Strategy:

- Scoring system automatically assigns initial credit limits during the scoring process.
- The credit limit that is applied to each applicant is determined by the level of their credit score or based on the credit policy.

Behavioral Scoring

- Behavioral scoring uses a customer's usage and payment history (usually the previous three or four months) within the organization, without the need for outside information from credit bureau.
- Its purpose is to predict if and when a customer is likely to go" bad" (to default on repayment or to write off an outstanding balance).
- Behavioral scoring will most likely have an effect on a bank's bad debt rate.

Credit Scoring Importance

- Proper use of risk management tools allow the lenders to plan for economic cycle activity and to mitigate risk associated with new credit users.
- Consequently, financial institutions need to find a way to balance portfolio growth and risk management on a day-to-day basis.
- The trend continues for enhanced data sharing. Improved data scenarios offer the opportunity for banks to graduate the risk management concept from demographic information-based underwriting to a concept based on bureau scores.
- The first step in this direction is to build judgmental models that make use of the positive and negative data available.
- The reporting and sharing of positive data appears to help financial institutions allocate credit in a more equal and open fashion, and is being actively encouraged by a variety of governments and by organizations such as the World Bank.

Examples for uses of "Credit Scoring"

- Deciding to whom credit should be granted.
- Cutting the cost of credit checks whilst maintaining desired credit quality.
- Controlling the profitability of loan portfolio before and after bad debts.
- Relating loan prices to risk.
- Measuring the effect of different advertising schemes on loan applicant quality.
- Determining optimum credit limits Training credit officers

How Credit Score works?

Age		21-25	26-29	30-40	41-49	50-55	56-60	60 +	
	10	1	3	10	8	7	6	3	
Salary/Income		from 1-2	from 2-3	from 4-5	from 6-10	from 11-20	from 21-35	from 36-75	from 76 +
(In 000)	60	5	15	40	50	60	45	30	5
Experience		from 1-2	from 2-3	from 4-5	from 6-10	from 11-15	from 16-20	from 21-30	30+
	25	2	5	10	15	20	25	20	10
Employer		Grade 1	Grade 2	Grade 3	Grade 4	Grade 5	Grade 6	Grade 7	
	10	10	8	6	4	3	2	1	
Job		Helper	Clerk	S. Clerk	Supervisor	Dept. Head	Manager	G. Manager	Chairman
	15	1	3	5	10	14	15	10	5
Education		Low	Medium	High	S. High				
	5	1	2	4	5				
Res. Address		Area 1	Area 2	Area 3	Area 4	Area 5	Area 6	Area 7	Area 8
	8	1	2	3	4	5	6	7	8
Res. Type		Other	Apprt.	Twin-house	Villa				
	10	2	6	8	10				
Res. Status		Other	New Rent	Old Rent	Owner				
	40	5	10	20	40				
Salary Transfer		Full Sal.	Instl.	No Trs.					
	10	10	5	Nil					
Utility Consumption		To 30	fr 31-80	fr 81-150	fr 151-250	fr 251-500	500+		
	30	2	10	20	22	25	30		
Debt Burden		Nil	10 %	11-15%	16-25%	26-34%	35-44%	45-55%	56% +
	40	40	35	30	25	20	15	5	Nil
Depositor		Yes	No						
	20	20	0						
Guarantor		Yes	No						
	25	25	0						

Debt Burden Ratio:

Debt Burden Ratio (DBR) is used to determine whether the applicant's income can cover his / her monthly obligations or not.
It refers to the percentage of total monthly obligations to monthly net income.

Example for DBR calculation:

- Other Credit Cards

Bank	*Limit*	*Min. Pay.*	*Monthly Payment*
A	10.000 LE	10 %	1.000 LE
B	7.000 LE	5 %	350 LE

- Other Loans

Bank	*Loan Amount*	*Type*	*Monthly Payment*
C	75.000 LE	Car Loan	650 LE
D	7.000 LE	Personal Loan	550 LE

- Net Monthly Income

  Net 5.000 LE (After all deductions).

Total Monthly Liabilities

  LE 1000 for Bank A
+ LE 350 for Bank B
+ LE 650 for Bank C
+ LE 550 for Bank D

= LE 2550 Monthly

DBR :
Total Monthly Liabilities ÷Net Monthly Income = LE 2550 ÷LE 5000 = **51%**

2. *Retail Credit Policy:*

This department is responsible for credit policy revision, to ensuring compliance with CBE regulations, & proposing detailed analysis of the current portfolio, identifying high risk areas of improvement.

3. *Retail Collection:*

This department is responsible for handling bad loans and managing the collection & recovery process for all retail banking products, through phone calls, field visits and external legal agencies, according to customer status.
The collections policy is one of the most important policies, to ensure the hard earned profit from consumer portfolio is realized.

Delinquency Accounts

The effective follow up & Quality performance of the Retail collection & Recovery department is a true indicator for a successful Retail Credit Operations.

The uncollected amount out the retail credit portfolio could turn into bad debts that reflect negatively on the profit & loss statement.

The credit account could turn to be Delinquent Account in case of defaults in payment of the monthly installment or minimum payment of credit cards within the stated payment frame of the credit (on certain date or before end of the month)

The best way to identify the account status of being prompt in payment or not prompt by defaulting in payment of installment or minimum balance required to be paid.

The performing Account

"The performing account is the account that has not defaulted in payment throughout the loan / credit period."

Or

"The account that has defaulted in payment for one or two times throughout the loan / credit period ". Such Account is the banks' targeted account and likes to maintain and continue relationship.

The non-performing Account

The non-performing account is the account that has defaulted in payment of the installment of the loan or minimum of credit card debt balance for 3 consecutive months throughout the loan / credit period.

The bad account is either a reflection of incapability of loan / credit repayment or undesired to repay back bank's funds. In both cases wither customer in unable to pay or able but does not want to pay the treat them as bad account.

The bank would not be interested to deal again with such customers in future. However such accounts are loss making to the bank as interest is taken into Profit but in marginalized account. Also the bank is threatened by possibilities of bad debt loss. Moreover the cost of follow-up and legal process if any would be added to the losses.

Delinquencies Reasons

There are many reasons for defaults of payment turning to be a bad debt such as:

1. Loss of monthly income (loss of a job)
2. A high debt burden allowed by banks and financial institutions.
3. Travelling outside the country without making necessary arrangements of repayment in his absence.
4. An objection on correctness of the debt balance specially cases of credit cards.

4. Fraud Risk:

This department is responsible for handling any suspicious applications received from the credit officers, to avoid any fraudulent incident. Besides, managing cards fraud risk through maintaining the needed parameters on bank cards system to filter any suspicions transaction.

5. Retail Insurance

This department is responsible for handling the agreement between the bank & insurance companies to ensure the proper life insurance coverage for all retail customers.

6. *Retail MIS*

This department is responsible for ongoing maintaining for the reports required to any kind of analysis to the portfolio performance, to ensure that the proposed data represents the right figures that match with bank books.

IV. Exercise:

1- Debt Burden Calculation

A customer works as an accountant at ABC Company with a monthly salary of 15000.00. He has a personal loan for 50.000.00 (paying monthly fixed installment of 1000.00). He has applied for auto loan in the amount of 40.000.00 whereby he would pay monthly installments of 700.00.

What is his debt burden before and after the personal loan?

DBR (before)………………………..,

DBR (after).……………………………

- Choose the right words:

2- To Cross Sell you need:
…………………

a. Training & incentive plan.
b. Time
c. Space

3- The department that is responsible for handling any suspicious applications

a. MIS department.
b. Collection department.
c. Fraud department.

Summary

In this module, you learned how to:

- Define retail banking
- List retail products and services
- Explain retail business activities
- Explain retail risk activities