CAIIB SUBJECTS

Objective of (he Rumination: To provide advanced knowledge in banking subjects for better decision making.

Question Paper Pattern: Objective Type - Multiple Choice Questions

Eligibility: I. Membership of the Institute

2. Pass in JAIIB examination of the Institute.

Revised Structure:

Revised CAIIB Examination **(2010)** is structured with **2** compulsory papers and **11** elective papers as given below.

I. COMPULSORY PAPERS

1. Advanced Bank Management
2. Bank Financial Management

II. OPTIONAL PAPERS (Candidates to choose any one)

1. Corporate Banking
2. Rural Banking
3. International Banking
4. Retail Banking
5. Co-operative Banking
6. l-i!!.iiM.il Advising
7. Human Resources Management
8. Information Technology
9. Risk Management
10. Central Banking
11. Treasury Management

To be eligible for the award of CAIIB a candidate must pass both the compulsory papers and any one of the electives of the candidate's choice. Electives have been developed with the objective of giving appropriate specialization to the candidates. Candidates may therefore choose those electives that are relevant to their current and or immediate prospective job profile. Electives contain, in addition to the knowledge inputs certain managerial inputs also. This is aimed to promote specialization in the study by candidates at the same time enabling them to acquire skills required in bank management.

RETAIL BANKING

SYLLABUS

MODULE A: Introduction

History and dcfinilion. role within the bank operations. Applicability of retailing concepts distinction between Retail and Corporate/Wholesale Banking

MODULE B: Retail Products

Retail Products Overview - Customer requirements. Products development process. Liabilities and Assets Products - Description of Liability products. Description of Asset Products, Approval process for retail loans. Credit scoring.

Important Asset Products - Home I .oans-Hligibility. Purpose. Amounts. Margin, Security. Disbursement Moratorium. Prepayment issues, Repayments/Collection.

Auto/Vehicle Loans - Eligibility. Purpose, Amounts. Margin. Security. Disbursement. Moratorium, Prepayment issues, Repayments/Collection.

Personal Ixtans - Eligibility, Purpose. Amounts. Security. Disbursement. Moratorium, Prepayment issues. Repayments/Collection.

Educational Loans - Eligibility, Purpose, Amounts, Security, Disbursement. Moratorium, Prepayment Issues. Repayments.

Credit/ Debit Cards - Credit Vs Debit Cards, Eligibility, Purpose, Amounts. Margin, Security, Process of using the cards. Billing Cycle. Credit Points.

Other Products - Remittances/Funds Transfer

MODULE C: Marketing/Selling of Retail Products, MIS and Accounting

Retail Strategies; Tie-up with Institutions for personal loans / credit cards /educational loans, with OEMs/ Authorised Dealers for auto/vehicle loans, and with builders/developers for home loans

Delivery Channels - Branch, Extension counters. ATMs. POS. Internet Banking. M Banking. Selling Process in retail products-Direct Selling Agents.

Customer Relationship Management - role and impact of customer relationship management. Stages in customer relationship management process. Regulations and compliance

XII I SYLLABUS

Technology for Retail Banking - Static information. Account opening, basic loan origination data etc. Updated information like income details at different frequencies. Transaction information from disbursement till final settlement of the loan amount. Analytics/Alerts.

Accounting entries - Loan process and the relevant accounting including EMI Computation.

MODULE D: Other issues related to Retail Banking

Securilisation. mortgage based securities.

Trends in retailing - New products like insurance, demut services, online/phone Banking, property services, investment advisory/wealth management. Reverse Mortgage. Growth of c-banking. Cmss selling opportunities.

Recovery of Retail Loans - Defaults, Rescheduling, recovery process. SARAFAESI Act. DRT Act. use of Lok Adalat (brum. Recovery Agents-RBi guidelines.

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11. Delivery Channels in Retail Banking
12. Delivery Models
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MODULE D
OTHER ISSUES RELATED TO RETAIL BANKING

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MODULE-A

RETAIL BANKING

Units

1. Retail Banking: Introduction
2. Retail Banking: Role within the Bank Operations
3. Applicability of Retail Banking Concepts and Distinction Between
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U N I T 1 RETAIL BANKING: INTRODUCTION

STRUCTURE

1.1 Introduction
1.2 Characteristics of Retail Banking
1.3 Advantages of Retail Banking
1.4 Constraints in Retail Banking
1.5 Evolution of Retail Banking

Terminal Questions Let Us Sum Up Keywords

1.1 INTRODUCTION

What is Retail Banking? Let us see the different definitions of retail banking.

"Retail Banking is a banking service that is geared primarily toward individual consumers. Retail banking is usually made available by commercial banks, as well as smaller community banks. Unlike wholesale banking, retail banking focuses strictly on consumer markets. Retail banking entities provide a wide range of personal banking services, including offering savings and checking accounts, bill paying services, as well as debit and credit cards. Through retail banking, consumers may also obtain mortgages and personal loans. Although retail banking is, for the most part, mass-market driven, many retail banking products may also extend to small and medium sized businesses. Today much of retail banking is streamlined electronically via Automated Teller Machines (ATMs), or through virtual retail banking known as online banking."

"Retail Banking deals with lending money to consumers. This includes a wide variety of loans, including credit cards, mortgage loans and auto loans, and can also be used to refer to loans taken out at either the prime rate or the subprime rate."

"Retail banking refers to banking in which banking institutions execute transactions directly with consumers, rather than corporations or other entities".

Retail Banking refers to "the part of a bank's operations providing services at its branches for small (in bank terms) account holders."

"Banking services offered to individual customers such as savings accounts, personal loans, remittance services etc.,"

"Pure retail banking is generally conceived to be the provision of mass market banking services to private individuals. It has been expanded over the years to include in many cases services provided to small- and medium sized businesses. Some banks may also include their "private banking" business (i.e. services to high net worth individuals) in their definition of retail banking".

1.2 CHARACTERISTICS OF RETAIL BANKING

The definitions of retail banking as discussed above bring out the following characteristics:

1. Banking facilities targeted at individual customers.
2. Focused towards mass market segment covering a large population of individuals.
3. Offer different liability, asset and a plethora of service products to the individual customers.
4. The delivery model of retail banking is both physical and virtual i.e. services are extended through branches and also through technology driven electronic off site delivery channels like ATMs, Internet Banking and Mobile Banking.
5. Extended to small and medium size businesses.

1.3 ADVANTAGES OF RETAIL BANKING

1. Client base will be large and therefore risk is spread across the customer base.
2. Customer Loyalty will be strong and customers tend not to change from one bank to another very often.
3. Attractive interest spreads since spreads are wide, since customers are too fragmented to bargain effectively; Credit risk tends to be well diversified, as loan amounts are relatively small.
4. There is less volatility in demand and credit cycle than from large corporates.
5. Large numbers of clients can facilitate marketing, mass selling and the ability to categorize/select clients using scoring systems/data mining.

1.4 CONSTRAINTS IN RETAIL BANKING

Though retail banking as a segment has a number of embedded advantages, the segment suffers from constraints also. A few of the constraints are listed below:

1. Problems in managing large numbers of clients, especially if IT systems are not sufficiently robust.
2. Rapid evolution of products can lead to IT complications.
3. The costs of maintaining branch networks and handling large numbers of low-value transactions tend to be relatively high. (For this reason banks are encouraging clients to use cheaper distribution channels, such as ATMs, the telephone or internet for these transactions and reserve the branches for higher added value transactions).
4. Higher delinquencies especially in unsecured retail loans and credit card receivables.

1.5 EVOLUTION OF RETAIL BANKING

Having understood what retail banking is all about; let us see the evolution and history of

retail banking. **Retail Banking as a Business Model**

Gung Ho Retail Banking! Retail banking as a business model of banks had evolved over the years from the traditional banking space. Historically banking in the Indian scenario before 1960s was identified with lending to business and corporate clients for working capital and project financing. The traditional forms of banking in the above period was restricted to class clients and satisfy their total banking requirements in the form of financing for raw materials, work in progress, finished goods and bills receivables. For delivering these services, various products, instruments and facilities were introduced to serve the corporate customers. The operative accounts like current accounts for extending the above services formed an integral part of the services. The basic premises under which these services were structured were that the needs and requirements were straight and simple. But over a period of time, as the needs and wants of the customers expanded and more and more products and services were needed, banks had redesigned their product and service paradigm. There was an absolute need by banks to develop specialized and sophisticated products to meet the manifold and diverse growth of organizations. The stage had come where the legacy architecture of banks was unable to service the diverse needs and hence emergence of banks with functional focus came into existence. From being plain vanilla commercial functions, banks took new avatars like Investment Banks and Merchant Banks to carry out the investment side of banking and also corporate capital raising, fund raising and debt structuring activities. Investment function was hived off as a separate activity and also standalone investment banks had emerged to take of the multi dimensional functions of Investment Banking, Mergers and Acquisitions etc.,. Merchant Banks were the answer for Capital and Debt raising and other related activities. But the buck did not stop there, as banking was always on the explosion mode and there was absolute necessity for banks to reposition themselves with newer business models to satisfy the ever changing needs of the existing customers and also to cater to the expectations of the new class of emerging customers. As the evolution of banking was a continuous process with the broadening of the customer base and the character of the customers base changed from homogenous to heterogeneous over a period of time, banks were under the compulsion to redesign their products and services models to cater to these customers and fulfill their varied needs. Thus came corporate banking and retail banking. In some banks retail banking was christened as consumer banking as the focus was towards individual consumers.

Before discussing about the design of retail banking, let us have a look at the evolution of retail banking across the globe. Capgemini. ING and the European Financial Management & Marketing Association (EFMA) have studied the global Retail Banking market with the aim of providing insights to financial services community through the World Retail Banking Report(WRBR).The study conducted in 20()6 covered 142 banks in 20 countries covering the geographies of Europe - eurozone (Austria, Belgium, France, Germany, Ireland. Italy, Netherlands, Portugal, Spain),Europe-non eurozone (Czech Republic, Norway, Poland, Slovakia, Sweden, Switzerland, UK).North America and Asia Pacific (Australia, Canada, China, US).

The WRBR 2006 gives an overview of the dynamics at work in this retail banking industry.The report profiles indicated what the end consumers pay in a given country for day to day banking services and also the channel strategies. The gist of findings in the pricing front is briefly presented below:

- The average price of banking services increased by over 3% in the countries surveyed. However it was observed that that his trend masked differences between zones, especially between North America, where prices went down and the euro zone where they rose.
- Prices were converging slowly in the euro zone even as price differences between countries - including neighbours - remained high. This trend will continue as a result of central initiatives such as the Single Euro Payments Area (SEPA).The SEPA initiative aims to create a domestic payments market across the euro zone by 2010 and will result in competition, price transparency and homogeneity and will affect the revenue structure of the banks.
- The pricing indices were developed based on three usage patterns viz., less active, active and very active users. Usage pattern for particular products vary significantly between countries, leading to major differences between global and local prices.
- The average price of basic banking services based on the local active customer profile was 76 Euros in 2005.
- In a given region, prices varied according to usage pattern, with a ratio of up to one to 4.6 between prices paid by very active and less active users.
- Although similar prices were observed within a given region, they were the result of very different pricing models.
- Fierce competition (US) and evolving retail banking markets (Eastern Europe, China) have prompted changing price structures.
- Banks are reducing remote channel prices in order to drive greater customer use.
- Prices of seldom - used products have steadily increased over the past two years.
- Banking services follow the standard industrial development pattern in which prices decline with maturity.

According to the Report, the emergence of the new remote channels has changed the distribution paradigm of banks and strategies are to be in place to take on the multi channel challenges. Traditional retail banks are counterattacking incorporating direct sales and service into their channel architectures and continue to invest in alternative channels to keep up with market developments and customer demand. The challenges are two dimensional in multi channel management. The first dimension is to both develop remote channels and reposition branches to create more value for customer engagement. The second dimension is how to increase customer satisfaction and differentiate themselves from the competition while also improving the productivity of the multi channel model.

Capgemini covered a sample of 41 leading retail banks across the globe which included 16 banks in the euro zone. 15 in the non euro zone, five in China and five in North America to study how the banks are dealing with the challenges in multi channel management.The important findings of the study are summarised below:

- The distribution of sales among channels is an important factor in the channel strategies. Selling through the branch channel is the main format but over the years the volumes have dropped. From a high of 94% of sales routed through the branches in 2()00,it has come down to 86% in 2005 and likely to go down to 67% in 2010.On the other hand, sales through the Web which was low at 2% in 2000 moved up to 5% in 2005 and likely to move up to 17% in 2010.Same is the case with sales through phone moving up from a low of 4% in 2000 to 8% in 2005 and likely to move up to 13% in 2010.The above indicates the rapid migration of sales from the direct channels to remote channels over the past five years and the likely more aggressive movement in the coming years.
- The distribution of services among channels is another important factor in channel strategies. The percentage of day-to-day banking transactions carried out through different channels underwent a drastic change over the years. From a level of 70% of the transactions that happened through branch in 2000, it has dropped to 42% in 2005 and likely to drop to 30% in 2()10.Consequently,the transaction level has improved from 19% in 2000 to 29% in 2005 and likely to touch 28% in 2010.1n the same way, the transactions through Web which was very low at 4% in 2000 has moved up to 18% in 2005 and likely to reach 28% in 2010.Phone Banking transaction usage also moved up from a low of 5% in 2000 to 9% in 2005 and to reach 12% in 2010.11 vindicates the growth of remote channels over direct channels in the recent years and the likely explosion of usage of remote channels in the coming years.
- The banks in the sample expect their remote channels to deliver 33% of their sales in 2010 up from 6% in 2000. This trend holds good for all kind of products from simple current accounts to more complex mortgages and insurance products.
- Among the remote channels, though ATMs were the early leader, the Internet is clearly driving the next wave of automation.
- The rise in usage of remote channels will necessitate a fresh look at the branch format and move to advisory selling in branches by suitably repositioning the branches for advisory selling. Staff will be trained as Advisors to handle the customers across multiple channels and their business enquiries. The emerging trend of development of advisors with proactive attitude to clients looks very positive with a score of 88%.
- Managing multi channel challenges includes creation of multi channel common customer file to handle in bound customers and also calls. Only 33% of the surveyed banks have an effective multi channel common customer file.

Retail Banking in UK

In UK the first significant changes in retail banking occurred after the introduction of the telegraph in the early 1850s which made the process of communication and information exchange faster and reduced the price differentials between stock markets. Moreover, a more intense level of communication induced frequent administrative transactions between the head offices and the branches. This later resulted in changes in the organizational structure so that peripheral offices became able of performing operations that were once exclusively delegated to the central offices. During the last quarter of the 19lh century, banks were actively involved in the consolidation of branch networks so that they could operate in a more integrated manner at regional level, opening new offices and creating a structure of financial activities from lending to exerting the control of customers. Banks accrued a large-scale dimension by means of extensive mergers and acquisitions. The decline of British banks over time was accompanied by an increase in the number of banking offices. From the beginning of the period, private banks operated just under one-half of all bank offices but this figure faced a decreasing trend after the 1850s. These changes in the management of outlets were mainly due to a greater willingness of joint-stock banks to operate branch networks and a greater concentration of ownership through inter-bank mergers. The aggressive policy of branching continued after the 1900s when the number of offices resulted three times bigger. These considerations lead to the conclusion that whilst diminishing in number, banks accrued higher market concentration and, most importantly, more interoperability. Financial services were then merely restricted to routine operations and the formal provision of short term loans. The necessity of an efficient and reliable information management became clear, for banks could not realize fruitful synergies with the set of industrial activities in the absence of adequate information flows. For these reasons, a core practice in banking has been, ever since the creation of confidential records, to be valid memoranda of the discontinuous relations with customers. More importantly, the activity of record keeping opened way to the definition of standardized practices aimed at connecting efficiently the local offices to the central management. The definition of unofficial standards in operative practices has been a long term phenomenon in banking and it is noteworthy to notice that the grounds of such an argument stand in the very nature of the banking, which is based on trust and confidence mutually established with customers and reinforced by information management. In this perspective, the emergence of clerks and typists seemed particularly important during this phase, due also to the commercial introduction of the typewriter in 1873, for these accrued a dynamic dimension to the process of division of labour. To make the system work more efficiently, introduction of technology initiatives in the banks had gained attention of the banks. The development of services in retail banking is an articulated process within which the technical and the organizational dimensions followed distinct, yet complementary, patterns of growth.

(Source: The evolution of retail banking services in United Kingdom: a Retrospective Analysis. Davide Consoli, CRIC Working Paper No 13, September 2003, ISBN: 184052 0116)

Retail Banking in US

The traditional image of banking in US features a stately office on Main Street where the branch manager understands the local market and has strong customer relationships. But technology and regulatory changes in the 1990s challenged this bricks-and-mortar business model. Automated teller machines (ATMs) proliferated after the national ATM networks dropped a ban on surcharges in 1996; by 2002, there were 352,000 machines in the United States. The Internet gave customers electronic access to their accounts and even gave rise to "virtual" banking organizations; in 2000, forty Internet banks were in operation. Banks also developed centralized call centers to handle customer service issues and to initiate transactions, including deposits and loans. In concert with these changes, many institutions shifted activities once carried out by branch bank personnel, such as small-business loan approval and management, to regional or national offices. All these developments appeared to reduce the role of the traditional bank branch in the delivery of retail banking services.

These changes were reinforced by deregulation in the 1990s. In particular, the Riegle-Neal Act of 1994 allowed banks to branch and merge across state lines, contributing to an era of bank consolidation that focused on reducing costs to boost profits. As a result, the number of US banks and Thrifts fell from about 12,500 in 1994 to a little more than 9,000 at the end of 2003. During the same period, the number of bank and thrift *branches* actually rose. Banking organizations began to expand their branch networks following the banking crisis of the late 1980s and the 1990-91 recession; from 1993 to 2002, the number of bank branches climbed 8.6 percent. The Riegle-Neal Act contributed to this branch expansion, as did the Gramm-Leach-Bliley Act of 1999—the latter because branches could be used to distribute the insurance and securities products that the legislation permitted banks to originate. Together, the declining number of banks and rising number of branches have resulted in greater consolidation of branches and deposits in the nation's larger bank and thrift organizations. In 1994, midsized branch networks (100 to 500 branches) and large branch networks (more than 500 branches) accounted for 53 percent of the country's deposits and 46 percent of the branches. By the middle of 2003, those figures had risen to 61 percent of deposits and 51 percent of branches. The greatest amount of consolidation has occurred in a subset of the large branch networks - specifically, those with more than 1,000 branches—which we term the "very largest" networks. These networks contained almost 20,000 branches in June 2003, up sharply from 9,200 branches in 1994. The very largest branch networks now claim nearly 25 percent of all US bank branches.

The consolidation of branches into larger networks has been accompanied by increased interstate branching and banking. Between 1994 and 2003, the number of organizations with branches in more than one state nearly doubled to 538, while the number of organizations decreased by one third. More than a dozen bank and thrift branch networks now have a presence in at least 20 percent of the country.

The institutions with the widest geographic reach have branches in about half the states—a field of operation that is still short of truly nationwide banking, but considerably more extensive than what prevailed ten years ago. The trend toward consolidation of branches into large branch networks has implications for bank customers and the banks themselves. Traditionally, consumers and small businesses have relied most heavily on bricks-and-mortar branches to access bank services. The evidence suggests that these customers face something of a trade-off in light of the growth of very large branch networks. On the one hand, larger banking organizations tend to charge higher fees than smaller institutions.

Thus, branch-dependent customers could face additional costs as branches are increasingly consolidated into the larger branch networks. On the other hand, large branch networks offer the convenience of many points of contact with the institution and, very often, the ability to avoid ATM surcharges and other usage fees by staying within the bank's network. Academic research suggests that depositors value geographic reach (branches in many states and municipalities) and local branch density (many branches of an institution in a given area) when selecting a depository institution. Market surveys also suggest that customers place a premium on convenience when choosing a bank: 39 percent of bank customers surveyed in 2001 indicated that they selected their bank primarily because of its location. These findings suggest that many customers value the scope and scale of large branch networks. For the banks themselves, the consolidation of branches within large branch networks has implications for cost structure, business focus, and profitability. Full-service branches entail significant costs that banks must cover through the revenues generated by these networks, primarily the implicit and explicit income associated with deposit accounts.

In choosing to continue to expand their branch networks, these organizations seem to have made the judgment that retail banking activities remain an effective channel for generating revenues, despite the associated costs and the development of alternative distribution channels such as call centers, ATMs, and online banking.

(Source: The Evolution of US. Bank Branch Networks: Growth, Consolidation and Strategy - Beverly Hirtle and Christopher Metli- Current Issues in Economics and Finance -Federal Reserve Bank of NewYork - July 2004)

Retail Banking in Europe

Europe's largest economy and the second-most populous nation, Germany was once celebrated as Europe's economic powerhouse. But falling exports combined with high costs due to an inflexible labour and services market and the modernization and integration of East Germany have contributed to muted economic growth. The German banking industry is dominated by universal banks that combine the functions of commercial and investment banks, including the securities business. The Association of German Banks estimates that universal banks contribute to over 75% of the industry's total business volume. A striking feature of the country's banking industry is the high number of banks and the dense branch network. There are over 2,300 banks in Germany with over 46,000 branches. Around 1,500 of the banks are very small in size with a business volume of less than €1 billion.

Germany's fragmented banking sector stands apart in the European banking landscape. Its large private banks, the "Big Five" - Deutsche Bank AG, HypoVereinsbank AG (HVB), Dresdner Bank AG, Commerzbank AG and Deutsche Postbank AG - account for a significantly smaller share of the sector compared to other economies. There are around 400 savings banks while of the 300 odd private banks, around 120 are foreign banks with branches in Germany. Bundesbank data shows that the top five banks together hold 12% of the nation's €1 trillion consumer lending market.

Historically, the country's banking system has been based on a unique three-pillar model comprising private commercial banks, public sector banks and cooperative banks. A recent paper from the Centre for European Reform states that savings banks control around 40% of the banking market, while the cooperative banks control around 30% of the market. Public sector banks include savings banks or "Sparkassen" that are organized on a regional basis and their head institutions are known as "Landesbanken". They focus primarily on the economic developments of their respective regions rather than profit maximization. This philosophy appeals to the ordinary consumer, especially during times of stress. Local media reports suggest that in face of the current financial crises, Germans are turning towards these savings banks to keep their savings safe. It is estimated that deposits at the 400-odd savings banks increased by more than €1 billion (SI.4 billion) in the first two weeks of October this year. However, the lack of competitiveness of co-operative banks has long been a cause of concern both for the German authorities and business.

According to an analysis by The Banker in 2007, German banks overall managed to increase profits as a percentage of capital, to 7.47% in 2007 from 4.67% in 2006. But. says The Banker, this remains far behind the other large European economies, "owing to low profitability in the Landesbank and savings bank sectors." Germany still hosts the most number of banks in Europe and exhibits the most fragmented market in the region. Savings and co-operative banks account for more than 50% of the country's deposit base and close to 70% of the savings deposits.

Competition is intense in the German retail banking sector. While on one hand, foreign banks such as Citi and Santandcr have established themselves in the highly competitive consumer finance segment, direct players such as ING DiBa, an online subsidiary of ING Bank of Netherlands, have a strong play in deposits and mortgage lending. ING DiBa has very successfully increased its customer base from 1 million in 2002 to over 6 million today. Another key player in the retail banking segment is Deutsche Bank, which for long had focused on expanding its investment banking operations abroad. Its retail banking ambitions are now obvious. In 2006 Deutsche Bank purchased Norisbank, a consumer bank and Berliner Bank, an up-market retail bank, and now has a stake in Postbank. the largest retail bank with 14.5 million customers in the country.

The direct banking model has proved highly successful in Germany. ING DiBa offers solely via phone, Internet, and a large network of ATMs and boasts of the third largest number of customers in the country. The financial services subsidiaries of German car makers such as Volkswagen also operate as direct banks. Volkswagen for instance, looks after 3 million private customers in Germany. Another banking business model gaining popularity is the cooperation of retailers and banks. Big German fashion retailer C&A founded its own bank in the beginning of 2007 and started offering consumer credits online as well as in its stores. In addition, C&A offers motor insurance contracts in collaboration with DA Direkt, a member of the Zurich Group. Another example of such collaboration is Tchibo, a big German coffee bar and shop chain, which offers consumer credits of RBS, current and savings accounts of Deutsche Postbank, sight deposits of Comdirect and insurance products of Asstel. Tchibo sells these products only online or by phone.

Investment in technology among banks is very high, not only among the top tier players but smaller banks as well. Adoption of technology by customers is high too, as is evident from the popularity of direct banks. At Postbank, for instance, over 65% of its customer base uses online banking. The demand for online banking services today is far more than account balance inquiries and transfers. Since the launch of Postbank's online brokerage, at the start of the new millennium, customers have been able to buy or sell shares, bonds and investment funds or subscribe to new issues. SMS alerts when salary payments are received or when chosen thresholds are reached in safe custody accounts complete the service offerings. In 2007, with iBanking, Postbank was the first bank in Germany to make it possible to use the iPhone for banking. Analyst firm, Forrester estimates that 39% of Germans now bank online. Forrester expects online banking to grow by about 4% each year with 47% of adults or 32 million Germans banking online by 2012. The main drivers of this trend will be users' confidence in the channel, banks' robust security measures, and strong competition for retail banking customers. Broadband connectivity too plays a key role in encouraging online banking usage. Forrester states that by the end of 2007, there were 16 million German broadband households — more than in any other Western European country — but this equated to only 43% of German households. Forrester predicts a further 11 million households will have broadband access by the end of 2013, many of which have dial-up connections today.

(Source .-Article on Banking in Europe - Rekha Menon, Research and Contributing Editor, FinacleConnect)

Retail Banking in Russia

The retail banking scenario in Russia had thrown different business scenarios for banks. A study in 2007 which analysed the retail market trends, non payment risks and loan portfolio profitability of different banks revealed that the retail banking market had not reached the saturation level and there was space to accommodate new banks. Some of the interesting revelations are

- The top ten banks accounted for 63% of retail loans.
- Overdue retail loans were at 75.5bn roubles.
- Overdue auto loans were growing faster than the market.
- Profitability of retail portfolios was between 23-50%.
- The share of retail loans in the loan portfolios increased at a stable rate and was over 24% in the first quarter of 2007.
- Interest margins on rouble retail loans had come down from the beginning of 2006 but remained higher than for other loans. This decline was due to the higher cost of resources and a general fall in interest rates.
- The retail loan market grew by 75% from the beginning of 2006. Auto loans, credit cards and mortgages were the fastest growing segments. Among the banks with the largest loan portfolios are those that entered the retail loan market in 2006, which showed the market had a large capacity and was not saturated.
- Sberbank was the number one in retail banking with a market share of 37% followed by Russian Standard Bank with a market share of 8%.The above banks were the major banks in the retail space and other banks were with market share of below 5%.

(Source : Retail Banking in Russia- Different Loans-Different Risks- June 2007- Report by Rus Rating)

Retail Banking in Asia and South Pacific

Asian banks experienced enormous growth in personal banking in the recent period fuelled by expansion in household credit, online banking, credit cards etc. In Korea, household credit now accounts for about half of the total outstanding bank loans and this trend was evident in several other Asian economies. In China as per a recent report of the Lehman Brothers, mortgage and consumer credit in China grew by 70 percent in 2001 and already reached 10 percent of the total bank loan outstanding. Korea, Thailand, Malaysia, Taiwan and Philippines experienced growth in credit cards in the range of 20 percent in 2002 and China's credit card market is expected to grow by 75 percent to 100 percent in the next three years. In Korea value of credit debt, now accounts for about 16 percent of the total household borrowing and about 11 percent of the total private credit outstanding. In 2002, Value of credit card debt outstanding has registered a growth of 47 percent in Korea, 34 percent in Philippines, 30 percent in Thailand, 28 percent in Taiwan, 21 percent in Malaysia and as a percentage of total domestic credit, it ranges from 3 percent in Malaysia to 11 percent in Korea. Growth in the household credit/personal loans was further accentuated by a number of relief measures announced by the governments to promote housing loans, use of credit cards and supplemented by additional measures announced by banks such as fee waivers, higher credit limits etc. With growth of personal banking and household credit, banks are transforming from transaction-based activities to process based activities that requires sophistication in risk management.

Retail Banking Scenario in India

The evolution of retail banking in India can be traced back to the entry of foreign banks. The conventional banking business by Public Sector Banks (PSBs) was done on a more generalized approach and there was no specific demarcation as retail and non retail activities. Customer and Industry segmentation was adopted within the overall business plan of banks. Offering products and services based on specific consumer segments was not attempted in a focused way. Foreign banks operating in India set the trend and in the late 1970 and early 1980s and came out with their consumer banking models with hybrid liability and asset products specifically targeted at the personal segment. Standard Chartered Bank and Grindlays Bank were the pioneers in introducing these types of products. Citibank created waves in the early 1980s with their credit card products and spurred the retail banking space. State Bank of India and some public sector banks like Indian Overseas Bank, Bank of India, Bank of Baroda and Andhra Bank developed and marketed asset products and card products to cater to retail segment. In fact, Bank of Baroda and Andhra Bank were two of the early players in the credit card business in the PSB space. The entry of new generation private sector banks in early 1990s has created a new approach to retail banking by banks. With the advantage of technology right from start, these banks had a clear positioning for retail banking and aggressively strategised for creating new markets for the retail segment. In addition, the new generation private banks had posed a threat to the retail business of foreign banks that had by then well defined business models for retail banking. To add to the fuel, PSBs also with technology initiatives and redefined business model for retail had aggressively entered the market space, creating a retail war and capture their share of the pie in the liberalized economic environment and the resultant opportunities in retail banking. The retail war is in full swing now with a win - win situation for all the players and the focus is on capturing and improving the market share and customer base.

Strong economic fundamentals, growing urban population, higher disposable incomes, rise in young population, emergence of new customer segments and rise in the mass affluent space, explosion of service economy in addition to manufacturing space have catapulted the scope for retail banking business in India. The segment has become an important component in the business design of the banks in India and almost all players in the foreign, public and private (old and new) space are in this and it has become almost a fashion statement for all the players. The retail plans basically stems from the enormous opportunities across geographies and customer segments and the huge untapped potential for retail banking in India. There is a virtual gold mine to be unearthed and even the top layer is not yet scratched fully. There is a whole lot of customer pyramid to be tapped and the present activities till recently were confined only to the top and higher middle end of the customer pyramid. Of late banks, especially foreign banks and new generation private players are seriously looking at the bottom of the customer pyramid and reengineering their retail strategies to develop independent and exclusive strategies for this segment. In addition, the recent trend is that Non Banking Finance Companies (NBFCs) have also aggressively entered and active in this 'Bottom of the Pyramid' segment and posing a big threat to the conventional banking players.

A recent study pointed out that the retail banking industry in India grew by a compounded annual growth rate of 30.5% between 1999 and 2004 and the figures will be much higher based on the performance of the banks in this space in the subsequent years.

In India total asset size of the retail banking industry grew at a rate of 120% to reach a value of $66 billion in 2005. This growth in retail banking sector has helped in the growth of the overall banking sector. Retail Banking is expected to grow at above 30% and retail assets are expected to tough a whooping $300 billion by 2010.But even with this growth rate, still the potential for the growth in retail assets looks very promising. The contribution of retail assets to Gross Domestic Product (GDP) n India is 6% and is comparatively lesser than that of other Asian counterparts like China (15%), Malaysia (33%), Thailand (24%) and Taiwan (52%).This indicates the lower level of penetration of retail banking in India and strengthen the views and strategies of the retail players.

(Source : Retail Banking - Models, Strategies,Performances and the Future- The Indian Scenario - Unpublished Research Report by Dr.J.Sethuraman for IIBF.)

A report by McKinsey & Company on 'Emerging Challenges to the Indian Financial System' (April 2007) has highlighted the huge potential available for personal financial services and the different spaces available for banks to encash this potential. The gist of the observations is detailed below:

- Three forces are shaping the personal financial services (PFS) in Asia: the continuing surge of new customers entering the banking system, the explosive growth of consumer credit at 30 per cent per annum and the emerging need for wealth management due to increasing affluence. These forces can dramatically shift the current focus of banking needs from traditional banking products and services(e.g., deposits,mortgages) to advanced investment, credit and advisory products and services(mutual funds, unsecured personal loans).
- With rising income levels, India is becoming an increasingly attractive market for retail financial products. India's consumer finance boom will see revenues rising from more than 20 to 25 per cent per annum over the next five years, from US $3 billion today to about US $10 billion by 2010.
- In addition to consumer credit, payment products such as credit and debit cards will drive growth, with more than 50 million credit cards likely to be in force by 2()l(),depending on issuers' ability to penetrate second tier towns and segments such as self employed.
- By 2010, the number of high net worth individuals (annual income greater than US $ l million) will grow to 400,000.
- Current offerings will be inadequate to capture these opportunities, leaving a gap for innovative players to fill in.
- In wealth management, local banks have primary relationships and branch networks, but these may not be key buying factors for more sophisticated consumers. Success in affluent/private banking will require an extensive product range spanning debt, equities, investment funds, alternative assets and a range of ancillary services, with a comprehensive expert advisory process.
- Global banks are at advantage since they can already provide a wider range of products and services and have the talent pool to deliver them well.
- To maintain leadership in the emerging sectors, Indian banks will have to develop talent, product and advisory skills within a short time.
- Despite credit and deposits growth in India, banking access remains limited to a few sections of the population and there is great disparity in the penetration of banking products among the different classes. While many customers are well served by

traditional financial services providers, the unbanked segment represents an under-penetrated opportunity.

Another proprietary McKinsey Personal Financial Services Survey in 2004 revealed the following:

- In the "urban mass" households (income between Rs.25,()(M) to Rs.200,000 per annum comprising nearly 32 percent of the total households in India), penetration of credit cards is only 4 percent and that of auto loans is negligible.
- As compared to the above, the penetration of credit cards and auto loans are 22 per cent and 5 per cent for "mass affluent" households (Income between Rs.2()(). (MX) and Rs.500, 000 per annum.).
- In case of "affluent households" (Income between Rs.500, (MM) and Rs. 1000, 000), the penetration levels for credit cards and auto loans are at 34 per cent and 14 per cent.

RBI Data on Retail Banking in India

The growth in various elements of retail banking space over the years are published by Reserve Bank of India in their "Report on Trend and Progress of Banking in India".The growth figures under various spaces as detailed below reflect the business performance achieved in the retail assets and other services:

(i) Growth Rate of Retail Assets of the Banking System

<Rs. In Crores)

S.No	*Type of Retail Asset*	*2004*	*2005*	*2006*	*2008*	*2009*
1.	Housing Loans	89449	134276 (50.5)	179165 (33.4)	252932 (12.7)	263235 (4.1)
2.	Consumer Durables Loans	6256	3810 (-39.10)	4469 (17.3)	4802 (-34.2)	5431 (13.1)
3.	Credit Card Receivables	6167	8405 (36.3)	12434 (47.9)	27437 (49.8)	29941 (9.1)

4.	Auto Loans		35043	61369		87998	83915
					(75.1)	(6.6)	(-4.6)
5.	Other Personal Loans	87170	85077	118355		197607	211294
				(37.8)	(39.1)	(27.5)	(6.9)
6.	Total Retail Loans	189042	266611	375739		570776	593815
				(41.2)	(40.9)	(17.1)	(4.0)

(ii) Percentage of Retail Assets to Total Assets of the Banking System

\ In Crores)

S.No.	Details of Advances	2004	2005	2006	2008	2009
1.	Total Advances of the Banking System	864271	1125056	1473723	2332032	2793572
2.	Percentage Share of Retail Assets to Total Advances	21.9	23.7	25.5	24.5	21.3
3.	Growth Rate				23.2	19.8

Source: Reserve Bank of India - Report on Trends & Progress in Banking in India

(Hi) Number of ATMs of Scheduled Commercial Banks(2008-09)

ATMs	Numbers
Number of Onsite ATMs	24645
Number of Offsite ATMS	19006
Total Number of ATMs	43651
Number of Bank Branches	64608
ATMs as a Percentage of Bank Branches	67%
Growth of ATM installations by Banks in 2009 over 2008	25.4%
No. of Branches covered under CBS	44304
Coverage of Branches under CBS in 2009	79.4%

Source: Reserve Bank of India - Report on Trends & Progress in Banking in India

(iv) Retail Electronic and Card Based Payments

Service	Transaction Volumes (ooos)		Growth in Volume (%)		Transaction Values (Rs. in Crs.)		Growth in Value (%)	
	2008	2009	2008	2009	2008	2009	2008	2009
ECS CREDITS	78365	88394	13.5	12.8	782222	97487	839.3	-87.5
ECS DEBITS	127120	160055	69.0	25.9	48937	66976	92.3	36.9
EFT/NEFT	13315	32161	178.8	141.5	140326	251956	81.2	79.6
CREDIT CARDS	228203	259561	34.6	13.7	57984	65356	40.2	12.7
DEBIT CARDS	88306	127654	46.7	44.6	12521	18547	53.2	48.1
TOTAL	535309	667825	41.4	24.8	1041990	500322	342.1	-52.0

Source: Reserve Bank of India - Report on Trends & Progress in Banking in India

(v) RTGS Transactions

S.No	*Transactions*	*March 2008*	*March 2009*
1.	Volume in millions	About 6	About 13 About
2.	Value in Rs. Billions	About 15000	34000

Source: Reserve Bank of India - Report on Trends & Progress in Banking in India

(vi) Deposit and CAS A figures

S.No	*Term Deposits and CASA*	*March 2008*	*March 2009*
1.	Term Deposit Growth Rate	23.1%	22.4% 13.4%
2.	CASA Growth Rate	20.2%	51.08%
3.	% of Term Deposit to Total Deposits	49.3%	

Source: Reserve Bank of India - Report on Trends & Progress *in Banking in India*

(vii) Share of Interest Income to Total Income

S. No	*Income Segment*	*2005-06*	*2006-07*	*2007-08*	*2008-09*
1.	Interest Income in%	84	84.3	83.6	83.8
2.	Non Interest Income in%	16	15.7	16.4	16.2

Source: Reserve Bank of India - Report on Trends & Progress in Banking in India

The above data throws open the following interesting revelations about the performance of the retail banking segment in the recent past.

Performance of Different Segments of Retail Banking from 2004 to 2009

l. Retail Banking in general which had shown a growth of more than 30% during 2005 to 2008 was under strain during 2009.All the major segments of retail banking had lesser growth rates in 2009 than the previous years. The deceleration of growth is more pronounced in the retail asset segment.

Financial turmoil across the globe was the main reason for the slower growth in retail banking and the resultant defaults in retail loans.

2. The retail asset growth which was at about 40% in 2005 and 2006 came down to about 17% in 2008 and further slided down to 4% in 2009.In the retail assets, the segments which suffered most were Consumer Durable Loans and Auto Loans. The receivables in Credit Cards were maintaining the growth rate till 2008 but came down drastically in 2009. Similarly in Housing Loans also there was a drastic reduction in growth.
3. The percentage of retail assts to total assets which was at 25.5% in 2006 had came down to 21.3% in 2009. Again the growth rate of retail assets had also came down to 19.8% in 2009.
4. The number of ATMs as on March 2009 was at 43651 as against the total number of bank branches at 64608.The number of ATMs as a percentage of bank branches was at 67% as on March 2(M)9 indicating the approach of the banks in customer migration from branches to electronic mode. To add. the number of on site and off site ATMS reflect that banks are serious in not only making the ATMS available in the branches but also had increased the convenience factor to enable the customer to use the ATMs in away from branch locations also at different and convenient points.
5. The number of branches covered under CBS looks very attractive.Out of the total 64608 branches of scheduled commercial banks, 44304 branches (69%) are covered under CBS. i.e. offering across geography banking solutions to customers and not restricting to the branch where the account is held. This gives tremendous opportunities for banks to devise an integrated approach to retail banking.
6. Retail electronic and card based payments registered a quantum jump in the past two years mainly due to introduction of RTGS (Real Time Gross Settlement) and NFFT (National Electronic Funds Transfer). The volume and value of transactions through RTGS had more than doubled, though wholesale remittances constitute a major proportion of RTGS transactions. The concept of electronic remittance mechanism is picking up fast over the past two years and this trend offers potential to package a remittance product as a add on in their retail banking package to the customers.
7. The growth rate of Term Deposits of scheduled commercial banks came down marginally during 2009.(Growth of only 22.4% in 2009 as against 23.1% in 2009).lf we take an average of 60% of the term deposits are from the household segments/retail segment (percentage extrapolated based on the historical published figure), the core deposit growth was under stress in 2009.
8. The most affected segment in the retail liabilities space was in the CASA front. CASA refers to Current Accounts and Savings Accounts. There was a drastic degrowth in CASA,with CASA sliding to 13.4% in 2009 from 20.2% in 20()8.The same is supported by the percentage of Term Deposits to Total Deposits which had improved to 51.08% in 2009 from 49.3% in 2008.
9. Another important point of discussion is about the composition of income of scheduled commercial banks. The share of interest income had almost remained steady at about 84% and the share of non interest income also is almost stable at around 16%.This indicates that there were no serious efforts by banks to increase the non interest income through fee based product and third party distribution models.

The different scenarios in retail banking indicated different dimensions of retail banking and its impact on profitability. Retail Banking is a critical source of revenue and profitability for most major banks around the world. According to a research study by Boston Consulting Group, retail segment brings in nearly 60% of the total banking revenues worldwide. It is expected that this situation will continue and retail banking will remain the dominant source of revenue for banks worldwide through 2015. But the fact is that retail banks are facing tougher competition and continuously declining margins and to overcome this, banks have to develop winning business models and requisite skills.

From the performance behaviour of retail banking space across the globe it is very clear that the segment had picked up momentum during the early 2000s and peaked during 2006 and 2007 but was affected due to the financial turmoil across the globe from 2008.Though India was insulated from the financial turmoil to a great extent due to regulatory discipline, the retail banking space suffered some setback taking a hit in credit card, housing and consumer loans. The growth rate was lower and the delinquencies had started moving up causing concern to the bankers. Of course corrective steps were put in place by the Government, Reserve Bank of India and Banks by formulating and implementing suitable restructuring and rescheduling measures to arrest the erupting Non Performing Assets due to defaults. But the bottom line is that retail banking as a business model is under stress.

Retail Banking - Present Status

A White Paper presented by Boston Consulting Group in October 2009 on the present status of Retail Banking is summarized below:

1. Today's retail banking industry is in crisis. The symptoms can be ticked off like so many ingredients in a bad recipe: lack of market growth, shrinking revenue pools, uncertain long term liquidity, huge loan losses, tightening regulation and sluggish value creation.
2. The economic fundamentals of the banking business are changing. Not only are deposit margins being squeezed by low rates, but the ability of banks to recover is being compromised by hyper-competition lor funding and pressure from regulators on fees. As a result the search for profitability is tilting permanently toward the asset side of the balance sheet where more difficulties arise.
3. Although margins on the lending side are widening and debts are worsening as the results of poor credit decisions made over the past five to ten years, the availability of credit has dropped, and underwriting and risk management have become more critical than ever.
4. Established brands will fare better than monolines or newer, attacker type companies. But both attackers and incumbents will have to dramatically improve their sales and service processes.

Global Trends in Retail Banking

The BCG report has further opined that the global trends in retail banking have crystallized. The retail banking objectives of any bank would mainly focus on the following:

1. Generating superior returns on assets.
2. Acquiring sufficient funding
3. Enhancing risk management
4. Understanding customers and regaining their trust.
5. Coping with increased demands regarding product transparency and overall service levels.
6. Achieving multi channel excellence with fully integrated banking channels.
7. Moving toward higher levels of industrialization (which is mandatory for rapid innovation and deployment.

Though the general scenario is under stress, the above trends are also creating opportunities for institutions that astutely adopt their strategies and implement changes quickly, efficiently and effectively and such banks will be the winners in the market.

(Source: Come out a Winner in Retail Banking- Killian Berz, Vincent Chin, and Andy Maguire- BCG White Paper -October 2009.)

Terminal Questions

1. Advantages of retail banking
   - (i) Risk is less as client base is large
   - (ii) Income is relatively more as spreads are more

(iii) Stable model with less volatility
(iv) i and ii
(v) all the above

Ans: iv

2. What are the disadvantages of retail banking

(i) Huge clientele requires more efforts for monitoring and tracking.
(ii) Cost of servicing will be relatively high.
(iii) Delinquencies relatively higher in unsecured retail loans like Personal Loans and Credit Card
Receivables
(iv) (ii) and (iii)
(v) All the above

Ans: v

Key

1.(iv); 2. (v)

Let Us Sum Up

- Banking services offered to a large group of individual customers is referred to as 'Retail Banking'.
- The delivery model of retail banking is both physical and remote - through branches and also through remote channels like ATMs, Internet Banking and Mobile Banking.
- Retail Banking has many advantages as a business segment for banks:
    - Risk is less as client base is large.
    - Income is relatively more as spreads are more.
    - Customer loyalty will be strong.
    - Stable model with less volatility in business as the client base is very large.
    - Higher cross selling potential.
- But it has its own disadvantages also:
    - Huge clientele requires more efforts for monitoring and tracking.

- Cost of servicing will be relatively high.
- Delinquencies relatively higher in unsecured retail loans like Personal Loans and Credit Card Receivables.

- Globally the retail banking space had a great growth trajectory and the emergence of the new remote channels has changed the distribution paradigm of banks. Alternate channels have gained prominence to meet the growing customer demands.
- The performance of banks in retail banking across the globe had a stable growth but was under stress in 2008 and 2009 mainly due to the global financial crisis. But the potential for retail banking based on customer segments and household incomes looks highly promising. The growth potential in Asia and South Pacific is very attractive and the numbers are expected to grow in the near future.
- Retail Banking as a concept in India has been initiated by the PSBs and nurtured by the foreign banks and new generation private sector banks. It grew by a compounded annual growth rate of 30.5% between 1999 and 2004 and expected to grow at above 30% in 2010. In 2008 and 2009, as per RBI data, the retail banking segment suffered setback due to the impact of the global economic turmoil but with the signs of recovery already visible, the industry is poised for a promising growth. The penetration level of retail banking in India is still very low as compared to the other Asian countries like China, Malaysia, Thailand etc..

Keywords

Retail Banking; customer base, risk diversification, spread, customer loyalty, database; delivery model.

UNIT
2

UNIT 2 RETAIL BANKING: ROLE WITHIN THE BANK OPERATIONS

STRUCTURE

2.1 Introduction

2.2 Business Models

Terminal Questions Let us Sum Up

Keywords

2.1 INTRODUCTION

Banks follow different approaches for their retail banking activities. The role and importance of retail banking across banks differ and different models are adopted by banks. The models and processes depend upon the importance attached to the retail banking space in their overall corporate business strategies and the business projection over the years for retail banking.

The business models for retail banking show interesting revelations across types of banks. The models adopted by banks vary among the public sector, private sector and foreign banks. The main approaches are as follows:

(a) Strategic Business Unit (SBU) Approach,
(b) Departmental Approach,
(c) Integrated Approach (part of the overall business plan).

Public Sector Banks in India generally have adopted the Departmental Approach as their retail banking business model. The model is uniformly adopted by all the banks immaterial of their balance sheet size or geography. It indicates that the approach is more a general one with retail banking as one of the business models and not a focused business model. In a research study on the models followed by about 10 banks comprising of public, private and foreign banks, the SBU approach is adopted by one of the top five public sector banks based in Mumbai and their business model is in alignment with private sector banks and foreign banks.

In old generation private sector banks the approach is more conservative. The business model for retail banking is built as a part of the overall business plan and not done as a separate departmental activity, leave alone SBU.

In new generation private sector banks, the business model is very clear. They had set up Strategic Business Units (SBU) to have clear focus and business objectives.

In foreign banks also, SBU is the business model followed with defined business focus. The demarcation as a SBU is more a Management By Objectives (MBO) process wherein the business model is dealt as a modular strategy for achieving targeted profits with a provision to knockdown the module, if the retail plans are not translated as per the objectives.

If we go further deep into the models of retail banking followed by banks with regard to products, processes, delivery channels, technology etc, the real depth of retail banking, the relevance of each element for the efficiency of the total model and the inter dependency of these elements for the success of the models are revealed. Let us have a look into the revelations.

■

2.2 BUSINESS MODELS

Banks generally structure their retail banking models mainly on a positioning platform and to be the best/top three among the peer group players or across players. Strategies are based on the positioning objectives and vary from bank to bank depending on the importance attached to the business model.

Among the public sector banks, some banks aim for a place among the top three retail players across banks including peer group banks while some other public sector aim for a space in the top three among the peer group. But the strategy adopted by these banks was a part of the overall strategy based on the business mix. projections and corporate objectives of the bank.

In case of old generation private banks, the positioning platform is very clear. It is based on the overall business plan and in line with their size and scale. But within the overall objective, for example, one Tamil Nadu based bank aims to achieve one of the top three slots among the peer group banks. Their technology initiatives were in line with their positioning objective.

The new generation private banks have clear vision about their positioning platform. They want to be in Ihe top slot across all class of banks and justifiably so. The technology, strategy, customer and business initiatives and aggressive positioning are the advantages these banks enjoy to achieve the desired objectives. Even recent entrants in the private sector side have clear positioning strategies about where they want to be, going forward, in the next two/three years and put suitable action plan to achieve their objectives.

Foreign banks generally do not go by positioning objectives but purely on business objectives. They go by customer, business and profit targets. They take a call on the business model itself or one segment of the overall model, if the same is not profitable and either exit the retail banking segment itself or exit a particular business line within the model. The classic example is BNP Paribas which entered the retail banking space very aggressively during the late 1990s with a full fledged brand building exercise but quit the space after they found that it was not a profitable segment for them with the business they generated. Likewise, American Express came out of their credit card business after taking stock of its viability. On the positive side, though ABN Amro Bank was a late entrant in the retail banking space with their entry in mid 1990s, still they had a clear positioning focus for building up the retail banking franchise. ABN Amro Bank was a late entrant in the credit card space also but they had built up the card base aggressively and posed a threat to other established credit card players.

Terminal Questions

1. The business model followed by Banks for retail banking are

(i) Strategic Business Unit (SBU) Approach
(ii) Departmental Approach
(iii) Integrated Approach
(iv) Anyone of the above.

Ans: iv

2. Foreign banks cited in the topic, which entered in retail banking activities, when not able to achieve the business objectives,

(i) Continued with their business in spite of not being profitable.
(ii) Moved out of the business.
(iii) Changed their focus with some strategic changes.
(iv) None of the above

Ans: ii

Let Us Sum Up

- The business models followed by banks for retail banking activities can be any one of the following:
- Strategic Business Unit (SBU) Approach
- Departmental Approach
- Integrated Approach (part of the overall business plan).
- Banks generally structure their retail banking models mainly on a positioning platform and to be the best/top three among the peer group players or across players. Strategies are based on the positioning objectives and vary from bank to bank depending on the importance attached to the business model.
- If the business objectives are not met,foreign banks in the recent past have taken a call to exit the space. BNP Paribas and Bank of America are classic examples in the late 1990s/early 2000s.

Keywords

Business Model; Strategic Business Unit; Business Plan; Positioning platform: peer group.

U N I T 3 APPLIC ABILITY OF

STRUCTURE

3.1 Applicability of Retail Banking Concepts

3.2 Distinction - Retail and Corporate/Wholesale Banking

Terminal Questions Let us Sum Up Keywords

3.1 APPLICABILITY OF RETAIL BANKING CONCEPTS

Retail Banking as a concept has a number of elements which individually and collectively contribute to the success of the segment. It spans across implementation models, business process structure, product and process models etc. Let us have a look at the applicability of the different retail banking concepts that shape the success of the space.

Implementation Models

Banks adopt different models for implementing their retail banking initiatives. The most common strategies are end to end outsourcing, predominant outsourcing, partial outsourcing and in house sourcing. The implementation model depends on the product range, process requirements, technology preparedness, delivery capabilities including human resources and regulatory prescriptions.

Most of the PSBs use only in house resources for retail banking. Only for some activities like ATM/ Credit Cards/Debit Cards, the issue part is outsourced due to lack of in - house facilities. Regulatory prescriptions are one of the major determinants of outsourcing or lack of it in these banks.

In case of old private sector banks also, the activities are carried out through in house resources only. In case of new generation private sector banks, the model is a balanced mix of outsourcing and in house, though a little skewed towards outsourcing. In some banks, asset side is outsourced whereas liability side is not outsourced, though centrally processed.

In foreign banks, the implementation model is mostly outsourced based on the business model. To add, in some foreign banks, both front and back end operations are outsourced and in some banks, the back end operations are outsourced while the front end operations like sourcing of HNI clients are done through captive resources.

Business Process Structure in Retail Banking

Boston Consulting Group had conducted a study on the retail banking processes (Transforming Retail Banking Processes) and deduced four broadly delined process models implemented across banks. These models were defined based on the technology and customer interface capabilities of the banks studied. The four broad classifications are

(i) Horizontally Organised Model
(ii) Vertically Organised Model
(iii) Predominantly Vertically Organised Model
(iv) Predominantly Horizontally Organised Model

The horizontal or vertical model depends on the level of customer information available in a single platform in the data base side for offering multiple products/services across assets, liabilities and other services. Horizontally organised model is a modular structure using different process models for different products offering end to end solutions product wise. Vertically organised model provides functionality across products with customer data base orientation and centralised customer data base is used across products. Predominantly horizontally organised model is mostly product oriented with common customer information for some products. In predominantly vertically organised model, common information is available for most of the products.

In most of the PSBs, horizontally organised model is the standard norm. Of course, in some banks, predominantly horizontally organised model do exist and reflect the level of common customer information available for some products. In one of the PSBs based in West, predominantly vertically organised model is the scenario implying that the common customer information is available for most of the products thereby enlarging the scope for cross selling and up selling.

The scenario is mixed in case of old private sector banks. In one bank, based in Karnataka. horizontally organised model exists and in another Tamilnadu based bank, the level of common customer information across products is relatively high with a blend of predominantly horizontally and vertically organised models. If we correlate this information with the positioning objective of the bank, the bank had strategised for aggressive retail banking growth.

New private sector banks generally follow a vertically organised model. But surprisingly, in one bank which is very aggressive in the retail side, the model is a blend of horizontally and predominantly horizontally organised. This shows mostly products are sold based on stand alone customer information and common customer information is not available for all products.

In foreign banks, it is mostly predominantly vertically organised model which implies that retail banking initiatives are attempted with common customer information across products.

Business Approach (Domain Specific) in Retail Banking

The business strategies with regard to the domains targeted are approached in different ways by different banks. The most common approaches are as follows:

(a) Segmented Approach - where branches are classified based on the business potential with regard to retail space and business targeted in these segments of branches only with focused marketing strategies. These branches will be positioned as resource centre branches and will form part of the overall segmentation game plan of the bank. Branches are classified as Resource Centres, Profit Centres, Priority Centres and General Centres to have a clear business focus. This concept is an effective business model for PSBs with large network and useful for focused strategies and already getting implemented in some public sector banks.
(b) Geography based approach - where retail models are built based on geographies.
(c) Classification based approach - where strategies are designed based on the type of branch viz., Rural. Semi Urban. Urban and Metro. This strategy helps in better product structuring for specific types of branches.

Most of the PSBs have not developed any specific business model on the above lines and generally adopt a holistic model based on the corporate objectives for retail. In some banks, segmented approach is being built in the corporate model but not a stand alone segmented approach. In old private banks also, the overall corporate objective for retail is the basis for the model and segmentation is built in that model only to a limited extent.

In new generation private sector banks, a mix of segmented model and classification based model is adopted to capture the retail potential in a structured way in segments where it matters. In foreign banks, the model not restricted to any of the above but is based on the retail game plan of the banks.

Product Models In Retail Banking

Product portfolio structuring play an important role in the retail banking strategies of banks and extend across liability, asset, other service and third party products. Though essentially retail assets and liability products constitute the basic structure of retail banking, the trend has changed in the recent years and marketing of third party products has emerged as one of the important constituents of retail banking initiatives of banks. Let us have a look of the product models of banks.

(a) liability Products

Liability products are offered to retail banking customers basically under three spaces - Savings Accounts, Current Accounts and Term Deposit Accounts. Product differentiation among these accounts is best achieved by adding different value propositions. Attempts are made by banks to expand the scope of generic products from a plain vanilla account to a value enriched account. The days of simple, functional products are gone. Functionality is now perceived to include changed needs. A simple pass book and cheque book to a Savings Account are passe" now. Built in ATM/Debit Cards/Credit Cards/Multi City Cheques have become generic features. Internet Banking, Telephone Banking, Mobile Banking have become essential value play. The value game has extended to tagging group insurance products in the life and non life space at a very competitive premium component. Group Life Policies as value additions and group health policies on a floater basis covering the entire family are offered as part of the account package. Monies in accounts are not allowed to sit idle and undertake active traveling by means of sweep facilities from savings accounts to fixed deposit accounts above a certain specified level. This increases the earning potential of the deposit balances in Savings Accounts. In case of Current Deposits also most of the above features are built in. In addition, in some banks an auto overdraft facility is structured as a part of the package.

In almost all PSBs Savings Bank with ATM/Debit Cards are offered as a standard entry level product. Sweep facilities and add on life/health cover are offered only in some banks. Super Savings Accounts with value bouquet for high Value Customers are also offered by some banks with specific brand names. In current accounts also, the above facilities are offered. In addition, current account with fixed overdraft facility is also offered by most of the banks.

In old private sector banks, in addition to standard savings accounts, add on life cover is offered. In current accounts also the facilities offered by PSBs are offered by them also. In new generation private sector banks, all the above products are offered by them and the same is the case with foreign banks also.

If we scan the products and services across banks, the product differentiation among banks is wafer thin and only value differentiation is the key factor across banks and the technology, process and delivery efficiencies separate men from boys.

All banks oiler term deposit products with provision for monthly, quarterly or cumulative interest payment options. Fixed Deposits built with units of fixed amount are also offered by banks. This is intended to inject an unfixed component in a fixed deposit and enable the depositors to partially withdraw without disturbing the entire amount and the resultant loss of interest. Banks also offer fixed deposits with built in overdraft facilities so that it becomes more a current account than a fixed deposit. These product reengineering measures are adopted by banks to enhance the comfort level of the term deposit account holders and offer convenience as a value proposition.

Almost all banks across sectors offer the above facilities. Some banks offer accidental life cover for term deposits but the group life cover and health cover are not normally offered to term deposits as they are structured as a part of demand deposit accounts due to operational reasons.

(b) Retail Asset Products

Retail asset financing is a major component of retail banking model of banks. In fact retail loans are the backbone of the revenue streams of banks. In any customer expansion strategy, retail loan is packed as the main attraction uniformly by all banks. Product, price, process and delivery innovations are receiving constant attention in the retail asset side. Cross selling and product bundling opportunities are always structured and implemented around retail asset products. The focus is so high that in some banks retail assets constitute as high as 40 to 45 percent of the total asset base. The main advantage is the stability of the asset base because of the large customer base. Other important reasons are the better spreads in income, risk diversification and scope for capturing additional revenue streams from other avenues. The standard retail asset products offered by banks are Housing Loans, Consumer Durable Loans, Car Loans, Credit Cards and Personal Loans. Other retail loans include loan against rental receivables, salary overdrafts, loan against securities, loans for traders in the personal segment. Retail Loans are also structured by some banks to target specific professional segments like doctors, architects and advocates etc, to finance their professional requirements.

Almost all banks extend the standard retail asset products to the customers and prospects. They also extend most of the other retail assets mentioned above. But only a few banks extend loans against rental receivables and salary overdraft. Some banks have special schemes for small traders in the personal segment and also schemes for extending loan/overdraft facility against cars for enhancing their equity. Cars, which do not have a loan tag already will be considered for overdraft facility against the market value. As already stated, retail loans are the bread and butter of retail banking space for banks and banks vie with one another in designing, marketing and expanding the retail asset space.

(c) Other Products/Services

Other products and services broadly cover the beyond product facilities tagged to the products and services. These enhance the service experiences of the customers by providing process and delivery efficiencies by additional service tools to the basic products. One set of these products are Credit Cards, Debit Cards. ATM Cards, Telephone Banking. Mobile Banking, Internet Banking. Depository Service and Broking Services. Distribution of third party products like life and non life policies, mutual funds, retail sale of gold coins, bill payment services, multi city cheques, payment gateway for rail, air ticket bookings, wealth management services, portfolio management services and private banking are some of the other services offered by banks. These services are offered with twin objectives of customer multiple need satisfaction and also to augment fee based income. The revenue models from these fee based services are quite attractive and some banks in the private space generate revenues of above 50% of their total revenues from fee based business.

Not all PSBs are in the credit card business since it is a big volume game and needs process efficiencies. Some PSBs offer these products, though Debit Cards, ATMs are offered by almost all PSBs. Most of the banks are now actively paying attention to Internet Banking and Mobile Banking, to realize the huge potential available in this space. Depository Services are offered by some banks but Broking Services are offered only by very few banks. Corporate Agency for Life and Non Life and distribution of mutual funds are done by almost all PSBs while sale of gold coins are done now by a good number of banks. Bill Payment services are attempted by a few banks and multi city cheque facility is offered by most of the banks. Payment Gateway facility is yet to make a big impact and offered only by select few banks. Wealth Management, Portfolio Management Services are not offered by any of the PSBs till now but the days are not far off for introduction of these services by PSBs. While old private sector banks offer standard services, they do not offer Credit Cards, Telephone Banking, Mobile Banking, Broking Services, Gold Coins etc., but some banks offer Depository Services, Mutual Fund Distribution, Life and Non Life policies. Wealth Management, Portfolio Management and Private Banking are not attempted by them. New generation private banks and foreign banks offer the complete bouquet of all the above products/services.

Product Development in Retail Banking

Product Development is attempted by banks in different ways. In house product development independently developing the products based on research and on the market dynamics is one way. In the process, hybrid cross pollination incorporating the best features in the products available in the market along with additional value engineering form part of the product development. Another way of product development is based purely on market conditions and customer segments without any background research and also 'follow the leader approach' by developing on the same lines as the leader. The other most common model is simply following the instructions of the Top Management without any background research or analysis. The basis for these product developments, as said earlier, is either on the segmentation approach or geography based approach or classification based approach or approach based on specific customer segments like NRI, HNI, Mass Affluent, Salaried, Professionals, Women etc.,

In most of the PSBs, product development is done in house incorporating the market dynamics. The market conditions and customer segments of the bank are factored in the development. The views and instructions of the Top Management are the prime drivers of product development in PSBs. In the development process, geography is not given importance but type of branch and centre and business potential are given due importance.

In private sector banks, both old and new, product development is done in house independently, incorporating the market dynamics, segmentation, classification, customer segments, market dynamics and the product positioning adopted by other players.

The fundamental approach to product development starts from conducting a market survey about the need levels and gap among the target group, identifying the needs, developing the product, pilot testing to a sample universe, getting feed back, fine tuning the product based on feedback and then the final roll out of the product across targeted segments. One or more elements of this process are sometimes bypassed due to various factors and are product related or management related. Sometimes some part of the process is outsourced and some through in house resources and also some part of the process is skipped. The practices vary across banks.

In PSBs, market survey is done only through in house resources and not outsourced. In some banks, no market survey is done and products developed are launched based on industry practices and need are expressed by customers and without any pilot run and feedback.

Process Models for Products and Services

Processing of products and services in retail banking is basically approached from three dimensions viz., the entire processing is done through in house resources, some products processed in house and for some products outsourcing is done for process and the third approach is outsourcing of entire process subject to prescribing process standards.

In PSBs and old private banks the entire process for products and services are done through in house resources but in some banks, process part of some products are outsourced. But generally no outsourcing is done for the process part. In new generation private sector banks, outsourcing is attempted partially for some process areas. In foreign banks, the entire process is outsourced and normally happens through a dedicated back office covering the entire gamut of retail banking services.

Banks adopt different process models for retail asset products. Since retail assets form the fulcrum of retail banking activities, banks vie with one another to achieve the best process efficiencies for capturing the customers and enhance their retail asset book. The common form of process models are Centralised Retail Assets Processing Centres where all the retail loans sourced at the branches and marketing team are processed at a single point and assets are financed through that centre or processing alone done at the centre and financing done at the branches. Another model is centralized processing for some asset products (say Housing Loans) and regional processing centres or stand alone processing at branches for other products. The third model is no centralized processing but only regional processing hubs to cater to specific cluster or geography of branches and process on or more loans. It will exist along with the stand alone processing at the branch level. Some banks follow the stand alone branch level processing and delivery of retail assets without resorting to any centralized model or regional hubs. The ultimate aim is to build absolute process efficiencies.

Public sector banks are also implementing the centralized processing model for all assets in a phased way. Some banks have centralized/regional processing hubs for some products and stand alone model for other products and in most of the banks, no centralized model is followed but process happen only through either regional hubs or branches or a blend of both. The level of implementation of centralized retail loan processing centres is low in PSBs and only local processing is happening in most of the banks. In private sector banks, in case of old banks the model is mainly stand alone and in new banks, a blended model comprising of centralized processing for some products and regional hubs for some other products are followed for effectively controlling the lead time for processing. In foreign banks, centralised processing is the norm for retail asset processing.

The model for processing liability products differs across banks. Some banks follow the centralized model for processing liability products. For example, the opening of a Savings Account involves different stage of processing for tangibilising the service nature into a product nature. Opening of account, issue of Pass Book, Cheque Book, ATM Card/Debit Card, PIN Mailers for the Cards are the stages in the tangibilisation process. In centralised processing all the above activities are carried out in a single point. In regional processing hubs, the same activities are carried out geography wise. In some banks, some activities like issue of cheque books, cards, PIN mailers are centralised or done at regional hubs while opening of accounts will be on a stand alone basis. Some banks follow the conventional model of stand alone processing at the branch level.

In almost all PSBs. stand alone processing model is the norm for processing liability products. Opening of accounts, related KYC compliance and issue of cheque books are done at the branch level itself. Of course, issue of ATM/Debit Cards is done centrally in almost all the banks. In old private banks, in some banks centralised model is adopted while in other banks, stand alone process model is implemented though they are aggressive in the core banking model. In new private sector banks, a judicious mix of centralised, regional and stand alone models are implemented for liability products depending upon the type of products/services. In foreign banks, centralised processing is the norm and mostly done through outsourcing or dedicated back office.

Process models differ for products which require single stage process and multi stage process. For example, opening a fixed deposit and issuing receipt involves only a single stage process. Like wise, giving car loan is a single stage process. But in case of housing loans or Savings/Current Accounts, multi stage processing is involved. In this scenario, the process model should be stand alone or centralised depending on the product for better process/delivery efficiencies. Banks adopt different models in this area. In case of PSBs, no watertight process model is adopted but a judicious mix of the different models is in place. In some banks, end to end process model at a single point is adopted. In old private sector banks, in one bank end to end model is adopted while in new private banks, a holistic model encompassing all the models is attempted. In foreign banks, end to end model for all products and that too outsourced model is the standard practice.

Process time is a major differentiator in the efficacy of retail banking operations. Process Time is business sensitive and customer sensitive. It is an important component of business promises with regard to product delivery. It reflects the confidence and process efficiencies of the bank. The quicker the process time, more the delivery efficiencies and customer recognition. Banks are implementing process time prescriptions for different retail asset products.

Most of the PSBs have prescribed process time for different asset products. Interestingly one south based PSB has implemented the Six Sigma Quality Implementation Model in which the process time also finds a place. In most of the other PSBs, the process time is prescribed and varies from 7 days to 15 days depending upon whether it is processed at the branch or regional hub or centralised processing. The general trend noticed in PSBs is that the process time is almost uniform across products. In old private banks, process time is relatively less for retail asset products revealing their extra commitment in retail asset expansion. In new private sector and foreign banks, the process time for various asset products is structured based on the type of asset as centralised processing is the standard model adopted by these banks. The process time in these banks are clearly drawn between sanction time and actual release of finance.

Pricing of Products and Services

Banks develop models for pricing of products and services based on certain fundamental parameters. Market dynamics, risk perception, return expectations, tenor/duration, resources position, asset liability management positions and customer profile are some of the variables which are factored into the pricing model by banks. The balancing of these various variables dynamically with changing market dynamics is the key function for good pricing model. In addition, regulatory advices (both overt and covert) also influence the pricing models. The fundamental concept of costing in pricing has now gelled with the asset liability management practices of banks.

In PSBs, though pricing is market driven and competitive, in almost all the banks, pricing is mainly driven on the basis of the asset liability management practices of the banks. Of course regulatory advices form part of the price structuring. In general, the model is built on the basis of all the above factors. But some banks like State Bank of India and Bank of Baroda have started implementing aggressive pricing strategies in Housing Loan segment to not only capture fresh accounts but also focus on migration from other banks. They follow a structured step up pricing model with a initial low and attractive price and switch over to market related pricing after 3 years. The pricing will be slightly aggressive than PSBs in order to capture business in the competitive environment in case of old private sector banks. In new private banks and foreign banks, though the pricing fundamentals almost remain the same, the pricing of products are always aggressive and ahead of the market to set a price race in the market for demand driven products like term deposits, credit cards, car loans, housing loans etc.

Price structuring for products and services is attempted by banks in many ways. Stand alone pricing for different products and services is the basic structure. While the general structuring is basically an outcome of the pricing models, fine tuning always happens due to different factors. Quantum and volumes are two important determinants. Price Preferences/Price rebates based on the above also form part of the structuring. Special quotes for high value deposits and concessional rates of interest are examples of this structuring. Structuring also involves price bundling where a holistic pricing is offered across a specific bundling of products and services so that the total price proposition is attractive than the stand alone pricing for the individual products of the bundle. This structuring is a cross selling strategy to entice the customer to avail more products so that profitability per customer is enhanced.

In addition to stand alone pricing structure, most of the PSBs have price concessions as well as rebates as a part of the pricing structure. But the same is applied depending on the volumes, quantum and of course relationship. Offering rebates on completing the repayment schedule is also attempted by some banks. Price bundling is not adopted in a big way by PSBs. In new private banks and foreign banks, effective price structuring happens by actively adopting both concessional pricing based on the above discussed factors and also aggressive bundled pricing structure to effectively cross sell.

In case of olher products and services, some banks are structuring additional models indirectly as a part of the pricing structure. In addition to or in lieu of price rebates/discounts, alternate pricing propositions for other services are offered as additional facilities. For example, free remittance facilities, issue of drafts, waiver of service charges, processing charges are offered as concealed price structures and offered as tag on for quantum and volume business. Almost all banks follow the above structure both as a pricing initiative as well as cross selling initiative.

Technology Models in Retail Banking

The technology platform for retail banking plays a major role in the retail banking initiatives of banks. In today's scenario, technology is the backbone of the process and delivery efficiencies of banks. The technology models basically adopted by banks are In House Models, Outsourced Models, Partially In House and Partially Outsourced Models. Each model will have advantages and disadvantages and the overall business will be the decider of the effectiveness of the model.

Most of the PSBs have primarily in house models with partial outsourcing also. Again, total in house development and implementation by the in house team is practiced by some banks whereas in some other banks, the development is done by some vendor and implementation is taken care of by the bank. In case of total, in house development, the cost factor will be favourable while in the second model, cost factor matters. A south based PSB has successfully implemented the total in house development and implementation and migrated to the core banking platform also seamlessly. Some other banks have totally outsourced packages but implemented in house. Almost all old private banks follow outsourced model for technology basically because of the scale to migrate to Core Banking Model. In case of new private banks, the model is predominantly outsourced with partial in house model. In foreign banks, outsourced model is mostly adopted.

Technology and Retail Banking are inseparables. Technology is the foundation on which the retail banking edifice is built across the globe. Technology is the enabler for building and translating a customer data base into retail banking business. Banks adopt different technology platforms in line with the global trends. The levels of technology implementation in PSBs started from stand alone Automated Ledger Posting Machines

(ALPMs) in the early days of computerisation and graduated to total branch automation and regional net worked hubs. New private banks started with technology advantage of a single server environment which gave them the edge over other banks. PSB banks have reengineered their technology initiatives and started implementing core banking solutions networking the customers and accounts in a single platform.Some banks have almost completed the core banking solutions process while in other banks the level of implementation is at various stages. The level of implementation of core banking will directly increase the chances of availability of customer data base across products and will increase the scope for cross selling and up selling. Core banking gives clues about the level to which the data base is horizontally or vertically organized. Horizontal or vertical organized refers to whether data is available product wise on a stand alone basis or data is available customer wise on an integrated basis.

Most of the PSBs have implemented cent percent core banking solution and only a very few banks are yet to catch up. In those banks the present technology model is a mix of Core Banking Model at various stages of implementation. Total Branch Automation and legacy systems (stand alone ALPMs) depending on the type of branch and business. To add, PSBs are more horizontally organized in the process model with various levels of vertical position across banks. Customer data base and products integration has not materialised fully which will be a hindrance to effective retail business. In new private banks and foreign banks, core banking is the technology and process model with which the entire business model is built. It is a vertically organized model with total customer product integration and used effectively to market a bouquet of retail products to a targeted customer base.

3.2 DISTINCTION BETWEEN RETAIL AND CORPORATE/WHOLESALE BANKING

Retail Banking and Corporate or Wholesale Banking differ in their basic approach to banking. The major differences between the two segments are discussed as follows:

1. Retail Banking targets at the individual segment while corporate banking deals mainly with corporate clients.
2. Retail Banking is a mass market banking model whereas wholesale/corporate banking look at a relatively smaller segment of business/corporate client base as compared to retail segment.
3. Retail Banking is a B2C approach (Business to Customer) whereas corporate banking is a B2B approach (Business to Business).
4. The ticket size of loans in retail banking is low whereas the ticket size is high in corporate loans.
5. Risk is widespread in retail banking as customer base is huge whereas in Corporate Banking, the risk is more as the ticket size is big though customer base is relatively small.
6. Returns are more in retail banking as the spreads are more for different asset classes in retail. But in corporate banking, the returns will be low as corporates bargain for lower rates due to higher loan amounts.
7. Monitoring and recovery in retail assets are more laborious because of the larger customer base as compared to corporate banking.
8. In the liability side also, the cost of deposits is relatively less and mostly go along with the card rates as the ticket size in retail deposits is small. In corporate banking, as the ticket sizes of deposits will be large, the cost of deposits will be high due to pressure from the corporates for higher rates and competitive forces to garner the deposits.
9. The impact of NPA will be more pronounced in corporate banking than retail banking as the ticket sizes in corporate loans are higher than retail loans.

Terminal Questions

1. The implementation models followed by banks for retail banking are

    (i) Horizontally Organised Model
    (ii) Vertically Organised Model
    (iii) Predominantly Vertically Organised Model
    (iv) Predominantly Horizontally Organised Model
    (v) Anyone of the above.

Ans: V

2. Price structuring for products and services is attempted by banks in the following ways.

    (i) Stand alone pricing for different products and services.
    (ii) Special quotes for high value deposits and retail assets.
    (iii) Bundled pricing/Holistic pricing based on total relationship.
    (iv) All the above.

Ans: IV

Key

1.(v); 2. (iv)

Let Us Sum Up

• *The imple*mentation models in retail banking are mainly built under the following broad classifications:

- Horizontally Organised Model
- Vertically Organised Model
- Predominantly Vertically Organised Model
- Predominantly Horizontally Organised Model

- The horizontal or vertical model depends on the level of customer information available in a single platform in the data base side for offering multiple products/services across assets, liabilities and other services. Horizontally organised model is a modular structure using different process models for different products offering end to end solutions product wise. Vertically organised model provides functionality across products with customer data base orientation and centralised customer data base is used across products. Predominantly horizontally organised model is mostly product oriented with common customer information for some products. In predominantly vertically organised model, common information is available for most of the products.
- Retail Banking Solutions are offered by banks by extending different retail asset products, retail liability products and plethora of other services covering the entire financial services and investment services and requirements of customers. Banks implement these services mainly through their technology initiatives. Almost all banks have implemented their core banking solutions to offer their customers borderless banking and end to end solutions for total banking experience.
- As discussed above, retail banking is different from corporate banking. In retail banking the impact of NPA will be well spread whereas in corporate banking, the NPA impact will be higher. Likewise, the cost of deposits will be relatively less than corporate banking as the customer base is huge in retail banking and hence pressure for finer rates will be less.

Keywords

Horizontally organised; Vertically organised; standalone pricing; holistic pricing; product models; process models; technology model; deposit products, asset products; other services.

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MODULE B RETAIL PRODUCTS

Units

4. Customer Requirements
5. Product Development Process
6. Credit Scoring
7. Important Retail Asset Products
8. Credit and Debit Cards
9. Remittance Products

UNIT
4

UNIT 4 CUSTOMER REQUIREMENTS

STRUCTURE

4.1 Introduction
4.2 Maslow's Theory and Customer Requirementsls
4.3 Service Quality

Terminal Questions Let Us
Sum Up Keywords

4.1 INTRODUCTION

Let us first try to understand the customer segment first before discussing about their requirements. Broadly customers are segmented based on their income levels as their need pyramid will vary with the rise in their income levels. Banks develop and market their products based on this segmentation and target the relevant segment for maximum conversion of business. The basic segmentation of customers based on their income levels is presented below.

Income Levels (Rs. Lakhs)	*Customer Segment*
2-10	Mass Market
10-50	Mass Affluent
50-400	Super Affluent
400-4,000	HNW
4000-120,000	Super HNW
Above 120,000	Ultra HNW

HNW - High Net Worth

(Source : Celent Research)

If we look at the customer segments above, the first three segments namely Mass Market. Mass Affluent and Super Affluent are the most important segments for banks with regard to their retail banking initiatives. The products and services will be structured mostly to meet the requirements of the above segments.

The fundamental assumptions about customers for building retail banking products and services are briefly explained as follows:

(i) Customers are different.

(ii) Needs of the customers are different
(iii) Each customer will have different sets of need for financial services.
(iv) The need requirements of customers for financial services will be unique.
(v) Customers can be broadly grouped together based on their need pyramids.
(vi) Customers can be grouped together based on their income, age, geography, profession, employment,
vocation gender and family size.
(vii) Product and services can be developed for a single or a combination of the above elements to
satisfy most of the needs.
(viii) Products and services can be structured on a niche basis within one or any of the above elements.

The above assumptions about customers help banks to develop suitable products and services to cater to the need spectrum of the customers. To understand this concept, a look into the 'Maslow's Need Hierarchy Theory of Motivation' is necessary. The theory will help us to understand how banks structure products to match the different stages of the need pyramid of the customers.

Customers buy the products and services of the bank primarily to satisfy their needs and if their needs and banks' products match, there is absolute synchrony and if the benefits promised by the bank to the customer are delivered then there will be absolute satisfaction from the customer end. The requirements of the customers in general can be related with the need hierarchy theory by Abraham Maslow.

4.2 MOSLOW'S THEORY AND CUSTOMER REQUIREMENTS

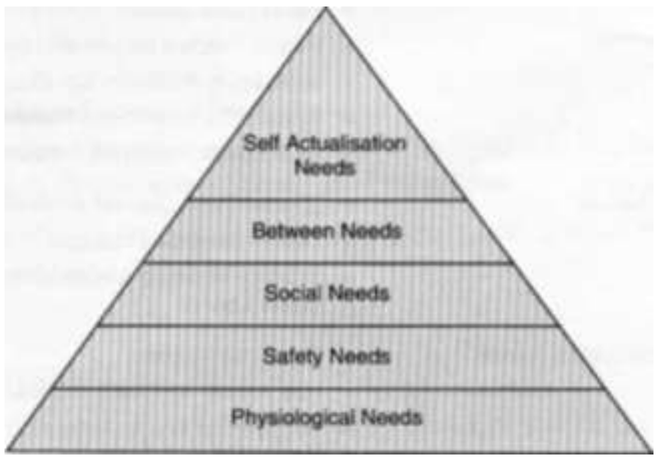

Fig. 4.1 Abraham Maslow's Motivation Theory

Maslow has defined five needs of individuals in their various stages of life. The needs start from the basic requirements and move up the value chain during the life stage progression. Obviously, the need ladder will also move up with the change in the life stage of the customers. If banks structure products and services to match the different stages in the need spectrum, banks will achieve the twin objectives of customer satisfaction and business conversion.Let us demonstrate the above concept with the following illustration:

S.No.	*Need Level*	*Matching Banking, Investment and Insurance Products*
1.	Physiological Needs	• Core Savings Accounts • Personal Accident Cover • Housing Loans
2.	Security/Safety Needs	• Recurring, Fixed Deposit Products. • Life Insurance Products - Endowment Products with low premium, long tenor and high maturity amounts. • Tax Planning Banking, Insurance and Mutual Fund Products.
3.	Social Needs	• Consumer Loans • Personal Loans • Home Loans • Car Loans • Loans for Professional Development for Doctors, Engineers, Lawyers, Chartered Accountants, Management Consultants, Architects etc., • Insurance Cover tagged to above loans. • Retail Gold Coins. • Health Policies for self and family. • Investment Products like Mutual Fund Schemes. • Systematic Investment Plans of Mutual Funds. • Unit Linked Insurance Products.
4.	Esteem Needs	• Special Term Deposit Products. • Term Insurance Products. • Second Housing Loans/Home Improvement/Home Decor Loans.
5.	Self Actualization Needs	• Pensioners Loans

	• Retirement Solutions in Banking & Pension Plans in Insurance • Senior Citizens Term Deposit Products

The above table is only suggestive and not absolute and products may tend to overlap across the need spectrum and again the banks may come across all the stages run concurrently for the customer base and hence there is tremendous opportunity for banks to convert the potential available across needs for their huge customer base.

Customer Requirements about Service Quality

Service quality is what customers expect from Banks and has different dimensions. Following are some of the requirement s/expectations form the customers about the service quality of banks.

(a) **Tangibles:** Appearance of physical facilities.equipment, personnel and communication materials

- Are bank's facilities attractive?
- Is my credit card statement easy to understand?

(b) **Reliability:** Ability to perform the promised service dependably and accurately.

- Where an Officer says that the amount will be sanctioned in 2 days, does he follow up and inform the status?
- Is my credit card statement accurate?

(c) **Responsiveness:** Willingness to help customers and provide prompt service.

- When there is a problem with the bank statement, does the bank resolve the bank quickly?
- Are the charges which are debited wrongly are recredited to my account properly,

(d) **Assurance**

- Competence - Possession of required skills and knowledge to perform services.
- Courtesy - Politeness, respect, consideration and friendliness of the contact personnel.

- Credibility - Trustworthiness about the service provider.
- Security - Freedom from risk and doubt.

(e) **Empathy**

- Access - Approachability and ease of contact.
- Communication - Keeping customers informed in a language that they understand.
- Understanding the customer - Making an effort to know customers and their needs.

(Source: Competitiveness in Banking Industry and Marketing Challenges, Abraham Koshy, Professor, Marketing Area, Indian Institute of Management, Ahmedabad.)

Customer Requirements and Satisfaction Levels

Fulfillment of the customers' requirements can be measured only from the satisfaction level of the customers. The satisfaction will emanate out of the customers' experiences of the products and services offered by different banks. The experiences may vary across banks like public sector banks, private sector banks (old and new generation private sector banks) and foreign banks. A recent study conducted by a leading research agency to measure the Customer Service Quality as a reflection of the meeting of customers' requirements revealed the following interesting findings:

(i) The study covered about 20000 customers across Metro, Urban, Semi Urban and Rural Branches of Banks having Savings Accounts, about 4000 customers who have availed Home Loans and about 3500 customers who have availed credit cards.
(ii) The objective of the study is to measure the customer service quality of the banks by creating Key Performance Indicators (KPI) on service quality and measure the quality based on the benchmark value of the KPI for that sector/segment.
(iii) The measurement of satisfaction was made on the three basic parameters viz.. Overall Satisfaction, Advocacy and Loyalty.
(iv) The ratings show healthy overall performance by the industry. Ratings on the 3 overall measures are above 80% (satisfaction) for all 3-product segments.
(v) When asked how has their experience with their banks changed, in the last 1 -2 years, $2/3^{rd}$ customers said it has improved a lot/somewhat improved.
(vi) Almost 9 out of 10 Savings Account and Home Loan customers find excellent value in the respective bank offering. This score is significantly lower for Credit Cards.
(vii) On the satisfaction index. Private banks lead in Savings Accounts and Credit Cards; whereas Public sector banks lead in Home Loans and Foreign banks in Home Loans and Credit Cards.
(viii) Banks were ranked in three clusters and ranked according to Index score for each cluster. Public sector banks lead across clusters in the home loan front. In the credit card side, foreign banks and private banks lead the rankings.
(ix) Amongst all the touch points (channels of interactions) of customers with banks, branch interactions and Communication are seen to be the key drivers of the Index for satisfaction.

Let us see the satisfaction levels of customers with regard to two main retail banking products viz. Savings Bank accounts and Home Loans in case of a south based public sector bank which came second in the rankings.

4.3 SERVICE QUALITY

Savings Bank

The following dimensions revealed the service quality and delivery parameters for savings accounts:

1. Touch point Experience: Overall Measures - At an overall level, the PSU bank is comparable to the PS banks average across touch points.
2. Branch-Layout and Cash transactions: Performance across parameters above PS banks average.
3. Savings Account: No serious concerns on savings account; Parameters at or above par vis-a-vis private banks.
4. Branch Non-Cash Transactions: Scores on most parameters at par with PS Banks average.
5. Communication: Communication channels available along with information How to customer meets average expectations.
6. Problem Incidence/Recurrence - Very low problem incidence just like the industry.
7. Key Performance Indicator - Savings Account Activation Time - Account activation within 3-day window similar to industry average.
8. Key Performance Indicator - Welcome Kit Receipt Time - Close to 90% receive welcome kit within 14 days.
9. Customer Mindspace (Image Map) - The PSU Bank differentiated on problem resolution & delivering on promise, amongst its customers.

Further Mreasures Needed to Enhance Service Quality

The study suggested further measures to improve the service quality to meet the customer expectations with regard to savings accounts.

1. Need to improve transaction time at the branch.
2. Branch offerings need to be relooked at, in terms of range of services offered, in light of people-related drivers being seen as driving overall customer satisfaction.
3. Lack of adequate channels is felt by the customer, in addressing his needs. Need to relook at current channels and their ease of access/usage for the customer.

Home Loans

The PSU Bank came second in the rankings for service quality with regard to Home Loans. Important service parameters satisfied by the Bank are listed below :

1. The PSU Bank index is above the average for the Cluster it belongs to.
2. Drivers of Satisfaction (Identifying the most important touch points): Product features and communication seen to be driving overall experience the most.
3. Overall Measures: At an overall level, the Bank scored above PS banks average across touch points.
4. Home loan parameters perform above PS banks average.
5. Communication channels & communication received from the bank, all score above PS banks average.
6. Loan Disbursement Time: Disbursement within the 14 day window for the bank far higher than Industry average.
7. Customer Mindspace (Image Map) -The Bank differentiated on responsiveness and customer service, amongst its customers.

Measures Needed to Enhance Service Quality

The bank has scored across parameters at par or above PSU banks' average. But to enhance the service quality, bank has to take the following initiatives.

1. Bank has to focus on strengthening performance across parameters
2. Bank has to pay special attention to range of product features.
3. Proactive customer communication needs to have a systemic approach.
4. Customer-friendly modules on branch network, new products and services need to be developed.
5. Score comparatively lower on handling special requests.

6. Need to reorient employees, towards this key aspect of customer experience, through training and reviews around service time.

The study highlighted that the existing product and service levels are satisfactory and above industry averages among PSBs and also highlighted the action areas in the above segments from the bank side. The above points indicate that the customer requirements with regard to products and processes are generally met by public sector banks and also indicate that there is always scope for improvement to meet the dynamic nature of the customers' requirement.

From the above study of analysing customers' expectations and the service quality offered by different banks with regard to Savings Accounts and Housing Loans, the requirements of the customers from the banks are broadly detailed in the next paragraph.

Customers' Reqirement from Banks

Generally, customers require the following from their bank/s for maintaining their accounts/relationship.

(i) Right product mix to satisfy different customer segments.
(ii) Right channel mix (both direct channels and e channels).
(iii) Structured process time across products and adherence to the time prescriptions.
(iv) Delivery of the promises with regard to products/services and channels.
(v) Satisfactory service experience from the delivery channels and the service personnel.
(vi) Effective Communication about the different products and services.
(vii) Transparent service charges.
(viii) Good ambience.
(ix) Effective and time bound greivance redressal mechanism.

If the above expectations are met by the banks, customer loyalty will be at its peak and deficiency in the above will result in dissatisfaction and deterioration of loyalty and will trigger customer switching.

Terminal Questions

1. The customer segment whose income level is between Rs. 10 lacs to Rs.50 lacs is referred to as

   (i) Mass Affluent
   (ii) Super Affluent
   (iii) HNW

Ans: I

2. According to Maslow's Need Hierarchy Theory, needs may be broadly classified as

   (i) Physiological Needs
   (ii) Safety Needs
   (iii) Social Needs
   (iv) Esteem Needs
   (v) Self Actualisation Needs
   (vi) All the above.

Ans: VI

3. Customers' expectations of service quality mainly depend on the following :

   (i) Tangibility in services.
   (ii) Reliability.
   (iii) Responsiveness.
   (iv) Assurance
   (v) Empathy.
   (vi) All the above.

Ans: VI

Key

1.(i); 2. (vi)3. (vi)

Let Us Sum Up

- Customer segment is the fulcrum around which the entire retail banking business is operating. Customers can be broadly divided into the following segments: Mass Market, Mass Affluent, Super Affluent, HNW, Super HNW and Ultra HNW.
- Customers are different and their needs are also different. But customers can be grouped and segmented based on their needs. Customers buy different products and services based on their needs and their needs may differ based on their income and also life stages. The needs may be

  broadly classified as Physiological Needs, Safety Needs, Social Needs, Esteem Needs and Self Actualization Needs. Banks should target, position and offer suitable products to match the need grid for effective marketing.

  Expectations from the customers about the service quality of the bank basically depend on the following factors:

  - Tangibility in services- physical side of the service
  - Reliability- Sticking to agreed terms and promises.
  - Responsiveness- willingness to help and extend prompt service.
  - Assurance - Competence, Courtesy, Credibility and Security.
  - Empathy - Understanding the service expectations from the customers' point of view.

  Customer Satisfaction levels are basically derived from the quality of service for different products like Savings Accounts, Home Loans, Personal Loans and varies across products and banks. While PSBs score over private banks in products like Home Loans, private banks do better in Personal Loans.

Keywords

Service Quality; Need Hierarchy; Tangibility; Reliability; Assurance; Empathy; Customer Satisfaction.

UNIT
5

UNIT 5 PRODUCT DEVELOPMENT PROCESS

STRUCTURE

5.1 Product Development Process

5.2 Product Life Cycle

5.3 Product Lines of a Banker

5.4 Deposit Products

5.5 Credit Products

5.6 Other Services

5.7 Other Fee Based Services - Third Party Distribution

5.8 New Product Development

5.9 Stages in New Product Development

5.10 Constraints in New Product Development

5.11 Product Management

5.12 Product Policy

Terminal Questions Let Us Sum Up

Keywords

5.1 PRODUCT DEVELOPMENT PROCESS

In retail banking, product is the starting point of the marketing process. Product is the fulcrum on which the entire retail banking revolves. Everything is centered on it. The add on and the other value propositions are tagged to the products to offer better value and acceptance to the product. The different definitions for product are discussed below :

Theodre Levitt observes that *"Products are almost always combinations of the tangible and the*

intangible . To the potential buyer, a product is a complex cluster of value satisfactions .... A customer

attaches value to a product in proportion to its perceived ability to help solve his problems or meet his needs. All else is derivate".

A bank product can be defined as *"Anything that has the capacity to provide the satisfaction, use and return desired by the customer".*

This brings into focus, the importance of product and the relevance of the product from the customer side. The key factor remains that if the bank product is no longer capable of satisfying customer needs and wants, the product will fade out. To understand more about the products, and develop products, we should understand the concepts of product life cycle.

5.2 PRODUCT LIFE CYCLE

There are various stages in the life of the product. The product after development goes through different stages in its sales journey and in each stage, the impact on sales will be different. The product life cycle journey is illustrated in the following diagram.

Product Life Cycle Curve	
CO a> CD	Int ro du cti on *!* *x* i ^ *V* **i**
Time	

Fig. **5.1**

The first stage is the 'introduction' stage when the product is introduced. When a product is introduced the sales volume will be low and revenue from the products will not be sufficient to cover the cost of producing, marketing and servicing it. In the introduction stage it happens because it takes time for the product to occupy the minds of the customers.

In the 'growth' stage, which is the second stage in the product life cycle, the sales volume of the product picks up and the product is likely to break even and start generating profits for the organisation. During this period the consumer awareness of the product will be more and that will result in growth. In the third stage which is the 'maturity' stage, there is more growth and sales volume peaks. Here there is a wide customer base which will result in maximisation of sales with inflow of business and profits. In the fourth stage, which is the 'staleness' stage or 'saturation' stage, because of competition and better products available from the competitors, staleness will creep in, which will result in saturation of sales. Here the business and profits stagnate, customer develop a tendency of indifference to the product.

This will result in the final stage of the product life cycle called as 'decline stage'. In this stage, the product becomes less attractive for the consumers due to various reasons and results in drop in sales volume and profits. This stage if not attended properly will lead to product death. This can be avoided by fine tuning and value adding to revitalise the product for continued acceptance.

These stages of product life cycle are very important for banks in product development. Banks should aim for keeping the product in the maturity stage as long as possible, so that business and profit maximisation happens continuously. And another important point is that product life cycle is different for different products. But it is not always a must that a product should travel through the product life cycle process. Some products will have an instant death immediately after introduction phase. This may happen due to wrong approach towards marketing research und consumer perceptions. Like that, in some case, there will be immediate spurt to the growth and maturity phase in a very short period and will stay there in the maturity period for a very long time. The success of these phases depends on proper approach by the marketer towards packaging strategies and repositioning strategies, so that the products stay in the maturity phase for quite a long period to occupy a permanent place in the perceptual need map of the consumers. In the same way, product obsolescence often contributes to the premature death of products even after effective market research. In the case of computer products, the product life cycle will be very short because of fast changing technologies. This results into a high degree of product obsolescence.

In the banking scenario the product life cycle depends on whether the product is a core product or augmented product.

Core products are essentially those products which define what kind of business we are in. In the banking scenario, some of the core products are Savings Bank, Current Account Term Deposit, Recurring Deposit, Cash Credit, Overdraft, Retail Loans, Term Loan, Drafts etc., These core products are essential products and need not have a strong marketing content. These products will have a stable life in the growth stage of product life cycle, because they are indispensable for the different segments of customers.

Augmented products are products which are developed from formal products by combining two core products and adding value to the product in terms of benefits and comforts to the customer. The augmented product when availed by the customer will result in some value addition to the customer. The concept of augmented product had changed over the years and will continue to change. A decade back, offering an

ATM Card was considered as a value addition to enable the customer to withdraw money 24 hours. But the implementation of technology initiatives aggressively by banks in the past decade had made ATM/ Debit Card as a part of the core product. The penetration of Internet Banking and Mobile Banking has changed the concept of core and augmented products. In the present day scenario, a core Savings Bank will include an ATM/Debit Card and a Cheque Book and augmented product will include Internet Banking, Mobile Banking and a group health or life insurance product tagged to it.

5.3 PRODUCT LINES OF A BANKER

To be successful in retail banking, any Bank has to understand different segments and develop appropriate products to meet these segments. Though different products cater to different segments, there are certain products like core products which cater to all segments. Likewise different bankers market their different products in different names though they have common features. The idea of this is to make the customer identify the bank with the particular name of the product. This initiative of banks to create recall for the products is termed as "Branding". Banks basically adopt two types of branding exercises. Product branding is attempted by banks to create product recall and Corporate Branding is intended to create recall about the banks itself. More of branding initiatives by banks will be discussed separately. Branding initiatives by banks will help them to develop definite business through that product by developing product specific strategies and they do that exercise for different products. These products include core products as well as augmented products. For core products there need not be much marketing orientation but for augmented products to succeed there should be a concerted effort from the marketing angle for the product to succeed. Let us try to explain the different types of products normally marketed by banks. Products can be broadly classified into following:

(i) Deposit Products or Liability Products
(ii) Asset Products or Retail Credit Products
(iii) Other Products and Services.

5.4 DEPOSIT PRODUCTS

In the deposit products category, the deposit products can be classified into Savings Deposits, Current Deposits, Term Deposits and Combination Deposits.

Deposit Product

"

Saving Account 3

Current

Term Deposits

(a) Demand Deposits (CASA Deposits)

Currrent Accounts (CA)

Saving Accounts (SA)

Core Current Accounts

Augmented Currrent Accounts

Core Current Accounts

Augmented Currrent Accounts

- Basic Current Account

Basic Current Account with Cheque Book + Value Additions like tagged insurance cover (life and non life)
Other concessions like fi remittance etc.

- Basic Savings Account with Cheque Book .Debit Card, Internet, Mobile Banking +

with Cheque Book

- Basic Savings Account with Cheque Book, Debit Card

- Value Additions like tagged insurance cover (life and non life)
- Personal Accident Cover
- Sweep In/Sweep Out Facility
- Other concessions like free remittance etc.,

Fig. 5.3

(b) Term Deposits (Fixed Deposits)

Term Deposoit Products

Recurring Deposits

- Deposit can be built up on a monthly basis.
- Term Deposit Interest Rate tor the relevant period.
- Flexibility with respect of amount payable every month

Fixed Deposits

- Deposits offered lor a fixed period.
- Option to receive interest at maturity/monthly/quarterly/half yearly.
- Interest also reinvested ad payable on matumy along with principal

Combination Term Deposits

- Combination of Recurring Deposits and Fixed Deposits.
- Different combinations are structured.
- The first part will be in the form of RD and the second part will be on any one type ol fixed deposit.

Savings Deposits are offered mainly as a simple product for inculcating the habit of savings and routing the Savings transactions in that account. It's features include free deposit and withdrawal of money by cash and by cheques. It gives absolute flexibility for the customer to operate his account and price is kept at a low level. But the complexion of Savings as a plain vanilla product has changed drastically with the advent of tecnology.ATM Cards/Debit Cards are issued along with the Savings Accounts as essential tags for operation of the account. In addition, for augmenting the product and as a value addition to the customers, some banks are offering group life cover and/or group health cover at a very attractive price as compared to a stand alone cover.

Current Deposits are offered mainly for carrying out business and trade transactions. There is absolute freedom for withdrawal and deposit of trade/business related transactions and service charges are charged for this depending on the volume of transactions. No interest will be paid for the deposit amounts. This is a 'no cost deposit' for the banks. Some banks are offering a tagged Life cover or health cover or both.The core nature of the product has undergone change.

Term Deposits are offered to the customers as a high interest yielding product for the deposit held with the bank for a definite period with interest depending upon the period of deposit. There are different types of term deposits offered by banks with facility for getting monthly quarterly interest as well as deposits with cumulative interest at the end of the deposit period. The second option benefits the customer because the quarterly interest accrued on the deposit is reinvested again to earn a higher yield for the depositor. Another type of term deposits is the 'Recurring Deposit' where the depositor is required to deposit fixed sums of money every months for a specific period and at the end of the period, the principal along with the accrued interest are paid back to the depositor. The advantage of Recurring Deposit is term deposit interest rates for the specified period are offered for this deposit also. It helps the monthly income segment to save regularly a fixed amount and earn higher rates of interest applicable to term deposits. As an additional product extension of Recurring Deposits some banks also offer more than one option regarding the quantum of monthly deposit, the flexibility of paying the instalments in bunch and also combination of both. This will attract business from the segments which do not have regular periodic cash inflows but want to save regularly and earn higher interest.

The fourth important type of bank deposit is the combination deposit. The principal aim of the bank marketer is customer need/comfort maximisation and banks innovate in product development and satisfy the customer by offering a combination of two types of deposits, as a single term deposit. For example, a product is offered in this type in which the customer will have option of putting separate amounts at his will and pleasure. A passbook will be issued for the same. Each of his remittances will be treated as a separate term deposit and interest will be given on a cumulative basis depending on the period of deposit. In another product, the deposit will be kept in multiples of Rs. 1000 in term deposit and when there is an urgent need for some money, they can withdraw part of the deposit in multiples of Rs. 1000 and the remaining amount continues to earn the same rate of interest. Different banks offer these products in different names likeFlexi Deposit Account, Multiple Deposit Account, Unfixed Deposit, Quantum Deposit etc., Some banks are offering these deposits to customers to keep their deposit in multiples of Rel, so that in case of necessity, he can withdraw the exactly required amount.

Fig. 5.4

Opening of Deposit Accounts and KYC Norms

Deposits are the core resources on which the edifice of retail banking is built. Hence mobilisation of resources assumes great significance. While CASA resources help the banks to bring down the cost of resources and increase the customer base, term deposits bring stability to the resources mobilisation and help the banks to expand the retail asset base with relevant pricing models. In this context, banks go all out to mobilise deposits through different marketing strategies.

Different banks adopt different methods for opening of accounts. In most of the private and foreign banks, opening of deposit accounts is done in a centralised liability processing centre. The application details and other documents are scanned and forwarded to their centralised processing centres for opening of accounts.Most of the public sector banks (PSBs) have already implemented Core Banking Solutions and are technologically at par with their private counterparts. In some PSBs, deposit accounts are opened at the branch level itself. A centralised model is adopted in some other banks and partially centralised model is adopted in other banks. In the partially centralised model, account opening and issue of Pass Book happen at the branch level and issue of Cheque Book and Debit Card are done through a centralised approach. In a centralised model, based on the details forwarded by the branch, end to end opening of accounts are done centrally. The above procedures apply to opening of Current and Savings Accounts. In case of opening of Term Deposits almost all banks do it at the branch level and issue Term Deposit Receipts at the branch itself to the customers.

An important aspect of opening of accounts is the obtention of documents to verify the identity of the customer. The bank opening the account should know the background and credentials of the customer. Initially an introduction is needed for opening of accounts. Norms are prescribed for documents of proof of identity to be submitted by the applicant like copy of Ration Card, Voters Identity Card, Passport Copy etc.,. In addition applicant customers are required to submit another form called KYC Form as an Annexure to Account Opening Form. Submission of KYC Form is a statutory requirement with the objective of knowing about the customer and his background not only for transaction purposes but also to have a check for money laundering activities. KYC Form also serves as a data base for cross selling other products to the customer.

Know Your Customer Forms (KYC Forms)

KYC Forms, as said earlier, are required to be obtained from all the account holders while opening the account itself. It is obtained as an Annexure to the Account Opening Form. It throws light on the different dimensions of the customers and helps the banks to deal with them appropriately. The important details which are to be furnished in the KYC Form are discussed below:

(i) Name and Address of the Customer and PAN/TIN Number
(ii) Details of Spouse/Father and also Son(s)/Daughter(s)
(iii) Type of Account - Savings/Current/Term Deposit/Loan
(iv) Age - Age band - < 20, 21 -40,41 -60 and >60.
(v) Occupation - Details of Service, Profession, Others
(vi) Educational Qualifications - Non Graduate, Graduate, Post Graduate, Others
(vii) Nationality
(viii) Accomodation - Own/Residential
(ix) Conveyance - Two Wheeler/Car etc.,
(x) Telephone
(xi) Credit Card - Details of Credit Cards held
(xii) Details of Deposits/Loans held with other branches/banks
(xiii) Purpose of opening the account.
(xiv) Source of funds - Salary/Business etc.,
(xv) Annual Income
(xvi) If in business, all business details
(xvii) Details of passport, if any.
(xviii) Details of foreign countries visited during the past three years.
(xix) Any other relevant information.

Based on the above information, the branch will record in the from endorsing the identity and genuineness, address verification and risk perception and fix a Risk Level Threshold Limit for the customer. The details will be updated on an annual basis. A look at the above details will indicate that the branch would be able to map the entire biographical, professional, social and credit profile of the customer. In addition to fulfilling a regulatory requirement, KYC Forms also serve as a tool to cross sell different products and services to the customers.

5.5 CREDIT PRODUCTS

Credit products offered by the bank, again, can be classified into two broad categories, traditional credit schemes and market oriented new credit schemes. Traditional credit products are cash credit accounts for business people to fix credit limits and allow them to operate freely within the limits subject to certain stipulations. Overdraft scheme is to allow credit for a short period to be adjusted in a very short time. Likewise Demand Loans, Term Loans and Bill Finance are credit schemes to meet specific credit requirement of the borrowers in their business for purchase of machinery, equipments and other requirements and against their receivables. While the Bill Finance facility is self liquidating with the realisation of bills purchased/discounted for the borrower. Demand Loan and Term Loan have definite repayment period.

In the retail side, credit schemes are offered by the banks for specific segments based on the needs of these segments. Home Loans, Personal Loans, Auto Loans and Credit Card Receivables are some of the generic retail credit schemes.

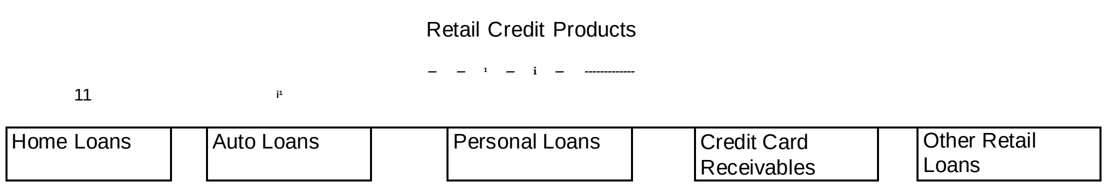

Fig. 5.5 Retail Loans

In addition, loans tailored to meet the individual requirements like Loans for Professionals, Doctors, Lawyers are offered by banks. The basic premises for developing niche credit schemes are two dimensional. The first dimension is looking at the customer segment. If the customer segment is in need of a product and the size of the segment is quite large, then customer need satisfaction will be the first objective of the banks. The second dimension is the business orientation of the bank. If the customer size is justifiable for the product to be developed and marketed and the developed product will generate sufficient volumes and ultimately reward the bank, then the bank will definitely develop and market the product with the proper pricing and features. The details about the individual retail loans are dealt separately.

5.6 OTHER SERVICES

In the other services category, all the services offered by the bank other than the Deposit schemes and Credit schemes can be grouped. Again it can be further classified into Remittances and other Fee Based Services.

In the remittances services, issue of Drafts, Bank Orders/Bankers Cheques, National Electronic Funds Transfers (NEFT),Real Time Gross Settlements (RTGS) are the types of services offered to the customer. The cost of availing these services will depend on the quantum of transactions and the customer's business relationship with the bank.

In other fee based services, Collection of Cheques, Safe Deposit Lockers, Standing Instructions for carrying out the instructions of the customer on a periodic basis. Merchant banking services in the area of capital market issue management in the capacity of Lead Manager, Co-Manager to the issues etc., undertaking Portfolio Management Services for their Non-Resident Indian clients to manage their investment portfolio, Consultancy Services for projects in Agriculture and Export Oriented Projects are some of the other services offered by the bank.

Another important product line for the banker in the 'Other Services' is the non fund based business of the banks. In these types of services, the bank will be guaranteeing on behalf of the customer for whom they will be offering these products. Two examples of non fund based business for the banks are:

(i) Letter of Guarantee

(ii) Letter of Credit

In the Letter of Credit and also in the Letter of guarantee, though at the time of offering these services, there is no fund outlay but at any future time, a liability may arise for the banker to part with the bank's funds. The liability is depending upon the happening or non happening of certain events as specified in the letter of guarantee. Letter of Guarantee is a guarantee given by the bank on behalf of their customer to a beneficiary, guaranteeing the beneficiary to pay if the customer is not paying or performing.

Letter of credit is an undertaking from the banker to pay the beneficiary the prescribed amount, subject to production of certain documents as required in the contract between the customer and beneficiary specifically those that are listed in the L/C itself, if the documents are negotiated as per prescriptions. In the case of Letter of Credit also, through at the time of offering the service, there would be no funds outlay, at a future date a liability may crystallise on the bank. These types of non fund based businesses offer tremendous scope for income and profit because banks collect commission for offering these services without outlay of funds. But the risk involved is, if there is failure of the obligation by the party, then banks' outlay of funds is involved.

The above are illustrations of non fund based business not exactly on the retail side but certain elements of the above embraces retail banking segment also. Non fund based business offers a wonderful scope for the banker to augment their income without outlay of funds. Banks offer these products normally to their well established customers.

5.7 OTHER FEE BASED SERVICES - THIRD PARTY DISTRIBUTION

Another important segment in retail banking which had emerged on the past decade is the third party distribution model adopted by banks to augment fee based income. Let us see what exactly third party distribution is.

Third Party Distribution is an emerging business model of the banks to augment fee based income by selling products and services of other manufacturers in the financial and investment space like insurance companies - life and non life and also mutual funds etc., These activities are called as para banking activities and Reserve Bank of India has prescribed rules and regulations for carrying out these activities by banks. These aspects will be dealt in detail separately. By this broad classification of the products, we can develop a good understanding of the product line of a banker.

5.8 NEW PRODUCT DEVELOPMENT

We have discussed about the product life cycle in the previous pages and came to know that any product has to normally pass through the various stages of a product life cycle. It goes without saying that even though the products stay in the growth and maturity period longer for long term survival of the product, still any product has to decline and to be phased out over a period with very rare exceptions. The Valve Radio and Record Player are classic examples of death of products. Though stereo cassette recorders as a product class were in the maturity stage of the product life cycle for a long period, they have been replaced by MP3s, MP4s, DVDs etc through technological innovations. The success of the marketer will be to correctly identify the existing phase of the product life cycle and by correctly foreseeing the future, has to develop new products to enable the new products to go through the introduction phase and jump to the growth phase when the old product starts its decline phase. This will enable the organisation to survive and achieve the business objectives. Thus a proactive marketer should particularly watch the product life cycle of the product and the present stage of the product. New product development is an important area for the marketer to survive and grow. Bank marketer is not an exception. The bank marketer has to constantly watch the market, gauge the changing needs of the customer, compare it with the features of the existing product range, check up whether there is scope for developing new products and have to immediately start developing new product and market them to proactively seize the emerging, changing customer needs.

5.9 STAGES IN NEW PRODUCT DEVELOPMENT

A new product development has to pass through several important stages as shown below:

Idea Generation

Idea Screening

Product Dev., Test Marketing and Commercialisation

Concept Testing

Business and Market Analysis

Fig. 5.6 New Product Development

(i) Generating new product ideas
(ii) Idea screening
(iii) Concept Testing
(iv) Business analysis and Market analysis
(v) Actual product development, test marketing and commercialisation :

(i) Generating New Product Ideas

New product ideas are generated from market research based on customer expectations from the existing and potential customers. It is also generated in house from the employees of the banks. In some banks, new product ideas are solicited from the staff members under staff suggestion scheme and members are requested to freely vent their ideas about new products based on their exposures and experiences and feedback they receive from the customers. The suggestion will be invited both on refining the existing products as well as ideas for new products.

(ii) Idea Screening

With the grouping together of all the ideas generated from various sources, internal and external, the ideas are analysed based on the following approach:

(a) Whether there is any felt need for the new product?
(b) Is it an improvement of the existing product?
(c) Can the existing infrastructure can handle the new product?
(d) Is the new product is in our existing line or a new line of business?

The ideas which meet the above questions pass through the screening test.

(iii) Concept Testing

The next stage is the 'concept testing'. The concepts of the new product are tested. The idea here is testing the product concept itself by taking the feedback from the customers about their understanding about the concepts of the product and whether the concepts are attractive enough for them to avail when it is launched to them. This helps the marketer to understand the market response to the 'product concept' idea and to know about the customer perception of the product concept.

(iv) Business Analysis and Market Analysis

This stage will decide whether the product is viable from the financial and marketing aspects. This will be based on a cost benefit analysis of the product from the banker's view point and the customer's viewpoint. It will also analyse the expected increase in business, and profits and also the effect on the expansion and retention of customer base. It will also analyse the expected effect on the market share and also the expected penetration of markets of the competitors.

(v) Actual Product Development, Test Marketing and Commercialisation

After passing through the above stages, then the concepts, analysis are internalised and product development takes place from the data generated. The new product developed is first test marketed in a selected market segment and based on the feedback received from the market the product is launched on a full scale to the desired segments.

A good example of the above stages in new product development is the marketing of a Deposit Cum Credit Linked product by a public sector bank in recent years. The bank developed the new product for working women. The new product idea came from the market as well as from the internal sources. The bank sensing the enormous potential available for business from this segment, developed the product with features of saving in Recurring Deposit Account in fixed monthly installments, and after 3 months they can avail a loan in fixed multiples of RD installment depending on their salary and certain conditions. The end use of the loan would be as per the will and pleasure of the customer. There will be more than one option to repay the loan either directly to the loan account or servicing the interest regularly and adjusting the principal loan amount from the Recurring Deposit maturity proceeds. The product had so many attractive features for the working women segment. It was launched initially only in metro and urban towns targeting the working women in those centres. It was received well but there was some resistance to one of the features of the product that the customer had to wait for 3 months for availing the loan. This minor irritant was immediately rectified so that both RD opening and loan sanction can take place simultaneously. There was very good market response to this new product and it became a big hit for the bank.

Sensing the tremendous potential for the new product, the bank extended the product to the working women is semi-urban and rural branches also and the eligibility norms lor better market acceptance.

Another classic case is new product development on the basis of ideas from the customers of the bank. This is again a case of new product development of a public sector bank. The bank branch was situated in highly densely populated village area in a southern district of a state. In that village almost 90% of the population belongs to a minority community. Because of the employment opportunities boom in Gulf Countries, a number of people moved from that village to various Gulf countries for employment. The composition of the people who were moving to Gulf was mostly semi skilled and unskilled labourers. For meeting the expenses for their visa and other travel costs, they found it very difficult to manage and borrowed money at exorbitant rates to get to Gulf. Some of the valued customers of the bank suggested to the branch manager to think of considering some loan facilities to these people for meeting their visa and travel costs. The idea was passed on to the higher authorities with details of potential business and the resultant customer expansion. A new product 'Visa Loan' was developed and credit was extended to them based on their Visa and travel documents. That was a great marketing success in new product development. The loan beneficiaries not only repaid their loans but also opened Non-Resident Savings and Deposit Accounts in the branch and sent quite a large amount of remittances. Additionally they served as marketers for the branch in Gulf and brought lot of new business connections from new customers in the Gulf for that branch and also for other neighbouring branches of the bank. The business of the branch zoomed like anything. This concept was extended to other similar branches also by the bank.

The success of new product development depends on how effectively the various ideas from different sources had to be given importance and how effectively the marketer can convert these ideas into successful products that maximise the business.

5.10 CONSTRAINTS IN NEW PRODUCT DEVELOPMENT

Though new product development brings new business opportunities for the banks, there are accompanying constraints also. In bank marketing, where competition is the keyword with lot of players vying with one another to take their slice and also grab other's slice of the cake, new product development is inevitable but also faced with lot of constraints.

The following are some of the constraints:

(a) Heterogeneity of the customer base in different branches is one of the external constraints. It would be very difficult to develop a new product to satisfy all the customer segments. The bank while they develop new product, has to take this constraint into account and crystallise the homogeneity among the heterogeneous group and product development had to be attempted.
(b) With the technological revolution in its peak, product obsolescence is very fast and so customer preferences would also change drastically. This would have an effect on the product life cycle of the new product which will affect the economics of the product.
(c) The existing product range is another constraint in new product development with most of the public sector banks. With deposit products more than around 20. their product range had become unwieldy. The exercise was more towards product pruning rather than new product development.
(d) Sometimes the ideation stage in product development would be attractive. But it would be difficult to convert the idea as a product with business potential. This is again a constraint.
(f) Resistance from the staff for new product development with a view that new products would increase their work load or result in staff pruning/relocation. This attitudinal problem is again a constraint.

We have discussed about some of the constraints in new product development. The constraints are only illustrative but not exhaustive. Each bank marketer will have unique constraints over and above the above mentioned constraints which are more general in nature.

5.11 PRODUCT MANAGEMENT

Product Evolution

Product management is one of the important aspects of the marketing strategies of banks. We have described in the previous chapter, what exactly is a product and products are almost always combinations of the tangible and the intangible. To put in simple terms, product is a 'need satisfying entity' for the customer. But product has undergone great changes over a period from the marketer and the customer's viewpoint. The product has been undergoing rapid changes over the period based on the changing needs of the customer and the marketer constantly upgrading the product and enriching the product. The marketer, to score over competition over a period had refined the product from its basic features to higher and higher levels to satisfy the customer. Let us now try to find out the refinements that had taken place in the product over a period. According to Theodre Levitt, product, over a period, evolved on the following lines :

(i) The Generic Product
(ii) The Expected Product
(iii) The Augmented Product
(iv) The Potential Product

(i) The Generic Product

The generic product is an unbranded and undifferentiated commodity. Like rice, wheat, bread, cloth. It is a core product. In the banking scenario, some examples of generic products are Savings Banks, Current Account, Term Deposits, Drafts, etc., These are core products in banking. The products get an identity through a 'name' given to a deposit as 'Reinvestment Deposit' to give an identity to the product.

(ii) The Expected Product

The expected product represents the customer's minimal purchase condition and what the customer expects from the product. The customer expectations may be different also. For satisfying this, the banker when structuring the product will make these expectations as a part of product structuring and will try to differentiate the product to enjoy the distinction from other similar products. The bank marketer will customise the product accordingly. For example, in a Savings Bank, customer expectation is to withdraw money at will and also collect his cheques through his account and also wants to keep track of his balances in the account. These expectations are met by incorporating the facility of Pass Book for knowing the current balances, cheque book/withdrawal slips for withdrawing money and collection facilities for collecting cheques of the customer.

(iii) The Augmented Product

The Augmented product is augmenting or enriching the product voluntarily. The augmented product is the result of voluntary improvements brought about by the marketers, in order to enhance the value of the product. These improvements are neither suggested by the customer nor even expected by them. The bank marketer on his own, augments the product by adding an extra facility or an extra feature to the product. For example some banks, as a part of their Savings Bank Account, offers the facility of collecting the cheques of the customer at their doorsteps and offers free collection of cheques. Some other banks offer the facility of operating the customer's Savings Bank Account not only from the branch where the customer is maintaining the account but also from any of their branches in India. This type of access to his account from any branch is an augmented feature of the product.

(iv) The Potential Product

Everything that might be done to attract and hold customers is called the potential product. This potential product may be developed based on suggestions, new ideas, redesigning of existing products. In short potential product is tomorrow's product with enormous scope for improvements in the changed competitive scenario. One example of a potential product is availing the service from the site of the customer without going to the bank. In the technology sensitive banking scenario, setting up computer terminals at the customer's site and offering him to bank from his place for retail customers may be a potential product of tomorrow, though it is available today for select corporate customers.

From the above we will be able to understand about the evolvement of product over a period, how each and every stage of the product results in some value addition. Of course the entire development is focussed in one direction (i.e.) the satisfaction of the customer to the maximum possible extent and by continuously reviewing, redesigning the product from various dimensions. The main aim of the exercise, would be of course achieving business objective through customer ecstasy.

5.12 PRODUCT POLICY

Product policy is one of the main tasks in product management. The marketer should decide what exactly the products to be offered to different segments are. Again if the customer base is fairly very large, the product line should be based on the homogenous needs of the heterogeneous customer base and customer segments. Otherwise it will result in unwieldy product range. But of course the marketer has to consider designing product tailored to specific customer base if the segment is an important segment. For deciding that the marketer should develop a product policy which involves the following concepts:

(i) Appraisal of the product line and individual products
(ii) Decisions on product differentiation
(iii) Product positioning
(iv) Brand decisions
(v) Decisions on packaging
(vi) New Product Development

(i) Appraisal of Product Line and Individual Products

A bank marketer, to be effective, has to constantly review his product line. Changes in the environment, changes in customer preferences, competition in the business are potential threats to the existence of products. Though there may not be much changes still the marketer has to take stock of the potential of the present product line. Products which were attractive yesterday may not be that attractive today and may be obsolete tomorrow. A banker has to scan the environment. For example, in the case of Term Deposit, Product variants in this product are Term Deposit with monthly interest facility, a Deposit with Quarterly Interest facility and a Deposit with cumulative Interest facility. These are product extensions. If the banker simply continues to offer these products, separately, without analysing the business potential and taking stock of the situation which may necessitate phasing out the product, it will have direct negative impact on the business strategies.

For example, out of the three term deposit products only one may receive good patronage and others will not have that support. In that case the banker has to think of referring the product or phasing out the products depending on the situation. Another example is where there are too many product extensions in the case of Recurring Deposits that creates confusion among the customer base. An attempt like integrating the various recurring deposit products into one may help in clearing the confusion among the customers and ultimately help in product pruning also.

(ii) Decisions on Product Differentiation

In the highly competitive field of banking, almost all banks offer products with the features of the product being almost the same. But then how the bank marketer will have an edge over other competitors'.'. For achieving, this marketer has to adopt product differentiation. The efforts of the marketer should be to differentiate his product as far as possible from the competitor's product. The differentiation strategies are adopted by differentiating their features, benefits and satisfaction level by doing some value addition to the product. For achieving this, a tool available for bank marketers is to highlight the USP of the product. USP is nothing but 'Unique Selling Proposition' of the product. Unique Selling Proposition is the specific feature available with the particular product. Each product will have a 'USP' and the differentiation strategy depends on the highlighting the USP of the product. For example, in the case of Reinvestment Deposit Plan of banks, the USP is 'cumulative interest on a quarterly compounded basis In the case of 'Multi-Deposit Account' of Citibank, the USP of the deposit was 'withdrawing part of deposit without loss of interest'. In the case of 'Freedom account' offered by HDFC Bank earlier, 'no minimum balance' was the USP of the product. Like this, in the case of Special Fixed Deposit offered by another nationalised bank, the USP is 'receiving monthly or quarterly interest'.

Thus different banks use USP as a product differentiation tool in planning their products. But over a very short period the uniqueness of the USP will be lost as all banks will come out with the similar products and banks have to build their service capabilities and competencies to strengthen the proposition.

(iii) Product Positioning

Product positioning is an important concept to be recognised when we finalise the product policy. Though it may sound to be an extension of unique selling proposition (USP), it is definitely different from USP. Rosser Reeves in his famous book 'Reality in Advertising' defines 'Positioning' as 'the art of selecting out of a number of unique selling propositions, the one which will get you maximum sales'. For 'positioning' the most important factor is the customer's mind. Positioning therefore starts with the understanding or 'mapping' of a prospective/existing customer's mental perception of products. The customer's mind would be occupied with the different products/services of different banks based on the following positioning grid.

Customer's mental perception of the products of the banks mainly occupies different positions in their mind, based on the return and liquidity aspects of the deposit. The period of occupation of these products in the mental perception of the customer again is there for a short period depending on the effectiveness of the product. The strategy of the bank marketer should therefore be to create a perception of their product in the customer's mind so that it stands apart from competing bank's products and approximates much more closely, to what the consumers want. Again the approach should be to occupy our slot in the mind of the customer for a long period. For achieving this the marketer should find a strong position in customer's mind and sit on that.

Jack Trout, the Positioning Guru defines 'positioning' as 'not as what you do to the product, but what you do to the mind'.

The classic case of positioning in bank marketing is the 'Un Fixed Deposit' marketed by Citibank decades back when they started positioning themselves as a retail bank. Here a unified attempt of product differentiation and unique selling proposition had made an impact on the positioning strategy of the bank. Every bank offered Fixed Deposits and when they want money against the deposit, they have to raise a loan and complete certain formalities. So though the 'return' is fair, the 'liquidity' is poor in the case of fixed deposits. There is some space in the minds of the consumer and the perception of the 'consumer is to have both return and liquidity on the higher side. Citibank sensing the positioning slot available to them, proactively designed a new product called as 'Unfixed Deposit' which had features of a Fixed Deposit with high returns, with a facility to withdraw money when required through a cheque book, without any formalities and marketed them with a unique brand name 'Unfixed Deposit'. The product became an instant hit and occupied a strong position in the customer's mind. But the success of positioning depends on the proactiveness and alertness of the marketer to identify the positional slots. Again the early starter will derive the maximum mileage, because the subsequent followers will take time to position the product in that slot. This proactive positioning idea was copied by other competitors to compete for the position in the customer's mind.

With the environmental changes due to competition, if the positioning is threatened, bank marketers will review the product features and USP's of the product and add value to the product and try to recapture or retain the position. This approach is called as a repositioning strategy. Banks have to constantly review their positioning strategies and evolve repositioning strategies depending on the need and the business realities.

(iv) Product Branding

Product branding is an important area in the bank marketing. Though banks try to market themselves, as brands in a competitive market, branding the various products of the banks is a very relevant area for branch marketing. Branding can be a powerful tool for relationship building. The branding efforts of products in "banks' begin at the corporate level. Branding exercise for bank products generally involves giving the different products catchy, attractive names for the products according to the features of the product. For example, a Nationalised bank has branded one of their credit products as 'Pushpaka' a scheme for purchasing cars, and 'Subha Gruha' for loans for housing. Branding the products creates customer/prospective customer awareness when it comes to seeing or hearing advertising message and helps the customers in identifying the brand with the bank. Branding also helps in competitive positioning of the products in the existing and new markets. More and more banks are now adopting branding strategies for their products with the increase in competition. It is but natural that the best brands only will survive and grow.

Terminal Questions

1. State whether the following is true :

   (i) Customers are different.
   (ii) Needs of the customers are different
   (iii) Each customer will have different sets of need for financial services.
   (iv) i and ii are true

   (v.) i and iii are true

   (vi) i, ii and iii are true

Ans: VI

2. Statement 1 - In the introduction' stage of a product, the sales volume will be low and revenue from the products will not be sufficient to cover the cost of producing, marketing and servicing it.
   Statement 2 - In the 'growth' stage, which is the second stage in the product life cycle, the sales volumes remains stagnant.

   (i) Statement 1 is true
   (ii) Statement 2 is true
   (iii) Statement 1 and 2 are true

Ans: I

3. Product architecture consists of the following component/s

   (i) The Generic Product - the core product.
   (ii) The Expected Product - adding additional features.
   (iii) The Augmented Product- adding value in addition to features.
   (iv) The Potential Product - futuristic features in anticipation.
   (v) All the above.

Ans: V

Key

1. (vi); 2. (i); 3. (v)

Let Us Sum Up

- Product Development is a very important element in retail banking. Any product development has the following components viz., Generating new product ideas. Idea screening, Concept Testing, Business Analysis and Market Analysis, Actual product development. Test marketing and commercialisation. But product development has its own constraints like heterogeneous customer base, technology explosion and the resultant product obsolescence, lack of clearly defined segment for the products etc., Product ideas emanate from different sources like market intelligence, original market research, customer feed back and banks factor all the ideas in their product development. Product architecture in retail banking is a four stage process:

  - The Generic Product - the core product.
  - The Expected Product - adding additional features.
  - The Augmented Product- adding value in addition to features.
  - The Potential Product - futuristic features in anticipation.

- In the liability side, Banks offer different retail products like Demand Deposits, Time Deposits with different variations with regard to product features and duration. In the asset side banks offer mainly Home Loans, Auto Loans, Personal Loans and credit lines against credit card receivables. In addition, specific products designed for niche customer groups are also developed and offered by banks. In addition a host of fee based products are also offered by banks.
- To improve the sale of products banks adopt different strategies and market with Unique Selling Propositions (USPs) and proper positioning and branding strategies are adopted by banks.

Keywords

Product Life Cycle; Introduction; Growth, Maturity, Decline; Idea Screening; Concept Testing; Business Analysis; Market Analysis; Generic Product; Expected Product; Augmented Product; Potential Product; Unique Selling Proposition(USP).

UNIT 6 CREDIT SCORING

STRUCTURE

6.1 Introduction

6.2 What is a Credit Score?

6.3 Evolution of Credit Scoring

6.4 What's a Good Credit Score?

6.5 Credit Scoring Model

6.6 Managing the Credit Score

6.7 Positive Side of Credit Score

6.8 Warning Signs in Credit Score

6.9 Credit Scoring Bureau in India

6.10 Issues in Credit Scoring

6.11 Mistakes in Credit Scoring

6.12 Troubleshooting Credit Score

Terminal Questions Let Us Sum Up Keywords

6.1 INTRODUCTION

What is credit scoring? Why credit scoring? What are the benefits to the customers and banks through credit scoring?

"We should not forget that the basic economic function of these regulated entities (banks) is to take risk. If we minimise risk taking in order to reduce failure rates to zero, we will, by definition, have eliminated the purpose of the banking system,"

-Alan Greenspan, President, Federal Reserve Board, New York (May 19%)

The above statement emphasises the need for banks to take risks. As said by Mr.Greenspan, risk is embedded in every action and inaction and the best way to counter risk is to manage the risk in a professional way. To manage the risks, we have to understand the different types of risk and how to mitigate the risks. Basically in the retail side, the types of risks as applicable for corporate credit are applicable for retail credit also. The types of risks and the triggers for the risk are mentioned below:

(i) Credit Risk - Customer fails to pay
(ii) Business Risk - Loosing money due to wrong strategy.

(iii) Market Risk - Change in market prices.
(iv) Operations Risk - Processing failures and frauds,

The same is illustrated below :

Fig. 6.1 Risks and Reasons

To obviate the above risks and to have a reason based and professional appraisal mechanism for sanctioning of retail loans, the concept of credit scoring was introduced by banks. Since borrowers may avail different retail credit products from different banks based on their needs, pricing, process speed and other features

it was felt that a centralized database for arriving at the credit score will be an effective risk mitigation step, a centralized approach is adopted by banks for credit scoring. The different dimensions of credit scoring are discussed below.

Credit Scoring - Concepts

Every borrower seeks the lowest interest rate, every lender the highest. The return a lender seeks factors in, apart from his profit, a premium for the risk he feels he bears of not being paid back. This risk perception is different for di fferent borrowers and, ideally, should be determined from their credit history. But, till recently, lending banks had only their own experience with an individual to fall back on for this assessment. That has changed now with the entry of agencies that assess the creditworthiness of people. The lending bank can judge how good a borrower can be by sourcing their credit score from different agencies. In this context credit record of the applicant is crucial because a good score can make the loan friendlier with lower rates.

A lending bank can source the credit score of the applicant from credit information agencies to supplement the information they furnish in their loan application. Now, if any applicant had already defaulted on a loan from one bank, the default would bring down the credit score, which any other lender would also be privy to. And it could determine not only whether the applicant would get a loan or not, but also the rate of interest.

6.2 WHAT IS A CREDIT SCORE?

A credit score takes a 'snapshot' of a consumer's credit report and through advanced analytics turns the information into a 3-digit number representing the amount of risk he brings to a particular transaction. For instance, the Cibil-TransUnion model gives scores ranging from 300 to 900. The higher the score, the lesser is the risk of the consumer going 91-plus days overdue in the next year. While credit scores are new to India, the US has had them since 1989, when the FICO scores were launched. The lines of credit assessed to arrive at this score would mainly be retail products like home loans, auto loans, personal loans, credit cards and overdrafts.

6.3 EVOLUTION OF CREDIT SCORING

In its embryonic days, retail banking in India meant lending to the rich and affluent. But as lenders chase growth, they were increasingly expanding to lower income groups. This calls for sophistication to accurately assess borrowers' ability to repay and, also, to correctly price the loan. To achieve this, banks sought the assistance of credit information companies who provide a comprehensive report on every retail credit customer containing their verified address, the extent of loans they've taken and whether or not they have ever defaulted or failed to repay any loans on time and in full.

Global experience shows that managing risk and knowing retail loan customers is important for business. For instance, when retail credit took off in South Korea and Hong Kong, both countries experienced large increases in dud loans. A McKinsey study showed that lenders in South Korea and Hong Kong suffered huge losses from defaults in retail loans. Individuals in Hong Kong who went bankrupt were holding, on an average, 14 different cards and debts averaging $75,000 (Rs 32.25 lakh). In fact, bankrupt individuals in Hong Kong owed, on average, 42 times their monthly income as compared to the average of 21 times in the US. In South Korea, too, as credit card usage raised by 90 per cent during 1999-2001, delinquent accounts almost quadrupled. In the U.S.A. three credit bureaus viz. TransUnion, Equifax and Experian provided the credit score for retail customers.

A Credit bureau tracks the indebtedness and repayment history of individual borrowers on loans they have taken from banks, non-banking financial service companies and financial institutions. It also contains certain personal information of each borrower, like name, age and verified permanent address. The information is collected in a credit information report, which is made available to loan-issuing members. Using the credit information report (CIR) provided by the bureau, bankers figure they should be able to avoid disasters like non payment of dues. The credit information bureaus broadly use the following weightages given below to arrive at the score.

(i) Payment History - 35%
(ii) Amounts Owed - 30%
(iii) Length of Credit History - 15%
(iv) New Credit - 10%
(v) Types of Credit in Use - 10%

6.4 WHAT'S A GOOD CREDIT SCORE?

In the US, a FICO score of more than 700 is considered excellent. But whether a score is good or not will depend on the bank's internal policy, its customer profile and its risk appetite. Some bank may perceive 700 as a good score and another may not. Thus, in India, different banks will rank different scores as good. Still, any score over 800 will be considered excellent across the board. But credit score is only an indicative tool for managing risk and its effectiveness depends on the banks' internal control mechanism. An objective thing like the credit score will not only help the banks to reduce defaults but also make loan disbursing faster, improve operational efficiency and bring costs down.

6.5 CREDIT SCORING MODEL

The scoring model used by Cibil-TransUnion employs multiple attributes. The weight it gives to each of these attributes is proprietary information. The following are the details of the attributes.

(i) Credit Utilisation

(ii) Payment History

(i) Credit Utilisation

One of the most important determinants is credit utilisation, that is, how much credit is the customer using. For instance, if you can safely borrow Rs. 1 lakh, but go for a loan of only

Rs 50,000, then you are a very safe candidate. It also means that you are not overleveraging.

(ii) Payment history

This is extremely important. The first question that is addressed is: has the person involved ever defaulted on his payments? If he has, it is examined in how many accounts defaults occurred, by how many days and by how much. Earlier, even one instance of default turned you into a bad customer. Today, an otherwise good repayment history can offset the blemish of a default due to unforeseeable reasons.

6.6 MANAGING THE CREDIT SCORE

We have studied about the two important determinants of the credit scoring by banks. But to effectively manage the credit score, the following points are very important.

(i) Credit Utilisation

Effective credit utilisation is a very important step in individual's credit score. If your safe limit is Rs 10000 and you are using only Rs 5000, then you are a very safe customer. If your limit is Rs 10000 and you are not only fully using it, but also seeking further credit, you could be overleveraging yourself and your score could fall.

Are the numbers of enquiries very high? Have you applied for additional credit lines, recently? Unnecessary and frequent shopping for credit or too many new accounts can be taken as an indicator of being over-hungry for loans and impact the score negatively.

(ii) Payment Defaults

How many past accounts are due, by how many days and by how much? The fewer, the better.

(iii) Trade Attributes

How old are your lines of credit and what type are they? Do you have a good mix or is it, say, all credit cards? A history of consistent repayment of various types of credit will improve your score.

6.7 POSITIVE SIDE OF CREDIT SCORE

A good credit score will indicate the character of the borrower in his financial matters. The following are some of the indicators of good score.

(i) Evidence of financial discipline.
(ii) If the borrower has defaulted once or twice due to reasons beyond their control, those would show up as clear aberrations in an overall consistent payment history.
(iii) The longer the credit history, the better. The lender's assessment presumably improves as he gets bigger spans of repayment. One should be judicious about closing old accounts and opening new ones.
(iv) The score normally ranges between 300 and 900 and 800+ is considered as a good score but this may vary from bank to bank.

6.8 WARNING SIGNS IN CREDIT SCORE

The behavioroul pattern of the borrowers will impact the credit score of the borrowers. The following are some of the signals.

(i) Craving for credit.
(ii) Frequent and unnecessary shopping for credit,
(iii) Several new accounts or recent requests for loans can be taken as signs of an over-hungry borrower.

(iv) The length of credit history is also important. Older accounts are generally better, so you should be
judicious about closing old accounts and opening new ones.
(v) Trade attributes - does the customer use a good mix of credit?

The above activities will ultimately bring down the credit score. To overcome this the borrower should maintain financial discipline, repay dues on time and do not over leverage themselves. But then how to know one's credit score to maintain financial discipline? Unlike in U.S.A the score is not available to individuals and available only for lending banks. But the days are not far off for the individuals knowing their credit score.

6.9 CREDIT SCORING BUREAU IN INDIA

The first credit bureau in the world. Dun & Bradstreet, (a shareholder in CIBIL) was set up back in 1841. In India. Cibil, in a tie-up with TransUnion of the US, launched the first generic credit score in India. Others have followed—Fair Issac Corporation in a tie-up with High Mark Credit Information Services, and Equifax in association with Crisil and Tata Capital. Let us see the evolution of CIBIL and the services it offers to the banks for credit scoring for retail customers.

Credit Information Bureau of India Limited (CIBIL) is a privately owned company, which collects credit information on over 140 million credit card holders and loan takers. CIBIL is India's first credit information bureau. This credit information bureau was formed on the basis of recommendations of a working group constituted by RBI to establish a world class bureau in India in the private sector, which would be a technology-driven service provider.

The company is owned by a syndicate of banks now, but was originally promoted by the State Bank of India (SBI), Housing Development Finance Corporation Limited (HDFC), Dun & Bradstreet Information Services India Private Limited (D&B) and TransUnion International Inc (TransUnion). A number of banks, including Bank of India, HSBC. ICICI. Central Bank, etc, now hold stakes within this firm.

It helps banks, financial institutions and other financiers to share credit histories of retail and commercial customers. The bureau provides both positive and negative information about bank's borrowers, which empowers lenders in assessing the credit worthiness of potential customers.
CIBIL shares a relationship with all banks based on the concept of sharing. They collate the credit information available from all financing institutions, which are its members, and provide an informed report, which takes into consideration all the financial activities of a consumer when asked for by the bank. Suppose a person has taken a loan from one bank where they have paid their EMI's promptly, however, on another loan taken from a second bank they have defaulted on the payment. In this case, when this customer applies for a credit card or loan again, say to the first bank where his record is impeccable, the bank, by following the norm, would seek out his credit report from CIBIL, which would then show his default oh his prior loan with the other bank. CIBIL works mainly on the concept of reciprocation. Therefore, only those banks, which share all their customers' credit information with them will be given access to the credit reports that CIBIL has. CIBIL's primary job is to collate data on the credit worthiness of all borrowers from banks and prepare customer information reports (CIR) to help credit grantors make faster and more objective lending decisions.

6.10 ISSUES IN CREDIT SCORING

Credit scoring is an enabler for banks to take a call on the risk based on the score and accordingly decide at the price for the risk. IT also enables the banks to speed up credit decisions and disbursement based on the score.

With a bureau in place, responsible customers can expect faster and more competitive services at better terms and rates from banks and other credit companies. Based on CIR, the credit bureau would assign a credit score to every potential borrower which would bring about the differentiation in rates. As per CIBIL norms, customer information reports (CIRs) can be accessed only by member banks. Further disclosure to any other person is prohibited. However, if the bank has drawn a report on you, then you can obtain a copy of the same from the bank. However, a person can access their credit reports directly as well now-a-days by putting in a request to CIBIL directly. One can then go through their report and if there are errors found, one can notify the bank and CIBIL regarding the same. While some people have found out their credit score as well, which is usually a number between 300-900, why is that their score or how can they improve it, if they have no defaults to their name, is still unknown.

On an average a defaulter whose name is on the CIBIL list, and he/she has actually defaulted by intent or circumstances, their name remains on the list for at least 7 years, during which getting a credit card or loan is virtually impossible. The quality of CIBIL reports have further been helped by certain government measures like introduction of PAN numbers and making the same mandatory for availing most banking services.

6.11 MISTAKES IN CREDIT SCORING

It is but natural that mistakes may occur in the credit scoring process due to various factors and if we do not take steps to correct it, our credit score will be arrived at wrongly and will be a detriment when we need a retail loan or credit card. Let us see the common mistakes in credit scoring which will affect the score.

(a) Confusion of Names

There can be lakhs of names that are similar in the CIBIL database. Things can go haywire if a person with your name has defaulted and all his defaults get recorded in your file.

(b) Human Input Error

The information that goes from the banks to the CIBIL on a default may have been erroneous due to simple input error by one of the bank employees.

(c) Identity Theft

This is the most serious of all causes of errors and can have a disastrous impact on a person's credit profile. In recent times, identity thefts are on the rise. Right from a petty shopkeeper who swipes your card several times to sneak in an unofficial payment or track credit card details, which he can exploit, to a terrorist who wants to access a billionaire's account in a remote corner of the world, identity theft is becoming a serious crime that needs check.

6.12 TROUBLESHOOTING CREDIT SCORE

We have to accept that there are chances of mistake in arriving of credit score or mistaken identities creating confusion in the scoring process. Errors and inaccuracies are possible with CIBIL report. The steps for seeking clarifications in your credit report are as follows.

(a) Contact the bank that declined a credit card or loan application on the basis of your poor credit score. Ask them for a clarification on the poor credit score and request them to provide the control number for your credit report.
(b) The bank will provide you with the control number of the credit report and also share the information on the credit report that is responsible for your poor credit score.
(c) Get in touch with CIBIL by calling their help desk numbers in their website, www.cibil.com. You could also drop in an email at info@cibil.com referring your credit report's control number. When attempting to clarify the information on your credit report, you need to inform CIBIL about the exact nature of the discrepancies in the report that you have been made aware of, by the bank.
(d) The control number is a nine digit unique number that helps CIBIL track an individual's credit report from its database. Banks feed in borrower data and personal information, which the CIBIL systems pool together. The control number is generated when banks pull out your credit report on a requirement basis. The control number is a unique number, which is generated every time any bank or credit institution pulls out a credit report on you.
(e) CIBIL requires this number because it enables them to view the exact details that the bank has seen when they drew a report on you. Hence, it is important for you to request the bank to provide you the control number.

(f) When the bank is uncooperative you could post a complaint in the bank's website and if the bank does not respond within 15 days, you can register a complaint with the banking ombudsman.

presenting a copy of the complaint posted on the bank's website as proof. You can either register this complaint through their website, www.bankingombudsman.rbi.org.in or locate the nearest branch office through this link, http://rbidocs.rbi.org.in/rdocs/Content/PDFs/68033.pdf to register your complaint.

(Sources : CIBIL, Article on Mint Newspaper and other sources)

Terminal Questions

1. Credit Scoring Models are based on the following details of applicants:

   (i) Family Size
   (ii) Income Levels
   (iii) Occupation/Business
   (iv) Repayment History on earlier loans
   (v) All the above.

Ans: v

2. The most common mistakes in credit score will be due to the following;

   (i) Confusion of names
   (ii) Human Input Error
   (iii) Identity Theft
   (iv) All the above.

Ans: iv
key
1. (v); 2. (iv)

Let Us Sum Up

- For retail asset products, to take a call on the lending decisions, credit scoring models are adopted by banks. Credit Scoring Models are used to arrive at the credit score based on the applicants' family size, income levels, occupation/vocation/business, status, repayment history on earlier loans etc.
- Scores are awarded based on each parameter of reference for arriving at the total score. For each parameter, the strength of the applicant will earn higher scores. This total score by the borrower will be the determinant to enable banks to take a lending call. Credit Score helps banks to take more qualitative lending decisions.

Keywords

Credit Score; Family Size, Income Levels, Identity Theft, Repayment History; CIBIL.

U N I T 7 IMPORTANT RETAIL ASSET PRODUCTS

STRUCTURE

7.1 Home Loans
7.2 Home Improvement Loans
7.3 Home Decor Loans
7.4 Auto/Vehicle Loans
7.5 Personal Loans
7.6 Educational Loans
7.7 Processing of Retail Loans

Terminal Questions Let Us Sum

Up Keywords

As mentioned earlier the important Retail Asset Products are Home Loans, Auto Loans, Personal Loans, Credit Card and Other Personal Loans. Let us see the details of the different retail loans.

7.1 HOME LOANS

No.	*Particulars*	*Features*
1.	Eligibility and Other Conditions	• Individuals/Group of Individuals/Members of Cooperative Society. • Individuals should have regular income from Agriculture/Profession/Trade, Business/Salary in case of employment. • In case of employed persons, minimum three years of confirmed service is necessary. • In case of Self Employed Professionals, Business Persons, minimum three years standing in their respective field is necessary. • Applicant should not be enjoying credit facility for the same purpose from any bank/financial institution and should not be a defaulter in the case of any other credit facility from any bank/financial institution. • Applicants who own a house in the name of self or spouse or minor children are also eligible. • Applicant should not be more than 60 years of age.
2.	Purpose	• For purchase/construction of new/old houses/flats and for extension of already owned houses. • In case of old houses/flats, the age of the house/flat should not be more than 15 years.
3.	Amount	• Many banks offer Housing Finance for resident individuals upto Rs.50 lakhs. • For High Net worth Individuals, loan up to Rs.2 crores is considered. • Loan is fixed based on the age and repayment capacity of the applicant.
4.	Margin	• 20%
5.	Security	• First Mortgage of the property to be financed. • The land should be in the name of the applicant or jointly with the spouse who should be a co obligant. The applicant should have a clear and marketable title to the property.
6.	Disbursement	• In case of construction of house, the disbursement will be in stages based on the progress in construction.

		• In case of purchase of plot and construction, loan will be disbursed first for purchase of flat and then as per the procedure described above for construction. • In case of flat, again disbursement will be made based on the progress of construction in case of new flat. • In case of already completed flat and old flats, the loan amount will be disbursed in one go based on the Agreement of sale.
7.	Moratorium	• Holiday period - upto 18 months for construction of house and 3 months for purchase of house/flat.
8.	Prepayment Issues	• Some banks levy pre payment charges for pre closure of loans. • Generally public sector banks do not charge the customers for pre- closure.
9.	Repayments/ Collection	• Normally repayable in 15 to 20 years • Repayment period starts from even 5 years. • Some banks offer loans upto 25 years. • In case of fixed rate loans maximum repayment period is normally 10 years.
10.	Price and Interest Rate	• Interest rate depends on the size of the loan and repayment period. • Interest also depends on whether it is a fixed rate or floating rate loan. • A new pricing model has emerged for Home Loans in the recent past. Step up pricing i.e. lower interest (teaser interest rates to initially attract customers) for the entry years (2 to 3 years) and subsequently hiking to fixed or floating rates prevailing at that time for the remaining tenor. • Interest Band - 8 % to 12 % per annum depending on the tenor and also whether the loan is fixed or floating. • In case of floating rates, rate varies with the Bank's Prime Lending Rate. • In case of fixed rates, the rate is reset over every fixed period; say 5 years, indicating that even on fixed rate loans, the price will vary over a long tenor. • Most of the banks allow switch over from fixed rate to floating rate and a rewriting fee of 1 % is charged and a lock in period of three years is prescribed. • Processing charges varies from 0.5 % to 1 % and some banks waive processing charges during special campaigns to mobilise accounts and as a marketing initiative.

The above retail loan is a plain vanilla product for resident individuals. There are special products for High Net Worth Individuals. Non Resident Indians offered by different banks. In addition, banks offer loans for Home Improvement, furnishing Homes (Home Ddcor) as add on loans or stand alone loans in different brand names. Let us discuss about the different add on Home Loans offered by some banks.

7.2 HOME IMPROVEMENT LOANS

No.	*Particulars*	*Features*
1.	Eligibility and Other Conditions	• Individuals/Group ot Individuals/Members of Cooperative Society who owns a house/flat. • Individuals should have regular income from Agriculture/Profession/Trade, Business/Salary in case of employment. • In case of employed persons, minimum three years of confirmed service is necessary. • In case of Self Employed Professionals, Business Persons, minimum three years standing in their respective field is necessary.
2.	Purpose	• For repair, renovation, upgradation, painting, and other repairs.
3.	Amount	• Maximum of Rs. 5 lacs but some banks give higher amounts upto Rs.10 lacs also.
4.	Margin	• 20% to 50%
5.	Security	• Equitable mortgage of property under repair/ renovation or any other unencumbered immovable property also accepted by banks.
6.	Disbursement	• Depending on the nature of repair/renovation.
7.	Moratorium	• 3 months.
8.	Repayments/Collection	• Maximum 10 years.

7.3 HOME DECOR LOANS

No.	*Particulars*	*Features*
1.	Eligibility and Other Conditions	• Individuals/Group of Individuals/Members of Cooperative Society who owns a house/flat. • Individuals should have regular income from Agriculture/Profession/Trade, Business/Salary in case of employment.

		• In case of employed persons, minimum three years of confirmed service is necessary. • In case of Self Employed Professionals, Business Persons, minimum three years standing in their respective field is necessary.
2.	Purpose	• For furnishing the house/flat, interior decoration/air conditioners, etc.
3.	Amount	• Maximum of Rs. 5 lacs but some banks give higher amounts upto Rs.10 lacs also.
4.	Margin	• 20% to 50%
5.	Security	• Equitable mortgage of property under repair/ renovation or any other unencumbered immovable property also accepted by banks.
6.	Disbursement	• Depending on the nature of repair/renovation.
7.	Moratorium	• 3 months.
8.	Repayments/Collection	• Maximum 10 years.

Different banks offer different variations of the above loans. But the fundamental approaches of the banks will be to address the entire needs of the customers regarding housing loans.

7.4 AUTO/VEHICLE LOANS

The approach for sanctioning of car loans differs from bank to bank. Private sector banks and foreign banks approach it aggressively while public sector banks generally are not very aggressive in car loans but for a very few banks. Private sector banks adopt a model involving the manufacturer, dealer and the financier(bank).The pricing is structured after a combined approach to pricing by all the three involved factoring the manufacturer's pricing, dealer margin, volume of sales etc., This mechanism results in finer pricing by private banks and foreign banks. In addition, manufacturers themselves float their financing arms and through dealers they extend finance to their own cars through their dealer network. To take the competition on, private and foreign banks go aggressively on the marketing side and conduct special and seasonal campaigns jointly with the dealers to push up the off take of vehicle loans. They do so for both cars and two wheelers. But the two wheeler financing is not a focus area by banks nowadays as the ticket size is small and they are taken care of by Non Banking Finance Companies (NBFC) mostly. Let us discuss below the norms generally adopted by public sector banks for extending car loans.

No.	*Particulars*	*Features*
1.	Eligibility	• Individuals in confirmed service in Government, Public Sector Undertakings, reputed private organisations and institutions.

		• Professional & Self Employed persons ■• Business people • In case of employed people, take home pay not less than 50% of gross salary.
2	Purpose	• To buy new or used car. • In cased of used car, the age of the car should not be more than 5 years.
3	Amounts	• In case of new car, 90% of the invoice price. • In case of used car, 75% of the market value subject to a ceiling of Rs.5 lacs. This may vary among banks. • 90% of the invoice price or 10 times the gross salary or Rs.60000 whichever is less.
4	Margin	• 10% for new cars. • 25% for used cars • 10% for two wheelers. • Margins also may vary with the banks.
5	Security	• Hypothecation of the vehicle to be purchased out of the loan.
6	Disbursement	• Payment to the dealer for the cost of the car on road.
7	Moratorium	• Normally no moratorium. • Repayment of the loan commences from the immediate following month. • Some private banks collect the advance EMI at the time of disbursement.
8.	Prepayment issues	• Public sector banks normally do not charge any pre payment penalty. • Some Private Sector banks collect pre payment while some don't.
9.	Repayments/Collection	• New Cars - Normally 60 Earnest Monthly Instalments (EMIs). Used Cars - 36 EMIs
10.	Price	• Banks charge from 11% to 14% depending on the bank. • Processing charge is also collected by banks and the rates vary across banks.

7.5 PERSONAL LOANS

Personal Loans are basically unsecured in nature and are backed by personal guarantees only. As credit risk and delinquency rates are more in this segment, public sector banks tread cautiously in this segment and private banks do it aggressively. But post global financial crisis, this credit segment is down as private banks have become cautious and also due to southward movement in the demand side.

Personal Loans can be grouped under two segments:

(i) Big Ticket Personal Loans and

(ii) Small Ticket Personal Loans.

Big Ticket Personal Loans are loans in which the ticket size (amount of loan) is above Rs.50,000/- and an average ticket size of about Rs. 1,25,000/-. Small Ticket Personal Loans are loans less than Rs.50,000/ - and an average ticket size of Rs.23,000/-.Small Ticket Personal Loans are mostly extended by Non Banking Financial Companies.(NBFCs) and banks focus mainly on Big Ticket Personal Loans. The features of personal loans are discussed below :

No.	*Particulars*	*Features*
1.	Eligibility	• In most of the public sector banks -Salaried Class employed in Government,Public Sector Undertakings, reputed private • • organisations and institutions confirmed in service. In private sector banks they additionally cover -Professional & Self Employed persons and Business people In case of employed people, take home pay not less than 50% of gross salary.
2.	Purpose	• For any purpose including any social/financial commitment.
3.	Amounts	• • Upto Rs.5 lacs extended by private banks

		generally. But public sector banks extend upto Rs.2 lacs generally.
4.	Security	• • Unsecured Loans. Only Personal Guarantee from two guarantors, the salary of each guarantor being almost equal to that of the borrower.
5.	Disbursement	• Generally disbursed in one go.
6.	Pricing Issues	• • Pricing will be more as the loans are unsecured. Normally about 4% above the BPLR in case of PSBs. But private banks price it higher as compared to PSBs.
7.	Moratorium	• No moratorium. Repayment commences from the next month.
8.	Prepayment issues	• • No prepayment penalties levied by public sector banks. But some private banks levy pre payment penalties.
9.	Repayments/Collection	• • Normally repayment in 36 monthly EMIs. Some banks extend repayment upto 60 EMIs in case of big ticket personal loans.

- In case of bulk loans to a group of employed persons, public sector banks insist for either routing the salary account through them or undertaking from the employer to deduct the EMIs from the salary and remit to the bank.
- Banks also take post date cheques from the borrowers (minimum12 and to be replenished annually) for payment of EMIs on the due dates.

7.6 EDUCATIONAL LOANS

India has got the biggest advantage as regards to population and comprises of a good percentage of youth who will take our country forward to make it as a super power. This advantage which our country enjoys is called the "Demographic Dividend". Education is the important tool for empowering youth and to realize this, a simple and hassle free educational loan scheme was devised.By this scheme, nationalised banks were advised to implement a model educational loan framed by Indian Banks Association to make available educational loans to all the eligible students under the scheme. Let us see the important features of the scheme.

No.	*Particulars*	*Features*
1.	Eligibility	• Students studying in Professional/Other Colleges • Indian Banks' Association has brought out a Model Educational Loan Scheme prescribing the modalities to be followed by banks regarding disbursement of educational loans. The objective of IBA is to make the banks to adopt a uniform approach as per the prescribed guidelines. • Amount of loan, purposes, approval requirements of colleges, security prescriptions. • Loan to be given jointly to the student and their parent.
2.	Purpose	• To pursue professional degree/diploma and other course as prescribed in the IBA guidelines. • For studies in India and abroad.
3.	Amounts	• Inland Studies - Upto Rs.10 Lacs. • Foreign Studies - Upto Rs.20 Lacs • In case the amount required is more, the same can be considered by banks on a case to case basis.
4.	Security	• Upto Rs.4 Lacs - No security. • Above Rs.4 Lacs and upto Rs.7.50 Lacs - Additional Personal Guarantee worth the

		amount. • Above Rs.7.50 Lacs - To be secured by tangible asset to cover the loan in the form of property, Govt. Securities like NSC.KVP etc.,
5.	Disbursement	• To be disbursed in stages - semester wise or annual payments as per the requirements of the institutions • Payment to be made direct to the institution.
6.	Moratorium	• One year after completion of the studies or employment which ever is earlier.
7.	Prepayment issues	• No prepayment charges. • But generally pre payment will not happen in Educational Loans as the repayment is fixed only after completion of the studies and revenue streams for pre payment will be very rare. • But parents have the option to service the interest whenever due and if interest is serviced, Tax Exemption for interest serviced is available. • Some banks offer Interest Rebate of 1% for prompt repayment of the loan.
8.	Repayments	• Repayable in 60 monthly instalments (EMIs) after the moratorium period as prescribed above.

In addition to the core retail loans discussed as above, banks are structuring specific need oriented retail loans to niche retail segments. Loans to Professional like Doctors. Advocates, Architects, and Chartered Accountants for their professional development are structured by banks to cater to their customer segments. Banks always look for opportunities to introduce different and need oriented products to satisfy their customer needs as well as to bring in new customers into their fold.

7.7 PROCESSING OF RETAIL LOANS

The success of retail asset expansion by banks depends on the processing speed of retail loans and making the procedures hassle free for the customers. Banks adopt different models for processing of retail loans. The important models of retail loans processing are explained below:

(i) Stand Alone Model and

(ii) Centralised Model

Stand alone Model for Retail Loan Processing

Stand alone model for retail loan processing refers to processing of retail loans independently at the branch level. Based on the discretionary powers given the Branch Head, Branch will market the retail loans and process and sanction the loans based on the eligibility of the applicants. Obtention of the necessary documents, appraisal of the proposal and sanction of the loans will be done independently at the branch level. The valuation, legal opinion etc, are obtained at the branch level through the approved panel valuers/lawyers. If the proposal exceeds the discretionary limits of the Branch/Branch Head (as the case may be),the proposals are referred to the Regional/Circle/Zonal Office of the Bank for approval and sanction. On approval, the loan is released at the Branch after completing the documentation/mortgage formalities at the branch level.

Centralised Model for Retail Loans Processing

Centralised Model for retail loans processing refers to processing of loans at a centralised place depending upon the geography of branches. Banks adopt different centralised models for processing of retail loans. Some of the names. Banks give to these retail loans processing centres are

(i) Retail Loan Factory
(ii) Retail Loan Hub
(iii) Retail Loan Processing Centres
(iv) Retail Asset Processing Centres
(v) Retail Loan Branches

To explain further, some banks set up exclusive retail branches through which they sanction all retail loans in that location/specified geography. Some banks set up retail loan factories in specified locations and do the end to end processing at that branch. Some banks set up retail loan processing centres at metros, state capitals and centres where there is good potential for retail lending. These branches/ processing centres will be fully supported with marketing personnel, panel lawyers, approved valuers etc. for speeding up the process, sanction and disbursal. The process/workflow of these centres are on the following lines:

1. Branches attached to the Retail Loan Processing Centres (RLPCs)and marketing personnel in these centres market various retail asset products to the target segments. Business is sourced in both the above ways based on the customer data base as well as market scenario and market intelligence.
2. The application and the required documents are forwarded to the retail loan processing centres. In some banks, relevant information is transmitted electronically by the branches for quick processing.
3. On receipt of application and details from the branches, RLPCs do the following steps:

   (i) Process the application.
   (ii) Do the verification checks.
   (iii) Arrive at the Credit Score.
   (iv) Do the valuation (wherever applicable) through the panel valuer.
   (v) Obtain the Encumbrance Certificate (wherever applicable) through the panel lawyers.
   (vi) Obtain the legal opinion (wherever applicable) from the panel lawyer.
   (vii) Arrive at the quantum of finance based on the margin requirements for different loans.
   (viii) Pricing of the loan based on the Type of Loan/Credit Score/Individual Borrower/Group Borrowers.
   (ix) Advising the sanction of the loan to the Borrower/Branch with the terms and conditions.
   (x) Receiving acceptance for the terms and conditions from the applicant.
   (xi) Execution of documents for the loan and also completing the mortgage formalities wherever applicable (any mortgage backed retail loans like Housing Loans etc.,).
   (xii) Release of the loan to the borrower.
   (xiii) Verification of end use by the borrower.

The procedures for sanction and disbursement of loans through RLPCs vary among banks. In some banks, appraisal and upto sanction are taken care of by RLPCs and post sanction formalities like release of loan, documentation, creation of mortgage.follow up and monitoring are taken care of by the respective branches. In some other banks, RLPCs function as separate branches. They offer end to end solutions right from processing to release and also monitoring and follow up. Branches have to just source the business and forward the details to RLPCs. They do the rest of the job. In both the above methods, the objective is to speed up the process of sanctioning retail loans.

Stand Alone Vs Centralised Model for Retail Loans Processing

The above two models are implemented by banks for quick disposal of retail loans. Both the models have their own advantages as well as disadvantages. Let us discuss some of them.

S.No	*Stand Alone Model (Branch*	*Centralised Model (Retail*

	Level Processing)	*Loan Processing Hubs/Centres)*
1.	Better Understanding of the customer requirements.	Based on documents only.
2.	No standardised approach	Standardised approach.
3.	Retail Loans are only one part of the multiple activities.	Exclusive activity and hence will be more faster and professional in approach.
4.	Difference in quality of appraisal based on the branch and its personnel.	Quality will be uniform as the activity is exclusive.
5.	Processing time may differ based on the priorities of the branches and importance of the customers/proposals.	Processing time will be uniform and based on fixed Turn Around Time (TAT) for different retail loans.
6.	Compliance of appraisal norms may be biased based on the customer profile.	Uniform and impersonal appraisal standards.
7.	Documentation standards may not be uniform.	Professional documentation standards.

The above are only illustrative and not exhaustive. To sum up. RLPCs definitely have an edge with regard to processing of retail loans as compared to processing at branches. But as said above, branches will understand the customers' requirements on a personal basis as against the mechanical approach of RLPCs. But the introduction of RLPCs by banks has definitely helped banks to improve the quality appraisal and reduce the documentation gaps as compared to branch level appraisal.

Terminal Questions

1. Home Loans are sanctioned by Banks for the following purposes:

   (i) Purchase/Construction of House.
   (ii) Purchase/Construction of Flat
, (iii) Purchase of land and construction
   (iv) Additions to the existing house
   (v) All the above.

Ans: v

2. Auto Loans are given by banks for the following purposes:

   (i) Purchase of New Car
   (ii) Purchase of Used Car
   (iii) Purchase of Two Wheelers
   (iv) All the above.

Ans: iv

3. Personal Loans are sanctioned by banks based on

   (i) Salary in case of employees
   (ii) Monthly/Annual Income in case of business
   (iii) Number of years of service/in business
   (iv) All the above.

Ans: iv

4. Retail Loan Processing Centres of banks are designed to

   (i) Source retail asset business
   (ii) Process retail loans
   (iii) Do the valuation/legal opinion wherever necessary
   (iv) Release the loan either at their end or advise sanction to branches.

Ans: iv

Key

1.(v);2. (iv);3. (iv); 4. (iv)

Let Us Sum Up

- In the retail asset site, the important products offered by banks are Home Loans, Educational Loans, Personal Loans and other retail loans developed for specific customer segments.
- Each loan is designed for a specific purpose and need and structured in such a way that the needs and requirements of different customers are taken care of.
- Banks process and sanction retail loans in two different ways. They sanction retail loans on a stand alone basis (through the branches) or through a centralised model (through retail loan processing hubs/centres). Each model has its own advantages as well as disadvantages. In the branch model, personal touch is more, in the centralised model, more professional approach is followed. The introduction of RLPCs has definitely helped banks to improve the quality of appraisal and also has reduced the gaps and deficiencies in the documentation side.

Keywords

Retail Loans; Home Loans; Auto Loans; Personal Loans; Educational Loans; Retail Loan Processing Centres.

UNIT 8

UNIT 8 CREDIT AND DEBIT CARDS

STRUCTURE

8.1 Credit Cards

8.2 Evolution of Credit Cards

8.3 Type of Credit Cards

8.4 Salient Features of Credit Cards

8.5 Credit Card Issuing Process

8.6 Debit Cards

8.7 Credit Cards vs Debit Cards

Terminal Questions Let Us Sum

Up Keywords

8.1 CREDIT CARDS

What is a credit card? A credit card is a thin plastic card, usually 3-1/8 inches by 2-1/8 inches in size that contains identification information such as a signature or picture, and authorizes the person named on it to charge purchases or services to his account — charges for which he will be billed periodically. The information on the card can be read by ATMs, Point Of Sales (POS) Terminals at different establishments like Textile Stores, Super Markets, Jewellery Showrooms, Book Shops, Restaurants etc.. Before we go into the details of the end to end process cycle of the issue, use and management of credit cards, let us have a look into the operational process of credit card usage.

- **Different Type of Cards, Targeted Volumes and Business, Customer Screening and Selection based on Credit Scores, Type of Card, Card Limit etc.**

- **Usage Pattern and Frequency, Usage Amount, Type of Usage**
- **Percentage Usage to Total Limit on a regular basis**

- **Frequency of Card Payments - one time payment or using the credit limit and paying in instalments**
- **Payment on or before due dates, delayed payments and payment defaults**

Fig. 8.1 Operational Process of Credit Card Usage

To put it in a simple way, the concept behind Credit Card is "Buy Now, Pay Later". It sounds very simple but credit cards have lot of complexities. Credit Cards are plastic cards that double up in lieu of money for payment of goods/services and also enable withdrawal of cash if needed. The payments made through the card or cash withdrawn have to be paid after a certain agreed period of time and also with a payment option spread over a period. The process starts with the usage of the card and ends with the payment of card dues. The process gets repeated over a period depending upon the needs of the card user and also the periodicity of needs and requirements. Cards as a payment instrument have evolved tremendously over the past decade in India and the same are reflected by the volumes and values as shown below.

Service	*Transaction Volumes (ooos)*		*Growth in Volume **(%)***		*Transaction Values (Rs. in Crs.)*		*Growth in Value **(%)***	
CREDIT	2008	2009	2008	2009	2008	2009	2008	2009
CARDS	228203	259561	34.6	13.7	57984	65356	40.2	12.7

The volumes and value have shown a good growth 34.6% and 40.2% respectively in 2008 but has come down in 2009 basically due to the economic melt down and shrinkage in consumption by the consumers.

Let us look in detail, the evolution, growth, mechanics and dynamics of credit cards.

8.2 EVOLUTION OF CREDIT CARDS

Global Scenario

Credit Cards had their origin right from 1800s. It was first practiced by shop keepers who wanted a fast way of keeping track of customer purchases made on credit. Instead of constantly writing down their customers' personal information, they issued tokens with numbers on them. When the customer made a purchase the store keeper simply had to write down the token number. The history of credit cards is not all that exciting since nothing major happened for the creation of credit cards to come into being.

In the United States during the 1920s, individual companies, such as hotel chains and oil companies began issuing them to their customers for purchases made at those businesses. This use increased significantly after World War II.

The first universal credit card that could be used at a variety of stores and businesses — was introduced by Diner's Club Inc., in 1950. With this system, the credit-card company charged cardholders an annual fee and billed them on a monthly or yearly basis. Another major universal card — "Don't leave home without it!" — was established in 1958 by the American Express Company. In 1951 the Franklin National Bank thought of a revolutionary new way of issuing credit to their customers. They created revolving credit accounts which allowed their customers to borrow money, repay it and then borrow again without constantly having to be approved for a loan so long as they stayed under their credit limits. Soon other banks started following in their footsteps and began offering their customers revolving lines of credit.

Next the banks started issuing credit cards that could be used to make purchases at local merchants. However, customers quickly wanted to be able to use their credit cards beyond their own localities. Later came the bank credit-card system. Under this plan, the bank credits the account of the merchant as sales slips are received (this means merchants are paid quickly — something they love!) and assembles charges to be billed to the cardholder at the end of the billing period. The cardholder, in turn, pays the bank either the entire balance or in monthly installments with interest (sometimes called carrying charges).

The first national bank plan was BankAmericard, which was started on a statewide basis in 1959 by the Bank of America in California. This system was licensed in other states starting in 1966, and was renamed Visa in 1976.

Other major bank cards followed, including MasterCard formerly Master Charge. In order to offer expanded services, such as meals and lodging, many smaller banks that earlier offered credit cards on a local or regional basis formed relationships with large national or international banks'(Source: *Wikipedia and other Internet Resources)*

Indian Scenario

Citibank and HSBC were the pioneers in the Indian credit card market in the 1980s. Over the next two decades, the number of players increased to more than ten in 2000. The credit card market registered a healthy annual growth rate of over 25% during 1987-2001. Among the public sector banks, Andhra Bank, Bank of Baroda were the early starters followed by Bank of India.

Among the foreign banks, Standard Chartered Bank entered the credit card space and built volumes steadily. Canara Bank is another bank which entered credit card space subsequently but improved the volumes by tie up with other PSBs like Union Bank of India, Indian Overseas Bank etc., Canara Bank pioneered the concept of franchisee and co branded model in credit cards space for achieving critical mass in credit cards. But in spite of all the above developments, foreign banks continued to dominate the credit card market in India till the entry of two big local players viz., ICICI Bank and subsequently State Bank of India. Both the above banks aggressively launched their credit card initiatives and penetrated the market with user friendly requirements for availing the cards. State Bank of India started a separate subsidiary with GE Capital for their credit card operations. HDFC Bank is another major player along with the above two. A number of banks, both foreign, private and PSBs entered into the credit card space down the line but Citibank, Standard Chartered Bank, State Bank of India, ICICI Bank and HDFC Bank dominate the credit card market with more than 90% market share.

8.3 TYPE OF CREDIT CARDS

Credit Card as a product has a generic name but within the generic concept a number of sub brands which have different characteristics exist. The following are the main types of cards issued by banks.

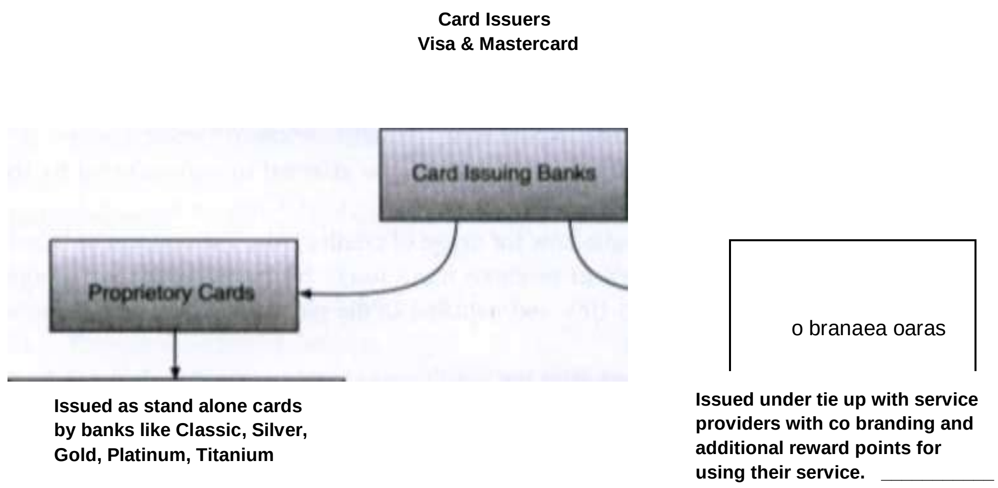

Fig. 8.2 Types of Cards

The proprietary card issuers like Visa and Master Card tie up with banks for issue of credit cards. Banks issue the cards under their brand and market the cards aggressively based on their business plan for credit cards. While marketing the cards they mention clearly their association of the card issuer in the card so that the brand equity of the card issuer is an impetus for generating volumes.

Mainly credit cards are issued by banks in two formats viz., the proprietary format and the co- branded format.

In the proprietary format, banks issue the card in different brand names like Classic. Silver, Gold, Platinum, Titanium etc. Credit limits, cash withdrawal limits and other facilities will depend on the type of card.

In the co branded format, banks tie up with service providers like Hotels, Oil Companies, Airline Companies etc. and offer the cards as a co branded product with the brand name of the tied up company also embossed in the card. This enables brand recall and results in better utilization of the products offered by the tied up product. Special incentives/reward points are offered for using the co branded card.

8.4 SALIENT FEATURES OF CREDIT CARDS

1. Credit Cards are accepted globally through their affiliation with Visa and Master Card.
2. Credit Cards are issued with limits of usage called "Card Limit" which fix the upper limit upto which the cards can be used. Within the overall limit, limits on cash withdrawal through ATMs are fixed which will be equal to or less than the total card limit. While the overall limit can be used at any point of time without any charges, for withdrawal of cash, finance charges are recovered depending upon the frequency of withdrawal.
3. Credit cards have a regular billing cycle and billing date and due date of payment is decided from the billing date. The period after which payment is to be made after the billing date is called as the free credit period and will be usually between 20 days and 50 days and differ across banks.
4. To induce usage of cards, reward points are awarded based on the amount and type of usage. Reward points vary for different classes like Silver, Gold, Platinum, Titanium etc. The reward points will be awarded based on the usage and will be a fixed points per Rs. 100 and the total reward points for the usage will be based on the usage and calculated per Rs. 100. The reward points can be redeemed by the card holders as prescribed by the card issuing bank. Usually, for every 2 reward points. Re 1 will be redeemable and the redemption of reward points can be affected in outlets listed by the card issuer.
5. Another promotional concept is in vogue now for usage of credit cards. The concept of "Cash Back Offer" was introduced in credit cards to promote more usage by incentivizing the usage. This incentivisation is offered from 2% to 10% and adjusted in the payment. Cash Back Offer always comes with a cap on the total amount.
6. The payment for the usage of the card after the credit period and on the due date can be paid in different ways. The payment can be made in full on or before the due date. Alternatively, a minimum of 10% of the outstanding amount can be paid every month

on due date. The third option for payment is to convert the outstanding amount into a loan and repay the same in equated monthly installments (EMIs).
7. Charges for late payment beyond the due date is collected as late fees and varies from Rs.200 to Rs.500 across banks.
8. Cards are issued with photos also as add on feature.
9. Liability for the card holder in case of loss of cards is limited to a small amount in case of most of the credit card issuers. Usually the liability is restricted to Rs. 1000/- (Rupees One Thousand Only) and the balance liability if any is borne by the card issuer through an insurance protection. Liability for lost card can be controlled from the time the loss is reported to the card centers which operate on a 24 hour basis.
10. For online purchases using credit cards, additional password protection just like PIN for ATM transactions can be secured with special security features such as Verified by Visa, Mastercard Secure Code etc., and the above procedure is mandated by Reserve Bank of India.
11. Some banks offer free personal accident insurance cover for the card holders ranging from Rs. 1 Lac to Rs. 10 Lacs depending on the type of card.

8.5 CREDIT CARD ISSUING PROCESS

Issue of credit card involves the following processes.

1. Obtaining an application from the prospect.
2. Processing the application.
3. Analysing and arriving at the Credit Score.
4. Decision on the type of card to be issued.
5. Issue of Card & PIN Mailer
6. Dispatch of Card & Acknowledgement of Receipt.
7. Card Operations.

Let us discuss the different aspects of the issue and operations in detail.

1. Credit Card Application Form

The details called for in the application form of a public sector bank are discussed below:

(a) Personal Data of the Card Applicant

(i) Name of the applicant
(ii) Name to be embossed in the Credit Card
(iii) Present Residential Address
(iv) Permanent Residential Address
(v) Contact Telephone Numbers - Landline and Mobile
(vi) Nationality
(vii) Income Tax Permanent Account Number (PAN Number)
(viii) Identity/Residential Proof Details - Passport/Voters ID/Driving License/Ration Card
(ix) E -mail Address
(x) Date of Birth & Age
(xi) Sex
(xii) Educational Qualifications
(xiii) Marital Status
(xiv) Residential Ownership Status
(xv) Vehicle Ownership Status

(b) Official/Professional Status

(i) Professional Status - Salaried, Self Employed, Business/Profession, Retired/Pensioner.Housewife etc.,
(ii) Company & Ownership Details
If employed - Public Sector/Private Sector/MNC
If Self Employed - Proprietor/Partner and Ownership Stake in percentage.

(iii) Designation/Profession
(iv) Completed years of experience in Service/Business/Profession.
(v) Name of the Company/Firm
(vi) Business/Office Address & Contact Numbers
(vii) Mailing address for Bills. - Residence, Office, email, mobile alerts.

(c) About Income

(i) Income from Salary/Business/Profession with proof
(ii) Other Income with Source
(iii) Income of Spouse - with proof
(iv) Spouse Name
(v) Spouse's Employment Details.

(d) Particulars of Savings and Liabilities

(i) Details of Bank Deposits Held
(ii) Details of Credit Facilities availed with Banks.

(e) Details of Immovable Properties Owned

(i) Residential House
(ii) Land/Plot
(iii) Total Value of the Property

(f) Details of Bank Account

(i) Name of the Bank & Branch
(ii) Type of Account - Savings/Current
(iii) Year of opening
(iv) Details of other accounts

(g) Details of Other Cards

(i) Other Credit Cards - Card Issuers/Card Limits/Expiry Date
(ii) Outstanding in Other Credit Cards.

(h) Nomination Details for Accident Insurance Cover

(i) Details of the Nominee - Name & Age.
(ii) Relationship
(iii) Address

(g) Payment Instructions

(i) Standing Instructions/ECS Payments Mandate
(ii) Bank Account Details for Payment Debits.

(h) Request for Add on Cards:

(i) Details of Add on Holder - Name, Age, Date of Birth, Relationship
(ii) Name to be embossed.

(i) Photos of the Card Applicant and Add on Members

(i) Photos of the applicant and add on members for incorporating

in the cards. *(j) Declaration*

(i) Confirmation about the terms and conditions for issuing the card.
(ii) Confirmation about the details submitted in the application form.

(iii) Confirmation for allowing the card issuing bank to share the information among other banks/
credit bureaus/other institutions.
(iv) Confirmation for the liability that may arise out of usage of add on cards.

If we look at the above information obtained by the card issuing banks, the objective is to get a holistic picture of the applicant to consider issue of a card and also a suitable limit based on the total picture reflected by the details in the application form. The details are processed by awarding a score for each element of information and arrive at the total credit score for taking a call on the card limit. To understand the above concepts let us look into a simple Credit Card Scoring Module for awarding the score.

8.6 CREDIT SCORING FOR CREDIT CARDS

Credit Scoring Module for credit cards consists of two parts.

Part I deals with the criterion to take a decision to issue a card or not.

Part II deals with the scoring for various parameters submitted by the applicant.

Credit Card Scoring Module - Part I

Part I deal with the eligibility criteria for issuing a credit card and check the primary status of the applicant.

S.No	Criteria	Yes/No
1	Is applicant a major and above 21 years of age	
2	Is the applicant residing in the present address for the past more than 6 months and has been identified to the satisfaction of the Branch. (if it is less than 6 months then valid reasons are given for shifting)	
3	If above address is temporary, whether permanent address is given?	
4	Is the applicant an existing customer of the bank and satisfactorily operating the bank account? OR The identity of the applicant has been established beyond doubt through standard acceptable proof such as Income Tax/PAN Number/ID Card/Driving License/ Passport/Ration Card.	
5	(i) Is the applicant serving and his minimum service is 3 years? OR (ii) Is the applicant self employed or a professional and he has been in this current profession for more than 2 years? OR (iii) Does the applicant have a positive net worth and earnings are reasonable to service and repay the dues in the credit card?	
6	Are the minimum annual income criteria as per norms satisfied?	

For all the above questions, a "YES" response is required, if the application is to be entertained. Only if the applicant clears the Part 1, the Part II portion will be assessed to arrive at the credit score. If the response to Part I is not on the desired lines, the process will stop and card request will be declined. Let us proceed to Part II of the Scoring Module.

Credit Card Scoring Module - Part II

Score will be allotted in a graded manner for different parameters and the total of the score will reflect the credit score of the applicant. The arrived score will form the basis for the final decision on the sanction of the credit card and the total score shall confirm to the benchmark prescribed by the bank. In this example the minimum qualifying score is fixed as 50 by the public sector Bank. Let us see the scoring module.

S. No.	Parameter	Categories		Marks Scored
		Band	Score	
1.	Age	(i) 21-30	4	
		(ii) 31-45	5	
		(iii) 46-59	3	
		(iv) = or > 60	1	
2.	Educational Qualifications	(i) Professional/PG	5	
		(«) Graduate	4	
		(iii) Diploma	3	
		(iv) Undergraduate	2	
3.a	Nature of Organisation working	(i) Govt./Public	5	
		(ii) Public Ltd. Co.	4	
		(iii) Pvt. Ltd. Co.	3	
		(iv) Others	1	
3.b	Self Employed/Ownership stake	(i) Solely Owned	5	
		(ii) Owning => 50%	4	
		(iii) Owning < 50%	2	
4.	Length of Service or Years in Profession/Business	(i) => 5 years	10	
		(ii) => 2 yrs < 5 yrs	5	
		(iii) => 1 yr < 2 yrs	3	
		(iv) < 1 year	1	
5	Dependants	(i) <=2	5	
		(«') 3 to 4	3	
		(iii) > 4	1	
6	Owning a House	(i) Self Owned	5	
		(ii) Company provided	4	
		(iii) Parent Owned	3	
		(iv) Rented	2	

		(v)	Others	0	
7	Owning a Vehicle	(i)	Self owned Car	5	
		(ii)	Financed Car	4	
		(iii)	Company provided Car	3	
		(iv)	Two Wheeler	2	
		(v)	Other	0	
8	Annual Income	(i)	> Rs.10 lacs	25	
		(«)	> 5 lacs <= 10 lacs	20	
		(iii)	> =2 lacs < 5 lacs	15	
		(iv)	<= 2 lacs	10	
9	Spouse Income	(i)	> Rs.10 lacs	3	
		(ii)	> 5 lacs <= 10 lacs	2	
		(iii)	< 5 lacs	1	

10	Banking with the Bank	(i) > 3 years (ii) 1 - 3 years (iii) 6months to 1 year (iv) < 6 months	5 3 1 0	
11	Deposits with Bank	(i) > 5 lacs (») 3 to 5 lacs (iii) >1 lac to < 3 lacs (iv) <= 1 lac	10 5 2 1	
12	Existing Credit Cards	(i) > 1 card (ii) 1 card (iii) No card	2 1 0	
13	Integrity, Character, Conduct and Branch Experience with the party	0) Excellent (H) Good (iii) Fair/Satisfactory	11-15 6-10 1-5	

If we look at each of the parameters, the score is based on the strength of the parameter. For example, more the income level more will be the score as the default risk is less. Likewise, in the employment parameter, the nature of job will be a determinant of the score. The classic case is the employees of software companies. In 2008, when there was a scam in a big software company, the employees' credit and cash withdrawal limit were immediately reduced drastically by the card issuing banks due to fear of job retrenchments and losses, hence expected higher default risk. In the same way, owning a house will carry a better score than a rented house. Employment of the spouse will get additional score. Likewise, an existing customer of the bank with good account relationship will earn a better score. In the same way, a person who already holds a credit card will get a better score as he had already been rated by another card issuer. The number of dependants is another factor. More the number of dependants less will be the score as the expenses will be more in a bigger family. Type of ownership of vehicle is another important parameter. Higher the type of vehicle, more will be the score as it reflects the social status and income levels.

The sum total of the score calculated for each parameter will indicate the risk perception for issuing the card. More the score less will be the risk of default in payment for usage of credit card. Credit Scoring is an effective risk mitigation tool used at the time of issuing the credit card.

If the credit score is at an agreeable level, then card limit will be finalized and approved by the competent authority. After approval, card and the PIN Mailer for operating through ATMs for cash withdrawal will be issued. Issue and dispatch of Credit Cards and PIN Mailers are usually outsourced by banks through authorized service providers.

Important Terms in Credit Card Operations

There are different terms used in credit card operations spelt out by card issuing banks for the various usage patterns. Credit Card users should clearly understand the meanings of the different terms and also know the implications of each term in the operations of credit cards. The important terms used in the credit card operations with regard to Fees, Charges, Interest etc., are discussed below:

Joining Fees & Annual Fees

Joining and Annual Fees are charged at the time of issue and at the end of every year respectively and varies with the type of card. While standard cards are issued 'life time free' by most of the card issuers as a marketing strategy, most of the premium cards are charged with annual fees or one time fees or free based on the card issuer.

Charges

Charges are levied from time to time and are payable by the cardholders for the different services offered by card issuing banks.

(i) **Finance Charges** - Applicable in the event of the card member deposits part of the Total Payment or the Minimum Amount Due. The balance outstanding amount payable shall be carried forward to subsequent statements. The amount attracts finance charges on entire outstanding including fresh purchases and other bank charges till the date of full and final payment. Finance Charges on cash advances are applicable from the date the card holder incurred the transactions until they are fully paid.

Finance charges are calculated on a daily basis at the end of every day based on the current outstanding balance of the customer.

Illustration:

- Balance outstanding as on the statement date - Rs.20000
- Balance is not paid on the due date.
- Interest - 3.5% per month
- Daily Interest Charge for the above balance is = 20000 x (3.5% x 12 months)/365 = Rs.23.01
- Total interest payable by the next statement cycle (after 30 days) = Rs.23.01 x 30 = Rs.690.41 + Service Tax

(ii) **Minimum Amount Due** - Minimum Amount Due (MAD) is calculated by adding New Debits for the month, previously unpaid payments and other charges. Minimum amount also includes the amount by which the card holder exceeded the card limit.

Minimum Amount Due every month shall be higher of the following:

(a) 5% of the statement outstanding or
(b) Sum total of all installments billed, interest, fees, other charges, amount that is over limit and 1 % of the principal or
(c) Rs.250/-. In case of default or if the statement balance is less than Rs.250/-. the entire outstanding amount has to be paid.

Minimum Amount Due is a very teasing concept in credit card dues repayment. It is intended to generate more revenues for the card issuer as it will prolong the repayment and interest will be charged at exorbitant rate for the balance amount. For example, if we spend Rs. 10,000/- and pay back exactly the Minimum Amount Due every month, it will take approximately 6.5 years to pay back the complete amount.

(iii) **Maximum Interest Free Period:** Maximum Interest Free Period is the period for which no interest is charged for the card balances subject to the condition that there are no outstanding previous card dues. The period depends on the type of card and may vary from 20 days to 50 days depending on the card issuer. This is applicable only on retail purchases and if previous month's balance is paid in full.

Illustration :

1. Assume that your statement date is 2^{nd} of every month.
2. For example, your 2^{nd} October Statement will contain all your transactions that have been billed between 3^{rd} September and 2^{nd} October and you have to pay in 22 days time and the card due date shall be fixed based on that.
3. If you make a transaction on 3^{rd} October, it will appear on the statement of 2^{nd} November and the payment due will be 22 days thereafter. But if the payment in full is not paid by the due date, then interest will be charged for the whole period and subsequent purchases.

Interest Free Period does not apply for Cash Advances and Revolving Balances.

(iv) **Annualised Percentage Rate (APR)** : Interest will be charged for the unpaid balances as on the due date and also subsequent purchases. The interest rate was expressed as a monthly percentage rate previously to reduce the impact of high rates when calculated on an annualized basis. But regulatory prescription had resulted in credit card issuers to clearly mention the interest rate on an annualised percentage rate. The monthly interest is annualized to arrive at the Annualised Percentage Rate (APR).

As an illustration, let us see the APR charges by a card issuing bank for different types of transactions.

(a) Monthly retail interest of 3.1% p.m. is annualised to arrive at an APR of 37.20%
(b) Cash Transactions will attract an interest rate of 3.49% and APR of 41.88%.
(c) The interest rate for retail transactions is variable and will vary between 2.49% p.m. (APR of 29.88%) and 3.49% p.m. (APR of 41.88%).
(d) In case of EMI Cards, monthly interest rate of 2% is annualised (APR of 24%) on transactions greater than Rs.2000/-.

From the above, it will be clear that interest rate varies with the type of transactions and more for cash withdrawals as compared to other retail transactions, though both the rates are abnormally high. But the rates are fixed high because card dues are unsecured and the expected delinquencies will be always high. But APR will be reviewed by most of the card holders every 3 months based on the card usage and repayment behavior.

(v) **Other Charges & Penalties:** Credit Card issuing bank levy different types of charges and penalties. The charges/penalties for various facilities/defaults charged by a bank are detailed below. It may vary among banks but broadly on the following lines:

S.No.	*Type of facility/Penalty*	*Charges*
1	Cash Advance Transaction Fee	2.5%(Min. Rs.300) of the cash amount
2	Card Replacement (lost/stolen/re-issue/ any other)	Rs.100/Rs.200 depending on the card
3	Overdue Penalty/Late Payment Fee	15% of Total Amount Due (Min.Rs.350, Max.Rs.650)
4	Over Limit Penalty	Rs.600/-
5	Cheque Return/Dishonour Fee	Rs.500/-

The charges are structured high to prompt repayment in time and operate within limits with sufficient balance in accounts to honour repayment cheques.

The above discussions on credit cards and their different dimensions throw open lot of important revelations about credit cards.

1. Credit Cards are customer friendly initiatives empowering them with financial limits to use it for different purposes including cash withdrawals.
2. But credit cards if not used judiciously will result in a debt trap on account of high financial charges and interest charges.
3. Credit Cards Receivables are unsecured advances for banks and hence higher pricing for card receivables.
4. Profitability from credit card operations is quite high due to higher interest charges but at the same time, the defaults/delinquencies will also be on the higher side.
5. Credit card usage should be strictly as per the terms of the card and any deviation will attract heavy charges. To put it simply credit cards are double edged swords which have to be used very carefully and judiciously.

8.6 DEBIT CARDS

The characteristics of Debit Cards differ vastly from Credit Cards. As already explained, Credit Cards define the concept of "Buy Now, Pay Later" but Debit Cards explain the concept of "Buy Now and Pay Now". The important aspect of Debit Card is that at the point of purchase itself, the payment is made directly from their account balances. The details of the account are embedded in the debit card and can be used at both merchant locations through a POS Machine for purchases made and also in ATMs for withdrawal of cash. The technology aspects of credit and debit cards are same with regard to usage, size, numbering etc., but there are differences between credit and debit cards with regard to features and charges. When debit cards were introduced initially, they were marketed with sub brand names Electron (Visa), Cirrus (Master).But the Electron and Cirrus are not seen nowadays and simply issued as International Debit Card by both Visa and Master.

Debit Cards are issued when account is opened with the bank and had become an essential value addition for Savings Banks and a part of the core product. Debit Cards are issued by banks in two ways. At the time of issue, a generic debit card without embossing the name is issued for immediate operations. The second way is, after opening account, the account details are incorporated and embossed/loaded in the debit card and issued within two/three weeks from the opening of the account. Like Credit Cards, Debit Card operations are centralized in banks. The card can be used for any operations like payment of purchases, cash withdrawal (subject to per day limit) through ATMs, Utility Payments etc. The important differences between Credit Cards and Debit Cards are summarized below:

8.7 CREDIT CARDS VS DEBIT CARDS

S.No.	*Credit Cards*	*Debit Cards*
1.	Different Types of Credit Cards are offered by different banks.	All banks offer a standard type of Debit Card either with Visa or MasterCard.
2.	Card Limit varies with individuals.	No limit prescribed as drawing is from the existing balance in the account.
3.	Allows purchases at one point and payment to be made subsequently.	Purchase and payment are happening at the same time.
4.	Free Credit Period is allowed.	Not applicable as payment is instantaneous.
5.	Payment can be made in EMIs converting the dues as a loan.	Direct debit from the account at the point of purchase.
6.	Interest is charged for unpaid and carried over balances.	Not applicable as payment is instant.
7.	Various Charges/Penalties are levied for facilities and defaults.	No penalty or charge of any nature.
8.	Specific Cash Withdrawal Limits are set within the card limits.	The limits can be set as per customers' requirements.
9.	Default Risk is high.	No Default Risk.
10.	Assumes the character of an Asset: when the card is used it becomes a Receivable.	Debit Card is only an operative instrument of a Liability Account. (Savings Accounts)

The above mentioned are some of the visible differences between Credit Cards and Debit Cards.

Apart from Credit and Debit Cards, a new class of cards has emerged in the recent past and has become an integral part of retail banking in banks. These cards are called as Prepaid Cards or Pre Loaded Cards. These cards are pre loaded with specific amount and offered as bearer cards with a PIN Number. The main feature of the card is that the card can be used by the bearer of the card only for purchases upto the amount loaded in the card. No cash withdrawal is permitted in the card. It is mainly intended as a Gift Card to be gifted to anybody with a choice to use it for any purpose except withdrawing of cash for the amount loaded. The advantage of the card is that it is a bearer card and anyone can gift it to anybody and the card can be used within the validity period for any purpose. Prepaid debit cards are issued by corporates to provide their staff with lunch expense reimbursement upto a designated amount and which can be topped up on a monthly basis. In addition to the above, a new class of Forex Cards was introduced by banks to substitute Foreign Currency Notes/Travellers Cheques for those travelling abroad. In these cards, a fixed amount of foreign exchange (Dollars) will be loaded and issued for travel abroad. Forex Cards facilitate monitoring of overseas spends, regulatory compliance and have international acceptance.

Terminal Questions

1. Types of credit cards issued by banks in general are

(i) Silver Card
(ii) Gold Card
(iii) Platinum Card
(iv) Titanium Card
(v) All the above

Ans: v

2. The features available in all types of cards are

(i) Facility for payment of purchases.
(ii) Facility to withdraw cash from ATMs upto a fixed limit.

(iii) Reward Points for usage of cards.
(iv) Cash Back offers upto a certain limit for purchases made.
(v) All the above.

Ans: v

3. The characteristics of Debit Cards are

(i) Payments for purchases are directly debited into the account.
(ii) Cash Withdrawals through ATMs are debited to the account immediately.
(iii) Payments made for purchases/usage will be debited subsequently after a certain period.
(iv) Only i is true.
(v) Both i and ii are true.

Ans: v

4. Payment Default Risk (chances of failure to pay the card dues) is embedded in

(i) Debit Cards
(ii) Credit Cards
(iii) Both i and ii.
(iv) Only ii.

Ans: iv

Key

1.(v);2. (v); 3. (v); 4. (iv)

Let Us Sum Up

- Credit Card is plastic money with pre-set limits based on the credit score of the customer and can be used across merchant establishments for payment of purchases and in ATMs for withdrawal of cash.

The operational process of a credit card starts from the card issue, matures into card usage and closes with the payment of credit card dues. Banks issue different types of cards with targeted volumes and business objectives after proper screening of applicants, arriving at the credit score and issuing the relevant card matching the credit score with fixing of appropriate limit. The card issue will be justified if only the card is used frequently upto the limit made available. Payments by the customers for credit card usage are the deciders for revenue generation. The payment may be made one time or in installments subject to the minimum payment due every month. More the credit limit is used; more will be the revenue but is subject to payment without defaults and delinquencies.

- Banks issue different types of cards like Classic, Silver, Gold.Platinum, Titanium etc., in collaboration with card issuers like Visa and Master Card and they mainly do it in two ways;proprietary cards and co branded cards. While proprietary cards are issued by banks generally, co-branded cards are issued with specific tie ups with other institutions like petroleum companies, travel companies, retail stores with the objective of focused marketing and extra benefits to the card user for using the facilities of the tied up institutions.
- Banks advise the credit card users about the terms and conditions of the credit card usage and the standard terms used in the payment mechanisms. These terms like Annual Fee, Minimum Payment Due, Credit Limit, EMI Payments, Interest and method of interest calculation. Penalties etc. have their own implications in the credit card payments.
- The characteristics of Debit Cards differ vastly from Credit Cards. As already explained, Credit Cards define the concept of "Buy Now, Pay Later" but Debit Cards explain the concept of "Buy Now and Pay Now". The important aspect of Debit Card is that at the point of purchase itself, the payment is made directly from their account balances. The details of the account are embedded in the debit card and can be used at both merchant locations through a POS Machine for purchases made and also in ATMs for withdrawal of cash. Debit Cards are issued when account is opened with the bank and had become an essential value addition for Savings Banks and a part of the core product.

- Other pre-paid debit cards are issued both in rupees for various domestic purposes and forex cards with pre denominated forex loaded in the cards for travellers going abroad.

Keywords

Silver, Gold, Platinum and Titanium Cards; Credit Score; Credit Limit; Minimum Payment Due; Visa Cards; Master Cards; Annua) Fees, Late Payment Charges; EMI; Reward Points; Cash Back Offer; Prepaid Debit Cards;

UNIT
9

UNIT 9 REMITTANCE PRODUCTS

STRUCTURE

9.1 Remittance Products

9.2 National Electronic Funds Transfer (NEFT)

9.3 NEFT - Rights and Obligations of Customers and Banks

9.4 Real Time Gross Settlement System (RTGS)

9.5 Electronic Clearing System (ECS)

Terminal Questions Let Us Sum Up

Keywords

9.1 REMITTANCE PRODUCTS

Remittances are important and integral part of retail banking. Remittance products have evolved over a period from physical movement of remittance instruments to instant electronic transfer of remittances across the country and globe. Cheques, Demand Drafts, Bank Orders, Telegraphic Transfers are some of the earliest remittance products that constituted the core remittance mechanism across banks. But the invasion of technology in banking has permeated into the remittances space also. Technology brought about a paradigm change in the whole remittance space with newer, speedier and innovative remittance products in banking. Most of the new generation remittance products are relevant in retail banking.

Retail electronic and card based payments registered a quantum jump in the past two years mainly due to introduction of RTGS (Real Time Gross Settlement) and NEFT (National Electronic Funds Transfer). The volume and value of transactions through RTGS had more than doubled, though wholesale remittances constitute a major proportion of RTGS transactions. The concept of electronic remittance mechanism is picking up fast over the past two years and this trend offers potential to package a remittance product as an add on in their retail banking package to the customers. Let us discuss in detail, the features of two important remittances products NEFT and RTGS which are applicable to retail banking operations also.

9.2 NATIONAL ELECTRONIC FUNDS TRANSFER (NEFT)

Reserve Bank of India has introduced an electronic funds transfer system called 'The Reserve Bank of India National Electronic Funds Transfer System"

The objects of the NEFT System are:

(i) to establish an Electronic Funds Transfer System to facilitate an efficient, secure, economical, reliable and expeditious system of funds transfer and clearing in the banking sector throughout India, and
(ii) to relieve the stress on the existing paper based funds transfer and clearing system.

The success of the NEFT is demonstrated by the spurt in volumes and transaction values through NEFT and the same are given below:

Retail Electronic Based Payments

Service	*Transaction Volumes (ooos)*		*Growth in Volume (%)*		*Transaction Values (Rs. in Crs.)*		*Growth in Value (%)*	
EFT/NEFT	2008	2009	2008	2009	2008	2009	2008	2009
	13315	32161	178.8	141.5	140326	251956	81.2	79.6

Source: Reserve Bank of India - Report on Trends & Progress in Banking in India

The transaction volumes and amounts have both shown stupendous growth in 2008 and 2009 and reflect the acceptance of NEFT as an effective electronic remittance product. Let us discuss the process flow of NEFT transactions.

NEFT - Process Flow

The parties to a funds transfer under NEFT System are

(a) the sending bank,
(b) the sending Service Centre,
(c) the NEFT Clearing Centre,
(d) the receiving Service Centre and
(e) the beneficiary branch.

The request from the customer of a bank to remit through NEFT will go through the following steps encompassing the above stages.

Request for NEFT by Bank Customer

- A bank customer (i.e. sender or originator) desirous of remitting funds under the system shall submit an "NEFT Application Form" (to be designed by the participating bank) authorising the sending bank to debit the sender's account and transfer funds to the beneficiary as specified in the NEFT Application Form.
- The application could be submitted either in physical form or electronically.
- A transaction within the NEFT system will be said to have been initiated when the sending bank accepts a payment instruction issued by the sender.
- If in a single payment instruction, the sender directs payments to several beneficiaries, each payment direction shall be treated as a separate payment instruction.
- A bank branch may reject a customer's request for funds transfer when, in the opinion of the sending branch,
  (i) the customer has not placed funds at the disposal of the sending bank; or funds placed are not adequate to cover the sum to be remitted and the service charge; or
  (ii) the beneficiary details given in the NEFT Application form are not adequate to identify beneficiary by the beneficiary bank. The essential elements of beneficiary's identification are:

  Beneficiary's Name:
  Beneficiary Branch Name:
  Beneficiary Bank Name:
  Beneficiary's Account
  Type: Beneficiary's
  Account No. :
  Beneficiary's Branch
  IFSC:

- The sending bank shall prominently display at its premises the cut-off timings up to which it shall receive the NEFT Application Forms from its customers for different settlements and the likely timings of the settlements by the NEFT centre.

  Any payment instruction received after the cut-off time shall be included for the next available settlement either on the same NEFT day or the next NEFT day.

Data Entry at the Sending Bank Branch

- The sending bank branch shall prepare the Structured Financial Messaging System (SFMS) message as and when the application for the funds transfer is received and arrange to send the message to NEFT Service Centre till the cut off time for the batch.

Processing/Data Upload at Sending NEFT Service Centre

- The sending NEFT Service Centre shall accept/reject the messages received from the branches/ from internet banking customer through net banking platform.

Transmission/Submission of NEFT message to the NEFT Centre

- The sending Service Centre shall transmit the NEFT SFMS message to the NEFT Clearing Centre by using the communication network designated by Reserve Bank. Processing & transmission of NEFT message to the beneficiary banks.
- After consolidating all NEFT messages received from originating banks, the NCC shall process the data and generate the settlement of each beneficiary bank which has at least one inward remittance transaction in a given batch.
- NEFT messages generated for destination banks will be transmitted to the service centre of each receiving banks using SFMS.

Data Validation at Receiving NEFT Service Centre

- On receipt of the NCC NEFT message, the receiving NEFT Service Centre shall process these files and forward them to the destination branches using SFMS.
- Alternatively, the receiving NEFT Service Centre may use the Straight Through Processing Interface (STPI) available in SFMS and upload these NEFT messages to their internal banking solution directly, to afford the credits to the beneficiary banks account centrally.

Payment to beneficiary

- The beneficiary branches would make payment to the beneficiaries instantly on the same day by crediting the specified account of the beneficiary or otherwise placing funds at the disposal of the beneficiary.

Revocation of Payment Instruction

- A payment instruction issued for execution shall become irrevocable when it is executed by the sending bank. Any revocation, after the payment instruction is executed by the sending bank shall not be binding on any other party in the NEFT system.

Acknowledgement by the Beneficiary Bank and Return in Case of Non-credit:

- No acknowledgements are envisaged under NEFT Scheme. A message which is not returned uneffected before the next settlement day is treated to have been completed and credit afforded to the beneficiary's account by the beneficiary branch.
- It is, therefore, vital that uneffected credits are re-transmitted back as return NEFT transactions in the immediate next batch itself.

Sender to be Advised in Case of Refund

- If the beneficiary specified in the sender's payment instruction fails to get payment through the NEFT system for some valid reasons, the sender shall be informed immediately after the sending bank gets the returned NEFT. The sending bank shall also arrange to make payment to the sender by crediting the account of the sender or otherwise placing funds at the disposal of the sender.

Beneficiary to be Advised of the Receipt of Funds

- After crediting the account of the beneficiary, the beneficiary bank shall advise the beneficiary of the funds received. The Statement of account/Pass Book entry or any online messaging system shall indicate briefly the source of funds as well.

Holidays

- In case of a holiday at the beneficiary branch, the credit will have to be effected on a value dated basis wherever feasible or latest at the commencement of business on the next working day.

9.3 NEFT - RIGHTS AND OBLIGATIONS OF CUSTOMERS AND BANKS

Reserve Bank of India has prescribed the rights and obligations under NEFT for both customers and banks. The same are detailed below.

1. Every participating bank or institution shall maintain the security, integrity and efficiency of the System.
2. Funds transfer instruction shall be issued by the customer in a manner prescribed by the participant bank.
3. The format shall be complete in all requisite particulars.
4. The customer shall be responsible for the accuracy of the particulars given in the payment instruction.
5. The customer shall be bound by any payment instruction executed by the bank if the bank had executed the payment instruction in good faith and in compliance with the security procedure, provided that the customer shall not be bound by any payment instruction executed by the bank, if he proves that the same was not issued by him and that it was caused either by negligence or a fraudulent act of any employee of the bank.
6. The customer shall ensure availability of funds in his account while issuing the payment instruction to his bank.
7. The payment instruction shall become irrevocable once it is executed by the Bank. The bank is not bound by any notice of revocation unless it is not in compliance with the security procedure.
8. In the event of any delay in the completion of the Funds Transfer or any loss on account of error in the execution of the Funds Transfer pursuant to a payment instruction, the bank's liability shall be limited to the extent of payment of interest at the Bank Rate for the period of delay in the case of delayed payment and refund of the amount together with interest at the Bank Rate upto the date of refund, in the event of loss on account of error, negligence or fraud on the part of any employee of the bank.
9. The sender/originator shall be entitled to claim compensation from the sending bank for the period of delay in the completion of funds transfer, and/or any other penalty which may be levied/decided by RBI.
10. Customers can complain to the Banking Ombudsman if the complaint is not resolved within thirty days.

(Source: National Electronic Funds Transfer System, Procedural Guidelines, Reserve Bank of India, Department of Payment & Settlement Systems, Central Office, Mumbai)

6.4 REAL TIME GROSS SETTLEMENT SYSTEM (RTGS)

Real Time Gross Settlement System (RTGS) is a remittance product that has drastically changed the complexion of the remittances scenario in financial services. This global practice was introduced in India for changing the model of remittances and to bring in efficiency in settlement of transactions on a real time basis. The impact and growth of RTGS in the past two years is demonstrated by the following figures. The quantum jump in volumes and value by more than 100% in 2009 over 2008 reflect the acceptance and growth of the product as an effective and speedy remittance tool though it is skewed more on the corporate and interbank side than the retail side.

S.No	*Transactions*	*March 2008*	*March 2009*
1.	Volume in millions Value	About 6 About	About 13 About
2.	in Rs. Billions	15000	34000

Source: Reserve Bank of India - Report on Trend & Progress in Banking in India

RTGS has replaced high value clearing across all the centres in India, thus saving a significant expense in the manual running of such activities. With the implementation of Core Banking Systems (CBS) in all the banks, many banks have enabled Straight Through Processing (STP) of RTGS transactions by corporate and retail customers with the use of net banking tools. This has greatly reduced operating expenses and consequent operational risks for the banks which were handling remittances in a manual mode till recently.

International remittances from NRIs has been considerably made faster and more accurate with the introduction of electronic payment platforms like SWIFT, INDIA LINK, Western Union transfers etc., This has replaced the more time consuming and expensive practices of mailing DDs which were prevalent till recently.

Evolution of Real Time Gross Settlement System (RTGS)

Real Time Gross Settlement System (RTGS) is regarded as the centre piece of an integrated payments system.

The Core Principles for Systemically Important Payment Systems, outlined by the Committee on Payment and Settlement Systems of the Bank for International Settlements, Basle, define payment systems as *"a set of instruments, procedures and rules for the transfer of funds among system participants".*

As per our Payment System Bill, 2002, a 'payment system' means "a system that enables payment to be effected between a payer and a beneficiary and includes clearing, settlement or payment service".

The Payment System has importance for the functioning and integration of financial markets. It influences the speed, financial risk, reliability and cost of domestic and international transactions. Payment system operates on the following principle.

"Anyone can make payments to whomsoever one likes, whenever one likes, in whatever type of currency one likes, at the cost of a few cents per transaction. There are no settlement delays or mountains of paperwork and value is received instantaneously. There are no distinctions in costs or delays between a domestic and a foreign currency transaction. Interest is computed real-time rather than on a "settlement day ", a relic from the ancient times, when accounting was done manually. Finally, privacy and security are guaranteed."

The above quote sums up the essence of RTGS. Transactions are processed instantaneously and settlement made on a gross basis.

RTGS - Process Flow

Remittances and Funds Transfers through RTGS are transmitted through a series of process inputs and travel from the customer end to the beneficiary end. The remittances are communicated through a structured messaging process and settlement for the message is made on a gross basis from the liquidity maintained by the sender bank with the settlement bank. The remittances are credited on a dynamic basis and settlement also made on a dynamic basis. That is message communication, remittance, credit and settlement for the credit are done immediately subject to the systems and procedures prescribed for remittances through RTGS. The procedure for remittance through RTGS is explained below:

1. The transactions carried out by RTGS are "Inter Bank Transactions" and "Customer Payment Transactions" and "Delivery Vs Payment Transactions"
2. Inter Bank Transactions are used to settle the participant bank's financial obligations on their own account.
3. In "Customer Payment Transaction", customer information along with the payment message can be transmitted in a structured format.
4. "Delivery Vs Payment Transactions" will arise out of RBI's Securities Settlement System and is settled in the RTGS as a separate transaction.

   - Inter Bank Payments and Transactions mainly arise out of treasury operations such as money and debt market deals and foreign exchange transactions.
   - In Customer to Customer Transactions, remittances from the customer to a beneficiary in the same bank/other bank are handled. The transactions are routed from one RTGS enabled branch to another RTGS enabled branch of the same bank/other bank through the centralised RTGS operations of the bank and routed through a centralised gateway to another bank.

- Own account transactions relate to the transfer of funds from the bank's one RBI account to another done by the treasury department of banks to maintain the liquidity limits prescribed by RBI.

In retail banking space, customer based transactions mainly assume importance and RTGS has emerged as a very effective remittance mechanism in lieu of drafts, bank orders but only if the amounts to be transferred is above the minimum prescribed limit to be eligible for RTGS remittance. Let us see the process flow for customer based transactions.

1. Request to emanate from the customer to route a remittance through RTGS. The customer would request his banker to debit his account and pay the money to the beneficiary providing the details of bank account of the beneficiary.
2. The originating bank would debit the account as per the mandate and create a structured message under RTGS.
3. The message after due authentication would be communicated to the payment system gateway of the bank. The same would be transmitted to the RTGS system.
4. The messages would be routed through a central hub which will receive the messages in a queue and forward the message to the gateway of the other bank.
5. After authentication, the message will be processed and debited from the sender bank and credited to the beneficiary bank. After the debit, credit is made with the customer details and beneficiary details.
6. The beneficiary bank (message receiving bank) will then transmit the message to the beneficiary branch for credit of the beneficiaries account with the branch.
7. For effecting RTGS debits and credits, banks would be maintaining settlement accounts separately with RBI and sufficient liquidity has to be maintained in these accounts.
8. If there are any shortfalls in the liquidity of banks in their settlement accounts, mechanisms are in place to provide temporary liquidity so that the transaction processes are not jeopardised.

RTGS as a funds transfer mechanism has revolutionalised the concept of remittances though it is more relevant for big ticket transactions and applicable in a limited way for retail banking.

9.5 ELECTRONIC CLEARING SERVICES (ECS)

Though NEFT and RTGS have emerged as very fast remittance products in the recent past, Electronic Clearing Services (ECS) has stood the test of times as a dependable payment product. ECS when introduced decades back has won instant recognition from users as it has offered lot of convenience for the account holders to manage their routine payments.

Electronic Clearing Services (ECS) is a mechanism to effect payments to a desired beneficiary on a periodical basis for the monies payable to them. The process flow of ECS is briefly mentioned below:

1- (iii); 2- (iv);3. (v)

Let Us Sum Up

- Remittance products have evolved over a period from physical movement of remittance instruments to instant electronic transfer of remittances across the country and globe. Cheques, Demand Drafts, Bank Orders, Telegraphic Transfers are some of the earliest remittance products that constituted the core remittance mechanism across banks. But the invasion of technology in banking has permeated into the remittances space also. Technology brought about a paradigm change in the whole remittance space with newer, speedier and innovative remittance product in banking. Most of the new generation remittance products are relevant in retail banking.
- Retail electronic and card based payments registered a quantum jump in the past two years mainly due to introduction of RTGS (Real Time Gross Settlement) and NEFT (National Electronic Funds Transfer). The volume and value of transactions through RTGS had more than doubled, though wholesale remittances constitute a major proportion of RTGS transactions. The concept of electronic remittance mechanism is picking up fast over the past two years and this trend offers potential to package a remittance product as a add on in their retail banking package to the customers.
- The parties to a NEFT transaction are

(a) Customer who wants to send the remittance.
(b) Sending bank who originates the remittance.
(c) Sending Service Centre who channelizes the remittance.
(d) NEFT Clearing Centre who clears the transactions.
(e) Receiving Service Centre who redirects the receipt of remittances and
(f) Beneficiary branch who receives the remittance.
(g) Beneficiary who receives the amount

- Real Time Gross Settlement System (RTGS) has drastically changed the complexion of the remittances scenario in financial services. This global practice was introduced in India for changing the model of remittances and to bring in efficiency in settlement of transactions on a real time basis. The impact and growth of RTGS in the past two years are demonstrated the effectiveness of the product. The quantum jump in volumes and value by more than 100% in 2009 over 2008 reflect the acceptance and growth of the product as an effective and speedy remittance tool though it is skewed more on the corporate and interbank side than the retail side.
- Customer Based Transactions in RTGS are relevant for retail banking. The process flow for customer based transactions is as follows :

V

1. Request to emanate from the customer to route a remittance through RTGS.
2. The originating bank would debit the account as per the mandate and create a structured message under RTGS.
3. The message after due authentication would be communicated to the payment system gateway of the bank. The same would be transmitted to the RTGS system.
4. The messages would be routed through a central hub which will receive the messages in a queue and forward the message to the gateway of the other bank.
5. After authentication, the message will be processed and debited from the sender bank and credited to the beneficiary bank. After the debit, credit is made with the customer details and beneficiary details.
6. The beneficiary bank (message receiving bank) will then transmit the message to the beneficiary branch for credit of the beneficiaries account with the branch.

- RTGS as a funds transfer mechanism has revolutionalised the concept of remittances though it is more relevant for big ticket transactions and applicable in a limited way for retail banking.
- Electronic Clearing Services (ECS) is another payment mechanism in which the payments are authorized for a specific period and amount through a mandate to the beneficiary. ECS is a convenient and flexible payment option for both the parties concerned i.e. the issuer and the beneficiary.

Keywords

National Electronic Funds Transfer; Real Time Gross Settlement; Customer Transactions; Sender Bank; Beneficiary Bank; Remittances, Electronic Clearing System

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MODULE C MARKETING IN RETAIL BANKING

Units

10. Marketing in Retail Banking
11. Delivery Channels in Retail Banking
12. Delivery Models
13. Customer Relationship Management in Retail Banking
14. Service Standards for Retail Banking
15. Technology in Retail Banking

UNIT 10 MARKETING IN RETAIL BANKING

STRUCTURE

10.1 Marketing and Delivery Channels In Retail Banking

10.2 Marketing In Retail Banking

10.3 Marketing Mix In Retail Banking

Terminal Questions Let Us

Sum Up Keywords

10.1 MARKETING AND DELIVERY CHANNELS IN RETAIL BANKING

Retail Banking unlike Corporate Banking is primarily driven by number of customers each bank possesses. More the number of customers more will be the profitability and strength of the retail banking models. Since profits have to be derived from a large clientele base, banks would be more comfortable with a broader base and would focus on building up the customer base. To achieve that marketing promises and delivery of products and services are the top priorities of banks in the retail banking space. Let us see the different dimensions of marketing of retail banking services and the changing paradigm of delivery channels in retail banking.

10.2 MARKETING IN RETAIL BANKING

Let us first understand what is marketing in banking and the relevance of marketing to a customer base.

Sir Frederick Seebohmn defines Bank Marketing as 'the creation and delivery of customer - satisfying services at a profit to the bank'.

Kenneth Andrew defines Bank Marketing as 'the matching of bank's resources with the customer's needs in the most profitable manner'.

A more specific definition spelt out by Deryk Vander Weyer looks at Bank Marketing as a proactive business strategy aimed at organisational excellence. The explanation more apt to retail banking space as spelt out by him is as follows:

(i) Identifying the most profitable markets now and in the future.
(ii) Assessing the present and future needs of customers.
(iii) Setting business development goals and making plans to meet them,
(iii) Adapting to a changing environment in the market place

It will be clear that all the above concepts point out for a well laid marketing strategy for retail banking focussing on the customer. As said earlier, customer is the centre of attraction in retail banking and marketing and all the activities have to be focussed towards

(a) Identifying the customers' needs,
(b) Developing appropriate products to satisfy their needs,
(c) Providing them with efficient delivery channels for availing the products.
(d) Making them avail the products continuously.

The ultimate objectives of the above initiatives are to achieve the business objectives of growth and profit.

10.3 MARKETING MIX IN RETAIL BANKING

Marketing mix in retail banking refers to the different ingredients that make up a good meal for the customer. The ingredients are structured and offered to the customers to make them consume sumptuously and enjoy and get satisfied also. For that the service and delivery levels should match the expectations of and all the activities havying the customers' need iping appropriate produc ing them with efficient (the customers. If the customers like the spread, they will go on consuming it continuously, the feast offered. What are the ingredients that make up an apt and good marketing meal for the customers. Let us discuss the fundamental ingredients of an effective marketing mix in retail banking which are as follows:

(i) Product
(ii) Price
(iii) Promotion
(iv) Place
(v) People
(vi) Process
(vii) Physical evidence

Basically the above seven Ps play a vital role for the banks in their retail banking strategies. Bankers give lot of importance for these factors while designing and developing the marketing strategies.

The difference lies in how the different dimensions in the above Ps are tweaked and reengineered by the retail bankers. Those who develop winning combinations of the above Ps and also effectively deliver the promises tirade with regard to the above Ps will be the winners. It is a fact that there is more than one winner in retail banking. That shows that the retail banking canvas is very huge and there is place for every body to play their game and win their customers. Let us now discuss about the different elements of the marketing mix.

1. Product

A bank product can be defined as "Anything that has the capacity to provide the satisfaction, use, and return desired by the customer". The different retail banking products like Deposit, Asset and Other Service products were already discussed in the earlier chapters.

2. Price

'Price' in the marketing mix refers to resultant transaction cost to be borne by the banker or the customer depending upon the product offered or availed.

In the case of deposit products, 'Price' refers to the interest rate offered by the banker to the customer. In asset products, 'price' refers to the interest the bank is quoting to the borrower customer for offering the loan product to the customer. In case of other services, price refers to the fee/charges the bank is charging for offering the different services.

3. Promotion

'Promotion' refers to the efforts of the banks to reach the customers. The promotion of the product will be based on a multipronged approach by developing various promotional strategies. This includes personal promotional measures and other promotional measures. But the ultimate objective of these promotional measures is only to win the customer and make him to avail the bank's products & services. The various ways in which the marketer develops promotion strategies are through Personal Selling, Advertisement, Sales Promotions, Publicity etc.,

4. Place

'Place' in retail banking generally refers to the place where the Bank is offering its product. The concept of place has undergone drastic changes during the past decade. Earlier 'Place' was very much limited to the place of bankers (i.e.) the location of Branch and where the services were delivered. But technology has changed the concept and place has shifted from the brick and mortar format to e format and has reached the customer in his place through internet banking and mobile banking.

5. People

'People' again is a vital link in the marketing strategy chain. Retail Banking basically being services marketing addressed to a large customer base, human factor plays a very essential role in the success of the retail banking strategy. Again if we take the marketing concepts, the important aspect of bank marketing is How of services from the banker to the customer through effective marketing strategies.

In the chain of events taking place in marketing, the effort starts from human factor and ends with human factor (i.e.) the banker and the customer. So 'People' concept in marketing refers to the people who are doing the marketing strategies and also 'people' wh«. are the beneficiaries of the marketing strategies. The inseparability principle of bank products adds more importance to the people concept because the effectiveness of the product depends on the effectiveness of the people delivering the product.

6. Process

'Process' is an all permeating concept running through the product development, product structuring and delivery stage. Process will be successful only when the out put derived from the process is delivered in the expected way fulfilling the promise. In short, process relates to all organisational activities which go into the marketing of the final product to the customer including delivery channels.

7. Physical Evidence

Physical evidence refers to developing tangibility to the intangibility concept of banking services. Some of the approaches include developing an efficient packaging, other measures to improve the tangibility. Especially in the retail banking operations. Debit Card/ATM Card, Personalised Cheque Book are classic cases of attempts by banks for tangibilisation.

The seven Ps are both independent as well as interdependent in the marketing effectiveness. Each one of the Ps is very important in deciding the marketing strategies on its own because of the built in mechanism of the whole strategy. They individually contribute their part in the effectiveness. But the individual contribution is not the only factor. These P's are interlinked in such a way that one P will be a deciding

P for the effectiveness of the other P. For example, though product is an important element of the marketing mix, the effectiveness of the product and the strategy depends on the price. Like that, even though price is an important element in the marketing mix, the product and price will not matter much if the promotion or the place aspects are given due consideration. To go further, again if the 'process' element is not taken care of, the other Ps will not be effective. Thus it is not only a fact that the Ps in marketing mix contribute substantially to the effectiveness of the marketing strategies individually but also contribute in an integrated way. Thus marketing mix and the elements of marketing mix namely the seven Ps represents a holistic approach to retail banking and marketing effectiveness.

The effectiveness can be measured by the response of the customer to the marketing strategies. If the customer is responsive, availed the products/services from the marketer and satisfied about it, then that would result in repeated purchases/availment of the products/services. If the customer is not satisfied, there is no reason for him to come again because his needs were not satisfied with your products/ services. This will make the customer to think about the competitors. So the success of the seven Ps and the marketing strategies are measured only by the responses from the customers from the point of view of need satisfaction. Then the question of delivery channels in retail banking come into picture.

Terminal Questions

1. Bank Marketing refers to
   (i) Identifying the most profitable markets now and in the future.
   (ii) Assessing the present and future needs of customers.
   (iii) Setting business development goals and making plans to meet them.
   (iv) Adapting to a changing environment in the market place.
   (v) All the above.
2. Marketing Mix refers to
   (i) Product & Price
   (ii) Promotion &Place
   (iii) People & Process & Physical evidence
   (iv) All the above.

Key

1.(v); 2. (iv)

Let Us Sum Up

- The success of retail banking depends on effective marketing of the retail products and services. Customers are different and their needs are different but at the same time, as customers are grouped together into definite segment buckets, reaching them with relevant products and services is a must. This can be best achieved with the different elements of the marketing mix viz.. Product, Price, Promotion, Place, People, Process and Physical Evidence. The right mix will deliver the right results.

- Channels are the medium through which retail banking products and services are delivered to the customers. Delivery Channels are basically of two types. Physical Channels and Remote Channels.Branches and Extension Counters are referred to us Physical Channels. Remote Channels also called as Electronic Channels are designed to serve customers outside the branch and includes ATMs, Internet Banking and Mobile Banking. Each of the channels has their own strengths and weaknesses. While Branches give the personal touch to the service process, remote channels give the freedom to avail the services at their convenience.
- Procedures are fixed and processes are defined for availing the services through the above channels. ATMs help the customers to avail the services any time for withdrawing cash as well as to deposit cash and cheques. ATMs are installed by banks in the branch premises as well as in oft" branch locations convenient to the customers. All the ATMs of different banks are now connected and customers can access their accounts from any bank's ATM and withdraw cash upto a prescribed frequency free of cost. In Internet Banking, customers can do the transactions like debits, credits, fund transfers and bill payment services etc.. In Mobile Banking also, from their mobile phones, customers can do their transactions like Balance Enquiry, Funds Transfer etc,. Channels enhance the customer experience of the banking services and the satisfaction levels depend on how the customers' expectations are met by the banks. Foe achieving this. Banks should develop and adopt the right channel mix through proper customer profiling.

Keywords

Marketing Mix; Product; Price; Place; Promotion; People; Process; Physical Evidence; Delivery Channels; Remote Channels; Customer Profile.

UNIT 11 DELIVERY CHANNELS IN RETAIL BANKING

STRUCTURE

11.1 Channel Experience

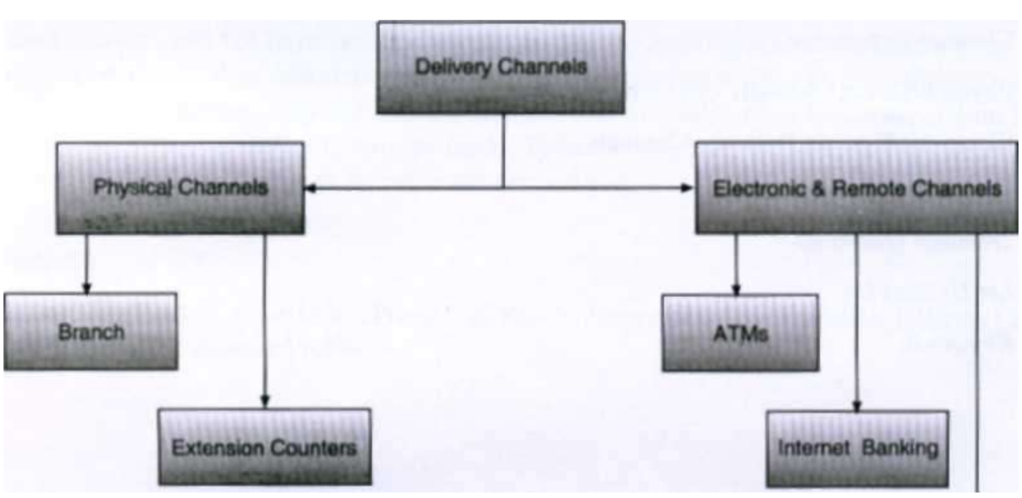
11.2 Physical/Direct Channels - Branch

11.3 Electronic/Remote Delivery Channels

Terminal Questions Let Us Sum Up Keywords

11.1 CHANNEL EXPERIENCE

Customer satisfaction has to happen through different channels and choices are to be offered to customers to experience the optimum channel mix for maximum satisfaction. Let us discuss in detail the efficacies of different channels in retail banking. Multi channel distribution is the practice adopted by almost all banks for total customer experience. Each channel either direct or remote has its plusses and minuses and also depends on the customer segments using the different channels. Direct channels may be the hcsi lit for a conservative customer whereas young and tech savvy customers may opt for remote channels. Let us understand the different channels in retail banking and importance of these channels for customer experience of products an services. The channels through which retail banking services are offered are illustrated below:



Mobile Banking

Fig. 11.1 Retail Banking - Delivery Channels

11.2 PHYSICAL/DIRECT CHANNELS - BRANCH Branch

Branch is the primary direct channel that drives retail banking. Research studies have pointed out that, with all the remote channels available to enhance the customer experience of retail banking services, the preference for the brick and mortar format has reigned supreme among customers. The main reasons for the same are:

- Branch tangibilises the intangible nature of banking services. The transactions carried out in the branch premises infuse a sense of confidence in the minds of the customers that they are not only physically involved in the transactions but also feel the service experience at the branch.
- Personnel at the branch relate with the customer for their transactions.
- Communication happens directly with the bank staff and customer and better understanding of the service expectations are achieved from both the customer and the bank end.
- Physically seeing the bank staff and effecting the transactions brings in a sense of bonding with the bank staff and which in turn enhances the loyalty factor.
- Products and services when explained to the customer directly in the branch by the Staff create a better understanding than through other channels.
- A good branch lay out and ambience enhances the feel good factor among the customers and strengthens the relationship with the bank.

Research studies have shown that though customers have accepted the electronic channels of delivery in retail banking with both hands, they still want to transact personally at the branch for their banking requirements. To put it short, they want a human intervention for their services than simply go through on-line or mechanical interventions like ATMs and Internet and Mobile Banking.

Branch being an important delivery channel in retail banking, let us see what are the essentials of a good branch lay out and what are the advantages of a good lay out and ambience at the branch.

Branch Lay Out and Ambience

The lay out of the branch is the deciding factor for improving the ambience of the branch. According to George Terry, "Layout refers to the arrangement of all physical components within the available floor space to provide maximum effectiveness and coordination of these components into an efficient and attractive unit". Branch layout is not an exception to this concept.

Branch layout may be broadly defined as the system of locating the various service facilities within the Branch in order to deliver the most convenient service to the customers. Customers should feel comfortable when they are inside the branch. The ambience of the branch should be such that it increases the 'comfort factor' in the minds of the customers.

Advantages of A Good Branch Lay Out

A good branch layout and ambience will result in the following advantages for the bank:

(a) Promotes efficiency as it will ensure smooth flow of services which results in time benefits.
(b) Because of the proper placing of various service facilities, internal communication effectiveness increases thereby facilitating better coordination among the staff resulting in better customer service.
(c) Provides a comfortable and congenial work environment to the staff which results in high employee motivation and acts as a morale booster.
(d) Serves as an image building tool for the bank because the layout creates as good impression and generates goodwill in the minds of the customer.
(e) It also helps in reducing cost as the facilities are planned for maximising efficiencies which results in cost optimisation.

Branch Lay Out And Service Delivery

Evolution of branch as a delivery channel has undergone a paradigm change. The concept of delivery of services at the branch level has changed over the years. In the early days of banking, a standardised front office with lengthy counters separated the customers and staff and staff will deliver the services across the counter. With the progression of banking over the years, the concept of counters with the corporate colour schemes has replaced the traditional counters. But the advent of technology in banking has changed the concept of counters. Total automation of branches across banks and the implementation of core banking solutions have completely changed the concept of service delivery in most of the banks. Single Window Concept in banks has brought the customer close to the service personnel of the bank. The counters were individually designed as desks to create a one to one relationship with the customers and the customer can avail any of his service requirements from any of the desks. This development has happened across banks in all metro and urban centres more particularly in private banks and of course in most public sector banks. But the traditional branch lay out continues in most of the rural and semi urban branches of public sector banks.

Personal Banking Branches

The concept of branch has moved from a plain vanilla approach to a more specialised approach over the years. Instead of one shop for all, branch design has moved to specialised branches like Corporate Branch, SSI Branch, Agri Finance Branch, Personal Banking/Retail Banking Branch etc. Specialised "Personal Banking Branches" were opened by almost all the Banks exclusively for retail customers to meet all their retail banking requirements. In addition specialised Retail Asset Processing Centres were opened for professional and speedy processing and disbursement of retail loans. The objective of the banks is to use the specialised branch as a tool to enhance the delivery effectiveness of services by prescribing TAT (Turn Around Time) for different retail loans and to march ahead of others in the competitive retail banking scenario.

Branch as a delivery channel has undergone various improvements in the liabilities side also. For opening of different liability accounts, branches in the brick and mortar format perform only the role of the marketing function and front office operations. In almost all the private sector banks as well as in some public sector banks, only the formalities for opening the accounts are completed at the branch level and opening of accounts, issue of Pass Book/Cheque Book, Debit Card, PIN etc are carried out through a centralised back-office mechanism. This is aimed to achieve standardisation as well as speedier compliance of bank's requirements and customer expectations. This method enables banks to offer improved benefits like personalised cheque books, debit cards etc. (which need a localised activity).

Extension Counters

Extension Counters are extensions of Branches opened in specified locations for offering banking services to the specified group within their command area. Extension Counters are basically attached to a Branch and controlled by the Branch for accounting purposes. They are permitted to offer products mainly in the liability side. The areas of operations of Extension Counters were restricted to a closed group like Courts, Educational Institutions like Schools and Colleges or a specific company in their premises.

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Extension Counters play a very vital role in the retail resources mobilisation for banks especially low cost and no cost resources like Savings and Current Accounts. They bring in core term deposits as well as CAS A resources which are held as operative resources of these institutions. But the concept of Extension Counters is getting diluted in the recent past as they are crossing their boundaries and cover the entire area in that geography by getting themselves upgraded as Branches. By that measure, they serve the area with the full complement of banking services. Banks are upgrading all their Extension Counters into Branches in a systematic way for the above purpose. But Extension Counter as a delivery channel always serves in a focussed way to a targeted entity/group of course with the liability products mainly.

11.3 ELECTRONIC/REMOTE DELIVERY CHANNELS

Automated Teller Machines (ATMs)

Automate Teller Machines (ATMs) have completely revolutionalised the service delivery paradigm of banks. ATMs are the starting point of remote channels that moved the customers away from the branch. The main objectives of banks to set up ATMs are

(a) To offer convenience to customers an additional choice to withdraw money during any time of the day according to their will and pleasure.

(b) To move the customers away from the counters as service cost is comparatively less through ATMs than across the counter at the branch.

There are basically two types of ATMs to deliver services to retail customers.

1. On Site ATMs and
2. Off Site ATMs.

On Site ATMs are intended to offer the facility of Cash Withdrawals, Cash Remittances, Balance Enquiry etc., at the branch premises itself. Off Site ATMs are designed to be situated away from the branches at convenient and busy locations to enable the customers to access it for their different needs but not necessarily from the branch. Off site model of ATMs has proved to be very popular as there was no compulsion for the customer to visit the branch even for transacting in an ATM.

The success of ATMs as a delivery channel is highlighted by the following figures. The number of ATMs in commercial banks has moved up to 43651 which consists of 24645 On-Site ATMs and 19006 Off-Site ATMs. If we compare the number of ATMs (43651) to the total number of branches of commercial banks (64608) as on March 2009, the percentage is very high at 67%. The growth of ATMs in 2009 over 2009 stood at an impressive 25.4%. If we compare the number of ATMs (43651), to the number of CBS (Core Banking Solutions) Branches (44304) as on March 2009, it is more than 90% of the CBS Branches and reflects the penetration of ATMs. This has to be viewed with the fact that only 79.4% of the Branches are covered under CBS. The transactions in ATMs mainly happen through either Debit Cards or Credit Cards.

Earlier there were restrictions on usage of ATMs by Customers. Customers were allowed to access only the ATMs of the bank they were maintaining the accounts. It restricted the customers to either use the off site or on site ATM of their bank only. But there was a change subsequently and customers were provided with the facility of withdrawing from other banks' ATMs also. For that purpose, a common networking arrangement "National Financial Switch" was initiated for ATM operations. Two of the important net working arrangements called "Cash Tree" and "INFINET-National Financial Switch offered networking facility across banks. Banks that are members of the network can offer their customers the said facility. But charges were levied for operations in ATMS of other banks. Subsequently from October 2009, RBI issued guidelines allowing operations free of any charge for customers using other banks' ATMs subject to the following conditions:

- With regard to Savings Bank Customers, five withdrawals through other Bank ATMs per month are allowed free of charges and thereafter a charge of Rs.20/- per transaction will be levied beyond five free withdrawals per month.
- With regard to our non-Savings Bank customers, there will not be any free withdrawals through other bank ATMs and all withdrawal transactions in other bank ATMs are chargeable at the rate of Rs.20/- per transaction.
- Maximum cash withdrawal would be Rs.10,000/- (Rupees Ten thousand only) per transaction for the customers of other Banks w.e.f October 15, 2009.

ATM Operations

Let us try to learn the non technical functions of an ATM to understand in a better way the background story behind ATM operations.

- All banks have several ATMs and they are located across geography based on their priorities of business and connected via a wide area network to a central server.
- Each and every ATM has the following important components viz. Card Reader, Cash Dispenser, Key Board/Display Unit/Touch Screen and a Receipt Printer and the entire package is bundled in the ATM machine. Customers normally have the following options for operations :
  - Withdraw cash from their accounts and
  - Balance Enquiry
- When a customer inserts an ATM card into the card reader, the transaction starts.
- On the back of the ATM card, the card number, the start date, and the expiry date are encoded on the black magnetic strip.
- Card recognition process by the ATM is the next stage. If the card is recognized, the system will ask for the Personal Identification Number called the PIN Number and the customer has to enter the PIN number. The PIN number will be a unique number and consists of four digits.
- ATM validates the PIN number and checks up that the expiry date has not passed, that the user-entered PIN matches the PIN maintained by the system, and that the card is not lost or stolen.
- The customer is allowed three attempts to enter the correct PIN and if the same is not entered correctly in all the three attempts, the card is confiscated if the third attempt fails. The card will not be chucked out by the ATM machine.
- Cards that have been reported lost or stolen are also confiscated.
- After verifying with the correctness of the PIN number, the customer is prompted for a withdrawal, query, or transfer transaction. The customer, if he wants to verify the balance in his account will go for the Balance Enquiry Mode and if he wants to withdraw money he will opt for Cash Withdrawal Mode.
- The screen will prompt the customer to enter the details of his withdrawal and the customer will enter the amount he wants to withdraw and press for enter for debiting the amount.
- Before approval of a withdrawal transaction, the system will verify for the sufficiency of funds in the account. If the amount is available in the account, again verifies whether the requested amount is within the maximum daily limit and whether the requested cash is available in the cash dispenser of the ATM.
- After verification of the above, transaction is approved and the requested amount of cash is dispensed, a receipt is printed containing information about the transaction, and the card is ejected.
- Cash dispensed is collected by the customer. But the important point to note is that the denomination will be pre determined by the system based on the set configuration and stock of cash in the cash dispenser and not as per the requirement of the customer.
- On a regular basis, cash will be replenished by the bank either directly by them or through an outsourcing agency.

ATMs - Issues and Risks

ATMs are double edged swords. In one way, ATMs are one of the most successful remote channels for service delivery. This can be seen by the aggressive growth in volumes as well as value generated over the years. The second dimension is the risks attached with the functioning efficiency of ATMs. ATMS are always complaint prone because of the break downs and cash out situations. The break down may be due to many reasons but the customer irritation about break downs would result in negative publicity to the bank. More damaging will be the cash out situations which will reflect the inefficiency of the banks to predict the withdrawal pattern and amounts from ATMs. These two faults would result in reputation risk for the bank and may result in customer switching also.

ATM as a remote channel has changed the concept of account management and cash management requirements of retail customers. Banks are vying with one another in increasing the ATM numbers (both on site and off site) in a big way as it the most convenient delivery channel for most of the retail customers. From the banks point of view also it considerably reduces the transaction costs of service delivery through the brick and mortar format.

Point Of Sale Terminal (POS)

Point of Sale terminals are the enablers of payment of credit and debit cards in merchant establishments. Whenever a customer makes a purchase in a merchant establishment. Point of Sale terminals facilitates the payment of amount of purchase by accessing the account and effecting payment.

POS - Process

- POS is simply an electronic transaction terminal used in an electronic Point of Sale system.
- The terminal interacts with a computer file to approve transactions and transmits sales information for posting against customer accounts.
- There are two basic types of POS terminals: electronic cash registers that are used by high volume merchants, such as department stores, and dial-up terminals that automatically dial a special telephone number, often a toll-free number, to obtain authorization.
- Net Settlement when the transfer of funds actually takes place, may occur at the same time as the transaction or soon afterward, or it may occur later in the day in POS systems that operate Off-Line in a Store and Forward mode. This

type of system operates off-line, that is, the merchant terminal is not connected directly to a central computer for authorization or processing of sales receipts.

- A POS terminal is predominantly used for payment for sale and purchase transaction, while an ATM can be used for several other services like balance enquiry.
- In this case, the bank pays charges which are split among the card-issuing bank, the bank that owns the POS terminal, the payment company. Mastercard or Visa, and the place where the POS terminal is located.
- The growth in POS is expected to be huge and going to be in the range of 50-70% in the coming years.

Banks have agreed to put a cap on charges they will levy on withdrawal of cash by customers using POS. In July 2008, the Reserve Bank of India (RBI) allowed cash to be withdrawn from any merchant establishment with a POS terminal. The RBI has, however, put a ceiling of Rs 1,000 a day on withdrawal of cash at merchant outlets using debit cards. RBI had left it to banks to decide among them on how much to charge customers for withdrawal of cash at merchant outlets. The fees have to be charged and then only the merchant gets his part and he also is equally excited to participate in this arrangement. The fees will be nominal and anywhere between free and Rs 20.

The rationale behind RBI allowing cash withdrawal was to capitalise on the wide reach of POS terminals across the country to enhance financial inclusion. There are about 450,000 POS terminals in the country, against 4().(KK) plus ATMs.RBI is planning to widen the scope of this facility by allowing holders of prepaid cards also to withdraw cash at POS terminals like debit card holders. The scope of POS terminals is going beyond the original definition and POS terminals are going to be used as a very effective delivery channel for inclusive banking using its enormous reach.

Mobile Banking

The latest and the most convenient delivery channel which has gained lot of interest in retail banking is mobile banking. To put it simply, banking can be done at your finger tips and right in the place where you are. It is convenient, simple and readily accessible.

The use of mobile as a delivery channel in retail banking is a recent phenomenon. Globally, mobile banking initiatives were stared by Wachovia in 2005 and the full fledged mobile browser in 2007. Most US banks viz. Bank of America, Citibank, Wells Fargo launched their mobile banking services in 2007.

As on April 2009, there were about 300 million mobile users in India and the growth in April '09 was a whopping 35% (annualised). It indicates that about more than 25% of the population are using mobile phones and the numbers are growing. Mobile has become an essential accessory from a snob value accessory when it was introduced. The growth potential is huge as the prices of mobile sets are moving southwards and also due to the drastic reduction in the usage charges by the network operators. Because of the operational conveniences, the reach and time flexibility afforded by Mobile Banking, banks are aggressively planning and executing their marketing strategies for mobile banking. The mobile banking initiatives in India were started by foreign and private banks followed by public sector banks.

Benefits and Uses of Mobile Banking

Benefits and uses for customers

- Facility for using banking facility from anywhere.
- Easy operations - instructions carried out by self.
- Option to pay utility bills.
- Transfer of funds between accounts - same bank and other banks.
- Facilities for setting up alerts for different transactions like account debits for various reasons.
- Balance Enquiries
- Facility for shopping and paying through mobile.

Benefits for banks

- Easy and most acceptable delivery channel.
- Cost effective solution as compared to ATMs.
- It is not a benefit to banks.
- Lesser transaction costs as compared to other channels.
- It is a tool to attract of the next generation clients.

Reserve Bank of India had come out with the operative guidelines for implementing mobile banking solutions. Banks have to obtain prior permission from Reserve Bank of India for offering mobile banking business service.

Mobile banking operations

Let us now discuss about the operational aspects of mobile banking. In addition to foreign and private banks, some public sector banks have also entered the mobile banking space with the twin objective of offering an additional user friendly channel as well as wooing the younger generation of customers to expand the customer base as the customer profile of PSBs is skewed more towards senior customers than youth. Mobile Banking is attempted by PSBs to draw youth segment towards them. Let us see the operational procedures followed by two public sector banks and the facilities provided by them.

Union Bank of India is one of the very early Public Sector Banks to offer mobile banking facility to their customers. Their branded mobile banking product "UMOBILE" with a tagline 'Bank in your pocket' provides the customers a secure and convenient means of banking and commerce from anywhere, anytime. Customers can check their account balances and a host of other service features which are explained below :

(i) Balance Enquiry
(ii) Mini Statement - last nine transactions.
(iii) Funds Transfer -
(a) Within the Bank -

- Mobile to Mobile (between two registered customers)
- Mobile to Account (to any account in Union Bank)

(b) To other banks (Using NEFT platform)

(iv) Bill Payments
(v) Airline Ticketing
(vi) Movie Ticketing
(vii) Shopping (shopping at the counters, on the move and online shopping).
(viii) Mobile Recharge
(ix) Corporate Fund Transfers
(x) Temple Donations
(xi) Fee Payments
(xii) Stop Payment of Cheques
(xiii) Cheque Status
(xiv) Hotlist Debit Card
(xv) ATM/Branch Locator
(xvi) Request to Bank for

Cheque Book Account
Statement Loans

Debit/Credit Card New
Account/Fixed Deposits

(xvii) MPIN Change
(xviii) Communication Mode - SMS,GPRS,WAP
(xix) Change Activation Code/Password
(xx) Enable/Disenable Transactions
(xxi) Change Service Number
(xxii) Feed back and Complaints.

The registration for mobile banking services is done through any of the Bank's ATMs. The procedure for registration is as follows:

(i) Customer has to insert his debit card and enter the debit card PIN number.
(ii) On the display screen, the 'Others' menu option has to be selected.
(iii) On the next screen, 'Mobile Payment' has to be selected.
(iv) Then 'Unimobile' has to be selected and again select 'Registration'.
(v) The system will prompt for entering the Mobile Number and confirm it for registration.
(vi) Once the mobile number is entered, it is validated by the system and if found valid, the system will print the receipt with the details of Activation Code and MPIN.

After activating the mobile banking facility through the above process, the customer can use the mobile banking facility. Another public sector bank. Indian Overseas Bank has launched their mobile banking operations in 2(K)9.The procedure for availing the facility is detailed below:

(i) For using the Mobile Banking facility, customers should use a mobile having any of the modes - SMS/GPRS/J2ME.Generally GPRS facility is available in almost all basic sets and it is provided by all service providers.

(ii) All Customers of the bank having operative and KYC-compliant Savings/Current/Cash Credit accounts are eligible to avail Mobile Banking Facility. The customers can register for the Mobile Banking facility at the branch, where he maintains his/her account. One time handing over of a signed application will be a must, as per RBI guidelines. In the first stage Mobile Banking facility shall be provided to individuals/proprietary concerns/HUF only. In the next phase, the facility shall be extended to corporate accounts, where the mode of operation is "several".

(iii) The customers can download the registration form from the bank’s site. The filled up application shall be submitted to the branch, where the customer is having the account. The account should be a KYC compliant one, for registration in Mobile Banking. The branch has to obtain the latest address of the customer with the address proof and correct the same in the database, if necessary.

(iv) One time physical presence of the customer at the branch and tendering the application form is a must as per RBI guidelines. This service is available to all customers having mobile phones of any network operator.

(v) The branch shall register the request through the option provided in CBS menu and approve the same and retain the application form at their end.

(vi) Upon successful registration, the customer will receive two SMS messages as below:

1. Welcoming the customer to the mobile banking facility and requesting the customer to visit the web site of the bank for the browser.
2. Advising the customer to download the relevant application form. The details of User Id and PIN will be sent by post and with a request to change the User id and PIN.

(vii) Mobile Banking MPIN would be dispatched to the customer's address directly within 3 working days. Presently, the bank's Mobile Banking works on SMS, GPRS, and J2ME over GPRS facilities.

(viii) The following facilities are provided :

SMS: It works on the "Text Messaging Facility" (also called the SMS) that is available on all mobile phones. This facility allows the customer to send a short text messages to a specified mobile number of the bank from the customer's mobile phone. The response is sent to the customer's mobile as an SMS message, all in the matter of few seconds.

GPRS: General Packet Radio Service (GPRS) is a packet oriented mobile data service, through which the customer can access the services of the bank using his/her MPIN. The mobile service provider will enable GPRS in the mobile.

J2ME: Using GPRS Internet Connection, customer can download the Mobile Banking application on his/her mobile handset from the Bank's website.

Customer can use the mobile banking facility after completing the above said formalities. Reserve Bank of India has recently enhanced the transaction amount through mobile banking to Rs.50,000/ and this higher limit is definitely going to create a greater impact in the mobile banking marketing initiatives of banks. Mobile banking as a channel is seriously attempted by all the banks now because of its benefits to the banks as well as the customers. With all out effort by banks, the penetration levels of mobile banking are going to be huge and days are not far off when mobile banking as a facility will become like Debit Cards which have become an essential feature for all new accounts opened.

Internet Banking

Before we discuss about the different important aspects of Internet Banking, it is pertinent to go through the classic observations of Mr.Ernest. T. Parkins, First Vice President, in October 1997 before the Bank of Japan about the evolution of retail banking and also about the various electronic channels and the opportunities in electronic banking including Internet Banking in USA. The observations cover the entire gamut of retail banking and electronic channels including internet banking and is a must read for every retail banker/student. He has broadly covered how internet banking will bring out a paradigm change in the following services.

Internet Banking And Electronic Channels In USA

Ernest. T. Parkins had observed that internet banking, going forward, would have great implications on (1) Internet commerce, (2) new types of electronic retail payments, (3) electronic retail banking, and (4) the movement more generally of retail financial services to electronic delivery, including insurance, discount brokerages, and mutual funds

Some of the important observations are summarized below:

- Electronic commerce over the Internet, involving both financial and nonfinancial products, would see rapid growth and would create demand for new payment instruments.
- ATMs (Automated Teller Machines) would become more sophisticated and offer more services.
- With access to electronic channels, retail banking would become largely an electronic, remote-delivery, self-service business.
- Movement of banking services to electronic delivery would bring about the following changes viz., (1) reduction of geographic barriers, (2) commoditization of banking products and (3) new competitive strategies deployed by banks.
- Banks would find ways to cut costs, and gain access to the consumer, at the same time avoiding direct competition in those dimensions where non bank competitors already have a big advantage. For example, rather than relying on conventional branches, or setting up Internet sites, and waiting for the consumer to take the initiative and eventually come to the bank in person or electronically, these banks are putting smaller branches in supermarket (large grocery-store) chains where many consumers, including the customers of their competitors, are virtually certain to come a few times each week. These banks, of course, are placing self-service, electronic, access devices in these supermarket branches to keep costs as low as possible, but also have one or two bank employees available to answer questions in person and sell banking products on a person-to-person basis. These scaled-back, but strategically placed, branches might help these banks capture that segment of the retail market that is not ready for total electronic delivery of financial products, or those who might not actively seek information about financial products. In any case, this approach to bank branching is considerably less expensive than conventional, stand-alone branches and is one of the alternative branch configurations many banks in the United Slates are considering.
- Banks would convert the large amount of information about their customers in their electronic data bases and make efforts to consolidate the information into data warehouses for targeting certain customer segments for new product offerings and not waste resources making the same product offering to other segments that probably would not be interested. The transmission of the product offerings to the targeted consumer segments will become more electronic, with banks "pushing out" the information over the ATM and personal computer networks.
- Banks would charge fees for financial services that reflect the overall relationship with the customer, reducing the chances that the individual products would be reduced to the level of commodities in the eyes of the consumer. In other words, banks would try to sell the value of the overall, individually customized relationship in the provision of financial services, thereby preserving their "brand names" in the minds of their customers and preventing defection to nonbank competitors.

The entire concept as electronic and remote channels has been expressed in a holistic way in the above piece including the effectiveness, acceptance and user convenience, technology issues and also the risk dimensions in using the channels. The above speech highlights the following dimensions of electronic banking.

(i) migration from traditional channels to electronic channels in delivery of retail banking services.
(ii) potential available and the ability of these channels to change the competition dynamics in retail banking
(iii) impact of these channels and changes in customer experiences of retail banking products and

(iv) expected risks from these channels and managing the same.

The situation prevailing today in the retail banking space has been prophetically brought out a decade back vey accurately. The issues are very relevant and banks are addressing these issues in the right way. With the understanding of the global perspectives of retail banking, let us look into the internet banking evolution in India. Internet Banking as a service and channel was initiated by foreign banks and new generation private sector banks in the past decade. With the advantage of technology right from their inception, new generation private banks aggressively implemented their internet banking channels and increased their customer base. Through their technology initiatives, they were able to build a relationship portfolio skewed more towards the younger generation. The usage of electronic channels was more in private banks due to these younger generations of customers. Public sector banks also aggressively implemented technology upgradation by moving towards Core Banking Solutions and also implemented Internet Banking solutions to their customer base. The level of acceptance of Internet Banking, generally, from the public sector bank customers was initially lukewarm though some banks were able to push it hard. This is basically due to the older age profile of the customers as well as staff as compared to private sector banks. But over a period of time, with their fast track technology initiatives, public sector banks also have marketed their internet banking initiatives in a phased manner and were able to build up the numbers. But the level of penetration of internet banking in public sector banks is low as compared to private sector banks. Let us see the concepts, fundamentals and procedural aspects of internet banking.

Internet Banking - Concepts

Reserve Bank of India has codified the different concepts of Internet Banking. The important observations and views mentioned in the report of Internet Banking is edited and reproduced below to have an understanding of the different dimensions.

1. Broadly, the levels of banking services offered through INTERNET can be categorized in to three types:

(i) The Basic Level Service is the banks' websites which disseminate information on different products and services offered to customers and members of public in general. It may receive and reply customers' queries through e-mail,

(ii) In the next level are Simple Transactional Websites which allow customers to submit their instructions, applications for different services, queries on their account balances, etc, but do not permit any fund-based transactions on their accounts,

(iii) The third level of Internet banking services are offered by 'Fully Transactional Websites' which allow the customers to operate on their accounts for transfer of funds, payment of different bills, subscribing to other products of the bank and to transact, purchase and sale of securities, etc. The above forms of Internet banking services are offered by traditional banks, as an additional method of serving the customer or by new banks, who deliver banking services primarily through Internet or other electronic delivery channels as the value added services. Some of these banks are known as 'virtual' banks or 'Internet-only' banks and may not have any physical presence in a country despite offering different banking services.

2. From the perspective of banking products and services being offered through Internet, Internet banking is nothing more than traditional banking services delivered through an electronic communication backbone, viz, Internet. But, in the process it has thrown open issues which have ramifications beyond what a new delivery channel would normally envisage and, hence, has compelled regulators world over to take note of this emerging channel. Some of the distinctive features of i-banking are:

(a) It removes the traditional geographical barriers as it could reach out to customers of different countries/legal jurisdiction. This has raised the question of jurisdiction of law/supervisory system to which such transactions should be subjected.

(b) It has added a new dimension to different kinds of risks traditionally associated with banking, heightening some of them and throwing new risk control challenges.

(c) Security of banking transactions, validity of electronic contract, customers' privacy, etc., which have all along been concerns of both bankers and supervisors have assumed different dimensions given that Internet is a public domain, not subject to control by any single authority or group of users.

(d) It poses a strategic risk of loss of business to those banks who do not respond in time, to this new technology, being the efficient and cost effective delivery mechanism of banking services.

(e) A new form of competition has emerged both from the existing players and new players of the market who are not strictly banks.

3. Security of internet banking transactions is one of the most important areas of concerns. Security issues include questions of adopting internationally accepted state-of-the art minimum technology standards for access control, encryption/decryption (minimum key length etc), firewalls, verification of digital signature, Public Key Infrastructure (PKI) etc. The regulator is equally concerned about the security policy for the banking industry, security awareness and education.
4. The supervisory and operational issues include risk control measures, advance warning system. Information technology audit and re-engineering of operational procedures. The regulator would also be concerned with whether the nature of products and services offered are within the regulatory framework and whether the transactions do not camouflage money-laundering operations.
5. The Central Bank may have its concern about the impact of Internet banking on its monetary and credit policies. As long as Internet is used only as a medium for delivery of banking services and facilitator of normal payment transactions, perhaps, it may not impact monetary policy. However, when it assumes a stage where private sector initiative produces electronic substitution of money like e-cheque, account based cards and digital coins, its likely impact on monetary system can not be overlooked. Even countries where internet banking has been quite developed, its impact on monetary policy has not been significant.
6. The world over, central bankers and regulators have been addressing themselves to meet the new challenges thrown open by this form of banking. Several studies have pointed to the fact that the cost of delivery of

banking service through Internet is several times less than the traditional delivery methods. This alone is enough reason for banks to flock to Internet and to deliver more and more of their services through Internet and as soon as possible. Not adopting this new technology in time has the risk of banks getting edged out of competition. In such a scenario, the thrust of regulatory thinking has been to ensure that while the banks remain efficient and cost effective, they must be aware of the risks involved and have proper built-in safeguards, machinery and systems to manage the emerging risks. It is not enough for banks to have systems in place, but the systems must be constantly upgraded to changing and well-tested technologies, which is a much bigger challenge. The other aspect is to provide conducive regulatory environment for orderly growth of such form of banking. Central Banks of many countries have put in place broad regulatory framework for i-banking.

(Source : RBI Report on Internet Banking)

Internet Banking - Evolution Across the Globe

The evolution of Internet Banking across the globe as mentioned and reported in the report of RBI is presented below:

In the USA, the number of thrift institutions and commercial banks with transactional web-sites is 1275 or 12% of all banks and thrifts. Approximately 78% of all commercial banks with more than $5 billion in assets, 43% of banks with $500 million to $5 billion in assets, and 10% of banks under $ 500 million in assets have transactional web-sites. Of the 1275-thrifts/commercial banks offering transactional Internet banking, 7 could be considered 'virtual banks'. 10 traditional banks have established Internet branches or divisions that operate under a unique brand name. Several new business process and technological advances such as Electronic Bill Presentment and Payment (EBPP), hand held access devices such as Personal Digital Assistants (PDAs), Internet Telephone and Wireless Communication channels and phones are emerging in the US market. A few banks have become Internet Service Providers (ISPs), and banks may become Internet portal sites and online service providers in the near future. Reliance on third party vendors is a common feature of electronic banking ventures of all sizes and degrees of sophistication in the US. Currently, payments made over the Internet are almost exclusively conducted through existing payment instruments and networks.

Most banks in U.K. are offering transactional services through a wider range of channels including Wireless Application Protocol (WAP), mobile phone and TV.

Swedish and Finnish markets lead the world in terms of Internet penetration and the range and quality of their online services. Merita Nordbanken (MRB) (now Nordic Bank Holding, a merger between Finland's Merita and Nordbanker of Sweden) leads in 'log-ins per month' with l .2 million Internet customers, and its penetration rate in Finland (around 45%) is among the highest in the world for a bank of 'brick and mortar' origin. Standinaviska Easkilda Banken (SEB) was Sweden's first Internet bank, having gone online in December 19%. Swedbank was the first bank in the world to introduce Electronic Bill Presentment and Payment (EBPP).

Internet Banking in Australia is offered in two forms: web-based and through the provision of proprietary software. Initial web-based products have focused on personal banking whereas the provision of proprietary software has been targeted at the business/corporate sector. Most Australian-owned banks and some foreign subsidiaries of banks have transactional or interactive web-sites. Online banking services range from Pis' websites providing information on financial products to enabling account management and financial transactions. Customer services offered online include account monitoring (electronic statements, real-time account balances), account management (bill payments, funds transfers, applying for products on-line) and financial transactions (securities trading, foreign currency transactions).

In New Zealand, major banks who offer Internet banking service to customers operate as a division of the bank rather than as a separate legal entity.

In Singapore, the Monetary Authority of Singapore (MAS) has reviewed its framework for licensing, and for prudential regulation and supervision of banks, to ensure its relevance in the light of developments in Internet banking, either as an additional channel or in the form of a specialized division, or as standalone entities (Internet Only Banks), owned either by existing banks or by new players entering the banking industry.

Banks in Japan are increasingly focusing on e-banking transactions with customers. Internet banking is an important part of their strategy. While some banks provide services such as inquiry, settlement, purchase of financial products and loan application, others are looking at setting up finance portals with non-finance business corporations. Most banks use outside vendors in addition to in-house services.

Internet Banking Operations by Indian Banks

As said earlier, Indian banks were in line with their global peers in offering internet banking services. Initially the service level was restricted to account information, very soon almost all the private sector banks and a few public sector banks started offering full fledged transactional websites to cover the entire range of internet transactions. Most of the public sector banks that have implemented cent per cent core banking solutions have gone for full fledged internet banking services. Let us, for example, discuss about the internet banking model of a public sector bank and the services they offer.

Sen-ices Offered

The services can be accessed from the website of the bank offering internet banking. The facility will enable customers to transact online with the bank and from any where at any time of the day through Internet.

The services offered by the Bank are as follows:

(i) View of balance in account.
(ii) View of last few transactions.
(iii) Generate statement of Account
(iv) Transfer of funds from Savings, Current, Cash Credit accounts to another Savings, Current, Cash Credit, Loan or Recurring Deposit accounts within the bank.
(v) Transfer of funds to accounts with other banks through NEFT mechanism.
(vi) Viewing of Recurring Deposit/Loan Accounts.
(vii) Pay their indirect taxes (Excise and Service taxes).
(viii) Pay their direct tax (TDS and Income Tax dues, etc.)
(ix) Utility Payment facility like payment of insurance premium, telephone bills, energy bills.
(x) Book air tickets, hotel rooms through popular travel sites.
(xi) Purchase of units in select mutual funds.
(xii) Payments to several other merchant establishments, etc.

Eligible Customers

The eligibility of the customer depends on the type of branch at which the customer is having the account and also the type of customers. The following types of customers can open internet banking accounts.

(i) Individuals and Corporate customers of networked branches. New generation private banks are operating through the CBS platform and most of the public sector banks also under CBS now.
(ii) Proprietary concerns.
(iii) Corporate customers which include Limited Companies, Partnership firms, Trust, Society, Association etc where the operation of the account is entrusted to a specific person/persons by the Corporate/partnership firm/Trust/society/Association. These customers should register only through 'Corporate Banking' module.
(iv) The Customer should comply with KYC and AML norms as per rules in force.
(v) In the case of individuals (or proprietary concerns) the mode of operation of the account should be 'Single' or 'E or S' or 'Any One or Survivor'.
(vi) If the account is operated 'JOINTLY' or if the account holder is a minor, they are not eligible.
(vii) If an account holder has more than one account, he/she can register all the accounts under the same login-id. However an account holder cannot add accounts that are not in his name.
(viii) Accounts in the names of Minors and jointly operated Accounts are not eligible for Internet Banking facility.

Procedure for Availing the Service

Retail Customers have to comply with the following procedures for registering and availing internet banking.

(i) The customer has to register online for the services through the web site of the bank.
(ii) The customer can register only the accounts he is authorized to operate in his individual capacity.
(iii) To operate the account through Internet Banking, each individual will have a unique login id selected by him during the registration process.
(iv) The user is expected to have a customer-id in the branch system.
(v) Individuals have to submit to the branch the registration form duly signed.
(vi) After completion of registration, a four digit pin number will be generated by the system.
(vii) The customer should memorize it and use it at the time of availing the funds transfer facility.
(viii) The customer can change his PIN number by selecting Change Pin option under Account Services menu after logging into Internet Banking using the login-id/password provided.
(ix) Where the customer has account in more then one branch, they can register all the accounts. The registration forms have to be submitted to the respective branches.

After submission of registration forms by customers, the bank will verify the particulars, do all the necessary compliance formalities for internet banking and activate the internet banking facility to the customer if the requirements for opening the account are met by the customers.

The penetration of internet banking has definitely improved over the years but in public sector banks though the numbers are growing, the growth is not in line with the customer base. This is basically due to the good number of rural branches in PSBs and the rural customers may not be rather inclined towards internet banking. In addition, the scope for internet banking is also less in rural branches as compared to urban and metro branches since internet banking is not a 'bottom of the pyramid' product. But public sector banks are attempting their best to rope most of their urban and metro customers into internet banking through services like utility payments, account to account transfers across banks, investment in mutual funds etc. The numbers are steadily progressing in the last two years.

If you compare internet banking and mobile banking, mobile banking will score over internet banking as a complete remote channel because of the strong penetration of mobile services across geography including rural areas. While internet banking is an attractive channel for the upper middle end customers who are tech savvy, mobile banking is a universal remote channel attracting bottom of pyramid customers as well as high end customers. In the long run, mobile banking as a remote channel will be the king of delivery channels in retail banking because of its simplicity and reach.

Terminal Questions

1. Electronic Channels in retail banking refers to
   (i) ATMs
   (ii) Internet Banking
   (iii) Mobile Banking
   (iv) All the above.

Ans: iv

2. Advantages of a good branch layout are
   (i) Promotes efficiency as it will ensure smooth flow of services.
   (ii) Internal communication effectiveness increases thereby facilitating better coordination among the staff resulting in better customer service.
   (iii) Provides a comfortable and congenial work environment to the staff which results in high employee motivation and acts as a morale booster.
   (iv) Serves as an image building tool for the bank.
   (v) All the above.

Ans: v

3. The facilities available for mobile banking customers are
   (i) Facility for using banking facility from anywhere.
   (ii) Easy operations - instructions carried out by self.
   (iii) Option to pay utility bills.
   (iv) Transfer of funds between accounts - same bank and other banks.
   (v) All the above

Ans: v

4. The services offered for Internet Banking Customers are:
   (i) View of Balance and last few transactions.
   (ii) Generate statement of Account.
   (iii) Transfer of funds between accounts within the bank.
   (iv) Utility Payment facility like payment of insurance premium, telephone bills, energy bills.
   (v) All the above.

Ans: v

Key

1. (iv); 2. (v);3.(v);4. (v)

Let Us Sum Up

- Delivery channels, both physical and remote, play a crucial role in the delivery paradigm but delivery effectiveness in physical channels is determined more by the persons who are delivering the services.
- In electronic channels, like ATM, Net Banking and Mobile Banking, human intervention is not there and the delivery requested is met through the machines or on line solutions.
- But in case of physical channels like Branches, Direct Marketing etc., the individuals involved in the service delivery process are very important for the success of the customer relationship and loyalty factors.

Keywords

Physical and Remote Delivery Channels; Branch; Extension Counter, Automated Teller Machine: (ash Withdrawal: Personal Identification Number (PIN);National Financial Switch; Mobile Banking; Account View; Funds Transfer; Internet Banking; Utility Payments; Investments in mutual funds.

UNIT 12 DELIVERY MODELS

STRUCTURE

12.1 Delivery Models

12.2 Internal Customers - Staff At The Branch Level

12.3 Dedicated Marketing Managers

12.4 Direct Selling Agents (DSAs)

12.5 Sales through Tie Ups

Terminal Questions Let Us Sum Up Keywords

12.1 DELIVERY MODELS

Retail Banking is a customer oriented business model and the success of the same depends on how the products and services are delivered to the customer. Of course, delivery channels, both physical and remote, play a crucial role in the delivery paradigm but delivery effectiveness in physical channels is determined more by the persons who are delivering the services. In electronic channels, like ATM, Net Banking and Mobile Banking human intervention is not there and the delivery requested is met through the machines or on line solutions. But in cases of physical channels like Branches, Direct Marketing etc., the individuals involved in the service delivery process are very important for the success of the customer relationship and loyalty factors. The three important human interventions in physical channels are

(i) Internal Customer - Staff of the Branch
(ii) Specialised Marketing Personnel
(iii) Direct Selling Associates (DSAs).

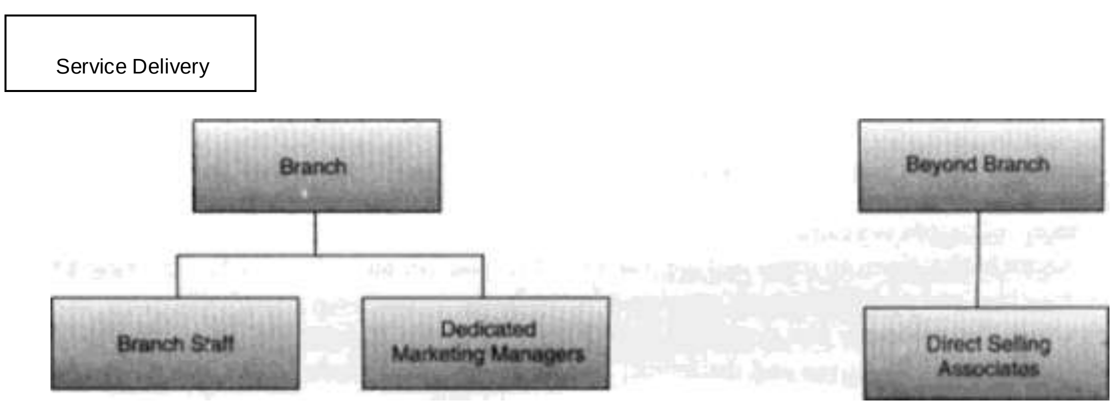


Fig. 12.1 Service Delivery

Let us discuss one by one, the people involved in the delivery process to make retail banking effective.

12.2 INTERNAL CUSTOMERS - STAFF AT THE BRANCH LEVEL

In retail banking delivery, staffs of the branch play a very crucial role in the entire delivery process. They are responsible for the end to end service delivery and any deficiency in delivery will result in customer dissatisfaction. All the staff members should aim at a focused approach for effective delivery of services. But in any branch, all the staff will not be the same and there is bound to be difference in the delivery quality. How to overcome this problem? In many of the public sector banks, retail banking is carried on only as a separate departmental activity and not as a Strategic Business Unit (SBU). Only in foreign banks and new generation private banks, retail banking is practiced as a SBU. Hence the internal customer is more focused in service delivery in new private sector banks. But in public sector banks, even without a strategic focus to retail banking in many banks and carried on as an activity within the total business model, the service delivery is generally more personalised and caring because of the loyalty factor of public sector bank customers and better personal understanding of the customers' profile by the staff in PSBs. This is more pronounced in semi urban and rural branches where retail customers are more loyal and value their relationships with the banks.

For efficient service delivery, staff should possess the following characteristics and traits.

1. Understanding the customer, his income level, his financial profile, his needs, his requirements of financial products and his life stage.
2. Cross selling the right products to match their requirements.
3. Post sales service follow up for customer satisfaction.
4. Customer Empathy - Putting yourself in the shoes of the customer and looking the service level from customer' perspective.
5. Understanding the product features and service prescriptions and conviction about the bank's products services for right selling and better product and service delivery.
6. Attitude for customer service and the concept of team in customer delivery.

The above discussed essentials from the staff would definitely result in better realization of retail banking business and also will help the banks to cross sell effectively other relevant products.

12.3 DEDICATED MARKETING MANAGERS

The concept of people in retail banking has undergone dramatic changes in the past decade especially in public sector banks. From an integrated approach to retail banking, banks have started building a stand alone franchise and specialists were appointed in the banks to carry out specifically retail banking marketing initiatives in the past decade. In foreign and private banks, since there was mismatch with their retail banking objectives and the human resources available to achieve the objectives, private banks engaged external agencies to carry out marketing and customer acquisitions. Public sector banks have redesigned their marketing approach and appointed specialist officers for marketing and retail banking initiatives. Separate verticals for marketing were set up in banks and dedicated Marketing Managers were appointed in addition to existing internal human resources. These specialist Marketing Managers (MBAs in Marketing) were young and energetic and recruited from the campuses of management schools. Some banks appointed them in Junior Management and some other banks in middle management. The compensation structures were also attractive and consisted of both fixed and variable components thus making them as performance oriented. The expectations from these officers are explained below:

(i) Market Intelligence.
(ii) Potential Sourcing.
(iii) Product and Service Delivery Presentations to the identified customer segments.
(iv) Right selling to the targeted customer group.
(v) Sales Conversions
(vi) Closing the leads with sales.
(vii) Compliance of promises made and conforming to the service delivery standards.
(viii) Following up with the operations department for effective process and delivery of products sold.
(ix) Customer Relationship Management on a continuous basis for improving the loyalty factor as well as additional sales.

Since these officers were given dedicated assignments for better and focused marketing approach, the conversion levels and service delivery quality were better achieved. Though the stand alone marketing model was practiced initially only by a few banks, since the initiatives yielded the desired results, more banks followed suit and this phenomenon is happening in almost all banks. The effectiveness of delivery to retail customers has improved very well in this dedicated model.

12.4 DIRECT SELLING AGENTS (DSAS)

The concept of Direct Selling Agents (DSAs) was pioneered by foreign banks and nurtured well by new generation private sector banks. DSAs are agencies appointed by banks to source business for them on a fee basis. Banks which do not have a branch penetration and geography, to service a large section of customers, they seek the help of DSAs for sourcing business on behalf of the bank and also complete the preliminary formalities for acquiring customers. DSAs positioned across geographies will make the tasks easier for the banks. DSAs are primarily engaged in sourcing Credit Cards and Retail Loans. The appointed DSA appoints field personnel and supplemented by tele callers, start the marketing process and follow up to meet the customers and convert them into sales. But the scrutiny and KYC formalities for the above are basically done by the banks before offering the same to the customers. But misselling by DSAs are rampant especially in the credit card space. The employees of the DSAs missell credit card products and make the customers fall into a debt trap by misusing the cards. Same is the case with misselling of retail loans and in this space, the pricing for the loans are not explained clearly. Ultimately this will result in dissatisfaction for the customers and reputation risk for the bank. With limited branch networks, private sector banks are increasingly depending on outside agencies to sell their retail products.

Despite the lack of loyalty and accountability associated with direct selling agencies, new generation private sector banks see this as the only way in which they can grow their scale of operations in the country. Unmatched with the public sector banks in terms of reach, private banks need feet on the street to sell and cross-sell their products and the same is achieved through DSAs. In case of a large private player whose more than 50% of the assets are sourced from the retail side, DSAs play a vital role in mobilising business and more than 70% of the retail asset portfolio including Home Loans are sourced through DSAs. Through DSAs, private banks were able to achieve Doorstep Banking in a big way as DSAs reach the customers for sourcing retail assets and other banking products. Private bankers implement sufficient checks and balances to keep DSAs under check. Banks outsource the end to end marketing function to the agency that in turn will engage people for reaching the customers. By this the cost of delivery of service would be considerably reduced for the private banks as DSAs are not in their pay rolls. The compensation for the DSAs will basically depend on the volumes of business sourced.

DSAs achieve business volumes but there is always a risk attached with their kind of selling. Reputation Risk is always a threatening factor in the DSA model as the field personnel deployed by the DSAs for sourcing business try to make some false promises in the Turn Around Time (TAT) in retail asset processing and issue of credit cards. DSAs focus on pure selling by pushing the products than effective marketing after verifying the needs of the customers and their actual requirements. The classic cases are misselling card products and retail asset products like Personal Loans. Ultimately it would affect the bank and not the DS As since for DS As, this is one of the jobs and they may do it for many banks. But for the bank, the relationship reputation built over years will be at stake if the DSA fails to perform the expectations professionally.

12.5 SALES THROUGH TIE UPS

In addition to the above sales channels, bulk sale through tie up is another option to expand retail assets. Banks enter into tie ups with the following agencies for extending different types of loans.

(i) Tie up with Builders as a preferred financier for extending Home Loans to prospective buyers. Special concessions like waiver of processing charges, documentation charges, mortgage charges etc., will be offered as additional attractions for these borrowers. In this type of tie ups, bank will approve the specific projects of builders and express their interest to finance the individual or group buyers of the project. Builders in turn will refer their buyer customers to the Bank for considering home loans. Banks will follow up with the customers regarding their loan requirements. Based on the eligibility of the borrowers banks will sanction home loans to the applicants. In another type of tie up, banks will finance the builders for their housing projects and enter into arrangement with the builders for repaying the loan from the proceeds of sale of flats to different buyers. They also collaborate with the builders as preferred financiers and sanction loans based on merits to the buyers and the loan proceeds will be adjusted to the loans extended to the builders.

(ii) Tie ups with auto dealers is another method adopted by banks for expanding retail credit. This model is more prevalent among private sector and foreign banks. Banks tie up with auto dealers as a preferred financier and set up a counter/desk in the showroom of the auto dealer for soliciting/ capturing customers for extending loans. When a person visits a tied up car dealer's showroom, on completion of his choice, the customer is referred to the bank's staff at the showroom and the bank staff immediately get the details and requirements and start processing the loan based on merits. As discussed in case of home loan, banks extend loans to the car dealer as loan against receivables and adjust the loan from the loans sanctioned to the individual buyers of cars. In the above tie ups, the dealer offers some concessions from their profit margin to increase sales. Banks offer concessional interest rates and also waiver of processing charges for such loans. There is another type of tie up where the manufacturer, dealer and banker coming together for offering loans with maximum concession through sharing of the concessions by all the three. This is a win-win situation for all concerned, manufacturer and dealer will sell more cars and banker will extend more retail loans thus improving the profits for all. But this model is under strain as manufacturers through their financing arms (NBFCs) extend the credit facility to the ultimate buyers thus making additional profits from the sale of cars.

(iii) Sanctioning of Personal Loans under tie up with different institutions is another model adopted by banks to expand retail loans. Banks tie up with institutions for extending Personal Loan to group of employees of the institutions and the repayment of loan will be undertaken by the company. The institutions will recover the salary from the employees on a monthly basis and remit to the bank directly. Thus repayment is assured for the bank.

(iv) Even educational loans are disbursed on a tie up basis. Banks set up special counters during the admission season in reputed educational institutions and offer education loans based on merit. By this way, they could garner good number of loans.

The service levels through the electronic and remote and tie up channels are upto the expectations or not can be gauged by the behavior of the customers and the loyalty factor. To strengthen the loyalty factor, customers should be made to avail maximum number of products and services. To achieve this, an integrated Customer Relationship Management (CRM) programme should be in place in banks. Let us look into the purpose, process and benefits of an effective CRM applicable to retail banking.

Terminal Questions

1. Human interventions in the delivery of services are

(i) Internal Customer - Staff of the Branch
(ii) Specialised Marketing Personnel
(iii) Direct Selling Associates (DSAs)
(iv) All the above.

Ans: iv

2. The requirements for delivering effective service to the customers are

(i) Understanding the customer, his income level, his financial profile, his needs, his requirements of financial products and his life stage.
(ii) Selling and Cross selling the right products to match their requirements.
(iii) Post sales service follow up for customer satisfaction.
(iv) Customer Empathy
(v) All the above.

Ans: v

3. Tie ups are entered into by banks for bulk sale of the following assets

(i) Home Loans
(ii) Auto Loans
(iii) Personal Loans
(iv) Education Loans
(v) All the above.

Ans: v

Key

1.(iv)**;2.**(v)**;3.** (v)

Let Us Sum Up

- Delivery channels, both physical and remote, play a crucial role in the delivery paradigm but delivery effectiveness in physical channels is determined more by the persons who are delivering the services.
- In electronic channels, like ATM, Net Banking and Mobile Banking, human intervention is not there and the delivery requested is met through the machines or on line solutions.

- But in cases of physical channels like Branches, Direct Marketing etc., the individuals involved in the service delivery process are very important for the success of the customer relationship and loyalty factors. The three important human interventions in physical channels are
  - Internal Customer - Staff of the Branch
  - Specialised Marketing Personnel and
  - Direct Selling Associates (DSAs).
- Staff of the branch is the first point of contact in the retail banking experience of customers and customers' service expectations are to be met primarily through effective and efficient service delivery. For efficient service delivery, staff should possess the following characteristics and traits.
  - Understanding the customer, his income level, his financial profile, his needs, his requirements of financial products and his life stage.
  - Cross selling the right products to match their requirements.
  - Post sales service follow up for customer satisfaction.
- Specialised Marketing Managers support retail baking initiative through customer sourcing and their need identification and serving them end to end for making them to avail the products and services. In private banks, the specialised marketing managers do the customer sourcing and after completing the need verification and after obtaining the documents and verification of the same, they forward it to the process team to complete the process. But in some public sector banks, marketing managers posted for retail banking do end to end servicing for retail products and retail assets.
- Direct Selling Associates (DSAs) are effective intermediaries between the banks and customers for sourcing and completing the initial formalities. But there are cases of DSAs working for business maximisation with focus on revenue than customer satisfaction. Though the job is done professionally mostly, many cases of mis-selling were also reported. This was more pronounced in credit card sales and resultant delinquencies. Because of this, there are chances of reputation risk for the bank.
- Tie ups with builders for expanding home loan portfolio, auto dealers/manufacturers for auto loans and institutions for Personal Loans and educational institutions for Educational Loans are some of the tie up channels for expanding retail assets of banks.

Keywords

Physical and Remote Channels; Internal Customers; Marketing Managers; Direct Selling Associates; Cross Selling; Tie ups for Retail Loans.

UNIT 13 CUSTOMER RELATIONSHIP MANAGEMENT IN RETAIL BANKING

STRUCTURE

13.1 Customer Relationship Management (CRM) in Retail Banking

13.2 Why CRM?

13.3 Implementation Process of CRM In Banks

13.4 Implementation Stages in CRM

13.5 Benefits of CRM

Terminal Questions Let Us Sum Up

Keywords

13.1 CUSTOMER RELATIONSHIP MANAGEMENT IN RETAIL BANKING

What is Customer Relationship Management (CRM) in banking in general and retail banking in particular? As we are all aware, there are three elements in CRM viz.

(a) Customer
(b) Relationship
(c) Management

The above three Factors indicate that banks have to manage the customers and manage their relationship also. Bank has to manage the customer by offering the right product/s matching the needs of the customer. Relationship with the customer means that the service quality of the bank should match the customer expectations in total and result in total satisfaction of the customer. It additionally emphasises that the total need spectrum of the customers should be addressed and service delivery should result in absolute satisfaction for the customer. Customer Relationship Management (CRM) is basically having a 360 degree view of the customers and their profile, dynamically tracking their requirements, offering matching products and services, cross selling relevant products to his changing needs and keeping him happy for ever. Let us now see the dynamics of CRM.

The objectives of a good CRM are aimed at to build long term profitable relationships with specific customers through a better understanding of the customers in order to develop close relationships offer optimal products and services on a dynamic basis and achieve life time value from customers. This would be achieved by systematic and technology oriented processes and models. The purpose of CRM is to increase the share of wallet of the customer with the banks' services and increase the per customer profitability of banks. The stages involved in a CRM initiative are

(i) Capturing the customers' profile through a technology enabled model.
(ii) Dissecting the profiles into common information buckets.
(iii) Designing suitable products and services to cater to the different information buckets.
(iv) Offering the products and services to the targeted and segmented customers from the information buckets with the right pricing.
(v) Providing the right sales and service processes to achieve total customer satisfaction.
(vi) Tracking the customer information on a dynamic basis to design new products and services to meet the changing dynamics of the customers.

All the above initiatives indicate that CRM provides a mechanism for banks for being proactive in addressing customer needs and expectations and analyzing information from all channels and data sources to profile customers, predict churn and predict customer profitability. Customer optimisation is the essence of CRM and can be addressed through three dimensions viz.

(a) Acquisition of New Customers who are immediately profitable to the bank.
(b) Retention of Existing Customers who are most profitable and valuable to the Bank for the longest duration.
(c) Expansion of the customer relationship with the bank encouraging more purchases and shifting the less profitable customers to lower - cost delivery channels.

13.2 WHY CRM?

Why CRM? This is an important question which has to be answered by all concerned in retail banking Without CRM, whether banks cannot track the customers' profile and offer those products and services to match their expectations and needs? But the following needs for banks for implementation of a CRM program will answer the above questions.

(i) Need to increase operational efficiencies
(ii) Need to derive more value from employees.
(iii) Increasing Competition in retail banking.
(iv) Rising NPAs.
(v) Increasing Importance of Fee Based Income.
(vi) Delivery Channel Efficacy
(vii) Application of Technology

CRM is not just an option for the banks but a compulsion to achieve business synergies and optimization of resources. CRM as a tool can be effectively utilized to explore new frontiers in product development and management and improve the per customer profitability in addition to building and sustaining customer loyalty and brand equity. Let us discuss each of these needs in detail for a better understanding of CRM.

(i) Need to increase operational efficiencies.

Operational efficiencies are basically managing operational costs for the bank in general and delivery cost in particular as applicable to retail banking. The classic example in branch banking is shifting the customers to electronic and remote channels like ATM. The cost of direct delivery in the branch across the counter is more costly than delivery through

ATM. Hence the objective of the banks would be to shift the customer from the branch to the ATM thereby reducing operation cost and improve operational efficiencies. CRM is an enabler to identify the customers segments which can be migrated to ATM as an additional delivery option for them.

(ii) Need to derive more value from employees.

The next dimension is to improve employee productivity by redefining their roles to deliver service to customers who are more profitable. The spate of retirements through VRS and superannuation has necessitated banks to go very aggressive in technology implementation and the reduced manpower has to be more productively deployed for deriving more value. Here the value dimensions are two fold: employee value and customer value. Employee value is increased by deploying them in marketing and for cross selling/upselling opportunities, better business values and volumes. Customer value is a derivative of employees out put and per customer profitability in making the customers availing the maximum number of products/services. Effective CRM solutions would improve the quality of output by employees and would improve the overall employee productivity.

(iii) Increasing Competition in retail banking.

Competition is the buzz word in retail banking. As retail banking is a profitable business model for private and foreign banks, they vie with each other to grab their market share. For achieving this, customer orientation is their top most priority and they implement a whole range of activities in product development, process efficiencies, delivery channels, pricing and value additions to acquire, retain and improve their customer base. A good CRM program helps banks to achieve the above objectives.

(iv) Rising NPAs

Retail Banking and NPAs go together. Though Retail Banking is an attractive revenue model for banks, it has its inherent risks in managing the business. Sensitive retail products like Credit Cards and Personal Loans are basically unsecured and are susceptible to become NPAs. In fact, some private banks are experiencing huge delinquencies in this segment which made them to switch over their strategies from aggressive to the watch mode and also shrinking their retail asset expansion. Some public sector banks also experiencing rising NPAs mainly in the Home Loans segment due to defaults and delinquencies. This calls for an effecting customer tracking mechanism for monitoring and recovery of retail loans. Though Credit Scoring models are adopted while assessing the card limits, loan limits etc., the NPA phenomenon happens in spite of this. CRM helps to track customers and follow up for recovery.

(v) Increasing Importance of Fee Based Income

Net Interest Margins are on the decline for most of the banks due to pressure in spreads and banks were looking out for avenues to improve the bottom lines. Fee Based income through Third Party Distribution is an attractive option for the banks. In some private banks, more than 50% of their revenues are generated through the fee based models. Public sector banks also are aggressively into fee based income generation through Third Party Distribution. Marketing of insurance products (both in the life insurance and non life insurance) and also mutual funds offered very good scope to earn fee based income by selling these products to targeted customer segments. Retail sale of Gold Coins is another avenue which was started by a few banks and adopted by almost all banks to augment fee based income. CRM solutions help the bank to identify potential customers for selling these products.

(vi) Delivery Channel Efficacy

Different channels both physical and remote are offered to the customers for enhancing their experience and derive satisfaction form the channel/s experienced. Some customers will like to experience direct channels like branches whereas some customer segments will go for remote channels like ATMs, Mobile Banking, and Internet Banking. But some of the customers will like to have a blend of channels for total satisfaction of their needs. CRM solutions help banks to offer the right channel mix to their different customer segments to enhance customer loyalty and retention.

(vii) Application of Technology

Technology is inseparable from retail banking and initiatives like Core Banking Solutions, Mobile Banking and Internet Banking are different manifestations of technology. Banks in order to optimise profits have to leverage technology to maximize business through a structured approach to customer mining and cross selling. CRM solutions enable this through application of technology.

The above points only highlight the need for CRM from different perspectives. All this when integrated and administered will make CRM very relevant and profitable also. But the backbone of CRM lies in the robustness of the customer data. Data Warehouse and Data Mining are two important tools which are critical for any meaningful CRM. The sourcing of data for the Data Warehouse has to seamlessly flow from the Core Banking Solutions (CBS) platform without any manual intervention to ensure the accuracy of the data. This aspect is very important in the context of huge volumes which are typical in a retail banking environment and major business decisions and strategies are stemming out of the MIS generated from this tool. Hence CRM practice without robust customer data base will not yield the desired results and not serve the purpose.

Having understood the need for CRM in banks let us now look into the implementation aspects of CRM in banks.

13.3 IMPLEMENTATION PROCESS OF CRM IN BANKS

Though CRM is a must in the retail banking scenario in India, the process of implementation is a tough one because of the different nature of business process structure, organization structures and the technology structure and architecture, to name a few. Let us see the different key issues in the implementation of CRM by banks.

(i) Business Processes

The evaluation of the current business processes is essential to determine the nature of products the bank wants to offer and the way it wants to develop its customer portfolio. The orientation and the description of the business processes is a key requirement for the customisation of the CRM solution for the particular bank.

(ii) Information Processes

This involves the analysis of the existing information processes which the bank is currently working. The integration of these in the CRM system and the suitable restructuring is essential for implementation of the CRM systems in the bank. The information flows need to be channelised and arranged in such a manner that the new system should gel and improve with the existing system.

(iii) Information Systems

Retail Banks have their own legacy systems and IT infrastructure built during the evolution of IT in their banks. The existing information infrastructure of the bank needs to be analysed and the implementation of the CRM infrastructure accordingly customized. The focus has to be reinforcement rather than replacement.

(iv) Internal Organisational Culture

The integration of the systems is only one dimension for successful implementation and there is another important dimension. The bank's systems have to gel with the organizational change. The success of the CRM implementation lies in homogenization of the same in the organization systems and responsiveness of the organization to it to develop the particular customer relationships that CRM promises.

We were discussing about the process requirements for implementing CRM solution in banks. Based on the fulfillment of the above requirements, implementation of CRM takes place in four stages. Let us see the stages through which CRM gets internalized in a bank.

13.4 IMPLEMENTATION STAGES IN CRM

As said above there are four stages through which CRM is implemented. Let us now discuss the four stages.

Identification of Customers

This is the starting point for the implementation of CRM. The bank need to identify the customers based on their products availed and focus of the bank. This will help the banks to focus the segment they want to target and to use the CRM system to effective target at. For achieving this. Banks need to build a repository of data base about customers who buy different types of products and services. The customer data should be correctly complied through available channels as that is the basis on which CRM is structured.

Classification of Customers

From the data compiled as above, classification of customers with different perspectives, focus and attention has to be done. The nature of interactions bank has to have with the above information depending on the profitability and the size of the account have to be developed and accordingly the CRM database should be updated. Banks have to use the large repository of data collected in the previous stage, clean this data and apply choice rules through data mining and clustering techniques to classify customers on various parameters like profitability, product sage rate and cost to serve the customers. This will help the banks to develop different kinds of strategies to target the segments and design effective campaigns for generating higher returns from existing customers.

Interaction With the most Valued Customers

CRM solutions define customer segments and helps in strategizing a particular type of strategy for them. Banks can segment the whole market and then looking at the product and service usage of the customers can develop different kind of marketing strategy and design campaigns to reach at customers. Specific campaigns can be structured to meet specific customer segments based on the 360 degree information about the customers.

Customisation of Bank's Products and Services for Different Customer Segments

Selection of media mix and customer interaction points backed by the customers past usage data and intention forecasts, the product managers can design mass customized products for each of the target segments and launch campaigns. This will complete the CRM implementation process. Feed back from the customers will ring back a new set of customer data, which will help in refining the strategy further to target the segment with profitable product propositions.

13.5 BENEFITS OF CRM

An effective CRM implementation in retail banking will benefit the banks in more than way. The following are some of the important benefits that accrue to banks and enhance the customer focus of the banks:

(i) Improves the customer satisfaction and cross selling potential for the banks.
(ii) Helps the banks to derive increased share of wallet from the customer.
(iii) Enhances the operational efficiencies of the banks.
(iv) Helps to take on competition as CRM results in more customer focus and retention.
(v) Helps to understand Customer Lifetime Value through the structured data base on a dynamic basis.
(vi) Improves customer service through effective integration of all remote delivery channels.
(vii) Helps to manage multi delivery channels in a better way to adopt and maintain uniform service standards across channels.
(viii) Enables to achieve seamless information flow across functions in delivery.
(ix) Results in better relationship marketing as customer segments are better target based on the data available in CRM.

Thus CRM is a useful tool for a more calibrated approach to customer segmentation and design and offer more relevant products and services for the targeted segments. CRM will definitely enhance the customer value to the bank and also profitability for the bank.

Terminal Questions

1. Why CRM ?
   (i) Need to increase operational efficiencies and to derive more value from employees.
   (ii) Increasing Competition in retail banking.
   (iii) Increasing Importance of Fee Based Income.
   (iv) Delivery Channel Efficacy and application of technology.
   (v) All the above.

Ans: v

2. Stages involved in a CRM initiative are
   (i) Capturing the customers' profile and dissecting the profiles into common information buckets.
   (ii) Designing suitable products and services to cater to the different information buckets.
   (iii) Offering the products and services to the targeted and segmented customers from the information buckets with the right pricing and providing the right sales and service processes to achieve total customer satisfaction.
   (iv) Tracking the customer information on a dynamic basis to design new products and services.
   (v) All the above.

Ans: v

3. Benefits of CRM
   (i) Improves the customer satisfaction and cross selling potential for the banks.
   (ii) Helps the banks to derive increased share of wallet from the customer.
   (iii) Helps to understand Customer Lifetime Value.
   (iv) Helps to manage multi delivery channels in a better way.
   (v) Results in better relationship marketing.

Ans: v

Key

1.(v); 2. (v); 3. (v)

Let Us Sum Up

- Customer Relationship Management (CRM) is basically having a 360 degree view of the customers and their profile, dynamically tracking their requirements, offering matching products and services, cross selling relevant products to his changing needs and keeping him happy for ever.
- The objectives of a good CRM are aimed at to build long term profitable relationships with specific customers through a better understanding of the customers in order to develop close relationships offer optimal products and services on a dynamic basis and achieve life time value from customers. This would b achieved by systematic and technology oriented processes and models.
- The purpose of CRM is to increase the share of wallet of the customer with the banks' services and increase the per customer profitability of banks. Different stages are involved in CRM initiatives of banks. CRM is a useful tool for a more calibrated approach to customer segmentation and design and offer more relevant products and services for the targeted segments.

Keywords

Customer Relationship Management; Operational Efficiencies; Delivery Channel Efficacy; Cross Selling; Customer Lifetime Value; Share of Wallet; Improving per customer profitability.

UNIT
14

UNIT 14 SERVICE STANDARDS FOR RETAIL BANKING

STRUCTURE

14.1 Banking Codes And Standards Board Of India (BCSBI)

14.2 Commitment With Regard To Products And Services

14.3 Important Commitments To Customers Under BCSBI

Terminal Questions Let Us Sum Up

Keywords

14.1 BANKING CODES AND STANDARDS BOARD OF INDIA (BCSBI)

Banking Codes and Standards Board of India (BCSBI) prescribed the various compliance requirements for the promises made by the banks for offering services to retail banking customers and they have codified the promises into a document. The commitments made by banks for various services offered by banks are reproduced in the following pages. Most of the prescriptions are applicable to individual customers availing retail banking services.

This is a voluntary Code, which sets minimum standards of banking practices for banks to follow when they are dealing with individual customers. It provides protection to you and explains how banks are expected to deal with you for your day-to-day operations.

The Code does not replace or supersede regulatory or supervisory instructions of the Reserve Bank of India (RBI) and banks will comply with such instructions/directions issued by RBI from time to time. Provisions of the Code may set higher standards than what is indicated in the regulatory instructions and such higher standards will prevail as the Code represents best practices voluntarily agreed to by us as our commitment to you. In the Code, 'you' denotes the customer and 'we', the bank the customer deals with.

The Code has been developed to:

(a) promote good and fair banking practices by setting minimum standards while dealing with you.
(b) increase transparency so that you can have a better understanding of what you can reasonably expect of the services.
(c) encourage market forces, through competition, to achieve higher operating standards.
(d) promote a fair and cordial relationship between you and your bank.
(e) foster confidence in the banking system.

The code covers the commitment of the bank and applies to all the products and services listed below, whether they are provided by branches or subsidiaries, agents acting on our behalf, across the counter, over the phone, by post, through interactive electronic devices, on the internet or by any other method. However, all products discussed here may or may not be offered by us and applicable to Current accounts. Savings Accounts, Term Deposits, Recurring Deposits, PPF accounts and all other accounts.

14.2 COMMITMENT WITH REGARD TO PRODUCTS AND SERVICS

BCSBI has spelt out various commitments regarding the various services which are detailed below for information.

1. Objectives of the Code
2. Application of Code
3. Key Commitments
4. Our key commitments to you
5. Information - Transparency
6. General
7. Do Not Call Service

8. Interest rates
9. Tariff schedule
10. Terms and conditions
11. Advertising, Marketing and Sales
12. Privacy and Confidentiality
13. Credit Reference Agencies
14. Collection of dues
15. Security Repossession Policy
16. Complaints, Grievances and Feedback
17. Internal Procedures
16. Banking Ombudsman Service
17. Products and Services
18. Deposit Accounts
19. Clearing Cycle/Collection Services
20. Cash transactions
21. Stop Payment Facility
22. Cheques/Debit instructions issued by you
23. Branch closure/shifting
24. Settlement of claims in respect of Deceased Account Holders
25. Safe Deposit Lockers
26. Foreign Exchange Services
27. Remittances within India
28. Lending
29. Guarantee
30. General Information
31. Credit Card
32. Insurance
33. Mobile Banking
34. Credit Counselling Facility
35. Getting Records
36. Protecting Your Accounts
37. Secure and Reliable Banking and Payment Systems
38. Keeping Us Up To Date
39. Checking your account
40. Taking care
41. Internet banking
42. Cancelling payments
43. Liability for losses.

It will be very clear from the above list that the BCSBI has covered the service commitments of the entire spectrum of services offered for retail banking customers. Let us try to understand some of the important commitments spelt out in BCSBI for products and services in the following paragraphs. For the details of all the commitments under BCSBI readers have to go through the full text of BCSBI code available at the Reserve Bank of India website.

14.3 SOME IMPORTANT COMMITMENTS TO CUSTOMERS UNDER BCSBI

The commitments to customers pertaining to different products and services under BCSBI are reproduced below verbatume for easy understanding.

Deposit Accounts

(a) You may open different types of accounts with us such as, savings accounts, term deposits, current accounts including 'No Frills' Account etc. with us. You may open such accounts in the following styles:

(i) Single
(ii) Joint
(iii) Joint (Either or Survivor)
(iv) Joint (Former or Survivor)
(v) Joint (Latter or Survivor); or
(vi) in any other style

(b) The above may be opened by you with or without nomination facility. We will include the option for nomination in the account opening form. We will explain the implications of the foregoing accounts as also the nomination facilities at the time of opening of the account.
(c) We will acknowledge the receipt of your nomination details and record the fact of nomination on the passbook/Account Statement/FDRs. At your request, we will also indicate the name of the nominee thereon.
(d) We will also inform you about liquid deposit facility, sweep account and similar types of products offered by us and their implications and procedures involved, at the time of opening of account.

Account Opening and Operation of Deposit Accounts

Before opening any deposit account, we will:

(a) carry out due diligence as required under "Know Your Customer" (KYC) guidelines of the bank
(b) ask you to submit or provide necessary documents or proofs to do so
(c) obtain only such information to meet with our KYC.Anti Money Laundering or any other statutory requirements. In case any additional information is asked for, it will be sought separately and we will specify the objective of obtaining such additional information. Providing such information will be voluntary
(d) provide the account opening forms and other material to you. The same will contain details of essential information required to be furnished and documents to be produced for verification and/or for record for meeting the KYC requirements.
(e) explain the procedural formalities and provide necessary clarifications sought by you while opening a deposit account
(f) at the time of opening of the account, make available to you the details of the insurance cover in force under the insurance scheme, subject to certain limits and conditions offered by the Deposit Insurance and Credit Guarantee Corporation of India (DICGC)

Changing of Account

(a) If you are not happy about your choice of current/savings account, within 14 days of making your first payment into the account, we will help you switch to another of our accounts or we will give your money back with any interest it may have earned. We will ignore any notice period and any extra charges.
(b) If you decide to close your current/savings account we will close your account within three working days of receiving your instructions.
(c) If you want to transfer your account to another branch of our bank we will do so. Your account at the new branch will be operationalised within two weeks of receiving your request, subject to your complying with the required KYC formalities at the new branch. We will intimate you as soon as the account is operationalised. The new branch will be provided with information on your standing instructions/direct debits, if any.
(d) We will cancel any bank charges you would have to pay as a result of any mistake or unnecessary delay by us when you transfer your current/savings account to or from us.

Savings/Current Accounts

When you open a Deposit Account, we will:

(a) inform you about number of transactions, cash withdrawals, etc. that can be done free of charge within a given period.
(b) inform you about the kind of charges, if any, in case of exceeding such limits. Details of the charges will be included in the Tariff Schedule.
(c) inform you of the rate at which interest is paid on your savings deposits, how it is calculated and its periodicity.

Minimum Balance

The minimum balance to be maintained in the Savings Bank account will be displayed in our branches. For deposit products like Savings Bank Account and Current Account or any other type of Deposit Account, we will inform you:

(a) about minimum balance to be maintained as part of terms and conditions governing operation of such accounts
(b) about charges which will be levied in case of failure to maintain minimum balance in the account by you. Details of the charges will be included in the Tariff Schedule
(c) we will advise you of any change in minimum balance to be maintained 30 days in advance. During this notice period, we will not charge you for non-maintenance of higher minimum balance prescribed.

Charges

(a) Specific charges for issue of cheque books, additional/duplicate statement of accounts, duplicate pass book, copies of paid cheques, folio charges, debit card, ATM card, verification of signature, return of cheque for insufficient balance, change in mandate or style of account, closure of Savings Bank/Current accounts etc., will be included in our Tariff Schedule.
(b) Concessions or relief given (such as perpetual waiver of renewal fee on lifetime credit card[1]-) will not be withdrawn during the original validity period of the concession/relief.

Statements

(a) To help you manage your account and check entries in it, we will provide you with a monthly statement of account unless you have opted for a pass book.
(b) You can ask us to provide you with account statements more often than is normally available on your type of account, at a charge. This charge will be indicated in the Tariff Schedule.
(c) You will be able to see your last few transactions at the counter. You will also be able to see the transactions on ATM, internet as also through phone and mobile banking wherever such facilities are available with us.
(d) We will also send you statement of accounts by e-mail, or through our secure Internet banking service, if you so desire, provided we have such facility with us.
(e) We will ensure that entries in your pass book/statements are brief and intelligible.

Term Deposit

When you place a term deposit with us we will:

(a) obtain instructions from you for disposal of your deposits at maturity in the application form
(b) inform you the procedure for withdrawal of term deposit before maturity
(c) inform you of the interest rates applicable and charges for premature withdrawal of term deposit
(d) tell you the terms and conditions and interest rate applicable in case you renew the deposits after the date of maturity, at the time of acceptance of the deposit.
(e) advise you of provisions of I.T Act applicable to the interest income accruing to you on your deposits, our obligations under the act and provisions available to you for seeking exemptions from Tax Deduction at Source
(f) obtain Form 15 H/15 G from you at the time of application if you are not liable to pay tax on your interest income
(g) issue the requisite certificate if we deduct tax from interest accrued on your deposits.

Advances against Deposits

We will explain facility of loan/overdraft available against term deposits.

'No Frills' Account

We will make available a basic banking 'No Frills' Account either with 'nil' or very low minimum balance. The charges applicable for various services/products in such an account will be indicated in a separate Tariff Schedule. The nature and number of transactions in such accounts may be restricted, which will be made known to you at the time of opening of the account in a transparent manner.

Accounts of Minors

We will tell you, if enquired, how a minor can open a Deposit Account and how it can be operated.

Special Accounts

We will make our best efforts to make it easy and convenient for our special customers like senior citizens, physically challenged persons and illiterate persons to bank with us. This will include making convenient policies, products and services for such applicants and customers. We will inform the procedure for opening of the account and other terms and conditions to blind/other physically challenged persons provided he/she calls on the bank personally along with a witness who is known to both such person and the bank.

Dormant/Inoperative Accounts

We will:

(a) tell you when you open your account, what period of inoperation of the account would render your account being classified as dormant/inoperative account. You will also be informed three months before your account is classified as dormant/inoperative or treated as unclaimed account and the consequences thereof.
(b) notify the joint holder/s also before an account is classified as inoperative/dormant.
(c) tell you the procedure to be followed if you want to activate the account
(d) not charge you for activation of the inoperative account.

Closing Your Account

Under normal circumstances, we will not close your account without giving you at least 30 days' notice. Examples of circumstances, which are not 'normal', include improper conduct of account etc. In all such cases, you will be required to make alternate arrangements for cheques already issued by you and desist from issuing any fresh cheques on such account.

Clearing Cycle/Collection Services

We will:

(a) tell you about the clearing cycle for local instruments and the outstation instruments including details such as when you can withdraw money after lodging collection instruments and when you will be entitled to earn delayed interest as per our Cheque Collection Policy
(b) pay you compensation, as per our Cheque Collection/Compensation Policy for any delay in collection of instruments, without waiting for a demand from you.
(c) provide details, if we offer immediate credit for outstation cheques, including the applicable terms and conditions, such as the limit up to which instruments tendered by you can be credited, operating accounts satisfactorily, etc.
(d) proceed as per our Cheque Collection Policy and provide all assistance for you to obtain a duplicate cheque/instrument in case a cheque/instrument tendered by you is lost in transit.
(e) give the above information when you open your account and whenever you ask us. If there is any change in our policy, the revised policy will be displayed on our website and at all our branches.

Cash Transactions

(a) We will accept cheques/cash and dispense cash at any of our branches under core banking subject to any restrictions on type of transaction or charges, if any, applicable to such transactions.
(b) We will exchange soiled/mutilated notes and/or small coins at such of our branches as per RBI Directives.
(c) For transactions above a specified amount we may require you to furnish your PAN.
(d) We will reimburse amounts wrongly debited in failed ATM transactions within a maximum period of 12 working days from the date of receipt of your complaint.

Direct Debits and Standing Instructions

We will:

(a) at the time of opening the account tell you how direct debits/standing instructions work and how you may record/cancel them and the charges connected with them. Charges will be levied as per the Tariff Schedule as amended from time to time
(b) act upon mandates given by you for direct debits [say Electronic Clearing Service (ECS)] and other standing instructions. In case of any delay or failure in executing the mandate resulting in financial loss or additional cost, we will compensate as per the compensation policy of the bank. If the mandate cannot be executed due to insufficient balance in your account, we will levy charges as per the Tariff Schedule as amended from time to time.
(c) refund your amount with interest as soon as it is determined that it is unauthorisedly/erroneously debited from your account under a direct debit and compensate you as per the Compensation Policy of the bank.

Stop Payment Facility

We will:

(a) accept stop payment instructions from you in respect of cheques issued by you. Immediately on receipt of your instructions we will give acknowledgement and take action provided these cheques have not already been cleared by us.

(b) levy charges, if any, for this service and the same will be included in the Tariff Schedule as amended from time to time

(c) in case a cheque has been paid after stop payment instructions are acknowledged, reimburse and compensate you as per the Compensation Policy of the bank.

Cheques/Debit Instructions Issued by You

We will:

(a) keep original cheques/debit instructions paid from your account or copies or images of the same, for such periods as required by law.

(b) give you the cheque/debit instruction or a copy thereof as evidence as long as records are available with us. If there is a dispute about a cheque paid/debit instructions from your account, in case the request is made within a period of one year, no charge will be levied and beyond a period of one year charges will be levied as per the Tariff Schedule

(c) tell you how we will deal with unpaid cheques and out-of-date [stale] cheques. The details of charges to be levied will be included in the Tariff Schedule as amended from time to time.

Branch Closure/Shifting

If we plan to close our branch or shift our branch, we will give you:

(a) prior notice of three months, if there is no other branch of any bank functioning at your centre and inform you how we will continue to provide banking services to you.

(b) prior notice of two months, if there is a branch of any other bank functioning at your centre.

Settlement of Claims in Respect of Deceased Account Holders

We will follow a simplified procedure for settlement of accounts of deceased account holders. ***(a) Accounts With***

Survivor/Nominee Clause

In case of a deposit account of a deceased depositor where the depositor had utilized the nomination facility and made a valid nomination or where the account was opened with the survivorship clause ("either or survivor" or "anyone or survivor" or "former or survivor"), the payment of the balance in the deposit account to the survivor(s)/nominee of a deceased deposit account holder will be made provided:

(i) the identity of the survivor(s)/nominee(s) and the fact of the death of the account holder, is established through appropriate documentary evidence

(ii) there is no order from the competent court restraining the bank from making the payment from the account of the deceased

(iii) it has been made clear to the survivor(s)/nominee that he would be receiving the payment from the bank as a trustee of the legal heirs of the deceased depositor, i.e., such payment to him shall not affect the right or claim which any person may have against the survivor(s)/nominee to whom the payment is made.

The payment made to the survivor(s)/nominee, subject to the foregoing conditions, would constitute a full discharge of the bank's liability. In such cases, payment to the survivor(s)/nominee of the deceased depositors will be made without insisting on production of succession certificate, letter of administration or probate, etc. or obtaining any bond of indemnity or surety from the survivor(s)/nominee, irrespective of the amount standing to the credit of the deceased account holder.

(b) Accounts Without the Survivor/Nominee Clause

In case where the deceased depositor had not made any nomination or for the accounts other than those styled as "either or survivor" (such as single or jointly operated accounts), we will adopt a simplified procedure for repayment to legal heir(s) of the depositor keeping in view the imperative need to avoid inconvenience and undue hardship to the common person. Keeping in view our risk management systems, we will fix a minimum threshold limit, for the balance in the account of the deceased depositors, up to which claims in respect of the deceased depositors could be settled without insisting on production of any documentation other than a letter of indemnity.

(c) Premature Termination of Term Deposit Accounts

In the case of term deposits, we will incorporate a clause in the account opening form itself to the effect that in the event of the death of the depositor, premature termination of term deposits would be allowed. The conditions subject to which such premature withdrawal would be permitted would also be specified in the account opening form. Such premature withdrawal would not attract any penal charge.

(d) Treatment Of Flows in the Name of the Deceased Depositor

In order to avoid hardship to the survivor(s)/nominee of a deposit account, we will obtain appropriate agreement/authorization from the survivor(s)/nominee with regard to the treatment of pipeline Hows in the name of the deceased account holder. In this regard, we will consider adopting either of the following two approaches:

(i) We could be authorized by the survivor(s)/nominee of a deceased account holder to open an account styled as 'Estate of Shri________________________, the Deceased' where all the pipeline flows in the name of the deceased account holder could be allowed to be credited, provided no withdrawals are made.

OR

(ii) We could be authorized by the survivor(s)/nominee to return the pipeline flows to the remitter with the remark "Account holder deceased" and to intimate the survivor(s)/nominee accordingly. The survivor(s)/nominee/legal heir(s) could then approach the remitter to effect payment through a negotiable instrument or through electronic transfer in the name of the appropriate beneficiary.

(e) Time Limit for Settlement of Claims

We will settle the claims in respect of deceased depositors and release payments to survivor(s)/nominee(s) within a period not exceeding 15 days from the date of receipt of the claim subject to the production of proof of death of the depositor and suitable identification of the claim(s), to the bank's satisfaction.

Safe Deposit Lockers

We will give you the complete details of the rules and the procedures applicable for the safe deposit lockers and also safe deposit of valuables, in case we offer the service.

Foreign Exchange Services

(a) When you buy or sell foreign exchange, we will give you information on the services, details of the exchange rate and other charges which apply to foreign exchange transactions. If this is not possible, we will tell you how these will be worked out.

(b) If you want to transfer money abroad, we will tell you how to do this and will give you:

  (i) a description of the services and how to use them
  (ii) details of when the money you have sent abroad should get there and the reasons for delays, if any
  (iii) the exchange rate applied when converting to the foreign currency (if this is not possible at the time of the transaction, we will let you know later what the rate is)
  (iv) details of any commission or charges, which you will have to pay and a warning that the person receiving the money may also,have to pay the foreign bank's charges.

(c) We will tell you if the information provided by you for making a payment abroad is adequate or not. In case of any discrepancies or incomplete documentation, we will advise you immediately and assist you to rectify/complete the same.

(d) If money is transferred to your bank account from abroad, we will tell you the original amount received and charges if any levied. If the sender has agreed to pay all charges, we will not take any charges when we pay the money into your account.

(e) We will guide you about regulatory requirements or conditions relating to foreign exchange services offered by us as and when requested by you.

(f) In case of delay beyond the day when the amount is due for credit, you will be compensated (a) for any loss on account of interest for due period beyond the due date and (b) also for adverse movement of forex rate as per the Compensation Policy of the bank.

(g) All certificates required to be issued under regulatory/statutory instructions will be issued free of charge.

Remittances Within India

If you want to remit money within India we will inform you how to effect it and will:

(a) give description of services and how to use them
(b) suggest to you the best way to send the money to suit your needs
(c) disclose the details of all charges including commission that you will have to pay for the service as per the Tariff Schedule as amended from time to time.

In case of any delay we will compensate you for the delay and any loss/additional expense incurred by you.

Lending

Before we lend you any money or increase your overdraft, credit card limit or other borrowing, we will assess whether you will be able to repay it. If we cannot help you, we will communicate in writing the reason(s) for rejection of the loan application. If you want us to accept a guarantee or their security from someone for your liabilities, we may ask you for your permission to give confidential information about your finances to the person giving the guarantee or other security, or to their legal adviser.

We will also:

(a) encourage them to take independent legal advice to make sure that they understand their commitment and the possible consequences of their decision (where appropriate, the documents we ask them to sign will contain this recommendation as a clear and obvious notice).

(b) tell them that by giving the guarantee or other security they may become liable instead of, or as well as, you.

(c) tell them what their liability will be.

Loan Products

Applications for loans and their processing:

(a) At the time of sourcing a loan product, we will provide as part of the loan application form, information about the interest rates applicable whether floating rate or fixed rate, as also the fees/ charges payable for processing, the amount of such fees refundable if loan amount is not sanctioned/ disbursed, pre-payment options and charges, if any, penal rate of interest for delayed repayments, if any, conversion charges for switching your loan from fixed to floating rates or vice versa, existence of any interest reset clause and any other matter which affects the interest of the borrower, so that a meaningful comparison with those of other banks can be made and informed decision can be taken by you.

(b) We shall invariably provide you with an acknowledgement of your loan application. We shall make every endeavour to indicate on your application the period within which you can expect to receive a decision on your request for loan.

(c) We will give you the Most Important Terms and Conditions (MITC) governing the loan/credit facility you have availed.

(d) Normally all particulars required for processing the loan application will be collected by us at the time of application. In case we need any additional information we will contact you immediately.

(e) We will provide you the sanction letter detailing particulars of amount sanctioned, terms and conditions, your responsibilities as well as the bank's, etc.

(0 We will provide you an amortisation schedule (schedule of repayment of principal and interest for the duration of the loan).

(g) We will also inform you whether you have an option to let equated monthly installments stay constant and increase tenure or vice-versa when the interest rate changes.

(h) We will supply authenticated copies of all the loan documents executed by you at our cost along with a copy each of all enclosures quoted in the loan document.

SERVICE STANDARDS FOR RETAI

(i) We will give written receipt for all documents to title taken as security/collateral for any loan as well as for dated/undated cheques received from you.

(j) We will return the unpaid cheques/post dated cheques given by you on receipt of full amount representing the EMI/entire debt.

(k) We will return to you all the securities/documents/title deeds to mortgaged property within 15 days of the repayment of all dues agreed to or contracted. If any right to set off is to be exercised for any other claim, we will give due notice with full particulars about the other claims and retain the securities/documents/title to mortgaged property till the relevant claim is settled/paid.

(l) We will compensate you for any delay in return of securities/documents/title deeds to mortgaged property beyond 15 days of the repayment of all dues agreed to or contracted,

(m) We will not discriminate on grounds of sex, caste and religion in the matter of lending. However, this does not preclude us from instituting or participating in schemes framed for different sections of the society.

(n) We will process request for transfer of borrowal account, either from the borrower or from a bank/ financial institution, in the normal course and convey our concurrence or otherwise within 21 days of receipt of request.

Guarantee

(a) When you are considering to be a guarantor to a loan, we will tell you about:

(i) your liability as guarantor.
(ii) the amount of liability you will be committing yourself to the bank.
(iii) circumstances in which we will call on you to pay up your liability.
(iv) whether we have recourse to your other monies in the bank if you fail to pay up as a guarantor.
(v) whether your liabilities as a guarantor are limited to a specific quantum or they are unlimited,
(vi) time and circumstances in which your liabilities as a guarantor will be discharged as also the manner in which we will notify you about this.

(b) We will keep you informed of any material adverse change/s in the financial position of the borrower to whom you stand as a guarantor.

(c) We will return to you all the securities/documents/title deeds to mortgaged property within 15 days of the repayment of all dues agreed to or contracted.

(d) We will compensate you for any delay in return of securities/documents/title deeds of mortgaged property beyond 15 days of the repayment of all dues agreed to or contracted.

General Information

We will:

(a) give you information explaining the key features of our loan and credit card products including applicable fees and charges while communicating the sanction of the loan/credit card.

(b) give you the Most Important Terms and Conditions (MITC) governing the loan/credit facility you have availed.

(c) advise you what information/documentation we need from you to enable you to apply. We will also advise you what documentation we need from you with respect to your identity, address, employment etc., and any other document that may be stipulated by statutory authorities (e.g. PAN details), in order to comply with legal and regulatory requirements.

(d) verify the details mentioned by you in the loan/credit card application by contacting you at your residence and/or on business telephone numbers and/or physically visiting your residence and/or business addresses through agencies appointed by us for this purpose, if deemed necessary by us.

(e) if we offer you an overdraft, or an increase in your existing overdraft limit, tell you if your overdraft is repayable on demand or otherwise. We will, if required also advise about the method of calculation of overdrawn amount thereof and also the computation of interest on overdue loan amount.

(f) not offer any unsolicited pre-approved credit facility in any form, including enhancement of credit card limit and top up of personal loan limits, etc.

(g) in case we offer/approve a credit facility over the telephone, credit your account with the amount sanctioned only after receiving your acceptance in writing

(h) in case we do so without your consent/bill you for the card for which you have not given your consent, we will not only reverse the charges forthwith but will also pay a penalty amounting to twice the value of the charges reversed.

Credit Card

General information:

(a) When you apply for card, we will explain the relevant terms and conditions such as fees and interest charges, billing and payment, method of computation of overdues, renewal and termination procedures, and any other information that you may require to operate the card.

(b) We will give you a copy of the Most Important Terms and Conditions (MITC) at the time of application.

(c) We will advise you of our targeted turn around time while you are availing/applying for a product/service.

(d) We will send a service guide/member booklet giving detailed terms and conditions, losses on your account that you may be liable if your card is lost/misused and other relevant information with respect to usage of your card along with your first card.

(e) We will provide 'Online Alerts' to you for all 'card not present' transactions of the value of Rs.5000/ - and above.

(f) If you do not recognize a transaction, which appears on your card statement, we will give you more details if you ask us. In cases, where we do not accept your contention we will give you evidence that you had authorized the transaction, in question.

Issuance of Credit Card/PIN

(a) We will dispatch your credit card/PIN only to the mailing address mentioned by you or to the alternate address provided by you (if we are unable to deliver at the mailing address) through courier/post. Alternatively, if you desire we shall deliver your credit card/PIN at our branches after due identification.

(b) We may also issue deactivated (not ready to use) credit card if we consider your profile appropriate for issuing credit card and such deactivated card will become active only after you take steps for activation as required and subject to such other conditions as may be specified.

(c) In case we activate the card without your consent/bill you for the card for which you have not given your consent, we will not only reverse the charges forthwith but will also pay a penalty amounting to twice the value of the charges reversed.

(d) We will extend a loan/credit facility/enhance credit limit on your card only with your consent in writing.

(e) If the limit on your credit card is reduced, we will inform you immediately by SMS/e-mail followed by a confirmation in writing.

(f) PIN (Personal Identification Number) whenever allotted, will be sent to you separately at your mailing address.

Credit Card Statements

(a) To help you manage your credit card account and check details of purchases/cash drawings using the credit card, we will offer, you free of cost, a facility to receive credit card transaction details either via monthly mail and, if you so desire, also through the internet. Credit card statement will be dispatched on a predetermined date of every month free of cost at your mailing address.

(b) In the event of non-receipt of this information, we expect you to get in touch with us so that we can arrange to resend the details to enable you to make the payment and highlight exception, if any, in a timely manner.

(c) We will let you know/notify changes in schedule of fees and charges and terms and conditions. Normally, changes (other than interest rates and those which are a result of regulatory requirements) will be made with prospective effect giving notice of at least one month. The changes will be notified along with the monthly statement of account or copy thereof.

insurance

(a) We will inform you if we, as agents of any insurance company, offer any type of insurance on deposits and credit cards.

(b) We will ensure that we have your written consent to avail these insurance products.

(c) In case of securities lodged with us for loans availed by you, we will not insist on your obtaining insurance cover from any particular provider.

Mobile Banking

If you opt for mobile banking services we will, prior to your registration for the service inform you of:

(a) the security procedure adopted by us for user authentication and the legal risk, if any, associated with the same.

(b) the applicability or otherwise of stop payment instructions and the terms and conditions for the acceptance, if any, for the same.

Credit Counselling Facility

We will endeavour to provide credit counselling facility.

Getting Records

We will, on request, make available to you, at a cost, records pertaining to your transactions provided this is within the prescribed preservation period of such record.

The above discussed important commitments are applicable to products and services only and there are more commitments spelt out in the BCSBI regarding other obligations of banks to their customers. The complete schedule is available in the web site of RBI and readers are advised to go through all the banking standards for a better understanding of the commitments.

(Source: RBI website)

Terminal Questions

1. Banking Codes and Standards of India is aimed at the following

(i) promote good and fair banking practices by setting minimum standards increase transparency in services.

(ii) encourage market forces, through competition, to achieve higher operating standards.

(iii) promote a fair and cordial relationship between the customer and their bank.

(iv) All the above.

Ans: iv

2. Commitments to customers under BCSBI cover

(i) Savings Accounts

(ii) Loan Accounts

(iii) Remittances

(iv) Credit Cards & Mobile Banking

(v) All the above.

Ans: v

Key

1. (iv); 2. (v)

Let Us Sum Up

- Banking Codes and Standards Board of India (BCSBI) prescribed the various compliance requirements for the promises made by the banks for offering services to retail banking customers and they have codified the promises into a document. This is a voluntary Code, which sets minimum standards of banking practices for banks to follow when they are dealing with individual customers.
- The Code does not replace or supersede regulatory or supervisory instructions of the Reserve Bank of India (RBI) and banks will comply with such instructions/directions issued by

RBI from time to time. Provisions of the Code may set higher standards than what is indicated in the regulatory instructions and such higher standards will prevail as the Code represents best practices voluntarily agreed to by us as our commitment to you. In the Code, 'you' denotes the customer and 'we', the bank the customer deals with.

- The Code has been developed to:
  - (a) promote good and fair banking practices by setting minimum standards in dealing with you.
  - (b) increase transparency so that you can have a better understanding of what you can reasonably expect of the services.
  - (c) encourage market forces, through competition, to achieve higher operating standards.
  - (d) promote a fair and cordial relationship between you and your bank.
  - (e) foster confidence in the banking system.

Keywords

Banking Codes; fair banking practices; minimum standards; transparency in services; confidence; cordial relationship.

UNIT 15

TECHNOLOGY IN RETAIL BANKING

STRUCTURE

15.1 Technology In Retail Banking

15.2 Technology Processes In Retail Banking

15.3 Some Important User Friendly Features

15.4 Customer Analytics

Terminal Questions

Let Us Sum Up

Keywords

15.1 TECHNOLOGY IN RETAIL BANKING

Technology and Retail Banking are inseparable. Technology is the foundation on which the retail banking edifice is built across the globe. Technology is the enabler for building and translating a customer data base into retail banking business. Banks adopt different technology platforms in line with the global trends. The levels of technology implementation in PSBs started from stand alone Automated Ledger Posting Machines (ALPMs) in the early days of computerisation in 1980s and graduated to Total Branch Automation and regional net worked hubs. New generation private sector banks started with technology advantage of a single server environment which gave them advantage over other banks. PSB banks also have reengineered their technology initiatives and started implementing core banking solutions networking the customers and accounts on a single platform.

Most of the PSBs have completed the core banking solutions process while in a few banks the level of implementation is in various advanced stages. The implementation of core banking will directly increase the chances of availability of customer data base across products and will increase the scope for cross selling and up selling.

Core banking gives clues about the level to which the data base is horizontally or vertically organized. Horizontal or vertical organized refers to whether data is available product wise on a stand alone basis or data is available customer wise on an integrated basis. Technology integration with the business model will enable the banks to design their marketing strategies and through an integrated CRM solution will sell to the targeted customer base.

15.2 TECHNOLOGY PROCESSES IN RETAIL BANKING

A Boston Consulting Group Study in conducted in 2003. "Opportunities for Action in Financial Services -Transforming Retail Banking Processes" reported that in terms of processes for integration of technology in retail banking retail banks are using different approaches to modularise and standardise their processes. Four distinct process models have emerged from their study. They are

(i) Horizontally Organised Model where individual process platform supports one product only. The sub data in the model are not shared with other products and product platform.

(ii) Vertically Organised Model where functionality is provided across all products. In this model, customer information is centralised. Centralised customer information builds common origination and servicing processes across all its retail banking products.

(iii) Predominantly Horizontally Organised Model with some modularization within a product oriented feed back. Customer data integration is available to a certain extent for other products.

(iv) Predominantly Vertically Organised Model is a hybrid model that offers common information for most of the related services. The basic information is available across products for common services to the various products.

All the four models achieve a certain degree of modularity and standardization but there is no one-size-fits-all solutions and has to be suitably adapted to individual bank's requirements.

The studies have revealed that if a bank effectively transforms its processes, it can reduce its unit costs between 20% and 40%, completely changing its competitive position.

Technology plays a key role in the transformation of processes of banks. Large Banks in the United States spend approximately 20% of non interest expense on information technology and this investment shows no signs of abating (Wharton Study, 1998). Technological innovation in the retail banking industry has been spurred on by the forces described by Kotler, particularly in terms of new distribution channel systems to provide the customers more ways to access their accounts. Banks are forced to consider new ways to drive revenue through their distribution system and to increase the customer share of the wallet. The firs step is the platform automation and enables the employees to have a single view of the customers. The single view lets the employees understand how important is a customer based on the portfolio of products, rather than on their current checking account balance.

Research has shown that in organizational sub units where employee perceptions are favourable customers enjoy superior performance. (Garry A. Galade et al, 2005).The service profit chain model of business performance (Haskett.Sasser&Schesinger,1997) has identified customer satisfaction as a critical intervening variable in this relationship and confirms the relationships between organizational climate, employee attitudes, customer satisfaction and sales performance in the retail banking sector. Banks have recognized this relationship and developed people (both internal and external customers) strategies for implementing a successful retail banking model.

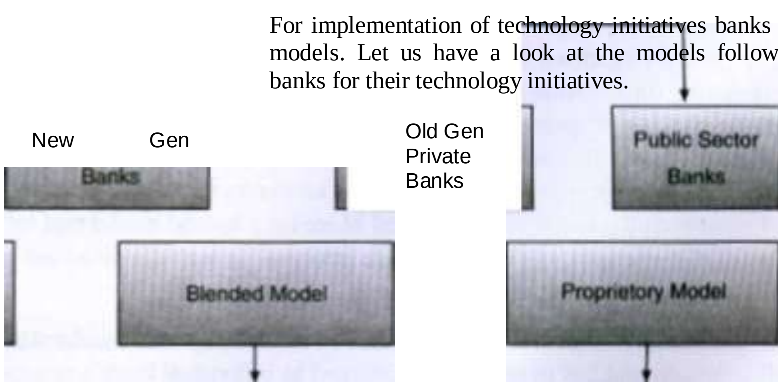
The above discussed concepts throw light on the different tenets of global retail banking space and how global banks are addressing the different dimensions and innovate across the important elements of retail banking namely product, process, people and technology.

In the technology side, in general, PSBs are more horizontally organized in the process model with various levels of vertical position across banks. Customer data base and products integration has not materialised fully which will be a hindrance to effective retail business. Technology integration with the business model will enable the banks to design their marketing strategies and through an integrated CRM solution will sell to the targeted customer base.

For implementation of technology initiatives banks follow different models. Let us have a look at the models followed by different banks for their technology initiatives.

New Gen

Old Gen Private Banks



Outsourced Model

Blend ot In House and Outsourced

Models Developed in House by Banks

Foreign Banks

Technology Initiatives

In Retail Banking

Model Outsourced from It Companies

Fig. 15.1 Technology Initiatives in Retail Banking

Technology implantation models differed among banks. Foreign banks who were aggressive on the retail side either implemented their own software developed for global operations or sourced it end to end from external vendors for their requirements. New generation private sectors banks had a great advantage as they were late entrants and hence they could start with the technology advantage and sourced the same from external vendors. In public sector banks it differed among banks and was not related necessarily to the size of the bank. The early birds took pains to develop their proprietary model and developed in house software for implementation in branches in a phased manner. The implementation progressed with time from a stand alone model at the individual branch level to an integrated model networking the branches. But this model had its own limitations after a certain time and to keep pace with the technology developments in retail banking, they had to necessarily join hands with an external vendor for certain applications and integrated it with their legacy systems. The late entrants in technology implementation among PSBs took the external vendor route for better channel delivery and efficiency. Some PSB banks which were following bits and pieces approach (engaging different vendors for different requirements) later migrated to a unified technology delivery model. In old generation private banks, because of their small size, most of the banks took to outsourcing route as they were very late entrants and took advantage of the latest technology scenario. Thus technology adoption for retail banking differed among banks, but all the banks in all the above models were effectively able to cross sell and up sell wherever they had a complete data base of the customers and a good CRM solution for retail banking. Different banks use different technology platforms for their retail banking models. Different software vendors are offering custom made solutions to suit the requirements of the banks and build their software around their requirements. But the core format remains the same. In the retail liabilities and asset side, the software is developed mainly to capture the following types of information viz.,

- Static Information - Account Opening, Basic Loan Origination Data etc.,
- Updated Information - Income Details at different frequencies etc.,
- Transaction Information - Information from disbursement to final settlement in loan accounts and operation details in liability accounts.
- Analytics and Alerts - Both operational and strategic alerts to take action or to develop strategies for further action.

In addition to the above, technology in retail banking will also include other supporting software applications like AML software, Loan Origination System, Credit Card Processing System, Data Warehouse, Switch for alternate banking channels etc. and all these systems should be seamlessly integrated with the Core Banking Solutions. The above points are discussed for academic information and are dealt in detail in other specialization paper on technology in banks.

Having understood the different models, let us have a look into the implementation of some of the retail banking modules for different purposes.

15.3 SOME IMPORTANT USER FRIENDLY FEATURES

Let us see, for example, some of the user friendly features and benefits offered for retail banking by a major player in the banking and financial services software solutions providers.

Advizor

(a) This product empowers banks to deliver products and services through a fully assisted self service channel that capitalizes on the organization's existing Internet banking capability. Leveraging Web 2.0 principles and recent technological advances in the IP convergence space, the solution brings to the self-service channel the comfort of human intervention through 'triple play' entailing video, audio and data communication along with co-browsing. In effect, this virtually recreates the service experience at a branch. The product provides banking customers real-time access to their relationships with the bank, such as account inquiries, fund transfers, remittances, credit card and mutual fund payments. It enables them to make payments to individuals and institutions, through channels like the Internet, kiosk Compatible with any multimedia capable PC with an Internet or intranet connection, the solution leverages the Microsoft application platform.

(b) **Key Modules**

- Customer Interface
- Advisor Interface
- Audio/Video Support
- Co-browsing
- Advisor Performance Management

(c) **Business Benefits:** Customer Delight - The solution's self-service capabilities empower customers to access comprehensive banking services in a completely secure environment. The interface also enables banking staff to understand customer needs better. The additional comfort of human intervention, through video, audio and data communication, creates a truly satisfactory customer experience.

(d) **Robust Inclusivity Framework:** The solution extends the reach of the bank's services, surmounting the complexities of diverse and far flung locations. This enables banks to include, through this new channel, their various customer segments, including specific under-banked and unbanked communities.

(e) **Cost Savings:** The product presents banks with the advantages of reduced integration by leveraging their existing Internet banking solution. It creates an alternate means to lower operation costs for banks. It facilitates a significant reduction in service distribution and transaction costs, by enabling the deployment of an optimized channel management strategy. It also supports the creation of demand generation for banks, without the need to add on cost-intensive branches to drive customer acquisition.

Alerts

The above alerts solution empowers banks with the capability to alert end users about events recorded by the bank's diverse business systems. The solution's subscription feature enables the bank's customers to select specific information they want to be alerted about, in addition to the time and channel of information receipt.

Built on new-generation industry standard technologies J2EE and.NET, the solution provides multichannel and multilingual support. In addition to alerting corporate and retail customers of the bank, the solution provides alerts for the bank's internal users as well. Banks can define alert categories to control access to various alerts. The solution allows a group of alerts to be combined into a message digest, minimizing the traffic of outgoing notifications. It also supports addition of branding messages as part of notifications.

The above details of the software solution of the company are discussed here only as an illustratration and only to acquire academic knowledge.

Customer Analytics

(a) The customer analytics solution, integrated with the universal banking solution, provides holistic customer analytics for banks, through both insightful business reports and rigorous statistical models. This enables the business to cross-leverage analytic output to strengthen its customer engagement and management strategy, resulting in institutionalization of customer relationships and differentiation of service experience. The solution empowers banks with comprehensive analytics support, ranging from data acquisition to reporting and analysis, leveraging quantitative modeling techniques and multi-dimensional reporting. It provides critical information such as customer attrition scores or profitability scores to enable comprehensive understanding of the customer. These scores can also be extended to front-end applications or combined with online tacit information to facilitate timely and effective decision making. Customer analytics solution presents banks with the flexibility to pick and choose specific customer analytic functions relevant to the business, across the customer life-cycle stages of acquisition, development and retention.

(b) **Key Modules**

- Campaign Management
- Cross-sell and Product Holding Analysis
- Customer Profitability and Lifetime Value Analysis
- Attrition and Loyalty Analysis
- Transaction Behavior Analysis
- Service Request Analysis

(c) **Business Benefits**

- Robust Framework for Customer Acquisition, Development and Retention.
- The solution encompasses end to end analytics across the customer relationship life-cycle. The interactive modules provide banks with a robust framework to understand the customer better and facilitate differentiated customer experience.

(d) **Enhanced Customer Value:** The analytics solution increases the bank's relationship revenue through analytical insights that facilitate effective cross-sell and up-sell, improved stickiness, targeted loyalty programs and profitable repositioning of offerings. This enables banks to take customer centric decisions and enhance customer value.

(e) **Improved Decision-making Support:** Arming banks with best-in-class analytical CRM capabilities throughout the customer lifecycle, customer analytics solutions empower the business with the intelligence to make informed, well-advised and timely decisions.

(f) **Reduced Time to Market:** The solutions provides predefined data mapping, extraction programs and data aggregation, draw analytical outputs through an automated process. The in-built analytical models and reporting templates further reduce time to go-live, significantly.

(g) **Low Total Cost of Ownership:** Customer analytics solutions mandate minimal investments in terms of infrastructure capabilities and resources. The technology agnostic solution can be deployed on banks' existing reporting and modeling tools with minimal customization effort.

6.4.2 Wealth Management

(a) Wealth management solutions are mostly modular, fully scalable, integrated core banking and investment management system designed for the specific needs of retail and private banks. They offer unique combination of an extensive portfolio of functions with impressive flexibility that enables end-to-end processing of investment products from diverse asset classes including structured deposits, structured notes, equities, mutual funds and insurance.

Financial institutions can leverage the solutions' rule-based definitions to launch new products -such as dual currency deposits, principal protected deposits, range accrual deposits, mutual funds and insurance products - with a distinct time-to-market advantage. Integrated with core banking and CRM solutions, the wealth management solutions ensure unique customer definition, a single, unified view of the customer's portfolio across asset classes and seamless flow of transactions. This helps banks capitalize on their customer base to create additional revenue streams, by offering HNWI and the mass affluent extended products and services.

(b) Key Modules

- Structured Products
- Mutual Funds
- Equities
- Insurance

(c) **Business Benefits:** Leverage the HNWI Opportunity - Finacle wealth management solution enables financial institutions to derive rich integrated insights about the HNWI client's investment portfolio. Sophisticated analytics, relevant financial planning and asset allocation tools can be deployed, to leverage the opportunities presented by hot listed clients to explore prospects for cross-selling and fee-based personalized advice.

(d) **Ease of Enhancing Product Portfolio:** The user-friendly solutions provide flexibility to tailor solutions and create new product flavors for emerging customer segments. It enables business users at the bank to add innovative functionalities and features to their offerings, without changing the source code of the application. The solutions also interface seamlessly with satellite and specialized systems, easily supporting faster rollout of new products at the bank.

(e) **Higher Operational Efficiency:** The solutions enable Straight Through Processing (STP) and are fortified with a powerful integration framework to interface with the bank's core banking solution and external data sources. This plays a crucial role in minimizing operational delays and ensuring seamless transaction flows at the bank.

Every financial operation is processed identically. Execution either ensures a successful update of all related data or a complete rollback incase of a technical problem. Consistency and reliability are guaranteed. Fully integrated and component - based, the solution also ensures consistency of data.

Access rights are rigorously managed, every transaction request is checked and systematic records are maintained as audit trails, ensuring robust security. The solutions allow users belonging to different legal entities to work on a single system and database. This directly results in significantly lower implementation costs and ease of centralized reporting for the bank,

(f) **Lower Total Cost of Ownership (TCO):** Built on new-generation technologies, wealth management solutions are generally future-proof and can be seamlessly integrated with other enterprise applications. With proven scalability and a flexible architecture, they ensure protection for the bank's technology investments.

The points discussed in the foregoing are only illustrative to highlight the application and features of technology in retail banking provided by one software company. There are different effective solutions provided by different software vendors. There are innumerable features available in the technology side for effective delivery of retail banking services. These features along with a good CRM solution will enable the banks to cross sell effectively and achieve total customer satisfaction. The pictorial illustrations and features are shown below.

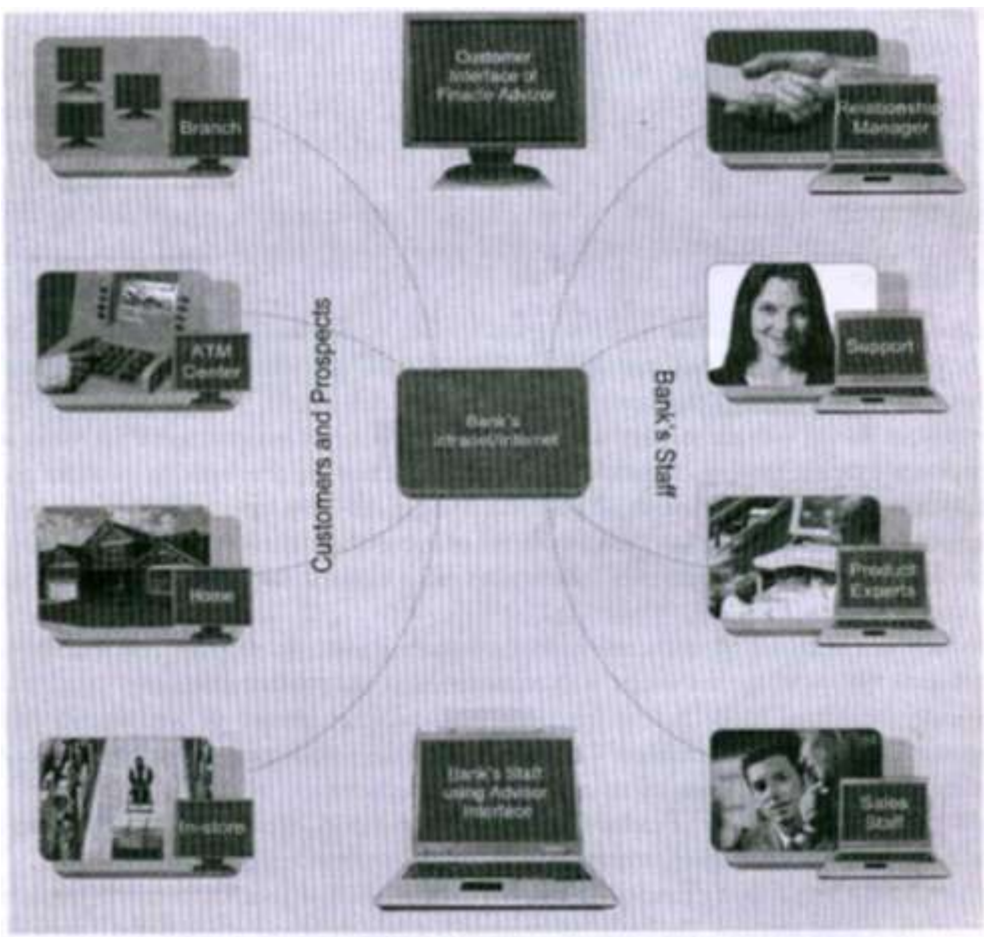


Fig. 15.2 Financial Advizor (Source-website of a software solutions company)

Terminal Questions

1. Process models in retail banking are structured as

   (i) Horizontally Organised Model where individual process platform supports one product only.
   (ii) Vertically Organised Model where functionality is provided across all products.
   (iii) Predominantly Horizontally Organised Model with some modularization within a product oriented feed back.
   (iv) Predominantly Vertically Organised Model is a hybrid model that offers common information for most of the related services.
   (v) Any one of the above.

Ans: v

2. The technology models adopted by banks are

   (i) Fully outsourced model
   (ii) Partially outsourced model
   (iii) In house model
   (iv) Anyone of the above.

Ans: iv

Key

1.(v); 2. (iv)

Let Us Sum Up

- Technology is the foundation on which the retail banking edifice is built across the globe. Technology is the enabler for building and translating a customer data base into retail banking business. Banks adopt different technology platforms in line with the global trends. New generation private sector banks were started with technology advantage of a single server environment.PSB banks also have reengineered their technology initiatives and started implementing core banking solutions networking the customers and accounts in a single platform. Most of the PSBs have completed the core banking solutions process while in a few banks the level of implementation is in various advanced stages.
- There are basically four approaches followed by retail banks in integrating technology with retail banking processes. They are,
- Horizontally Organised Model where individual process platform supports one product only. The sub data in the model are not shared with other products and product platform.
- Vertically Organised Model where functionality is provided across all products. In this model, customer information is centralised. Centralised customer information builds common origination and servicing processes across all its retail banking products.
- Predominantly Horizontally Organised Model with some modularization within a product oriented feed back. Customer data integration is available to a certain extent for other products.
- Predominantly Vertically Organised Model is a hybrid model that offers common information for most of the related services. The basic information is available across products for common services to the various products.

• Technology initiatives were adopted by banks in different ways. Some banks had implemented through in house resources for development and implementation while some other banks had done it through outsourced vendors. Some banks followed a blend of proprietary as well as outsourced model. Scalability and Sustainability are the main issues in all these models. The models outsourced as well as in-house developed offer various customer analytics solutions for the banks to help them in customer identification, need mapping and offering the right products and services.

Keywords

Horizontally Organised; Vertically organised; outsourced model; in house model, blended model; customer identification; need mapping.

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MODULE D OTHER ISSUES RELATED TO RETAIL BANKING

Units

16. Recovery of Retail Loans

17. Securitisation

18. Other Issues in Retail Banking

UNIT 16 RECOVERY OF RETAIL LOANS

STRUCTURE

16.1 Recovery of Retail Loans

16.2 Defaults And Rescheduling In Retail Loans

16.3 Recovery Process

16.4 SARFAESI Act

16.5 Debt Recovery Tribunal (DRT)

Terminal Questions Let Us Sum

Up Keywords

16.1 RECOVERY OF RETAIL LOANS

The success of any banking initiative is judged only by the profit generated from that business segment. Banks aggressively build up their retail asset portfolios to expand business as retail assets are one of the best revenue drivers in banking. More over, since the customer base is large and heterogeneous in nature, the risk in retail asset financing is well diversified. Banks take advantage of this phenomenon and expand exponentially, their retail asset portfolio. Apart from foreign banks, the new generation private sector banks aggressively expanded their retail asset portfolio in the past decade to the extent that the retail asset portfolio of one of the top private sector banks exceeded above 50% of their total asset portfolio. Public sector banks also expanded their retail asset portfolio in a big way but not to the extent of private sector banks. Their retail portfolio size, on an average, used to be in the range of 30%. Accordingly profits generated from that segment are also attractive but the inherent risk of default is always there in retail assets also. The unsecured nature of retail assets like Personal Loans and Credit Card Receivables made the portfolio more vulnerable for default as there is nothing to proceed against for banks except through money suits.

But the aggressive approach of private banks all these years toned down in 2008-09 due to the global financial crisis and its impact across the globe though the same was relatively lesser in India .The growth rates of retail assets came down as banks were more cautious in their retail lending. In addition the delinquencies and default rates were also on the rise making the banks to go on the back foot. In case of housing loans, rescheduling was done in a major way so that the assets do not slip to the Non Performing Asset category and attract loan loss provisioning and affect the bottomlines. Let us have a look at the retail asset portfolios of banks.

(i) Growth Rate of Retail Assets of the Banking System

(Rs. In Crores)

S.No	*Type of Retail Asset*	*2004*	*2005*	*2006*	*2008*	*2009*
1.	Housing Loans	89449	134276	179165	252932	263235
			(50.5)	(33.4)	(12.7)	(4.1)
2.	Consumer Durables Loans	6256	3810	4469	4802	5431
			(-39.10)	(17.3)	(-34.2)	(13.1)
3.	Credit Card Receivables	6167	8405	12434	27437	29941
			(36.3)	(47.9)	(49.8)	(9.1)
4.	[illegible]		[illegible]	[illegible]	[illegible]	[illegible]

(ii) Percentage of Retail Assets to Total Assets of the Banking System:

(Rs. In Crores)

S.No.	Details of Advances	2004	2005	2006	2008	2009
1.	Total Advances of the Banking System	864271	1125056	1473723	2332032	2793572
2.	Percentage Share of Retail Assets to Total Advances	21.9	23.7	25.5	24.5	21.3
3.	Growth Rate				23.2	19.8

Source: Reserve Bank of India - Report on Trend & Progress in Banking in India

The percentage of retail assets to total assets has come down during 2009 to 21.3% from 24.5% in 2008.The growth of retail assets which was at 40.9% in 2006 came down to 17.1% in 2008 and further down to only 4% in 2009.Within the retail loan segment, housing loans went down to 12.7 and 4.1% in 2008 and 2009.Credit Card Receivables showed a rapid decline in growth to 9.1% in 2009 from 49.8% in 2008.Other Personal Loans also showed a steep fall in growth to 6.9% in 2009 from 27.9% in 2008.Auto Loans showed a negative growth in 2009.1n general, there was all round negative growth in all segments of retail banking. The main reasons for this phenomenon are the global financial turmoil and its impact by means of loan defaults and build up of NPAs. Here comes the importance of recovery in retail loans. The first dimension is poor recovery performance and defaults in retail loans due to the changed economic conditions and the second dimension is that banks taking a cautious approach in retail asset expansion and aversion to certain segments like Personal Loans and downward revision of Credit Card Limits. The importance of recovery in retail loans is emphasized because, if recovery is poor, the after effects are toxic assets which result in asset shrinkage and stunted growth.

16.2 DEFAULTS AND RESCHEDULING IN RETAIL LOANS

What is default? Default is the occurrence of an event which happens due to non payment of agreed installments. If the repayment schedule is not adhered to as per the commitments made, then it translates into default. The strength of the default grades it according to the period of default from a simple overdue to the stage of NPA. What are the reasons for default in retail loans? Let us take the case of Home Loans.

Home Loans are offered in two price formats. One is fixed pricing and the second is variable pricing or floating pricing. The irony is that even fixed pricing takes the character of a floating pricing as interest is reset as per the reset clause agreed between the lender and borrower. The monthly installments also called as EMIs are fixed based on the rate prevailing at the time of availing the loan and the agreed repayment period based on the servicing capacity of the borrower. Steep changes in interest rates say 200 to 300 basis points will change the equilibrium of repayments. An increase in interest rate either fixed or floating will increase the EMI and hence the customer has to pay more than what was originally committed based on his repaying capacity. Since there are chances that the customer would not be able to service the higher EMI, the loan repayment will be under default. If the loan installments are not serviced for three months, then the loan becomes NPA. How to obviate this problem? The reasons for the increase in interest rates may be due to genuine reasons like macro economic factors or the asset liability management policy of the banks. There are two expected outcomes to this situation.

(i) To pay the higher EMI so that the repayment period is kept at the same level.
(ii) To pay reduced EMI and elongate the repayment period beyond the earlier committed repayment period but within the total repayment period permissible for Housing Loan (say 25 years) or extend even beyond that period.

Anyone of the above two has to be effected by the bank.

Some customers may be willing to pay the higher EMI and keep the repayment period at the same level. But most of the customers may not afford to pay the increased EMI as the same will be substantial. This will result in the loans becoming overdue and subsequently NPAs.

The other option is to pay the same EMI for an elongated repayment period and service the loan accordingly so that the asset continues to remain as a performing one. Most of the banks had elongated the repayment period so that customers are not under extra pressure to service the loan. Some private banks gave the option to the borrowers to pay higher EMIs or pay the same EMIs under extended repayment period. This phenomenon is called as rescheduling of retail loans. As said earlier, in retail loans, rescheduling mainly happens in Housing Loans as they are of long tenor and mortgage backed.

Rescheduling happens in Credit Cards and Personal Loan segments also where the interest rates are quite high and unsecured in nature. Here default happens mainly due to the following reasons;

(a) Genuine defaults due to reasons beyond the borrowers' control and
(b) Willful defaults where the borrowers deliberately default with malafide intention.

Let us discuss the above two types of defaults in detail.

(a) Genuine Defaults

In genuine defaults, the customers fail to repay the EMIs due to personal set backs, job losses, unforeseen medical expenses etc., that tilt the balance of their monthly pay outs and results in non payment of banks' dues. Here the intention to pay is intact but the ability to pay is affected and results in defaults. The approach of the banks for recovery will be one of care and concern and will be a customer oriented approach because the chances of recovery are bright.

(b) Willful Defaults

In willful defaults, the customers deliberately fail to pay the EMIs and the attitude is negative. The intentions of the borrowers are malafide and there is no attempt from the borrowers' side to service the loans as per the committed repayments. The objective is to delay the EMIs and put the banks into difficulties. In willful defaults the approach of the banks will be on a recovery basis as the chances of recovery are not so bright. So banks take a systematic and firm approach for recovery of these loans.

Having understood about the two major types of defaults in retail loans, let us discuss about the recovery procedures adopted by banks for recovery of retail loans in detail.

16.3 RECOVERY PROCESS

Recovery process is a scientific as well as an essential tool for maintaining the quality of retail assets. As discussed above it has to de designed in such a way that it addresses both genuine defaulters as well as willful defaulters. While genuine defaulters are to be handled very sensitively as they are otherwise good customers and default has happened due to circumstances beyond their control. The recovery process has to be gentle and professional and ultimately it should translate into recovery of monies. In case of willful defaulters, the recovery process should be strict and at the same time very professional as lot of pressure has to be put for recovering the monies. Banks are advising their recovery policies in their web sites and also inform the borrower customers about the recovery procedures adopted by them. The recovery process adopted by a new generation private sector bank is discussed below to understand the entire gamut of recovery in retail banking.

Recovery Policy

The recovery policy clauses are clearly spelt out in the recovery policy of the bank. The fundamental assumptions and approaches to recovery are clearly communicated to the customers. Let us see the different clauses of the recovery policy.

Preamble

(i) The debt collection policy of the bank is built around dignity and respect to customers.
(ii) The Bank will not follow policies that are unduly coercive in collection of dues.
(iii) The policy is built on courtesy, fair treatment and persuasion.
(iv) The bank believes in following fair practices with regard to collection of dues and repossession of security and thereby fostering customer confidence and long-term relationship.
(v) The repayment schedule for any loan sanctioned by the Bank will be fixed taking into account paying capacity and cash flow pattern of the borrower.
(vi) The Bank will explain to the customer upfront the method of calculation of interest and how the Equated Monthly Installments (EMI) or payments through any other mode of repayment will be appropriated against interest and principal due from the customers.
(vii) The Bank would expect the customers to adhere to the repayment schedule agreed to.
(viii) The Bank Security Repossession Policy aims at recovery of dues in the event of default and is not aimed at whimsical deprivation of the property.
(ix) The policy recognizes fairness and transparency in repossession, valuation and realization of security. All the practices adopted by the Bank for follow up and recovery of dues and repossession of security will be inconsonancc with the law.

General Guidelines

All the members of the staff or any person authorized to represent the Bank in collection or/and security repossession would follow the guidelines set out below:

1. The customer would be contacted ordinarily at the place of his/her choice and in the absence of any specified place, at the place of his/her residence and if unavailable at his/her residence, at the place of business/occupation.
2. Identity and authority of persons authorized to represent the Bank for follow up and recovery of dues would be made known to the borrowers at the first instance. Bank staff or any person authorized to represent the Bank in collection of dues or/and security repossession will identify himself/herself and display the authority letter issued by the Bank upon request.
3. Bank would respect privacy of its borrowers.
4. Bank is committed to ensure that all written and verbal communication with its borrowers will be in simple business language and Bank will adopt civil manners for interaction with borrowers.
5. Normally Bank's representatives will contact the borrower between 0700 hrs and 1900 hrs, unless the special circumstance of his/her business or occupation requires the Bank to contact at a different time.
6. Borrower's requests to avoid calls at a particular time or at a particular place would be honored as far as possible.
7. Bank will document the efforts made for the recovery of dues and the copies of communication set to customers, if any, will be kept on record.
8. All assistance will be given to resolve disputes or differences regarding dues in a mutually acceptable and in an orderly manner.
9. Inappropriate occasions such as bereavement in the family or such other calamitous occasions will be avoided for making calls/visits to collect dues.

Giving Notice to Borrowers

While written communications, telephonic reminders or visits by the Bank's representatives to the borrowers place or residence will be used as loan follow up measures, Bank will not initiate any legal or other recovery measures including repossession of the security without giving due notice in writing. Bank will follow all such procedures as required under law for recovery/repossession of security.

Repossession of Security

Repossession of security is aimed at recovery of dues and not to deprive the borrower of the property. The recovery process through repossession of security will involve repossession, valuation of security and realization of security through appropriate means. All these would be carried out in a fair and transparent manner. Repossession will be done only after issuing the notice as detailed above. Due process of law will be followed while taking repossession of the property. Bank will take all reasonable care for ensuring the safety and security of the property after taking custody, in the ordinary course of the business.

Valuation And Sale of Proerty

Valuation and sale of property repossessed by the Bank will be carried out as per law and in a fair and transparent manner. Bank will the have right to recover from the borrower the balance due if any, after sale of property. Bank shall have the right of set-off and lien, irrespective of any other lien or charge, present as well as future all account/deposits of the deposit holder with the Bank , whether in single name or joint name(s), to the extent of all outstanding dues to the Bank. For such purposes. Bank may at its sole discretion close the deposits prematurely and apply a penal rate of interest in respect of the same. The lien shall be valid and binding on the borrower and operative until repayment in full of all moneys due to the Bank from the borrower. Excess amount if any, obtained on sale of property will be returned to the borrower after meeting all the related expenses provided the Bank is not having any other claims against the customer.

Opportunity for the Borrower to Take Back the Security

As indicated earlier in the policy document, bank will resort to repossession of security only for the purpose of realization of its dues as the last resort and not with intention of depriving the borrower of the property. Accordingly Bank will be willing to consider handing over possession of property to the borrower any time after repossession and before concluding sale transaction of the property, provided the bank dues are cleared in full within the time frame specified by the Bank. If satisfied with the genuineness of borrower's inability to pay the loan installments as per the schedule which resulted in the repossession of security, Bank may at its discretion consider handing over the property after receiving the installments in arrears. However, this would be subject to the Bank being convinced of the arrangements made by the borrower to ensure timely repayment of remaining installments in future.

The above provisions highlight the recovery process that is structured in a sequential way to persuade the borrower for repayment of dues in different ways and if the expected response is not happening, then the procedure that will be followed by the Bank including taking possession of the property/adjustment of other balances with the bank for recovery of loans and delivering back or sale of property based on the repayment of dues, for adjusting the monies due to the bank and returning the amounts, if any, back to the borrower.

Recovery Agents

When we talk about recovery of retail loans, the first thing which flashes in our mind is the most dreaded recovery agents deployed by banks for recovery of loan in which defaults happen. Public Sector Banks' approach to recovery of loans is different from the strategies adopted by private sector banks and foreign banks. While PSBs administer recovery management through their own staff in case of retail loans, private and foreign banks outsource their recovery process and entrust the same to Recovery Agents for end to end recovery management when the accounts become delinquent. The methods adopted by these Recovery Agents exceeded the normal recovery routes and went to the extent of coercion, threats and intimidation and forced recovery of assets financed. This was more applicable for unsecured overdues in credit card receivables and personal loans. Suicides by borrowers due to unethical recovery practices followed by some banks resulted in regulatory intervention and Reserve Bank of India came out with guidelines prescribing the procedures for code of conduct for Recovery Agents. The salient features of the guidelines issued by Reserve Bank of India are discussed below:

RBI Guidelines For Recovery Agents

RBI vide their circular DBOD.No.Leg.BC.75/09.07.005/2007-08 dated April 24,2008, issued guidelines for all scheduled commercial banks for Recovery Agents engaged by them for recovery of loans. In view of the rise in the number of disputes and litigations against banks for engaging recovery agents in the recent past, it is felt that the adverse publicity would result in serious reputational risk for the banking sector as a whole. Hence RBI felt that a need has arisen to review the policy, practice, and procedure involved in the engagement of recovery agents by banks in India. Reserve Bank issued draft guidelines which were placed on their web-site for comments of all concerned. Based on the feedback received from a wide spectrum of banks/individuals/organizations, the draft guidelines have been suitably revised and the guidelines finalized and implemented by RBI are as follows:

Engagement of Recovery Agents

Banks are advised to take into account the following specific considerations while engaging recovery agents:

(i) 'Agent' in these guidelines would include agencies engaged by the bank and the agents/employees of the concerned agencies.

(ii) Banks should have a due diligence process in place for engagement of recovery agents, which should be so structured to cover, among others, individuals involved in the recovery process. The due diligence process should generally conform to the guidelines issued by RBI on outsourcing of financial services vide circular DBOD.No.BP.40/21.04.158/2006-07 dated November 3, 2006. Further, banks should ensure that the agents engaged by them in the recovery process carry out verification of the antecedents of their employees, which may include pre-employment police verification, as a matter of abundant caution. Banks may decide the periodicity at which reverification of antecedents should be resorted to.

(iii) To ensure due notice and appropriate authorization, banks should inform the borrower the details of recovery agency firms/companies while forwarding default cases to the recovery agency. Further, since in some of the cases, the borrower might not have received the details about the recovery agency due to refusal/non-availability/avoidance and to ensure identification, it would be appropriate if the agent also carries a copy of the notice and the authorization letter from the bank along with the identity card issued to him by the bank or the agency firm/company. Further, where recovery agency is changed by the bank during the recovery process, in addition to the bank notifying the borrower of the change, the new agent should carry the notice and the authorization letter along with his identity card.

(iv) The notice and the authorization letter should, among other details, also include the telephone numbers of the relevant recovery agency. Banks should ensure that there is a tape recording of the content/text of the calls made by recovery agents to the customers, and vice-versa. Banks may take reasonable precaution such as intimating the customer that the conversation is being recorded, etc.

(v) The up to date details of the recovery agency firms/companies engaged by banks may also be posted on the bank's website.

(vi) Where a grievance/complaint has been lodged, banks should not forward cases to recovery agencies till they have finally disposed of any grievance/complaint lodged by the concerned borrower: However, where the bank is convinced, with appropriate proof, that the borrower is continuously making frivolous/vexatious complaints, it may continue with the recovery proceedings through the Recovery Agents even if a grievance/complaint is pending with them. In cases where the subject matter of the borrower's dues might be *sub judice*, banks should exercise utmost caution, as appropriate, in referring the matter to the recovery agencies, depending on the circumstances.

(vii) Each bank should have a mechanism whereby the borrowers' grievances with regard to the recovery process can be addressed. The details of the mechanism should also be furnished to the borrower while advising the details of the recovery agency as at item (iii) above.

incentives to Recovery Agents

It is understood that some banks set very stiff recovery targets or offer high incentives to recovery agents. These have, in turn, induced the recovery agents to use intimidatory and questionable methods for recovery of dues. Banks are, therefore, advised to ensure that the contracts with the recovery agents do not induce adoption of uncivilized, unlawful and questionable behaviour or recovery process.

Training for Recovery Agents

As per RBI guidelines for managing risks and code of conduct in outsourcing of financial services by banks, banks were advised that they should ensure that, among others, the recovery agents are properly trained to handle with care and sensitivity, their responsibilities, in particular aspects like hours of calling, privacy of customer information etc.

Reserve Bank has requested the Indian Banks' Association to formulate, in consultation with Indian Institute of Banking and Finance (IIBF), a certificate course for Direct Recovery Agents with minimum 100 hours of training. Once the above course is introduced by IIBF, banks should ensure that over a period of one year all their Recovery Agents undergo the above training and obtain the certificate from the above institute. Further, the service providers engaged by banks should also employ only such personnel who have undergone the above training and obtained the certificate from the IIBF. Keeping in view the fact that a large number of agents throughout the country may have to be trained, other institutes/bank's own training colleges may provide the training to the recovery agents by having a tie-up arrangement with Indian Institute of Banking and Finance so that there is uniformity in the standards of training. However, every agent will have to pass the examination conducted by IIBF all over India.

Taking Possession of Property Mortgaged/Hypothecated to Banks

The recovery of loans or seizure of vehicles could be done only through legal means. Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 (SARFAESI Act) and the Security Interest (Enforcement) Rules, 2002 framed there under have laid down well defined procedures not only for enforcing security interest but also for auctioning the movable and immovable property after enforcing the security interest. It is, therefore, desirable that banks rely only on legal remedies available under the relevant statutes while enforcing security interest without intervention of the Courts.

Where banks have incorporated a re-possession clause in the contract with the borrower and rely on such re-possession clause for enforcing their rights, they should ensure that the repossession clause is legally valid, complies with the provisions of the Indian Contract Act in letter and spirit, and ensure that such repossession clause is clearly brought to the notice of the borrower at the time of execution of the contract. The terms and conditions of the contract should be strictly in terms of the Recovery Policy and should contain provisions regarding (a) notice period before taking possession (b) circumstances under which the notice period can be waived (c) the procedure for taking possession of the security (d) a provision regarding final chance to be given to the borrower for repayment of loan before the sale/ auction of the property (e) the procedure for giving repossession to the borrower and (f) the procedure for sale/auction of the property.

Recovery Through Lok Adalats

As per the suggestions of the Supreme Court of India and guidelines issued by Reserve Bank of India banks were advised to use the forum of Lok Adalats organized by Civil Courts for recovery of loans. Banks are encouraged to use the forum of Lok Adalats for recovery of personal loans, credit card loans or housing loans with less than Rs.10 lakh as suggested by the Honourable Supreme Court.

Utilisation of Credit Counsellors

Banks are encouraged to have in place an appropriate mechanism to utilise the services of the credit counsellors for providing suitable counselling to the borrowers where it becomes aware that the case of a particular borrower deserves sympathetic consideration.

Complaints against the Bank/its Recovery Agents

- Banks, as principals, are responsible for the actions of their agents. Hence, they should ensure that their agents engaged for recovery of their dues should strictly adhere to the above guidelines and instructions, including the BCSBI Code, while engaged in the process of recovery of dues.
- Complaints received by Reserve Bank regarding violation of the above guidelines and adoption of abusive practices followed by banks' recovery agents would be viewed seriously. Reserve Bank may consider imposing a ban on a bank from engaging recovery agents in a particular area, either jurisdictional or functional, for a limited period. In case of persistent breach of above guidelines,
- Reserve Bank may consider extending the period of ban or the area of ban. Similar supervisory action could be attracted when the High Courts or the Supreme Court pass strictures or impose penalties against any bank or its Directors/Officers/agents with regard to policy, practice and procedure

related to the recovery process. • It is expected that banks would, in the normal course ensure that their employees also adhere to the above guidelines during the loan recovery process.

Periodical Review

Banks engaging recovery agents are advised to undertake a periodical review of the mechanism to learn from experience, to effect improvements, and to bring to the notice of the Reserve Bank of India suggestions for improvement in the guidelines.

(Reproduced from RBI Website - Guidelines on Recovery Agents)

16.4 SARFAESI ACT

Evolution

With an aim to provide a structured platform to the Banking sector for managing its mounting NPA stocks and keep pace with international financial institutions, the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest (SARFAESI) Act was put in place to allow banks and FIs to take possession of securities and sell them. As stated in the Act, it has "enabled banks and FIs to realise long-term assets, manage problems of liquidity, asset-liability mismatches and improve recovery by taking possession of securities, sell them and reduce non performing assets (NPAs) by adopting measures for recovery or reconstruction." Prior to the Act, the legal framework relating to commercial transactions lagged behind the rapidly changing commercial practices and financial sector reforms, which led to slow recovery of defaulting loans and mounting levels of NPAs of banks and financial institutions.

By the late 1990s, rising level of Bank NPAs raised concerns and Committees like the Narasimham Committee II and Andhyarujina Committee, which were constituted for examining banking sector reforms considered the need for changes in the legal system to address the issue of NPAs. These committees suggested a new legislation for securitisation, and empowering banks and FIs to take possession of the securities and sell them without the intervention of the court and without allowing borrowers to take shelter under provisions of SICA/BIFR. Acting on these suggestions, the SARFAESI Act was passed in 2002 to legalise securitisation and reconstruction of financial assets and enforcement of security interest. The act envisaged the formation of asset reconstruction companies (ARCs)/Securitisation Companies (SCs).

Provisions of the SARFAESI Act

The Act has made provisions for registration and regulation of securitisation companies or reconstruction companies by the RBI, facilitate securitisation of financial assets of banks, empower SCs/ARCs to raise funds by issuing security receipts to qualified institutional buyers (QIBs), empowering banks and FIs to take possession of securities given for financial assistance and sell or lease the same to take over management in the event of default.

The Act provides alternative methods for recovery of NPAs, namely:

(a) Securitisation

It means issue of security by raising of receipts or funds by SCs/ARCs. A securitisation company or reconstruction company may raise funds from the QIBs by forming schemes for acquiring financial assets. The SC/ARC shall keep and maintain separate and distinct accounts in respect of each such scheme for every financial asset acquired, out of investments made by a QIB and ensure that realisations of such financial asset are held and applied towards redemption of investments and payment of returns assured on such investments under the relevant scheme.

(b) Asset Reconstruction

The SCs/ARCs for the purpose of asset reconstruction should provide for any one or more of the following measures:

- the proper management of the business of the borrower, by change in, or take over of, the management of the business of the borrower.
- the sale or lease of a part or whole of the business of the borrower.
- rescheduling of payment of debts payable by the borrower enforcement of security interest in accordance with the provisions of this Act.
- settlement of dues payable by the borrower
- taking possession of secured assets in accordance with the provisions of this Act.

16.5 DEBT RECOVERY TRIBUNALS (DRTs)

Debt Recovery Tribunals are apex bodies to settle recovery issues in case of loans extended by financial institutions. Debt Recovery Tribunals (DRTs) are constituted for helping financial institutions recover their bad debts quickly and efficiently. DRTs are governed by provisions of the Recovery of Debt Due to Banks and Financial Institutions Act, 1993, also popularly called as the RDB Act. Rules have been framed and notified under the Recovery of Debts Due to Banks and Financial Institutions Act, 1993. After the enactment of the Securitisation And Reconstruction of Financial Assets and Enforcement of Security Interests Act (S ARFAESI Act),borrowers could become first applicants before the Debt Recovery Tribunal. Earlier only lenders could be applicants.

The setting up of a DRT is dependant upon the volume of cases. Higher the number of cases within a territorial area, more Debt Recovery Tribunals would be set up. DRTs are located across the country. Some cities have more than one Debt Recovery Tribunal located therein. New Delhi and Mumbai have three benches in Debt Recovery Tribunal. Chennai and Kolkata have two benches Debt Recovery Tribunal each. One Debt Recovery Tribunal each has been constituted at Ahmedabad, Allahabad, Aurangabad, Bangalore, Chandigarh, Coimbatorc, Cuttack, Ernakulam, Guwahati, Hyderabad, Jabalpur, Jaipur, Lucknow, Nagpur, Patna, Pune, Ranchi and Vishakapatnam.

Each Debt Recovery Tribunal is presided over by a Presiding Officer. The Presiding Officer is generally a judge of the rank of Dist. & Sessions Judge. A Presiding Officer of a Debt Recovery Tribunal is assisted by a number of officers of other ranks, but none of them need necessarily have a judicial back ground. Therefore, the Presiding Officer of a Debt Recovery Tribunal is the sole judicial authority to hear and pass any judicial order. Each Debt Recovery Tribunal has two Recovery Officers. The work amongst the Recovery Officers is allocated by the Presiding Officer. Though a Recovery Officer need not be a judicial Officer, but the orders passed by a Recovery Officer are judicial in nature, and are appealable before the Presiding Officer of the Tribunal.

DRTs are fully empowered to pass comprehensive orders like in Civil Courts. The Tribunal can hear cross suits, counter claims and allow set offs. However, they cannot hear claims of damages or deficiency of services or breach of contract or criminal negligence on the part of the lenders.

DRTs can appoint Receivers, Commissioners, pass ex-parte orders, ad-interim orders, interim orders apart from powers to Review its own decision and hear appeals against orders passed by the Recovery Officers of the Tribunal.

Recording of evidence by Debt Recovery Tribunal is some what unique. All evidences are taken by way of an affidavit. Cross examination is allowed only on request by the defense and that too if the Tribunal feels that such a cross examination is in the interest of justice. Frivolous cross examination may be denied. There are a number of other unique features in the proceedings before the Debt Recovery Tribunal all aimed at expediting the proceedings.

Terminal Questions

1. Default in repayment in Credit Cards and Personal Loan segments is mainly due to

(i) Genuine Defaults due to reasons beyond the borrowers' control.
(ii) Wilful defaults where the default is intentional,
(iii) Anyone of the above.
(iv) Both the above.

Ans: iii

2. Recovery of loans through Lok Adalats can be resorted to by banks upto a limit of:

(i) Rs.2 lacs
(ii) Rs.5 lacs
(iii) Rs. 10 lacs
(iv) None of the above

Ans: iii

3. The terms and conditions for repossession as per the recovery policy should contain the following provisions :

(i) notice period before taking possession
(ii) circumstances under which the notice period can be waived
(iii) the procedure for taking possession of the security
(iv) a provision regarding final chance to be given to the borrower for repayment of loan before the sale/auction of the property
(v) All the above.

Ans: iv

Key

1. (iii); **2.** (iii); **3.**

(iv)

Let Us Sum

Up

- Recovery is one of the most important elements of retail banking which decides its success as a segment. Since, retail asset base is well spread out with a large number of customers, monitoring and follow up of all the retail assets for proper servicing is a must for retail bankers to keep the asset book healthy.
- The recovery processes are well defined in banks with step by step approach for following up the accounts in different stages of recovery. Recovery Policies are implemented by banks in a professional way for effective recovery of dues and overdues and non performing assets that may erupt due to genuine defaults s well as willful defaults.
- The major features of recovery policy by banks are summarized below:
  - The debt collection policy of the bank is built around dignity and respect to customers.
  - The repayment schedule for any loan sanctioned by the Bank will be fixed taking into account paying capacity and cash flow pattern of the borrower.
  - The Bank will explain to the customer upfront the method of calculation of interest and how the Equated Monthly Installments (EMI) or payments through any other mode of repayment will be appropriated against interest and principal due from the customers. The Bank would expect the customers to adhere to the repayment schedule agreed to.
  - The Bank Security Repossession Policy aims at recovery of dues in the event of default and is not aimed at whimsical deprivation of the property.
  - Debt Recovery Tribunals (DRTs) are constituted across the country for settlement of dues of financial institutions. DRTs can appoint Receivers, Commissioners, pass ex-parte orders, ad-interim orders, interim orders apart from powers to Review its own decision and hear appeals against orders passed by the Recovery Officers of the Tribunal.

Keywords

Genuine Default; Wilful Default; Lok Adalat; Repossession; Debt Collection Policy; Notice Period; Recovery Policy; SARFEASI; Debt Recovery Tribunal.

References

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2. RBI Website - Guidelines on Recovery Agents.
3. Other resources from different journals.

UNIT
17

UNIT 17 SECURITISATION

STRUCTURE

17.1 Securitisation of Assets

17.2 EMI for Repayment in Retail Loans

Terminal Questions Let Us Sum Up Keywords

17.1 SECURITISATION OF ASSETS

Securitisation - Concept

What is securitisation? Securitisation is the process of converting and breaking definable asset classes into tradable units and selling to others through a mechanism called as Special Purpose Vehicle (SPV). Through the securitisation process, the assets are removed from the balance sheet and the funds generated through securitisation can be ploughed back for further asset expansion. The Special Purpose Vehicle converts assets into securities called as 'Pass Through Certificates' and sell them to the buyers who may require that particular asset class as a requirement or investment. Since these certificates are backed by assets, they are also called asset backed securities (ABS).If assets which have underlying mortgages are secuiritised, they are called as "Mortgage Based Securitisation".

From the above we can define Securitisation as follows:

Securitisation is the process of pooling of individual long term loans which are packaged and sold to various investors in the form of Pass Through Certificates (marketable securities) through a Special Purpose Vehicle with the provision that the inflow of cash in the form of recoveries will be distributed pro rata to the buyers.

The advantage of securitisation is that the receivables are removed from the books as they have been sold but the transaction does not create a liability in the balance-sheet. Thus, securitisation helps in asset-liability management and also in capital adequacy.

Securitisation Process

Suppose an institution wants to securitise an asset of say Rs.2(K) Crores, the process flow for the securitisation is as follows:

(a) The lender first selects the assets they want to securitise.
(b) The issuer (Special Purpose Vehicle) makes payment to the lender for the loans securitised.
(c) The assets are converted into a pool of securities by the issuer for the purpose of issuing Pass Through Certificate (PTC).
(d) The PTCs are sold to other investors who are willing to invest.
(e) The lender continues to receive the recoveries from the original borrowers and the same are passed on to the SPV.
(0 The SPV in turn passes the recoveries to the investors.

Securitisation is a structured process and effected only for standard assets and rated by the rating agencies to enable the buyers to take a call on investing in the PTCs.

Securitisation in Retail Banking

In the retail side, another concept called Collateral Debt Obligation (CDO) is also in vogue. In CDO, asset classes/receivables like Car Loans, Credit Card Receivables and Mortgage Loans like Home Loans, are grouped together and securitised. Multiple layers of PTCs with varying rates and coupons are issued based on the quality of assets and risk perceptions underlying in the assets.

In 2009, the Indian retail asset securitization market was at about Rs. 193.1 billion as against Rs.300 billion in FY08. The unfolding of credit crisis in USA and European markets and the resulting liquidity crunch in Indian market made investors in securitized papers/deals cautiously. This caution was further heightened by rising delinquencies in retail asset finance market. However, the performance of securitized pools in India continues to be strong with no defaults till date. The priority sector lending requirement for Banks was the key driver behind securitization during the year. Majority of the retail loan pools securitized in FY08-09 were backed by priority sector loans. Transactions through direct assignment route dominated the market in FY08-09, as this route facilitates the transfer of priority sector loans directly to the acquirer's loan book instead of investment book and thereby fulfilling priority sector lending requirement.

The Asset backed securitization (ABS), which is backed by retail loans other than housing loans formed about 76% (in terms of value of loans securitized) of total retail asset securitization market during FY09, with balance transactions (MBS-Mortgage Backed Securitisation) backed by residential housing loans. In ABS, the asset classes securitized in FY09 included Commercial Vehicles (CV), Cars, Construction Equipments (CE), Personal Loans (PL), Small & Medium Enterprise loans (SME), Tractor loans (TL), Two Wheeler loans (TW), Three Wheeler loans (TWH), Microfinance loans (Mf), Utility Vehicles, Gold loans and others. CV loans continue to be the largest asset class securitized in FY09 followed by Cars and CE loans, respectively. Majority of the CV, CE and TL pools securitized qualify for priority sector norms.

(Source: Overview of Retail Asset Securitisation Market FY 09, CARE Ratings)

17.2 EMI FOR REPAYMENT IN RETAIL LOANS

When we discuss about securitisation, it is very pertinent to know about the method of recovery of retail loans. Recoveries are effected in retail loans by Equated Monthly Installments or simply EMIs. In EMI model of repayment, the loan is repaid in full in uniform monthly installments spread over the repayment period. The EMI will consist of two components namely the principal and interest. In EMI, the principal component will be less during the initial months and the interest component will be more. As the repayment progresses, the principal component will increase and the interest component will reduce. This is because, as the repayment progresses, the principal component will get reduced and hence interest charges also will decrease. Hence the subsequent installment will service more of the principal. Let us see how EMI is calculated for loans.

The formula for calculation of EMI :

$$\text{EMI} = \frac{P \times r \times (1+r)^{n}}{\left[(1+r)^{n}-1\right]}$$

where p = principal (amount of loan),

r = rate of interest per month (eg.: if interest rate per annum is 10%

then 10/(12*100))

n = no. of installments

By using the above formula, the EMI will be calculated and advised to the customers for prompt servicing of the loan.

MODULE E
ADDITIONAL READING MATERIAL ON HOME LOANS

Units

19. Lender's Appraisal Procedure
20. Securitisation - Mortgage Backed Securities
21. Housing Finance and Tax Planning
22. Mortgage Advice
23. Valuation of Real Property

UNIT 19 LENDER'S APPRAISAL PROCEDURE

STRUCTURE

19.0 Objectives
19.1 Introduction
19.2 Appraisal Procedures
19.3 Application Form
19.4 Documents to be Submitted for Availing a Home Loan
19.5 Other Relevant Issues at Pre-sanction Stage
19.6 Documentation
19.7 Mortgage as Security
19.8 Detection of Forged and Fabricated Title Deeds
19.9 Other Securities

Keywords Let Us Sum Up Terminal Questions

19.0 OBJECTIVES

After reading this chapter you would have learnt the following:

- Lending principles and procedures
- Contents of an application form and documents to be submitted for availing loan
- Pre-sanction and post-sanction procedures
- Closure of a loan account

19.1 INTRODUCTION

Loan origination refers to processes right from the time the customer walks into the bank with a request for loan, till the time the loan is finally disbursed. Three major phases of loan origination are information acquisition, credit appraisal and sanction, and disbursement.

The processes revolve around two key aspects. One critically appraising the credit worthiness of a customer and two analyzing the risk in lending. It is necessary to capture all the information required to cater to these aspects. Demographic, employment, financial details are a must for processing. To minimize the risk, it is necessary to check that the customer is not a fraud or black listed within the bank or with other institutions. It is also important to verify that the information provided by the customer is correct and authentic. Banks achieve this mostly through external agencies. Another method of validation of information is to collect and verify documentary proofs of income, residence, age and other information.

As a factor of loan amount and the financial product, a bank may request co-borrowers or guarantors to support the loan. This may be required as a risk mitigant.

Banks collect fees for processing, documentation, and administration, from customer as part of application processing. This supplements a banks' income.
The second phase in loan origination is credit appraisal and sanction. Credit officers scrutinize the information made available to them and arrive at the loan eligibility and fix the terms and conditions to be offered to the customer. Generally two key techniques are used for this purpose. Confirming that the customer satisfies the basic norms and policies and by applying weighted risk based credit scoring. This is an important phase in the origination cycle as decisions made here affect the health of the portfolio. Incorrect decisions increase the risk and may add to bad debts, affecting the portfolio performance.

The third phase is disbursement. Either a cheque for the sanctioned amount is issued to the customer, or the amount is transferred to the customer account. A repayment schedule stating the amortization is prepared for the customer.

19.2 APPRAISAL PROCEDURES

The previous chapter dealt with the process of home loans from application to disbursement. The present chapter deals with the procedures that the lender must follow internally, as well as the underlying principles.

Secondly, since the execution of documents is a process, the preparation and procedure could be complex given the laws of the land on transfer of property. The lender's operation manual, desk cards etc. would deal with each step in some detail. This chapter captures the essential features of each of these procedures. It also lists the requirements in each step of the process, the sub-processes, related activities and documentation.

19.3 APPLICATION FORM

The appraisal process begins with an application form. An application form is designed to collect all relevant information that a lender needs, to decide whether *prima facie* the loan exposure would be an acceptable risk and falls within the policy parameters of the bank. This is a first step preceding other processes. A typical application form is appended.

APPLICATION FOR HOUSING LOAN

. OFFICE USE ONLY		
Rs... Date:.....................................		
view by :......................................File No. :..............................		
		;pace for Applicant's Photograph

Application No.

Space for Co-Applicant's Photograph

I. Personal Information:

	Applicant				Co-applicant			
e (In BLOCK LETTERS)								
er's/Husbands Name								
of Birth and Age			'Y				'	
ification								
	e		ale		e		ale	
tal status	le		ried		le		ried	
onality	an		r		an		r	
ıs	Resident Indian				Resident Indian			
RI, which country								

Dependents	lationship Age			elationship Age		
loyment Information:						
	Applicant			*Co-applicant*		
Occupation (Income Source)	Profes- sional	yed culture	Business Other	essional	yed culture	Business Other
loyer's/Business Name and Address						
loyed						
gnation & Employee No						
ment						
Date of Joining (DD/MM/YYYY)						
Date of Retirement (DD/MM/YYYY)						
Gross Income						
	lationship Age			elationship Age		
	lationship Age			elationship Age		
ess for Communication						
	one No.			one No.		
	address:			address:		
In case of NRI applicants, power of Attorney's Address	address:			address:		
ther you have taken a housing loan from any other financial Institution:						
If yes, please give details. Have you or						

your spouse stood as guarantee for any other Housing Finance loan? If yes, please give details		

ıal Net Income		
r Income		
ıpation & Source:		
lf Employed:		
re of Business		
of years in Business		
ared Annual Income		

3. **Loan Information:**

ount: Rs .... Your Monthly Expenditure: Rs... n: .... Years Instalment you and co-applicant can pay per month		
Purpose of Loan	*Cost of Property (Rs)*	*Source of Funds*
Purpose of new flat under construction	1. Cost of land	. Saving in bank
Purchase of Flat being Resold	2. Cost of construction/ Extension	. Disposal of nvestment/property
Construction of new house	3. Cost of amenities/ Service charges	. PF (Refundable/ Non-refundable)
Purchase of house being resold	4. Registration charges	. Others (Specify)
Extension of Flat/House	5. Cost of flat/ house (II Sales)	. Loan from HFL Total funds (B)
Please note that the total requirement of funds (A) should equal the estimated souce of funds (B) Mode of repayment: EMI instalments Equated Monthly/Quarterly/Half Yearly		

4. **Financial Information:**

Saving/ investments etc.	*Applicant*	*Co-appli*	*Loans Proposed/* en	*Appli-cant* Rs			*Co-applicant* Rs
			se indicate below loans taken/proposed to be taken employer/PF/Others and instalment payable per month				
			ce	Loan	thly instalment	Loan	Monthly Instalments
vings in Bank			nployer				

ımovable property			ank				
vestments			3. Credit/ Society				
ther (Specify)			4. Others Specify)				

5. **Existing Property Details:**

you already own a property	Vhether the property is/was under HFL loan: Yes/No	f yes, Loan Amount
ive full address:		
Built up Area: File No/ML No.:	Monthly Commitment	

Credit Card/Bank Account Details:

Name of A/c hold	*Name and Address of the Bank*	*Type of*	*Account*
1. 2.			

ıerty Details:

Property Address Details

No.:	r No.		of Land	t		Office use only
k No.	r No.		t up Area	t		
No.	).		ther land is freehold?			
et	ılity		you the sole owner of the unit?			
ıge/Town	r details		Is the legal title to the unit clear?			Code
			HFC be given the first mortgage of the dwelling unit?			Code
			Do you propose to rent the dwelling unit?			No.

LE

e and Adress of Builder/Vender:	In case of existing	In case of Lease: flat/house:
	Year of construction	Name of Lessor:
	Age of Flat/House:	Name of Lessee:
	Date of Sale/Agreement:	Term of Loans:
	Valid Upto:	Date of Expiry of Loans

7. **LIC Policy Details:** In case you are not insured, leave these coulumns Bank advice about policies wil be given after sanction of loan

y	ber	Assured: pplicant -applicant int	red	nium unt	e yment /H/Y	of me- nent	of rity
1.							
2.							

8. **General Details:**

Method of Loan Repayment counter Collecting bank Post-Dated Cheques Salary Savings		
What other security will you be able to provide, if required? Are you a member of any social Club? Yes No e.g.. Rotary Club, Lions Club, etc.	got to know us through Newspaper/Magazine Radio/TV Builder/Developer Friends/Relahve.	
B. References: We may make such enquiries from he referees ii deemed necessary		
Details	1	2
Name		
Address		
Phone Nos.	Off: Res:	Off: Res:

Declaration

I/We declare that all the particulars and information given in the application form are true, correct and complete and that they shall form the basis of the contract for any loan you decide to grant to me/us. 1/

RETAIL BANKING

We had no insolvency proceedings against me/us nor have 1/We ever been adjudicated insolvent and further confirm that I/we have read your brochure giving details of its loan schemes and understood its contents. I/We am/are aware that the Equated Monthly Instalment comprising of principal and interest is calculated on the basis of annual rests. I/We agree that you may take up such references and make enquiries in respect of this application, as it may deem necessary, from my/our Bankers or Employers or others. I/We undertake to inform you regarding any change in my/our occupation/employment and to provide any further information that you may require. I/We also undertake to authorize my/our employer(s) to deduct Equated Monthly Instalments from my/our salary and remit the same to you directly every month. I/We further agree that my loan shall be governed by the rules of your corporation which may be in force from time to time. I/We understand that the processing fees and Administrative fees are not refundable under any circumstances and the loan sanction or rejection is at the sole discretion of your corporation, even after payment of such fees.

In purchase cases, I/We am/are aware that the loan cheque will be given in favour of the vendor only and

(Signature of Applicant)

ee to this procedure.

'NESS:

ature

Name	ignature of Co-applicant)
nt/DO Code	ignature of Power of Attorney, if applicable)
ess	
	ace: Date :
phone	

19.4 DOCUMENTS TO BE SUBMITTED FOR AVAILING A HOME LOAN

Along with the application form, the lending institution should also call for a few other documents, which supplement/establish the particulars provided in the application form. The following is a list of the set of documents that will be called for:

- Duly completed application form
- Passport size photograph.
- Proof of identity such as Voters ID Card/Passport/Driving license/PAN card.
- Proof of residence - Recent Telephone Bills, Electricity Bill, Property tax receipt/Passport/Voters ID Card.
- Proof of business address for non-salaried individuals.
- Sale Deed/Agreement of Sale.

- Statement of Bank Account/Pass Book for last six months.
- Letter of allotment from Housing Board/Society, etc. (wherever applicable).
- Copy of approved plan, wherever applicable.
- Permission for construction, wherever applicable.
- Estimate/Valuation Report from approved valuers in respect of the property to be financed, wherever applicable.
- In case of conversion of agricultural land - copy of the relative order.
- Search Report/Non-encumbrance certificate for 13 years from Bank's Advocate.
- NOC under the provision of ULC Regulation Act. 1976 in original.

Appraisal

The appraisal comprises a validation of the information submitted by the applicant, collected by the various credit verification agencies, property appraisers, bank's solicitors etc. In the process of validation, the information is checked against the bank's policy, budgetary guidelines, risk management practices, any negative list etc.

Agreements/letters/application/forms required for the appraisal process:

- Housing Loan application.
- Appraisal form.
- Term Loan agreement for Home Finance.
- Guarantee Agreement (if required).
- Arrangement letter (Terms and conditions for Housing Finance).
- Equitable Mortgage intent letter.
- Equitable Mortgage confirmation letter.
- Letter of undertaking (where finance is availed for purchase of plot).
- Letter to be addressed by the borrower to his/her employer.
- Letter to be addressed by the borrower's employer to the Bank. Letter when the applicant himself/ herself is the drawing officer. Mortgage Deed (in case of Registered Mortgage)
- Mortgage Confirmation Letter.
- Documents in connection with pledge of other securities, wherever applicable.

Appraisal form for a Home Loan

I. Eligible loan amount

Eligibility: The lender could have a policy laying down the criteria for acceptance of a home loan exposure, against which a loan application is checked. The parameters could be:

- A preferred age group.
- Minimum salary/income level.
- Areas/localities where home loan will be given; and areas where he will not take an exposure.
- Negative list containing other disqualifications.

The banker/lender would be well advised to develop such Risk Asset Acceptance Criteria (RAAC). This will ensure that the portfolio quality is developed and maintained in terms of the policy of the bank. Leaving the same to the skills of the several credit officers of the institution could result in disparate credit standards being applied in selection of the borrowers

Parameter 1:

(a) Loan Amount Requested
(b) Cost of purchase/construction/renovation/repair of flat/house Plus registration fee/stamp duty
(c) Amount under (b) above less margin stipulated
(d) Loan amount: (a) or (c) whichever is less

Paramet er 2:

Rs. Rs.
Rs.
Rs.

(a) Gross monthly income Gross income of the applicant Add: Income of the spouse, if any Add: Other income, if any (say 50-60% of future rental) **Total**

Rs. Rs.
Rs.
Rs.

Net monthly income:
Net income of the applicant
(b) Add: Net Income of the spouse, if any
Add: Other net income, if any
(say 50-60% of future rental)
Total

Rs. Rs.
Rs. Rs.
Rs. Rs.
Rs. **Rs.**

(c) (d) (e) Certain multiples of (a) (say 36 times)
Certain multiples of (b) (say 60 times)
Loan amount (c) or (d) whichever is higher
Eligible loan limit: Lower than Parameter 1 **or Parameter** 2

(In case of take-over, the loan amount should not exceed the balance principal outstanding)

A. B. EMI for eligible loan amount for a repayment period of ... years Rs. Net monthly income minus 40% of Total Monthly Gross Income Rs. (B should be equal to or more than A)

II. Service Eligibility

Minimum years of service .... years (applicable for loan to salaried class people)

III. Age Eligibility

- Present age of the borrower
- Repayment period
- Age at the end of the repayment period
- Retirement age (in case of salaried class people)

IV. Legal Opinion

- Date of opinion
- Name of the advocate (who should be in the panel of the financing institution)

V. Valuation Details

- Date of valuation
- Name of the valuer (who should be in the panel of the financing institution) Value of the property as per valuer's report: Rs..................
- Estimated cost of construction/repair: Rs..................
  Whether the property is encumbered: Yes/No
- If yes, name of the mortgagee
- Amount of loan taken Rs..................
- Amount of loan outstanding Rs..................

VI. Inspection Details

- Date of inspection by staff of the financing institution:...........................
- Inspection done by:...

Observation: Specific comments on interaction with neighbours/officials of society in case of existing building, discussion with builder and observation regarding the state of construction in case of a building under construction, land mark of the area, approach details to the building, boundary details of the building and any other relevant information.

VII. Rate of Interest

- Rate of interest: .... % per annum
- Type of interest: Fixed/Floating

VIII. Security Details

- Market value of the land and house/flat (proposed to be financed) Rs. Rs.
- Collateral security value, if any Rs. Rs.
- Total Rs.
- Margin (.................. %)
- Drawing limit (Total minus Margin amount)

IX. Repayment Details

- Holiday period, if any....................... months
- Repayment to start from .... (Month) .... (Year)
- Type of EMI : Regular/Variable
- Repayment in..................... EMIs of Rs...................... each

X. Other Charges

- Processing Fee/Administrative Fee Rs.......................... Date of collection
- Upfront Fee Rs ....Date of collection........................

XI. Litigation Details, if any

XII. Relaxation/Concession, if any

XIII. Disbursement details

- First Stage: Rs ....Date of disbursement......................
- Second Stage: Rs............................Date of disbursement......................
- Third Stage: Rs............................Date of disbursement......................
- Total : Rs ....

Typical Format used by Banks for Assessment of Housing Loan

Loan for Construction of House

1. **In Case of House**

Area of Plot	Sq. ft.
Proposed built up area	Sq. ft.
Purchase Price of Plot	Rs.
Architect's fees	Rs.
Cost of construction	Rs.

In case of Flat

Area of undivided share of land	Sq. ft.
Cost of undivided share of land	Rs.
Cost of semi-finished flat	Rs.
Cost of Completion and/or additional items	Rs.
Registration Charges	Rs.
Total Cost	Rs.
Market Value as per Report	Rs.

Loan for Purchase of House/Flat (Ready Built)

Is the Unit New/Old :

Age of existing structure if old	Years
Purchase Price	Rs.
Cost of additional items	Rs.
Total Cost	Rs.
Area of Plot/undivided share of land	....
Built up area in Sq. Ft.	....
Market Value/Land Value	Rs.
Structure Value	Rs.

Loan for Extension

Age of Existing structure	....
Plot Area/Built up area of Flat	in sq. ft.

- Market value of existing structure Rs.
- Is the property mortgaged to any institution? YES/NO
- If yes, name of Institution ....
- Value of outstanding loan ....
- Mortgage Value Rs.
- Details of proposed repair/extension ....
- Estimated cost of repairs/extension Rs.

5. **Loan amount request:**

Cost of Property	*unt in INR*	*Source of funds*	*unt in INR*
1. Cost of land		1. Amount already invested	
2. Cost of construction extension		2. Savings in Bank	
3. Cost of amenities, service charges		3. Disposal of investment, property	
4. Cost of repairs, improvement		4. PF (a) refundable	
5. Cost of flat/house		(b) non-refundable	
		5. Others, specify	
6. Cost of stamp duty, electrical connections, municipal charges		6. Loan applied for	
Total costs*		**Total funds**	

"Total cost should equal Total funds

19.5 OTHER RELEVANT ISSUES AT PRE-SANCTION STAGE Interest

Both, fixed rate loans and floating rate loans may be offered. **Insurance**

The house/flat should be insured against the risk of fire/ riots/ earthquakes/ lightning/ floods etc. **Moratorium**

A repayment holiday may be allowed for a home loan when the construction is undertaken by a reputed builder, a Government agency etc. and the borrower makes payments in stages over the construction period. The moratorium will be upto 18 months after the first disbursement of the loan or two months after completion of construction.

Equated Monthly Instalment (EMI)

The monthly repayment by the applicant is related to his cash flow. There is an element of interest and of principal in the monthly payments. The interest payable over the period of the loan is calculated and added to the loan amount to arrive at the total payable amount. This amount, divided by the total number of monthly instalments is called the Equated Monthly Instalment (EMI).

Pre EMI interest

EMI payment usually commences one month after full disbursement. Until final disbursement and repayment commences, the borrower pays interest on the portion of the loan disbursed. This interest is called pre-EMI interest. Pre-EMI interest is payable every month from the date of each disbursement up to the date of commencement of EMI.

EMI Reset

In a floating rate interest home loan, the total dues to the lender will change when the rate of interest is changed. The lender does not usually change the EMI amount. The number of instalments is increased or reduced depending upon the change in the total dues.

Check-off facility

I. In the case of salaried persons, a check-off arrangement should be pursued. An appropriately worded irrevocable authority for making salary deductions and remittance to the lender should be taken from the borrower. The employer should be asked to record this authority and convey his acceptance to act on this instruction.

The arrangement will have the following elements:

(a) There will be an irrevocable letter of authority from the borrowers for deducting a specific amount of monthly instalment from his salary/wages.
(b) Irrevocable authority for making payment of dues to the lender out of any amount payable to the employee, terminal benefits in case of his/her retirement, resignation, discontinuance of service or death.
(c) An undertaking from the employer to obtain a clearance from the bank before settling the dues to the employee on transfer, resignation, or retirement.
(d) The check-off mechanism can work through a bank account if salary is paid through a bank; and the bank can record an irrevocable standing instruction to effect payment to the lender.
(e) The lender needs to keep himself informed of changes in the employment situation of the customer, changes in banking relationship by his employer and other factors that may affect the repayment.

II. In case of Government officers, who themselves are drawing and disbursing authorities and take housing loans, a letter of undertaking from them is sufficient.

III. The standing of the employer is clearly quite important in deciding to use the check off facility for collection of instalments.

Post-dated Cheques (PDCs)

Where check-off facility is not available to the bankers, post-dated cheques should be obtained.

In order to ensure prompt repayment of home loans, lending banks obtain post-dated cheques towards Equated Monthly Instalments (EMI). The banks have systems in place for dealing with the entire chain from custody, presentation of cheques on due dates, action to be taken on dishonour of cheques, etc.

(i) Date of PDCs

As a measure of practicality, lenders have the due date for instalments falling close to salary dates when the borrower's deposit account will contain funds.

(ii) Handling of cheques, returned unpaid

In case of cheques received unpaid from the paying banker for want of sufficient funds, the borrower should be immediately contacted. The cheque should be re-presented within a period of three days of its having been returned unpaid with written request from the borrower. In the event of the borrower failing to deposit the amount of the cheque, the undernoted procedure for initiating legal action under section 138 of the Negotiable Instruments Act, 1881, should be initiated:

Steps to be taken when a cheque is dishonoured on account of (a) insufficient funds (b) closing the account, (c) stop payment of the cheque (on account of insufficient funds).

Step 1

When a cheque is dishonoured, the bank has to give a notice in writing to the drawer within 15 days of the receipt of information by it from the finance institution regarding the return of the cheque.

Step 2

If drawer fails to make the payment of the said amount of money to the Bank within 15 days of the receipt of the notice mentioned in Step-1, Step-3 should be followed.

Step 3

A complaint should be filed before Court, within one month from the date of cause of action.

Example: If the last date for honouring the demand for payment was 1.1.2003, then cause of action is said to arise on that date. The complaint should be filed on or before 31.1.2003.

Management of PDCs is the most important measure for recovery as this ensures the regularity of repayment and prevention of overdues and NPAs.

19.6 DOCUMENTATION

The following is a listing of the documentation effort:

1. List of security documents related to the loan
2. Documents related to the property
3. Documentation where the mortgage is a second charge.

1. Documentation

Banks obtain the following documents, prior to disbursement of the loan.

- Demand Promissory Note and/or Term Loan Agreement for home loans.
- Agreement of Guarantee from the guarantors
- Letter authorising the bank to dispose of the proceeds of loan to ensure the end use of funds in accordance with the terms of sanction.
- Stamped letter of Memorandum of Equitable Mortgage (EM) for deposit of title deeds with an intention to create an EM in favour of the financing bank (or) Registered Mortgage Deed against the immovable property.
- Subrogation of mortgage agreement, in case of takeover of accounts from other bank/financial institution.
- Documents for pledge of Deposits in banks/NSC/IVP/KVP or assignment of Life Policy or hypothecation of movables. - Wherever applicable.
- An undertaking letter from the builders to the effect that they have not violated any norms or guidelines issued by Statutory authorities/Government restrictions/guidelines. (If this is not available, the branch must verify that the fiat financed has not been built in violation of the approved plan.)
- An indemnity/guarantee may be obtained if the builder has appealed to the authorities for regularisation of an unauthorised construction. (The decision to finance will depend upon the banks' judgment.)
- Valuation report from an engineer on the panel of the bank. Engineer's valuation report need not be insisted upon if the flat is acquired from Housing Board, State Development Authority/Bodies/ Local Improvement Trust. Engineer's valuation report should not be older than 5 years.
- Legal opinion from the bank's advocate
- Declaration as to whether any relative is working in the Bank's prescribed format.
- Letter authorizing the bank to furnish opinion on the borrower's credit to Credit Information Bureau of India Ltd. (CIBIL).
- No Objection Certificate (NOC) and a letter of undertaking from Housing Society (with whom flat is registered) to mark a lien in favour of the financing bank.

2. Documents relating to the house

- Sale deeds through which the applicant has acquired title to the property/Agreement of Sale along with patta.
- If parent sale deed is not available, patta is a must.
- Encumbrance Certificate for 13 years showing nil encumbrances.
- Approved Building Plan.
- Parent Documents of 30 years.
- Legal opinion from the Bank's advocate certifying clear title to the property.
- Letter of Allotment from Housing Board/Society.
- Copy of approved plan.
- License/Permit for construction.
- Estimate/Valuation Report from approved valuers.
- Search Report from the records of the Registrar under whose jurisdiction the property is located/ Non-encumbrance certificate for 13 years to be obtained by the Bank's advocate.
- Registration Receipt.
- NOC from builder/seller.
- Payment Receipts.
- Possession Certificate (where applicable).
- NOC under the provisions of ULC Regulation Act, 1976 in original, wherever applicable.
- Copy of relative order, in case of conversion of agricultural lands to homestead land.
- Certificate from the Bank/Govt, approved architect/structural engineer regarding the condition of the house/flat, in the case of purchase of old property.

3. List of documents to be obtained in case of second mortgage/pari-passu charge

- Letter from the borrower to the bank (prospective mortgagee) for extending the earlier mortgage to secure the bank's (loan).
- Letter to be addressed by the prior mortgagee to the subsequent mortgagee, stating that the existing mortgage charge will subsist and will rank prior in charge to the proposed charge and authorizing the new lender to create a further charge on the property.
- *Pari passu* letter to be exchanged.
- *Inter se pari passu* agreement.
- Letter from first charge holder addressed to second charge holder.
- Letter to be issued by Bank for having second charge on the fixed assets. (This letter is to be addressed by the second charge holder to the first charge holder).
- All documents necessary for creation of a mortgage listed in the preceding paragraphs will form a part of the documentation.

Note: Given the complex nature of the process it would be a good idea to get an advocate to vet the documentation, necessary in each case.

19.7 MORTGAGE AS SECURITY

The next section deals with an important part of the security documentation, viz. mortgage. The basic steps in creating a mortgage are listed therein. The legal position surrounding the creation of mortgage and the precautions to be taken by a lender to secure his position are discussed in some detail.

Mortgage

1. Section 58(a) of the Transfer of Property Act, 1882 defines mortgage as "a transfer of an interest in specific immovable property for the purpose of security, for the payment of money advanced or to be advanced by way of a loan, an existing or future debit or the performance of an engagement which may give rise to a pecuniary liability".

2. **Types of Mortgage:**

In India. Immovable property is accepted by the Banks as security usually by way of:

(a) Registered or Simple Mortgage,
(b) Mortgage by Deposit of Title Deeds.

(a) Simple registered mortgage

Where, without delivering possession of the mortgaged property, the mortgagor binds himself personally to pay the mortgage money, and agrees, either expressly or impliedly, that in the event of his failing to pay according to the contract, the mortgagee shall have a right to cause the mortgaged property to be sold and the proceeds of the sale to be applied, so far as may be necessary, in payment of mortgage money, the transaction is called simple registered mortgage.

Under simple registered mortgage, the Deed of Mortgage is required to be registered with the concerned sub-Registrar/Registrar of assurances by paying applicable stamp duty and registration charges within whose jurisdiction the whole or some portion of the property to which the document relates is situated, within four months from its date of execution. In this type of mortgage, property can be sold only with the intervention of the court. Thus, registered mortgage involves preparation of mortgage deed duly witnessed by two witnesses, payment of *ad valorem* stamp duty and registration of deed. Hence, it is a costly proposition.

(b) Mortgage by deposit of title deeds or equitable mortgage

1. Transfer of Property Act defines the "Mortgage by Deposit of Title Deeds" as follows:
"Where a person in any of the following towns, namely, the towns of Kolkata, Chennai and Mumbai and in any other town which the Statement Government concerned may, by notification in the Official Gazette, specify in this behalf, delivers to a creditor or his agent documents of title to immovable property, with intent to create a security thereon, the transaction is called a mortgage by Deposit of Title Deeds".
2. The essential requisites of a "Mortgage by Deposit of Title Deeds" are:
   (a) There must be a debt, existing or future.
   (b) There must be a deposit of documents of title to immovable property.
   (c) The deposit must be made in one of the notified towns.
   (d) The deposit must be made by the mortgagor or his agent with the mortgagee or his agent.
   (e) The deposit must be made with an intent to create a security for the debt.
   (f) Letter of intent should be obtained. Necessary entry should be made in the document register.
3. A mortgagee has the same rights under equitable and registered mortgages. So, an equitable mortgage will have priority over subsequent registered mortgages. An equitable mortgage remains valid as

long as the mortgagee retains the title deeds. If the mortgagee parts with possession of the title deeds, the mortgage will stand extinguished. If, however, the mortgagee parts with the possession of title deeds for a specific purpose, like examination by the solicitors or advocates of the intending purchaser of the mortgaged property, or for the creation of subsequent mortgage in favour of a second mortgagee on a specific understanding with the latter that the earlier mortgage is to subsist, the mortgagor will not be deemed to have parted with possession although he has parted with the custody of the title deeds.
4. The remedy of the mortgagee under an equitable mortgage is only sale of the mortgaged property through the court (i.e., suit for sale). One can tabulate, as follows, the transfer of rights in case of simple mortgage and equitable mortgage:

Particulars	›le gage	Equitable Mortgage
·ansfer of possession	No	No
ortgagee's right		
(i) To sue for personal liability		Yes
(ii) To sue for sale of mortgaged property	es	Yes

(iii) To sue for foreclosure	No	No
(iv) To sell property without court's permission	No	No
(v) To enjoy income out of mortgaged property	No	No
(vi) To appoint receiver with court's permission	No	No

Right of Foreclosure

On default by a mortgagor, in case of mortgage by conditional sale the mortgagee has the right to sue for a decree from the court to the effect that the former be debarred forever to get back the mortgaged property. Such a right is called Right of Foreclosure, which is provided for under section 67 of Transfer of Property Act. A suit for foreclosure must be filed within 30 years from the day the mortgage money becomes due.

Priority of Charge

1. Where a mortgagor creates more than one equitable mortgage over the same property in favour of two financing institutions, the institution in whose favour the mortgage is created first, has priority of charge.
2. Where a mortgagor has created separate registered mortgages over the same property in favour of two or more financing institutions, the priority of charge will be determined with reference to the date of the execution of the deeds which has been duly registered within four months of execution (not the date of registration).
3. Where a mortgagor gives the same property in equitable mortgage to one financing institution and in registered mortgage to another financing institution, the priority of charge will be determined with reference to the date of deposit of title deeds in equitable mortgage and the date of execution of registered mortgage deed. An equitable mortgage in no way gives inferior rights compared to a registered mortgage.

Important aspects to be looked into while obtaining equitable mortgage of immovable property :

1. It must be borne in mind that establishing title to property requires the expertise of an advocate, to whom the documents must be referred for clearance. The title to a property may have been derived out of differing conveyance acts, like partition, settlement, gift, decree of a court etc. and, therefore, the documents called for from the customer, as listed in the earlier paragraphs, are just generic. The bank's advocate will interact with the customer and will ask for and obtain all other necessary documents to establish title and the chain of ownership. All of these documents must be deposited with the bank to create a valid mortgage on the property.
2. Where mortgage cannot be readily created, an agreement to mortgage should be taken. This is a deviation from policy and is done at the absolute discretion of the lender, after appropriate internal approvals. There has to be an undertaking that by a certain future date, the underlying mortgage must be created. The responsibility for following this up and completing the formality lies with the credit officer of the lender bank.
3. Where immovable property (of which land is the main constituent) is taken as security (primary or collateral) either by way of registered mortgage or equitable mortgage, the following aspects should be looked into:

   (a) tenure
   (b) valuation
   (c) title of land

Tenure of Land

1. It is necessary to ascertain the tenure of land, viz., whether it is freehold, leasehold or state-owned. If it is freehold, the question of obtaining the consent of any person other than the owner does not arise. Under freehold tenure, the owner is the absolute owner of the land; he is only liable for payment of rates, taxes and assessments to Government and local authorities.
2. In leasehold tenure, the land is held for the period and on the terms and conditions contained in an instrument called 'Deed of Lease'.
3. In the case of State-owned lands, the ownership vests with the State or Central Government as the case may be and the holder of such land will be entitled to occupancy rights only.

Valuation of Land

1. The value of land should be examined to determine whether the price paid for the land is in line with the prevailing prices for similar land in the area. Where the land is not of recent acquisition, it is very important to assess the value of the land in line with the present market trend. The following steps help in this:
   I. personal inspection;
   II. comparison with recent sales of similar properties in the neighbourhood; and
   III. enquiries from parties having a good knowledge of local land values.
2. For this purpose, the assistance of qualified valuers is taken. The valuation given in their report should be cross-checked by independent (inquiries).
3. In general, while determining the value of the property to be mortgaged, allowance must always be made for the fact that the price realised under a forced sale often falls short of the real worth of the property and that it usually takes a considerable time to sell landed property even at a reduced value.

Title to property

1. The same amount of care as is taken for purchase of a property should be taken in investigating the title of the property to be mortgaged. A good 'root of title' is "a document which deals with the whole legal and equitable interest in the land, describes the property adequately and contains nothing to throw any doubt on the title". Copies of title deeds are not documents of title, the only exception being the case where the original has been destroyed or irretrievably lost and is not in existence. Certified copies of the title deeds issued by the Registrar of Assurances should, therefore, be accepted only in exceptional cases, where there is conclusive proof that originals have been destroyed or irretrievably lost.

2. In view of the priority of the Government's rights over the mortgage in the Bank's favour in the event of the borrower keeping the land revenue/other public dues in arrears, it is, therefore, necessary to ensure that:

(a) all land revenue and municipal taxes due on the immovable property have been paid upto date;
(b) all land revenue and municipal taxes accruing or falling due, subsequent to the creation of the mortgage are paid promptly in future;
(c) no income tax dues are outstanding, to avoid any claim of priority under section 295 of the Income Tax Act.

3. Reference to advocates/solicitors: The task of investigation of title and scrutiny of title deeds should be entrusted to advocates/solicitors and specific and categorical opinion should be obtained on the following points:

(a) Whether the documents of title are complete in all respects and sufficient to convey a clear, absolute and marketable title to the property;
(b) Whether the property offered as security to the bank is unencumbered/unattached;
(c) Whether the documents examined and based on which the opinion is furnished, form a complete set of documents of the subject property and deposit of these create a charge on the property;
(d) Whether the persons seeking to secure the property to the bank have a clear and marketable title thereto and are legally capable of creating the charge thereon in favour of the bank; and
(e) Whether the property is subject to any tenancy law, which will affect the bank's rights eventually to take possession thereof or cause it to be sold or otherwise exercise its rights as mortgagee.

4. Search to be carried out: Search of the registers and other records with the Sub-Registrar of Assurances, Collector and/or other revenue authorities should be carried out by the local advocates or the banks' solicitors, if and when considered necessary, for ascertaining whether there is any outstanding mortgage or charge on the property to be mortgaged to the Bank.

19.8 DETECTION OF FORGED AND FABRICATED TITLE DEEDS

The title deeds submitted by the applicants need to be examined to detect any fake/forged title deeds. The following are certain tips:

(a) Schedule of property and Registration of the document: It is necessary to verify the Schedule of the property where it is situated and the Registration of the same with the Sub-Registrar Office concerned. Any discrepancy could indicate forgery/fraud.
(b) Stamp Duty affixed on the document and the consideration shown in the document: It is necessary to verify the consideration paid in the document and also verify the Stamp Duty affixed on the document.
(c) Affixation of stamps, cancellation and date of execution: It is necessary to verify the source of purchase of stamps and its cancellation and also the execution of the document. The execution of the document should be subsequent to the cancellation of stamps/date of purchase.
(d) Examine security marks on the stamp paper, which are visible only on a close examination. The stamp paper should not be mutilated.

19.9 OTHER SECURITIES

The lender, at his discretion, may accept LIC policies, Government promissory notes, shares and debentures, gold ornaments of adequate value if a mortgage of property being financed is not possible. Margins stipulated for loans against these securities shall apply.

Monitoring

Monitoring relates to post-sanction activities, dealing with proper documentation, disbursement, in a manner, to ensure the proper end use of funds, periodical inspection, follow-up of recovery, restructuring of loan if needed, etc. It is a function of the credit administration department.

In some banks, the risk management department has to indicate by a certificate that documentation is in perfect order before disbursement can be authorized. If a part of documentation is incomplete and risk management does not sign off. the Manager (Credit) will have to seek waiver of procedures prescribed in policy before authorizing disbursement. Banks have well laid written policies on the level of authority, which must approve such waivers. For example, if a guarantee document is to be signed by four brothers of an applicant for a loan and one of them has not signed it for a reason acceptable to the bank, then such a fact must be recorded and a waiver sought to release the disbursement without the signature of the fourth guarantor. The waiver is usually accorded for a specific period of. say, one month up to a maximum of three months and by appropriate authority.

The discretion to approve the waiver in a single disbursement loan will be at higher levels than in multiple disbursement loans. This is because if in the period of waiver the lacuna in the documentation is not removed with completion of documentation, then further disbursements can be stopped.

Other routine checks that the credit administration will perform:

1. Check that the sanction letter contains complete particulars, records all covenants fully and is signed by authorized bank officials. Some banks require that the risk management officer sign on the sanction letter attesting that it is prepared in accordance with the policy of the bank and all terms of sanction have been incorporated in the letter. The authorized officer of the bank can sign the sanction letter only after it has been so signed off.
2. Check if the letter has been signed off by the borrower/guarantor acknowledging/agreeing to the terms and conditions.
3. Check that all the documents are complete in all particulars, with no blanks left and that these have been signed by the bank representative and borrower/guarantors.
4. Check that required registration of documents has been done.
5. Check that insurance policy is in place.
6. Noting in daily lists has been made to follow up renewals, instalment payments, inspection etc.

Inspection

Inspection should be conducted as stipulated in the sanction. A record of the inspection must be kept in the files. The inspection report must carry notings on the condition of the property, verification of payment of tax dues, and details of any other encumbrance noted. Annually/Periodically, a fresh encumbrance certificate must be obtained. Any change in the condition of the property should trigger a full-scale review.

Recovery

Check that EMI payments are coming in on due dates or that the post-dated cheques are being honoured on presentation. If the bank's accounts have been "computerized", there will be a detailed computer generated daily exception report on the defaulting accounts.

Restructuring

A home loan may have to be restructured when delays turn into defaults. A restructuring is considered where the borrower's integrity is not doubted and his willingness to repay the loan is clearly established and only his ability to do so is impaired. If the cash flows are found inadequate to pay in accordance with the EMI set, but enough to pay the loan over a longer period of time, then the EMI could be reset. The lender may also allow the borrower to repay the loan without changing the EMI, but allowing him to repay all the overdue and other interest charges in an extended period. There should be a written request from the borrower and the guarantor for taking up this exercise.

Other circumstances when a restructure may be considered:

- Unforeseen event/major illness/social functions requiring significant outlay of funds in the family of the borrower or any other circumstance that affect the repayment capacity.
- In case of salaried class, borrowers who are on "loss of pay" due to lock out/strike/disciplinary action/delayed payment of salary by employer

- Delayed completion of housing project.
- Death/Disability of the borrower.

However, wilful defaulters should not be covered under restructuring programs.

Annual Review of Credit Rating

The credit rating should be reviewed annually. Annual credit rating could include parameters like

(a) Record of repayment during the past 12 months.
(b) Documentation as per sanctioned terms.
(c) Percentage of security coverage of the outstanding loan.
(d) Land value as percentage of total property value (guidance value).
(e) Improvement in income level (as confirmed by Income-tax returns) plus including rental income at the post-sanction stage.
(f) Liquidity of the borrower in terms of deposits with the financing institution, to cover certain minimum number of EMIs.

Purchase of Old Property

The property should be valued afresh in accordance with the policy of the lender relating to old property. A structural condition certificate should also be taken from a Chartered Engineer, to verify that the condition of the fiat is such that the residual life of the fiat/house is adequate to cover the period of the loan. All other formalities and documentation for home loans will apply.

Closure

On repayment of the scheduled EMI or the outstanding loan amount along with interest due, penal charges, processing/servicing/documentation fees, if any, the loan account is closed. If the borrower has no other direct, indirect outstanding or contingent liability to the financing institution, the charge created in favour of the lender can be closed and documents of title to the property can be returned under acknowledgement of receipt.

It should be carefully considered whether the house/property is being bought for accommodation or for investment expecting appreciation of value over a period. In case of the latter, the loan should be considered as one having a higher risk with necessary improved margin/security/guarantee.

Home Loan Frauds

Studies have shown that the home loan market has multiplied 11 times in five years, with credit deployment increasing from Rs. 14,100 crore in 2000 to Rs. 153,267 crore by October 2005. This is great news, since adequate housing is a key factor in India's transformation. The bad news is that nationalised banks are another big target of home-loans fraudsters and defaults. A year ago, in one PSB officials colluded to hand over loans of Rs. 25 lakhs each to 110 workers of a construction company based on a single sheet of fake documentation. The money was quickly transferred and routed through several accounts and found its way to Mumbai. An investigation was launched, but the information was carefully hidden from the public. More recently, six nationalised banks and a housing finance company were cheated in Gujarat when the borrower was found to have used the same set of documents to borrow from each bank and defaulted in every case. This case too is being quietly investigated by the police. A leading bank reportedly shut down it home loan operations at certain branches after detecting collusion by its own staff in various frauds. Worryingly, the numbers are adding up.

Keywords

Power of attorney: It is an instrument empowering a specified person or persons to act for and in the name of the person executing it. The person for whom the act is done or who is so represented is called the principal. The person who is so authorised to do or represent is called the agent. It may be either notarised or registered depending on the transaction.

Let Us Sum Up

The process begins with receipt of application form along with the required documents giving information about applicant, employment, loan amount, sources of finance, property details etc. Then the bank undertakes the appraisal of the proposal. It comprises the validation of the information submitted by the applicant. After sanction of the loan the documentation work is initiated and completed. The mortgage formalities are completed. The mortgage may be of two types ***viz.*** registered (simple) mortgage or by deposit of title deeds. Issues relating to the right of foreclosure and priority of charges are settled and accordingly mentioned in the mortgage deed. The lender also gives due importance to monitoring of the loan accounts. Monitoring relates to post-sanction activities, dealing with proper documentation, disbursement, ensuring end use of funds, periodical inspection, follow-up of recovery, restructuring of loan if needed, etc. On repayment of the loan amount along with interest the loan account is closed and the charge created in favour of the lender is vacated and documents of title to the property are returned to the borrower.

Check Your Progress

(i) Prepayments charges collected by branches should be credited to which account?

(a) Interest A/c
(b) Commission A/c
(c) Exchange A/c
(d) Current A/c

Ans: Interest A/c

(ii) To consider the loan amount under housing loan scheme which of the following statements are true?

(i) the property is jointly held with the spouse and the spouse is co-borrower

the property is held in single name and the spouse stands as a guarantor the borrower's son or daughter who has a steady income, the salary is routed through Bank account and joins as a co-borrower
expected rental less taxes, cess, etc., in case the house/flat being purchased is proposed to be rented
Regular income from all sources can be considered to arrive at total eligible loan amount.

(a) All the above
(b) a,b,d & e
(c) a, d & e
(d) a, b, c & e
(e) a, c, d & e

ans: All the above

(iii) Mr. Satish Kumar working as a Senior Gazetted Officer in a Government Department having 20 years left over service was recently transferred to Hyderabad. He approached a branch and requested that he is in pursuit of a good house or apartment in Hyderabad for immediate purchase and he requires in principle sanction. Whether the Bank accede to his request? If so, it is valid for how many months?

(i) No. We cannot accede to such request
(ii) Yes, it is valid for one month
(iii) Yes, it is valid for three months
(iv) Yes, it is valid for six months
Ans: Yes, it is valid for three months

(iv) State whether the following statement is true or false:
If the house property is bought purely from investment angle, expecting appreciation of value over a period, the loan should be considered as risky and dealt with differently by tightening norms relating to margin, security and guarantee.
Ans: true

Answers to Check Your Progress

(i) Interest A/c
(ii) All the above
(iii) Yes, it is valid for three months
(iv) True

Terminal Questions

1. List out the circumstances, where the commercial banks are restructuring the terms of the home loans.
2. List out the various documents that are required by the commercial banks for sanctioning of a home loan.
3. Who can be co-applicant?
4. Mow is the home loan eligibility determined?
5. What is the maximum amount which an applicant can borrow?
6. What are the types of home loans available?
7. Can one take a home loan for a construction in a city while working in another city?
8. Can persons of Indian origin holding foreign passports get loans from Indian banks?
9. What security does the applicant provide to avail a home loan from commercial banks?
10. Write short notes on the following:
    (i) Simple registered mortgage.
    (ii) Right of foreclosure.
    (iii) Priority of charge.
    (iv) Restructuring of home loan.
11. What documents are required to get the loan sanctioned?
12. What is pre-EMI interest? How is it calculated?
13. When the EMI commences for the housing loan?
14. Can the EMI be reset during the tenure of a loan?
15. Can the EMI be fixed upwards?
16. What is the importance of an amortization schedule?
17. When is the IT certificate issued?
18. What is the security for the loan?
19. When will the lender disburse his/her share of housing loan?
20. What is property insurance?
21. Whether additional loan and extension of repayment period is possible in case of takeover of home loan?
22. How is the worth guarantor calculated?
23. What are the special features of a housing finance scheme for Persons of Indian Origin (PIO)?

UNIT 20 SECURITISATION - MORTGAGE BACKED SECURITIES

STRUCTURE

20.0 Objectives

20.1 Introduction

20.2 The Need for Securitisation

20.3 Securitisation - Concept and Rationale

20.4 Other Securitisation Efforts

Let Us Sum Up Keywords

Terminal Questions

20.0 OBJECTIVES

After reading this chapter you would have learnt the following:

- Concept of securitisation for generation of funds by selling loan portfolio
- *Modus operandi* of securitisation
- Mortgage Backed Securitisation (MBS)
- MBS in the Indian scenario and efforts made by NHB for popularization of MBS

20.1 INTRODUCTION

Simply put, 'securitisation' means the conversion of existing or future cash inflows to any person into tradable security which then may be sold in the market. The cash inflow from financial assets such as mortgage loans, automobile loans, trade receivables, credit card receivables, fare collections become the security against which borrowings are raised. In fact, even individuals can take the help of securitisation instruments for better economic efficiency, *e.g.*, an individual having regular inflows by way of rent from property can raise a loan by offering his/her rent receivables as security, *i.e.*, the rent receipts will first be used to pay the loan and then for other purposes. Since the lender is assured of regular cash inflows, there is an enhanced element of creditworthiness and, therefore, he/she may offer the loan at a lower rate of interest. Of course, corporate securitisation deals involving crores of rupees are much more complicated. The importance of securitisation lies in the fact that it helps convert illiquid assets or future receivables into current cash inflows and that too at a low cost. The company may sell the receivables in the market and raise loans.

20.2 THE NEED FOR SECURITISATION

The funds required for new housing are estimated at Rs. 140,000 crores for the next five years. The HFCs, banks and other lenders do not have resources of this magnitude to allocate specifically to home loans.

Banks generally lend for a short-term in the form of cash credits, with a repayment cycle of 12 months. The funds therefore become available for another cycle of lending in a period of a year. On the other hand, home loans have a life of 5 to 20 years, with probably an average life of 15 years. These funds therefore are not available for fresh lending for a long period of time.

In theory, one method by which the banks can generate fresh funds is to sell the home loan assets in the financial market. This would bring in funds into the banking system for fresh loans and each time a lender does this, he will be able to generate a new pool of home loan assets and earn new fee income. Of course, such sale of assets can take place if there are savers in the system looking for investments in assets; and market has adequate depth to create a continuous demand for the home loan assets that the lenders will place in the market.

If all placements of banks in the market were fully picked up by investors things would be smooth for the banker. This however does not happen. The market consists of players with differing expectations for investments and returns. They have no appetite for the home loan book of a bank, with all its retail lending features. These assets are transaction intensive and need regular follow-up and require an organization to manage the assets. In their original form, only other bankers with similar capabilities will be interested in acquiring these assets. Such a match of sale and purchase requirement would be rather rare, although it does happen. In general, though, the market players have different characteristics, relating to:

- *Risk Appetite:* Market contains participants with varying risk appetite. Some would prefer a low risk asset with an acceptable return, while another class of investors may accept a higher risk profde for a higher return.
- *Maturity:* Home loans have an average maturity of 15 years. The investors however may look for investments with a lower maturity. The average bond market investor may accept a maturity of 7 years.
- *Return Expectations:* The return expectations will be different. While every investor would expect a return higher than what a sovereign risk would pay, each class of investor would accept a different level of bond interest payment, depending upon its structure.
- *Periodicity:* Periodicity in which each investor would expect interest payments and the structure of interest payments, linked to fixed rate instruments or floating rate instruments.
- *Liquidity of Promissory Note:* If there is a well-developed secondary market, investments will come in easily. If not, the investor will expect a higher risk premium; or the sale of home loan assets may not take place, leaving the asset book to be carried by the bank.

Therefore, home loan assets have to be appropriately structured to meet some or all of these needs before they can be marketed. Before studying how such structuring is done, we can look at what are the features available in a home loan portfolio of a bank:

- Home loans are supported by mortgages. So, there is a pool of mortgage assets available for packaging as collateral for a bond/promissory note issue.
- Home loans are placed on monthly - and in some cases quarterly - repayments. As such, there is a pool of receivables.
- It would be possible to select home loans (mortgages), representing a mix of assets with average residual life of, say, 5 years, 7 years or 10 years etc.

The next step is to think in terms of structuring a bond or promissory note with features that would make it attractive to the market. The Lending Institution (Known as LI) who desires to raise funds by selling the home loans might take the following steps:

Approach another banker, (say "Bank A") to

1. Buy the identified class of home loans off the lender's books.
2. Accept the mortgages of the pool of home loans as security for the issue of promissory notes/bonds, which the "Bank A" would market.
3. Bank A would decide the size of the issue that can be marketed.
4. Bank A would determine the features of security, like (tenure), coupon rate, security needs etc. that would be well received in the market and recommend it to the lender.
5. "Bank A" would set up a trust that would deal with the management of promissory note issue. (The points to be taken care of would be, to secure the promissory notes, document the security, document the transaction between the lender and the trust, ensure that money is received either from the pool of home loan assets bought off the LI or from the lender who may be asked to continue to monitor and manage the loans in his book on behalf of the trust etc.)
6. The LI itself may not be able to issue the securities, if the, market perception is that he does not have a LI AAA risk. Perhaps, its home loan book may not get a good credit rating. Either of these would lead to the intervention of Bank A who would issue a letter of credit or a guarantee to enhance the credit of the proposed promissory notes/bonds.
7. Discuss and finalise the trustee's management fee, note issue charges, mortgage creation charges, and price the promissory note/bond. That is, decide the coupon rate of interest the note/bond will carry.
8. Discuss and decide how the receivables will be dealt with in future, whether they'll be received by the present LI and then passed on to Bank A or will be directly received by the bank.

9. Discuss and decide how shortfalls in monthly/periodic collections will be met. It is possible that the pool of mortgages or loans being sold may include a surplus amount as margin to deal with this contingency, based on historical rates of default/delinquency of the home loan book of the LI.
10. Bank A acts as a matchmaker between the LI who wants to off-load some assets from its books and the retail investor who is looking for return on his funds.

It is obvious that there are a number of issues, which would need to be resolved in structuring a mortgage backed securitisation effort. Each such effort would be unique and would depend upon

- The quality of the home loans (mortgages), the security value, the receivable quality.
- The history of collections, delinquencies.
- The home loan lender's credit rating.
- The probable rating for the proposed security, by a rating agency.
- Issue costs, including credit enhancement costs, trust management costs etc.

The housing finance system in many developed countries, particularly USA and UK, is characterised by the presence of a strong secondary market which enables the mortgage originators to off-load their loan portfolios from their balance sheets by selling them off to major players in the secondary market. This imparts greater liquidity to the system and results in larger funds flows to the housing sector. In India, the National Housing Bank is making an effort to create a market for such securities.

20.3 SECURITISATION - CONCEPT & RATIONALE

The process of converting mortgage loans (any loan for that matter) together with future receivables into negotiable securities or assignable debt, is called securitisation. It involves the steps discussed above viz. packaging designated pool of mortgages and receivables and selling these packages to the various investors in the form of securities which are collateralised by the underlying assets and their associated income streams.

Securitisation involves conversion of mortgages into securities, which are tradable debt instruments. The securities, which are backed by the mortgages, are then freely traded in the market, giving rise to a secondary market. The process helps the lender to re-assign his capital to different asset building efforts.

maybe even exit the home loan segment and enter other fields. This also facilitates inter-regional and inter-sectoral flow of funds.

Flow Chart - Securitisation

Originator

Functiona
l

Secondary
Investors

ender sells
loans to

Special
Purpose
Vehicle (SPV)

'V can

Investor 'V
purchases
PTC Bank 'A'

sell PTCs in Secon-dary Market

Securitisation is a process by which a selected pool of homogenous and quality credit assets (loans) of a lending institution is sold to investors through a trust/intermediary by packaging them in the form of securities, which are transferred by way of Pass Through or Pay Through Certificates (PTC). All homogenous assets having similar characteristics for maturities, interest rates, realisation, return etc. are pooled together by the lending institution and a Total Asset Base (TAB) is created. The investment 'quality' of this asset is established through credit rating.

Here we discuss one particular form of securitisation. In the above flow chart, the lending institution assigns/sells its receivables to Bank 'A' who acts as the special purpose vehicle and functional trustee. Bank A pays the discounted value of the receivables to LA, who issues a pass/pay through certificate in the form of a receipt to the former for having received the money. LA may continue to act as the receiving and paying agent. In that case, even after selling the debt, it collects the receivables due (principal and interest due on the underlying loans) and passes out the collections to the trust for distribution among the investors towards part or full liquidation of securities.

The trust notionally splits the pool of assets into small units/shares and sells the Pay Through or Pass Through Certificate in the form of negotiable promissory notes/bond to interested investors.

Asset-backed securities (ABS) can be structured in two different ways. The first is the 'Pass Through Structure'. This is generally used for loans with a tenure of more than one year, such as, car or housing loans. In a Pass Through Structure, a bunch of loans are converted into ABS. The maturity of the ABS is usually comparable to the tenure of the loans. The returns on ABS are paid directly from instalments of the loans.

The second structure, called the 'Pay-Through Structure,' is generally used for loans of short maturity such as credit card receivables. The ABS in this case are issued for longer periods than that of the loans securitised. This calls for active cash management by the issuer since he will have to reinvest the money he has received from instalments. The ABS holders are paid from the returns on this reinvestment.

Mortgage Backed Securitisation (MBS)

The concept is popular among housing finance companies in the west. The home-loan assets are bundled into securities and sold to investors. These are called mortgage-Backed Securities (MBS) because the pool of receivables sold to the SPV is supported by the mortgaged home-loans. MBS is structured in such a way that the HFCs simply pass on the cash flows from payments to the investors. Typically, a third party guarantees investment in MBS. In the US, for instance, Ginni Mae and Freddie Mac guarantee MBS. Besides, MBS offers a good yield to compensate for the re-investment risk. The guarantee and the yield make MBS an attractive investment. To structure an MBS, the HFCs, typically bundle loans off like maturities but as those that have differing credit risk for securitisation. A company can, for instance, bundle 500 individual loans with an average maturity of 10 years but varying credit risk into 10 years MBS. Such loans are actually transferred to a Special Purpose Vehicle (SPV) created for this purpose. It is the SPV that issues the securities to the investors. In order to pay for this portfolio, the Special Purpose Vehicle (SPV) in turn issues securities to the investors at a discounted present value.

There are two basic methods of securitisation. First, the originator does not actually sell the assets to the SPV. It merely enters into an 'agreement to assign' with the trustee. Accordingly the legal title of the pool of assets remains with the originator and only the beneficial interest in the portfolio of receivables held, is transferred to the SPV. This procedure is followed to avoid the high stamp duty ranging from 3-15% payable on the transfer of assets, but a nominal stamp duty still has to be paid, when the SPV issues certificates or securities in the form of receipts to the investors. However, these receipts are not negotiable instruments and, hence, not very liquid. Alternatively, the originator sells the assets i.e. transfers all the interest to the SPV. This transfer attracts stamp duty *ad valorem* and registration charges. In this transaction, SPV becomes the legal owner of the assets and it can issue certificates in the form of promissory notes, which are more liquid and marketable.

The MBS have not been popular in India on account of two reasons. Firstly, lack of stringent foreclosure laws. At present, if home loan borrowers default in payments, the HFCs cannot sell the property to realise their dues without going to court. The final disposal in these cases happens after long delays, with funds getting locked up, expenses going up and asset deteriorating in quality and therefore in value. This effectively kills the market and defeats attempts at securitisation. Secondly, conversion of assets into securities attracts high stamp duty, taking away any margin available for offering attractive yields. Also the stamp duty in most cases, for the SPV is very high, making it impossible for MBS to be a financially viable instrument.

Securitisation - NHB's Efforts

NHB is pioneering MBS in India. In order to introduce MBS in its true sense, NHB had to first resolve a number of issues. Such as the issues related to sale of mortgage loans (transferability of assets, method of transfer), insolvency of the originator, issuance and transferability of MBS, foreclosure of mortgages, provisions concerning investments by institutions, fiscal issues relating to borrowers, originators, issuers and investors, accounting issues and regulatory issues. Besides there were certain areas, like, selection of mortgage pools, credit rating and prepayment behaviour of mortgages which had to be examined.

As the existing law is biased against borrowers it would necessitate a large number of high quality loan originators and a large set of high quality mortgages. This would imply a narrow base of clientele among the home borrowers and act as a constraint. In order to simplify the recovery procedure, a new chapter has been added to the National Housing Bank Act. This chapter provides for appointment of officers of approved institutions as recovery officers, the procedures to make application to and hearings by such recovery officers and the procedure for promulgation and enforcement of orders by recovery officers. Further, in the case of securitised loans, NHB may, without prejudice to any other mode of recovery, make an application to the State Government for the recovery of the amount in the same manner as arrears of land revenue.
In the case of NHB the process of securitisation of home loan receivables works as follows: Securitisation process can be perceived as a two-stage process.

First stage: Transfer of mortgage debt from the primary lending institution (Originator) to a Special Purpose Vehicle (NHB SPV Trust set up by NHB through declaration) with or without the underlying security.

Second stage: The mortgage debt so acquired will be converted into tradable debt instruments (say in the form of pass through Certificates) without any recourse to the originator or the SPV.

Securitisation of Mortgage Debt: NHB SPV may purchase and convert the housing loans into securities/ PTCs concurrently and issue them in the capital market for investment by investing institutions.

Execution of Memorandum of Agreement with NHB: Based on the willingness to sell or securities its portfolio of housing loans, the Primary Lending Institution is required to enter into an umbrella agreement (called Memorandum of Agreement) with NHB to sell/securities its portfolio of housing loans. The Memorandum of Agreement encapsulates the entire MBS transaction and entitles NHB to take necessary steps to purchase or securities an identified pool of housing loans, including circulation of the Information Memorandum and collection of subscription amount from investors, as the case may be.

Selection of Pool of Housing Loans: The pool of housing loans would be selected by the Primary Lending Institution from its existing housing loans based upon a 'pool selection criteria'.

Eligibility criteria for home loans to qualify for securitisation: The home loans should satisfy the following standards for being considered for selection in the Mortgage Pool offered for securitization :

- The borrower should be individual(s).
- The home loans should be current at the time of selection/securitization.

- The home loans should have a minimum seasoning of 12 months (excluding moratorium period).
- The Maximum loan to Value (LTV) Ratio permissible is 85%. Housing loans originally sanctioned with an LTV of more than 85% but where the present outstanding is within 85% of the value of the security, will be eligible.
- The Maximum Instalment to (EMI) to Gross Income ratio permissible is 45%.
- The loan should not have overdues outstanding for more than three months, at any time throughout the period of the loan.
- The Quantum of Principal Outstanding Loan size should be in the range of Rs. 0.50 lakh to Rs. 100 lakhs.
- The pool of housing loans may comprise of fixed and/or variable interest rates.
- The Borrowers have only one loan contract with the Primary Lending Institution (PLI).

- The loans should be free from any encumbrances/charge on the date of selection/securitization. The sole exception to this norm being loans refinanced by NHB (In such cases, the loans may be securitised subject to the originator substituting the same with other eligible housing loans conforming with the provisions of the refinance schemes of NHB).
- The Loan Agreement in each of the individual housing loans, should have been duly executed and the security in respect thereof duly created by the borrower in favour of the PLI and all the documents should be legally valid and enforceable in accordance with the terms thereof.
- The Bank/HFC has with respect to each of the housing loans valid and enforceable mortgage in the land/building/dwelling unit securing such housing loan and have full and absolute right to transfer and assign the same to NHB.

The Pool selection criteria may be modified by NHB from time to time at its sole discretion.

Submission of Pool Information

The Primary Lending Institution will be required to submit loan details relating to the pool as under in prescribed formats attached.

Due Diligence Audit

The Primary Lending Institution will get a due diligence review of the loan accounts conducted by Statutory Auditors of the Company or a firm of Chartered Accountants acceptable to NHB and shall submit a due diligence and report to NHB after execution of the MoA certifying the following :—

- Each of the housing loans in the pool conforms and satisfies the selection criteria laid down by NHB.
- All the information furnished by the Primary Lending Agency to NHB with regard to the Borrower of the said agency is true and correct.
- All the documents connected with the pool of housing loans proposed for sale to/securitisation through NHB are legally valid and enforceable and the said agency has good and assignable right to each of the housing loans free and clear of any set off, cross-claims, demands, encumbrance, equity, pledge, charge, claim or security interest thereon.
- None of the housing loans has been sold, assigned, transferred or pledged to any person and I IK-HFC is sole legal and full beneficial owner of these housing loans and has full right to transfer and assign the housing loans to NHB.

Valuation of the Pool and Consideration of Assignment

NHB will consider making payment of purchase consideration to the Primary Lending Agency under the following methodology, with a view to obtain a sound and efficient pricing structure to the benefit of originators:

(i) Per Pricing Methodology: The consideration payable to the Primary Lender for transferring the pool would be equal to the total future outstanding principal balances of the individual loans on a Cut-Off Date.

(ii) Premium Pricing Methodology : The consideration paid to the Primary Lender for transferring the pool would be decided and paid on the basis of discounting of future stream of net cashflows relating to the pool. It shall normally be higher than the total outstanding principal balances of the individual loans on a Cut-Off Date as the discounting rate used shall be lower than the weighted average coupon of the pool.

(ii) Discount Pricing Methodology : The consideration paid to the Primary Lender for transferring the pool would be lower than the total outstanding principal balances of the individual loans on a Cut-Off Date as the discounting rate used shall be higher than the weighted average coupon of the pool due to higher risk perception.

Salient Aspects of Valuation

- The outstanding principal of the underlying home loans should not be less than the face value of the RMBS papers.

- Pool Receivables : The HFC shall assign, transfer and convey to NHB (either in its corporate capacity or in the capacity of Trustee) for securitization the balance outstanding principal of these housing loans as on the cut off date and all future interest due thereon together with all its other rights, titles and interest in relation thereto and in the mortage or other securities therefor.
- As per the structure of the arrangement between NHB and the PLI, interest differential portion of the pool *(i.e.*. Weighted Average Coupon of the pool less the Total Cost of the Transaction including coupon interest payable to the buyer of housing loans/investors in MBS, as the case may be), may be structured as continuous stream of subordinated cashflows in the form of either an "Excess Servicing Fee" or "Income on Investment in a particular class of MBS or in some other form.

Note:

In respect of (ii) *and (m) stated above, the net cashflows shall he arrived at by deducting the recurring expenses such as rating surveillance fee, trustee fee, registrar's fee, listing fee, audit/out-of-pocket expenses, and any other form of credit enhancement measure as decided in the structure, from the gross cashflows. The discounting factor shall be determined on the basis of some realistic assessment of the prevalent rate of interest in the debt market in respect of similarly rated papers as well as risk being transferred under the transaction and the risk premium perceived thereagainst, including assessment of the capabilities/credit-worthiness of the service provider.*

NHB will not purchase any overdue EMIs or penal interest/out-of-pocket expenses outstanding in the originator's books as on the cut-off date. These amounts as and when collected from the respective borrowers will be retained by the originator or shall be allowed to be deducted from the first month's collection after the cut off date as agreed to between parties.

Working Out Cut off Date Balances

The outstanding principal as on the cut-off date, may be worked out by adjusting the original loan amount to the extent of the principal component of the EMIs payable up to the cut-off date together with the adjustment for any prepayments received during this period. Any EMI/other charges remaining unpaid as on the cut off date shall be shown separately as the cut off date receivables.

SECURITISATION – MORTGAGE BACKED SECURITIES

Credit Enhancement

In order to maintain a AAA rating and to improve the performance of the pool as also to ensure uninterrupted cashflow for yielding the indicated coupon interest to the purchaser or subsequent investors in the MBS paper, the Rating Agency or NHB may insist for additional credit support (called credit enhancement) under the transaction. The credit enhancement may be provided in various forms such as setting aside a cash pool (called cash collateral account), limited corporate guarantee, third party guarantee, setting aside an additional mortgage pool (called over-collateralisation), investment in sub-ordinated MBS paper (in the event of securitisation) etc. In the event of securitisation of mortgage debt abinitio, credit support will be sought on the basis of recommendation of the credit rating agency.

Liquidity Adjustment Facility

In view of delayed receipt of instalments from some borrowers at times and grace periods allowed by the primary lending agencies to its borrowers, collection efficiencies may vary from month to month leading to inadequacy of cashflow required for servicing. In order to protect the purchaser of housing loans/ investors in MBS from such uncertainties, there may be a need to set up a 'liquidity Adjustment Facility' as a temporary stopgap arrangement. NHB may decide the size/quantum of such a facility and require the seller of housing loans to provide such a facility separately or in combination with the credit enhancement provided by them. NHB may also consider outsourcing such a facility at a cost to be borne by the seller or out of the pool cashflows depending on the structure of the arrangement.

Custody of Mortgage Documents

While the mortgage debt or the receivables pertaining to the MBS transaction will be legally transferred to NHB/SPV Trust, the originator (primary lending agency) will continue to physically hold the title documents in respect of the housing properties obtained as security on the loans issued, in the capacity of a custodian to NHB/SPV Trust and deal with the same or all realisations therefrom only in accordance with the directions of NHB. Also, the originator shall, on being so advised by NHB, give notice to the Borrower/s and/or third parties and enforce the security/lies in its own name, if so required, for realisations of the outstanding due/s which is/are unpaid by the Borrowers and shall, when so advised by NHB in writing, transfer or deliver to the NHB all relative documents records, contracts and writing and papers in respect of the housing loans and securities connected therewith.

Design of MBS Instruments

The mortgage debt will be purchased by NHB with a right to securitize them on the same/at later date. However, irrespective of whether the proposal is for purchase of mortgage debt or for securitization of housing loans, NHB will be free to design and issue any kind of innovative instruments as it may deem fit.

Appointment of Various Agencies

In the event of securitization of mortgage debts by NHB, NHB may decide to get the MBS instrument(s) rated by one or more rating agencies, engage the services of one or more Issue Arrangers for preparation of the Memorandum of Information pertaining to the issue and placement of the issue on private placement of public issue basis, appoint the originator (Primary Lending Agency) or any other agency as the Servicing and Paying Agent under the transaction, engage the services of Registrar and Transfer Agent (in the event of securitization) and such other agencies as NHB may consider appropriate for smooth operation of the scheme.

NHB may consider getting the MBS instrument listed in one or more Stock Exchange and dematerialized the same with any of the Depositories at its sole discretion.

Payment of Consideration

NHB will make payment of consideration for the purchase of mortgage debts (for holding it in its own book or for the purpose of securitization abinitio) after issue of allotment letters to investors or after execution of the legal documents relating to the transaction or on such date as mutually agreed to between the buyer and the seller.

Establishment of Special Purpose Vehicle for Issue of MBS

In the event of securitization of housing loans, NHB may set up one or more Special Purpose Vehicles (SPVs) in the form of Trust(s) or any other constitution for implementation of the scheme.

Post Issue of Servicing and Reporting Requirements

The Servicing and Paying Agent appointed by NHB shall submit monthly reports in respect of collections in the transferred pool of mortgages and such other MIS Reports, Statement of Accounts and Trial Balances as prescribed by NHB from time to time. NHB or a firm of Chartered Accountants appointed by NHB in this behalf will have the right to carry out inspection and/or audit of the loan account to verify the correctness of the reports and statements.

Hierarchy or Appropriation of Collection mounts (Payment "Waterfall")

The hierarchy of payments shall generally be as follows :

- Payment to Service Providers viz. Trustee, Servicing Agent, Rating Agency, & other service providers'
- Payment of Interest to Senior Class RMBS (Class A PTC) holders
- Payment of Principal to Senior Class RMBS (Class A PTC) holders
- Replenishment of Cash Collateral/Guarantee/such other form of credit enhancement
- Payment of Principal to Subordinate RMBS (Class B PTC) holders
- Payment of Residual income to Subordinate (Class B PTC) holders

The Servicing and Paying Agent appointment by NHB shall continue to make all reasonable endeavours to collect the monthly instalments from the borrower and shall continue to administer the housing loans and undertake to devote such time and to exercise such skill, due care and diligence in the administration and enforcement of the rights, powers, privileges and securities in respect of the housing loans as it would have exercised had the entire beneficial interest in housing loans been retained by it and release and return specific documents relating to any housing loan Agreement under advice to NHB, if and only if, the relative borrower has paid his entire dues.

The Servicing and Paying Agent will continue to follow the standard norms (as being followed in respect of its other borrowers) for apportionment of monies received from the borrowers. For specific deviation of norms or use of discretion by the Servicing and Paying Agent especially relating to waiver of penal interest, interest, treatment of prepayments, transfer out cases, re-schedulement of loans, conversion of loans from fixed rate to variable rate etc. specific of general approval of the buyer (NHB) shall be taken.

20.4 OTHER SECURITISATION EFFORTS

The securitisation of Housing Finance receivables was initiated in the early nineties by Citibank in the form of Pass Through Certificate (PTC), but MBS is still at a nascent stage in India on account of legal issues. The most formidable of these has been the stamp duty structure, the inter-State variations that come in the way of the development of a countrywide market etc. In March 1997, Maharashtra, Karnataka and Tamil Nadu slashed stamp duties on transactions by HFCs; but this is not a complete solution. The cumbersome foreclosure and transfer or property laws are also dampners.

Apart from legal impediments, the absence of uniform lending norms and documentation standards among the 23 HFCs/HFIs and a secondary market, stand in the way of the success of MBS in the country.

Conditions for a vibrant MBS market

One of the important reasons for the growth of housing finance in the developed markets is the systematic development of a secondary market. A secondary market provides liquidity to the lenders and moderates the cyclical flow of capital, in the real estate market. A vibrant secondary market will develop if a few of the following conditions are met:

1. Risk identification, packaging and rating of the mortgage pool/MBS by rating agencies.
2. Standard accounting procedure for all HFCs, banks and other lenders of home loans, especially on the treatment of securitised pool of assets as an off-balance sheet item.
3. Tax treatment and tax incidence amongst the originator of the mortgage based security, the SPV and the ultimate investor.
4. Effective foreclosure systems.
5. Reduction in stamp duty on transfer of assets.
6. Availability of mortgage insurance, title insurance providing risk cover.
7. Innovative mortgage instruments with features that meet the different investment requirements of the market players.
8. Standardisation in respect of loan origination and underwriting practices across different HFIs/ HFCs.
9. In order to induce institutional investors to invest in MBS, investment in such products could be declared as approved investments under the Insurance Act, as also for, the provident funds.

Home loans are becoming a significant part of bank loan books. There are more lenders in the market today. Product line expansion is happening. The larger lenders are already thinking in terms of securitised products to add depth to the market. The financial market is acquiring some depth as the economy grows in size. The new market players from the developed countries are bringing in good market practices. All of this augurs well for the development of a sound, healthy market in collateralized securities.

Let Us Sum Up

Securitisation is a process by which the future cash inflows of an entity (originator) are converted and sold as debt instruments called pay through or pass through certificates with a fixed rate of return to the holders of beneficial interest. The originator of a typical securitisation transfers a portfolio of financial assets to a Special Purpose Vehicle (SPV), commonly a trust. The SPV is basically funded by investors. In return for the transfer, the originator gets cash up-front on the basis of a mutually agreed valuation of the receivables. The transfer value of the receivables is done in such a manner so as to give the lenders a reasonable rate of return. In 'pass-through' and 'pay-through' securitisation, receivables are transferred to the SPV at the inception of the securitisation, and no further transfers are made. AH cash collections are paid to the holders of beneficial interests in the SPV (basically the lenders).

Keywords

Risk appetite: Market contains participants with varying risk appetite. Some would prefer a low risk asset with an acceptable return, while another class of investors may accept a higher risk profile for a higher return.

Mortgage Backed Securitisation (MBS): The Home Loan assets are bundled into securities and sold to investors called MBS.

Securitisation: Means conversion of mortgages in securities, which are tradable debt instruments.

Terminal Questions

1. Define Securitisation. What is the need of securitization in Financial Market ?
2. What are the issues involved in MBS ?
3. What are the features available in a Home Loan portfolio of a Bank ?
4. Draw the Flow Chart of Securitisation processes and elaborate each of the processes.
5. What is meant by Mortgage Backed Securitisation (MBS) ?
6. What are the conditions that are required for a vibrant MBS Market ?

UNIT 21

UNIT 21 HOUSING FINANCE AND TAX PLANNING

STRUCTURE

21.0 Objectives

21.1 Introduction

Keywords Let Us Sum Up Terminal Questions

21.0 OBJECTIVES

On reading this Chapter, you will learn the following :

- Tax Benefits available in respect of Housing Finance
- Use of the Benefits to reduce Tax Liability

21.1 INTRODUCTION

Over the years, announcements have been made in the Union Budgets for tax concessions, waivers, etc. to encourage housing & housing finance so as to counter the shortage of houses in India. The benefits available & use of the benefits to reduce one's tax liability are being detailed below.

Tax benefits in respect of Housing Finance

In respect of Loan taken for Purchase/Construction of a Residential Unit, the borrower can avail benefit of payment of interest as well as repayment of principal.

Interest on housing loan can be claimed as a deduction from income from property, salary, business/ profession, capital gains, or any other source upto a maximum of Rs. 1,50.000 under section *24(b)* of the Income-tax Act, 1961 every year subject to fulfilment of the following conditions.

(a) Loan has been taken on or after 1st April 1999.

(b) Loan is for purchase or construction of a residential property or as re-finance (takeover) of the principal amount outstanding under a loan taken earlier for purchase or construction of a residential property. However, in case of loan for construction, the construction should get completed within 3 Years of raising the Loan. Deduction can be claimed only from the financial year when the purchase/ construction is completed.

(c) The lender issues a certificate at the end of the financial year mentioning therein the interest & principal paid during the year in respect of that loan.

If any of the first 2 Conditions mentioned above is not satisfied, *i.e.*, loan was taken before 1st April 1999 &/or loan is for repairs/renovation/reconstruction, deduction of only upto a maximum of Rs. 30,(K)() every year can be claimed. The third condition mentioned above, however, has to be satisfied.

In case the Loan is for repairs/renovation/reconstruction, deduction on account of interest on that loan can be claimed only if the property is self-occupied or if the owner is not able to occupy the property only because of his employment/business/profession at another place, where he/she resides in a building not owned by him/her or his/her spouse/close blood relatives.

The deductions are permissible only in respect of one property of the borrower, *i.e.*, if he/she has raised loans for multiple properties, interest can be claimed as a deduction only in respect of one property, depending upon the borrower's choice.

As regards principal repayment, it can be claimed as a deduction from the gross total Income only by an Individual/HUF borrower under section 80C of the Income Tax Act, 1961. However, the maximum deduction which can be availed under Section 80C [deduction in respect of life insurance premium, deferred annuity, contribution to provident fund, repayment of housing loan, etc.], Section 80CCC [deduction in respect of pension fundi, & Section 80CCD deduction in respect of contribution to pension scheme of Central Government] cannot exceed Rs. 1,00,000.

If the property is rented out, interest paid on Loan can be fully deducted from the Income derived from the property without the limit of Rs. 1,50,000 or Rs. 30,000, as the case may be.

Interest on loan taken for commercial property or on loan taken for business/personal needs against the mortgage of property by an individual/HUF/partnership firm/company/any other person can be fully claimed as deduction from income from rent/business/profession/other sources, as the case may be. However, the benefit on account of principal repayment shall not be available in such cases.

Interest on unpaid interest, *i.e.*, penal interest, is not deductible.

Use of Benefits to Reduce Tax Liability

We shall consider the Scenario of a 35-year old man.

HOUSING FINANCE & TAX PLANNING

	No Housing Loan	Housing Loan taken for Purchase/ Construction of Residential Unit on or after 1st April 1999 for Self-occupation
me declared in ITR	Rs. 4,50,000	Rs. 4,50,000
ributions eligible for deduction under section 80C of the Income Tax Act, 1961	Rs. 1,00,000	Rs. 1,00,000
est paid on Housing Loan during F.Y. 2006-07	-	Rs. 1,68,000
yment towards principal amount of housing loan during F.Y. 2006-07		Rs. 21,000
c Tax Liability, excluding surcharge & education cess as per Income Tax Slabs & Rates applicable to A.Y. 2007-08	Rs. 54,000 [On Net Income of Rs. 3,50,000 (i.e., Rs. 4,50,000 -Rs. 1,00,000]	Rs. 14,000 [On Net Income of Rs. 2,00,000 (i.e., Rs. 4,50,000 - Rs. 1,50,000 {max. permissible Dedn. towards Interest} - Rs. 1,00,000 (max. permissible dedn. under Sec. 80C, 80CCC, & 80CCD}]

Suppose in the above Case, the Income of Rs. 4,50,000 included Rs. 30,000 as rental income from the property purchased/constructed with the Loan, the basic tax liability could have reduced to Rs. 8,600 [On Net Income of Rs. 1,74,800 *(i.e.*, Rs. 4,50,000 - Rs. 9,000 {Standard Deduction @ 30% of Rs. 30,000 under Section 24 (a) 1 -Rs. 1,68.0(H) {full interest amount as property is rented out) -Rs. 1,00.000].

However, if in para 12.3.1 above, the man had taken the loan before 1st April, 1999 &/or taken the loan for repairs/renovation/reconstruction, his basic tax liability for A.Y. 2007-08 would have been Rs. 45,000 [On Net Income of Rs. 2,00,000 *(i.e.,* Rs. 4,50,000 - Rs. 30,000 (Maximum permissible Deduction towards Interest) - Rs. 1,00,(XK) {Maximum Permissible Deduction under Sections 80C, 80CCC, & 80CCD)].

No Tax Benefit is available in respect of Loan taken for purchase of plot of land. Hence, instead of taking a Loan for purchase of plot, he/she should take loan for purchase of plot as well as construction of house & complete construction of a self-sufficient House within 3 Years of raising the Loan.

If Loan is raised jointly by husband & wife or any other combination of persons acceptable to the lender, the interest & principal can be claimed by the co-borrowers in proportion to the amounts paid by them, subject to the combined maximum limit of Rs. 1,50,000 (or Rs. 30,000) & Rs. 1.00.000 towards interest & principal respectively.

If the housing loan is taken before 1st April, 1999, deduction on account of interest shall be limited to Rs. 30,000 every Year. However, if the loan is taken after 1st April, 1999, deduction of interest upto Rs. 1,50,000 can be claimed every Year.

Keywords

HUF: Hindu Undivided Family ITR:

Income Tax Return A.Y.: Assessment

Year FY: Financial Year

Let Us Sum Up

Raising a housing loan can not only help in lowering one's tax liability, but can more importantly, allow one to get his/her home for self-occupation or for supplementing his/her existing Income. However, the benefits have to be used judiciously.

Check Your Progress

1: Fill in the Blanks by choosing the appropriate Words from the Bracket.

(a) An Individual took a Loan of Rs. 15.00 Lacs for purchasing a flat for self-occupation on 30/03/1999 & paid Rs. 1,20,000 towards Interest during FY. 2006-07. The maximum amount of Interest which he can claim as a deduction would be................................ (Rs. 1,50,000; Rs. 1,20,000; Rs. 30,000).

(b) Husband & Wife jointly raise a loan in April 2005 for constructing a house for self-occupation. The construction was completed in July 2006. They have been paying the housing loan instalments on 50:50 Basis from their respective Incomes. During FY 2006-07, they paid

Interest of Rs. 3,00,000. The maximum interest which each of them can claim as deduction is .... (Rs. 1,50,000; Rs. 75,000).

(c) An individual took a loan of Rs. 10.00 Lakhs for purchasing a plot of land during F.Y. 2005-06 & has paid around Rs. 1,10,000 towards Interest & around Rs. 57,000 towards principal during F.Y. 2006-07. He has not made any other contribution under Sections 80C, 80CCC, or 80CCD.
He will be able to claim deduction of............................. (Rs. 1,50,000; Rs. 1,10,000; Rs. 0) towards Interest & .... (Rs. 1,00,000; Rs. 57,000; Rs. 0) towards principal.

Answers to Check Your Progress

(a) Rs. 30,000; (b) Rs. 75,000; (c) Rs. 0; Rs. 0

Terminal questions

1. Enumerate the Benefits of taking a housing loan.
2. Demonstrate how housing loan can help in reduction of tax liability.

UNIT 22 MORTGAGE ADVICE

STRUCTURE

22.0 Objectives

22.1 Economic and Regulatory Context for Giving Mortgage Advice

22.2 Development of "Home Information Packs"

22.3 Time Value of Money-interest and Annuities

22.4 Capital Gains

22.5 Loan Calculator/Loan Amortization Schedule

Let Us Sum Up

Terminal Questions

22.0 OBJECTIVES

On reading this chapter you will learn the following :

- There is no regulation for mortgage advice services in the country
- The concept of information pack as prevailing in other advanced countries.
- Time value of money and computation of future value, present value
- Computation of capital gains with or without indexed cost, exemptions available and taxation of capital gains.
- The concept of F.MI and building loan calculator as well as amortization schedule.
- Registration of documents with Government authorities.

22.1 ECONOMIC AND REGULATORY CONTEXT FOR GIVING MORTGAGE ADVICE

In India, mortgage advice profession is carried out without any regulations. There is no entry barrier and no code of conduct or ethics are stipulated by any regulation. Any person can enter the profession and can provide advice and do business. There are regulations in US, UK and other countries regulating the mortgage advice services. It would be worthwhile to look at some of the legal provisions in US to understand the position prevailing in these counties and to feel the need of such regulations in India.

In US, in addition to direct support of housing and home finance, State and Federal Government agencies regulate the participants in the mortgage lending industry through chartering, licensing, auditing, and examinations. One such participant is Mortgage Broker. He is regulated by licensing. No individual or firm can carry out mortgage broking activities unless he/they are licensed. Once licensed, a mortgage broker becomes subject to the substantive provisions of the licensing law, which usually include mandatory standards of conduct and penalties for non-compliance.

22.2 DEVELOPMENT OF "HOME INFORMATION PACKS"

This concept is being introduced in UK from 1st August 2(K)7. An attempt has been made to explain in brief the concept and its utility. It is not at all applicable in India. However, the study of this concept and understanding its usefulness may be advisable. This may also pave the way for introducing the same in the country on a limited basis in a gradual manner.

What is Information Pack?

The Home Information Pack contains important information that buyers and sellers need to know. Home Information Packs including Energy Performance Certificates will be implemented on a phased basis from 1st August 2(K)7 in UK. From then on Packs will be required for the sale of four bedroom properties and larger, with smaller properties being phased in as soon as sufficient energy assessors are fully qualified

For sellers, providing a Pack promptly should reduce the likelihood of any nasty surprises in the selling process that could delay the sale, as buyers will be able to make more informed decisions about purchasing their home.

For buyers, the Pack provides essential information free of charge about properties they are considering buying.

The content of the pack is list of documents to be provided. The list consists of compulsory documents as well as optional documents to be provided for the use of buyers for taking right decision. The important compulsory documents are :

- Sale statement providing basic information about the site including the address of the property being sold, whether the property is freehold, leasehold,whether or not the property is being sold with vacant possession.
- Evidence of title to prove that the seller owns the property and therefore has the right to sell it.
- Energy Performance Certificate indicating how energy efficient a home is on a scale of A-Q The most efficient homes - which should have the lowest fuel bills are in band A.

The optional documents are :

- Home Condition Report containing information about the physical condition of a property, which sellers, buyers and lenders will be able to rely on legally as an accurate report.
- Legal summary giving summary of the legal aspects helpful to buyers. However, buyer can take his own legal advice as well.
- Home use/contents forms providing information on a range of matters relating to the property. These include information on boundaries, notices, services, sharing with neighbours, and other matters of interest to potential buyers. It is usual for sellers to declare which fixtures and fittings and other contents of the property are included in the sale, are excluded from the sale, or are subject to negotiation.

22.3 TIME VALUE OF MONEY-INTEREST AND ANNUITIES

A rupee today is worth more than a rupee tomorrow. To permit realistic appraisal the value of a cash payment or receipt must be related to the time when the payment takes place. In particular, it must be recognised that Re. 1 received today is worth more than Re. 1 receivable at some future date, because Re. 1 received today could be earning interest in the intervening period. This is the concept of the time value of money.

To illustrate this if Rs. 100 was invested today at 5% per annum compound interest, it would accumulate to Rs. 105 at the end of one year *(i.e.* Rs. 100 x 1.05) to Rs. 110.25 at the end of two years *(i.e.* Rs. 100 x 1.05 x 1.05 or Rs. 105 x (1.05)2 and so on. In other words, Rs. 110.25 receivable in two years time is only worth Rs. 1(X) today if 5% per annum can be earned in the meantime, *[i.e.* 110.25/(1.05 x 1.05) = 100].

The process of converting future sums into their present equivalents is known as discounting, which is simply the opposite of compounding. Compounding is used to determine the future value of present cash flows, whereas discounting is used to determine the present value of future cash Hows.

| ------------- ► ------------- ► Compounding -------- » ------- ► j

Present j J Future

| -« --------------- ■* ---------- Discounting ■» --------- « ----- J

Frequently compounding of interest What if interest is paid more frequently? Annually = P(1 + r) = Annual compounding Quarterly = $P(l + r/4)^4$ = Quarterly compounding

Monthly = $P(l+r/l2)^{12}$ = montly compounding

The following table shows the final principal (p) after t = 1 year of an account initially with P= 10000 at 6% interest rate with given compounding (n)

	P
ɜarly)	10600
ɜmiannually)	10609
ıarterly)	10613
nonthly)	10616
veekly)	10618

The Rule of 72

This rule allows you to determine the number of years before your money doubles whether in debt or investment. Here is how to do it.

Divide the number 72 by percentage rate you are paying on your debt (on earning on your investment)

For Illustration : Suppose, you borrowed Rs. 1000 at 6% interest. 72 divided by 6 is 12. That makes 12 the number of years it would take for your debt to double to Rs. 2000, if you did not make any payment. Similarly a saving account with Rs. 500 deposited in it earning 4% interest. 72 divided by 4 is 18. It will take 18 years for your Rs. 500 to double to Rs. 1000 if you don't make or withdraw any deposit.

Future Value of Money

For finding out future value (FV). we must use compounding formula which is given below

$$FV = PV(1 + r)n$$

Where PV means present value, 1 means one rupee, r means rate of interest and n means period or term.

Example:

If Rs. 100000 is invested for a period of 5 years at interest at 10% p.a. find the maturity sum *i.e.* future value

Solution •

The formula for finding FV is............

$$FV = PV(1 + r)n$$

$$= 100000(1 +0.10)5 =$$

$$100000(1.10)5 =$$

$$100000(1.61) = 1610000$$

So the maturity sum will be Rs. 1,61,000

The same value can be calculated by using future value table. Future value = PV x future value factor. Future value factors(FVF) of Rs. 1 at different rate of interest are given below for information

Year						
1						
2						
3						
4						
5						
6						

If you wish to calculate FVF of Re. 1 at 12% from 1 to 6 years by using simple calculator, do following.

(1) Press 1.12 (2) press multiplication sign *i.e.* X twice (press x, press x) (3) you get 1.12. Thus 1.12.is FVF for 1 year term. (4) for FVF for year 2, just press equal sign (=), you get 1.25 (5) for FVF for year 3, just press equal sign (=), you get 1.40 (6) for FVF for year 4, just press equal sign (=), you get 1.57 (7) for FVF for year 5, just press equal sign (=), you get 1.76 (8) for FVF for year 6, just press equal sign (=), you get 1.97. This way, you can find FVF of at any rate of interest for any term.

Let us work out one example.

Example :

If Rs. 100000 is invested for a period of 6 years at interest at 11% p.a. find the maturity sum *i.e.* future value

Future value = PV x future value factor

FV = 100000 x 1.87 = 1,87,000

Solving problem through MS EXCEL program

The in-built function of FV in excel is----------------

FV (RATE, NPER, PV, TYPE)

FV = Future value, RATE = rate of interest, NPER=Total number of periods, PV = present value. PMT and TYPE are included to handle annuities (a series of payments equally spaced over a period of time). TYPE is for indicating whether the cash flow occurs at the beginning (1) or at the end (0) of the period.

In order to do calculation with EXCEL go to Insert, go to function, click financial function.

Example :

If Rs. 100000 is invested for a period of 6 years at interest at 11% p.a. find the future value at the end of the period.

Enter: FV (0.11,6,0, - 100000, 0) [Please do not forget to put minus sign (-) before PV] The result is Rs. 187041. Future value of annuities

Annuities are essentially series of fixed payments required from you or paid to you at a specified frequency over the course of a fixed period of time.

- *Ordinary Annuity* : Payments are made/received at the end of each period.
- *Annuity Due* : Payments are made/received at the beginning of each period.

Calculating the Future Value of an Ordinary Annuity

If you know how much you can invest per period for a certain time period, the future value of an ordinary annuity formula is useful for finding out how much you would have in the future by investing at your given interest rate. If you are making payments on a loan, the future value is useful for determining the total cost of the loan. In order to calculate the future value of the annuity, we have to calculate the future value of each cash flow.

i

Where F = future value of an
annuity A = annuity i = interest rate
n = term

Calculating the Future Value of an Annuity Due

Since each payment in the series is made one period sooner, we need to discount the formula one period back. A slight modification to the FV-of-an-ordinary-annuity formula accounts for payments occurring at the beginning of each period.

Notice that when payments are made at the beginning of the period, each amount is held for longer time at the end of the period. For Illustration, if the Rs. 1000 was invested on January 1 st rather than December 31 st of each year, the last payment before we value our investment at the end of five years (on December 31st) would have been made a year prior (January 1st) rather than the same day on which it is valued. The future value of annuity formula would then read :

F,A^x(l+r) Therefore, future value of annuity due of Rs. 1000 for a period of 5 years at interest rate of 5% would be

FV (Annuity Due) = 1000* △+ º△~'»(l + ,05)

= Rs 1000*5.53*.05 =

Rs 5801.91

The same value can be calculated by using annuity table.

Future value of annuity = Annuity x CV factor

Compound value factor for annuity (CVA) of Re. lat different rates of interest are given below for information. Assume rupee to be invested at the end of the year.

Year	*7%*	*8%*	*9%*	*10%*	*11%*	*12%*
1	1.00	1.00	1.00	1.00	1.00	1.00
2	2.070	2.080	2.090	2.100	2.110	2.120
3	3.215	3.246	3.278	3.310	3.342	3.374
4	4.440	4.506	4.573	4.641	4.710	4.779
5	5.751	5.867	5.985	6.105	6.228	6.353
6	7.153	7.336	7.523	7.716	7.913	8.115

Example:

If Ms Anusaya is paying home loan instalment at Rs. 12000 per year for a period of 6 years how much she paid till the end of the loan period(What is the future value of an annuity of Rs. 10000 p.a. at 11% for a period of 6 years).

Solution:

By using the annuity table above, find CVA factor for 6 years at 11% and multiply by Rs. 10000. CVA for 6 years @

11% = 7.913 Annuity = Rs. 10000

So Future value of annuity = 7.913 x 10000 = Rs. 79130

Present Value

Present value is nothing but the reverse of future value.For finding out present value (PV), we must use discounting formula which is given below

PV = FV + (1 +r)n

Where PV means present value, I means one rupee, r means rate of interest and n means period or term and FV means future value

Example:

If Rs. 16KMX) is the maturity value(future value) of investment, invested for a period of 5 years at interest at 10% p.a. find the amount invested (present value)

Solution:

The formula for finding PV is--------------

PV = FV/(1 + r)n
= 161000/(1 +0.10)5 =
161000/(1.61) =
161000(1.61) = 100000

So the present value will be Rs. 100,000

The same value can be calculated by using present value table.

Present value = FV x Present value factor

Present value factors(PVF) of Rs. 1 at different rates of interest are given below for information

Solving Present Value problems with the use of Excel Program.

The in-built function of PV in excel is ---------------

PV (RATE, NPER, FV, TYPE)

PV = Present value. RATE = rate of interest, NPER = Total number of periods FV = Future value. TYPE is for indicating whether the cash flow occurs at the beginning (1) or at the end (0) of the period.

In order to do calculation with EXCEL go to Insert, go to function, click financial function. **Example :**

If the maturity value of an amount invested for a period of 6 years at interest at 11% p.a. is Rs. 187041 find the amount invested at the beginning (find present value)

Enter: PV (0.11,6, -187041, 0) [Please do not forget to put minus sign (-) before FV] The result is Rs. 100000.

22.4 CAPITAL GAINS

Any profit or gain from sale or transfer of a capital asset is chargeable to tax under the head "capital gains" Capital asset means any property whether movable or immovable, tangible or intangible. Transfer, in relation to capital asset, includes sale, exchange of the asset.

The following assets are, however, excluded from the definition of capital assets :

(a) Stock-in-trade, stores, raw material
(b) Personal effects (excluding Jewellery)
(c) Agricultural land outside the limit of municipality or notified area.

The transfer of assets on account gift, will etc. so also distribution of assets by HUF to its members on partition are not transfer from the point of capital gains chargeability. As such no capital gains arises from such transactions

Types of Capital Assets

- Short-term capital assets :
- Long-term capital assets

Short Term Capital Assets

Short term capital asset means a capital asset held for less than 36 months immediately prior to the date of transfer. However in following cases, asset held for less than 12 months is treated as short term capital asset :

- Equity or pref. shares (quoted as well as unquoted)
- Debentures/Govt. securities listed in a recognized stock exchange.
- Units of UTI/Mutual fund specified under section 1()(23D)
- Zero coupon bonds (whether quoted or not)

Long Term Capital Assets

Long term capital asset means a capital asset held for more than 36 months immediately prior to the date of transfer. However in following cases, asset held for more than 12 months is treated as long term capital asset:

- Equity or pref. shares (quoted as well as unquoted)
- Debentures/Govt. securities listed in a recognized stock exchange.
- Units of UTI/Mutual fund specified under section 10(23D)
- Zero coupon bonds (whether quoted or not)

Cost of Previous Owner

In the case of transfer by gift, will, inheritance, amalgamation, distribution of assets by HUF on partition, the cost of acquisition shall be the cost to the previous owner.

Method of Computation of Short-term and Long-term Capital Gain

putation of short term Cap. Gain	*Computation of Long term Cap. Gain*
1. Find out full value of consideration	1. Find out full value of consideration
2. Deduct the following:	2. Deduct the following :
(a) expenditure of transfer	expenditure of transfer
(b) cost of acquisition	(b) indexed cost of acquisition
(c) cost of improvement	(c) indexed cost of improvement
3. From the sum so arrived at deduct the exemptions provided by sections 54B, 54D	3. From the sum so arrived at deduct the exemptions provided by sections 54, 54B, 54D, 54EC,54F
4. The balancing amount is short term capital gain	4. The balancing amount is long term capital gain

Cost Inflation Index

The Central Government has notified the "cost inflation index" for the purpose of long term capital gains :

r. No.	*Financial Year*	Cosf *Inflation Index*
1.	1981-82	100
2.	1982-83	109
3.	1983-84	116
4.	1984-85	125
5.	1985-86	133
6.	1986-87	140
7.	1987-88	150
8.	1988-89	161
9.	1989-90	172
10.	1990-91	182
11.	1991-92	199
lo.	*Financial Year*	*Inflation Index*
12.	1992-93	223
13.	1993-94	244
14.	1994-95	259
15.	1995-96	281
16.	1996-97	305
17.	1997-98	331
18.	1998-99	351
19.	1999-2000	389

20.	2000-01	406
21.	2001-02	426
22.	2002-03	447
23.	2003-04	463
24.	2004-05	480
25.	2005-06	497
26.	2006-07	519

Capital Gains - When and to What Extent Exempt from Tax

1. Capital gains arising from the sale of residential house property (Section 54) is exempted provided the property is held for more than 36 months before sate and transferor has purchased another residential house by utilizing the capital gain amount within one year before sale of old house or within 2 years from the date of sale or construct a new house within a period of three years from the date of sale. If the amount of capital gain is not fully utilized for above, then only proportionate amount that is utilized will only be exempt.
2. Capital gains from transfer of land used for agricultural purpose (Section 54 B) is exempt if utilized for purchase of another land.
3. Capital gains on compulsory acquisitions of land and building of an industrial undertaking - (Section 54 D) is exempt if utilized for purchase of another land and building
4. Capital gain is invested in bonds issued by National Highway Authority of India or RECL (Section 54 EC)
5. Capital gains on transfer of long term capital assets other than a house property - (Section 54 F) is exempt provided the transferor has purchased residential house by utilizing the capital gain amount within one year before the date of transfer or within 2 years from the date of transfer or construct a new house within a period of three years from the date of transfer. If the amount of capital gain is not fully utilized for above, then only proportionate amount that is utilized will only be exempt.

Capital Gain Tax Calculator

• Long term capital gain on transfer of property is taxable at a flat rate of 20% (plus surcharge and education cess). The surcharge @> 10% is applicable if the total income including capital gains exceeds Rs. 10 lakh. The education cess @3% of income-tax (2% education cess and 1% Secondary and Higher education cess) is applicable.

- Deductions under sections 80C to 80U are not available in respect of long term capital gains.
- In case of resident individual or Resident HUF, if the taxable income minus long term capital gain is less than the amount of exemption limit (e.g. Rs. 185000 for senior citizen), the relief in capital gain upto exemption limit is available, e.g. if Mr. Manohar, a senior citizen, has total income of Rs. 300000 consisting of Rs. 200000 from capital gain and Rs. 100000 from other sources (interest) relief in capital gain to the extent of Rs. 85000 will be available to Mr. Manohar. [Rs. 185000 -(300000- 200000) = Rs. 85000]

Rates of Income-tax : F.Y. 2007-2008 (A.Y. 2008-2009) for Individual/HUF/AOP/BOI

Income	*Rate of Tax*
Rs. 110,000	Nil
10,000 to 1,50,000	10% of the amount by which the total income exceeds Rs. 110000

Income	*Rate of Tax*
50,000 to 2,50,000	Rs. 4000 plus 20% of the amount by which the total income exceeds Rs. 150000
250000 and above	Rs. 24000 plus 30% of the amount by which the total income exceeds Rs. 2,50,000
harge	Surcharge at 10% of the Income-tax if total income of an individual/HUF/AOP/BOI exceeds Rs. 10,00,000.
ation Cess	3% of Tax (2% education &1% higher education cess)

Rates of Income-tax: F.Y.2007-2008 (A.Y.2008-2009) for resident woman (below 65 years)

Income	*Rate of Tax*
Rs. 1,45,000	Nil

145,000 to 1,50,000	10% of the amount by which the total income exceeds Rs. 145,000
150,000 to 2,50,000	Rs. 500 plus 20% of the amount by which the total income exceeds Rs. 150000
250000 and above	Rs. 20500 plus 30% of the amount by which the total income exceeds Rs. 2,50,000
harge	Surcharge at 10% of the Income-tax if total income exceeds Rs. 10,00,000.
cation Cess	3 percent of Tax (2% education &1% higher education cess)

Rates of Income-tax : F.Y.2007-2008 (A.Y.2008-2009) for Senior Citizen (above 65 years)

Income	*Rate of Tax*
Rs. 1,95,000	Nil
1,95,000 to 2,50,000	20% of the amount by which the total income exceeds Rs. 1,95,000
2,50,000 and above	Rs. 11,000 plus 30% of the amount by which the total income exceeds Rs. 2,50,000
harge	Surcharge at 10% of the Income-tax if total income of an individual/HUF/AOP/BOl exceeds Rs. 10,00,000.
cation Cess	3 percent of Tax (2% education &1% higher education cess)

22.5 LOAN CALCULATOR/LOAN AMORTIZATION SCHEDULE

This section will demonstrate how to use formulas and functions to create two simple but useful worksheets

- A Loan Calculator
- A Loan Amortization Table.

Loan Calculator

Suppose you are taking out a home loan, and want to analyze the various loan options that are available. This exercise will show you how to create a simple, reusable loan calculator to determine what the monthly payments will be based on the loan amount, interest rate, and term.

Enter the following information onto a blank worksheet in excel.

CELL	*Entry*
B2	Loan Calculator
B5	Interest rate
C5	Term (months)
D5	Loan Amount
G5	Monthly Payment
G6	=PMT(B6/12,C6,- D6)
B6	10.0% (be sure to type the % sign
C6	24
D6	100000

You can play "what if?" by changing the interest rate, the number of monthly instalments.

est Rate	*Term (months)*	*Loan Amount*	*Monthly Payment*
9.00%	24	100000	4568.47
9.25%	24	100000	4579.95
9.50%	24	100000	4591.45
9.75%	24	100000	4602.96
0.00%	24	100000	4614.49
0.25%	24	100000	4626.04
0.50%	24	100000	4637.60
0.75%	24	100000	4649.19
11.00%	24	100000	4660.78

est Rate	*Term (months)*	*Loan Amount*	*Monthly Payment*
1.25%	24	100000	4672.40
1.50%	24	100000	4684.03
1.75%	24	100000	4695.68
2.00%	24	100000	4707.35
9.00%	24	200000	9136.95
9.25%	24	200000	9159.91
9.50%	24	200000	9182.90
9.75%	24	200000	9205.92
0.00%	24	200000	9228.99
0.25%	36	100000	3238.47
0.50%	36	100000	3250.24
0.75%	36	100000	326? n«
1.00%	36	/OOOOU	3273.87
1.25%		100000	3285.72
1.50%	36	100000	3297.60
1.75%	36	100000	3309.50
2.00%	36	100000	3321.43
0.25%	48	100000	2548.28
0.50%	48	100000	2560.34
0.75%	48	100000	2572.43
1.00%	48	100000	2584.55
1.25%	48	100000	2596.71
11.50%	48	100000	2608.90
11.75%	48	100000	2621.13
12.00%	48	100000	2633.38
10.25%	180	100000	1089.95
10.50%	180	100000	1105.40
10.75%	180	100000	1120.95
11.00%	180	100000	1136.60
11.25%	180	100000	1152.34

Interest Rate	*Term (months)*	*Loan Amount*	*Monthly Payment*
11.50%	180	100000	1168.19
11.75%	180	100000	1184.13
12.00%	180	100000	1200.17

Loan Amortization Schedule

The loan calculator tells you what the monthly payment is. Suppose that you want to know how much interest is being paid in a given year. This exercise will add a loan amortization schedule to the loan calculator

The basic calculations used in the table are :

- Beginning balance (except for initial) = ending balance from previous period
- Interest (compounded monthly) = annual interest rate divided by 12, multiplied by the beginning balance for the period
- Principal = payment less interest
- Ending balance = beginning balance less principal

A loan calculator and amortization schedule is given below : **Loan Calculator**

iterest rate	*ı (months)*	*Loan Amt.*	*thly Payment*
		100000	4614.49

Amortization Schedule

od	*Op. Bal*	*ment*	*iterest*	*rincipal*	*Cl. Balance*
	100000	.49	33.33	781.16	96218.84
	96218.84	.49	01.82	812.67	92406.17
	92406.17	.49	70.05	844.44	88561.73
	88561.73	.49	38.01	876.48	84685.25
	84685.25	.49	05.71	908.78	80776.47
	80776.47	.49	73.14	941.36	76835.11
	76835.11	.49	40.29	974.20	72860.91
	72860.91	.49	07.17	007.32	68853.60
	68853.60	.49	73.78	040.71	64812.88
0	64812.88	.49	40.11	074.39	60738.50
1	60738.50	.49	06.15	108.34	56630.16
2	56630.16	.49	71.92	142.57	52487.59
Period	*Op. Bal*	*ment*	*Interest*	*Principal*	*Cl. Balance*
13	52487.59	.49	437.40	4177.10	48310.49
14	48310.49	614.49	402.59	4211.91	44098.58
15	44098.58	.49	367.49	4247.00	39851.58
16	39851.58	614.49	332.10	4282.40	35569.18
17	35569.18	614.49	296.41	4318.08	31251.10
18	31251.10	614.49	260.43	4354.07	26897.03
19	26897.03	614.49	224.14	4390.35	22506.68
20	22506.68	614.49	187.56	4426.94	18079.75
21	18079.75	614.49	150.66	4463.83	13615.92
22	13615.92	614.49	113.47	4501.03	9114.89
23	9114.89	614.49	75.96	4538.54	4576.36
24	4576.36	614.49	38.14	4576.36	0.00

Registration of Cocuments

In each State the relevant Stamp Acts and registration formalities are required to be followed. The following points are relevant in connection with registration of documents in respect properties located in Maharashtra. Those persons who are referring this courseware should study the relevant provisions as prevailing in the particular State.

The Bombay Stamp Act (BSA), 1958 is applicable in the State of Maharashtra. This Act pertains to levy of stamp duty on certain types of documents executed in the State. The rates at which stamp duty is levied on these documents are mentioned in Schedule I of BSA. The stamp duty is payable on instrument and not on the transactions. Instrument means any document by which any right or liability is created or recorded. The payment of proper stamp duty on instruments bestows legality on them. The instruments which are not properly stamped are not admitted in evidence.

The documents arc registered for the purpose of conservation of evidence, assurance of title and prevention of fraud. Also, registration helps an intending purchaser to know if the title deeds of a particular property are free from encumbrance. The documents relating to the following transactions of immovable properties are required to be compulsorily registered :

(a) Gift
(b) Lease of immovable property from year-to-year or for any term exceeding one year
(c) Instruments which create any right in an immovable property of a value of more than one hundred rupees.

The term "Immovable property" includes: Land, buildings, rights to ways, any benefit arising out of land, and things attached to the earth but not standing like timber, growing crops or grass. All documents of which registration is compulsory if it relates to an immovable property should be presented for registration in the office of Sub-Registrar within whose sub-district the portion of the property to which the document relates is situated. For registration of any instrument, the original document typed/printed on one side only along with two photocopies of the original have to be submitted to the Registering Officer. The registration procedure also requires the presence of two witnesses and the payment of the appropriate registration fees. On completion of the procedure, a receipt bearing a distinct serial number is issued.

Fees for Registration of a Document

The State Government has been empowered to fix the fees for registration of the document. The registration fees at present fixed by the Govt, of Maharashtra are approximately 1 % of the consideration of the document but subject to a maximum limit of Rs. 20,000. The registration fee for the following immovable property transactions is leviable on the market value of property on which stamp duty is charged.

The transactions are as under :

(i) Conveyance,
(ii) Exchange,
(iii) Gift,
(iv) Partition
(v) Transfer of Lease by way of Assignment,
(vi) Sale,
(vii) Settlement,
(viii) Power of Attorney given for consideration and
(ix) Authorising the attorney to sell the property.

In the case of lease, the amount of registration fees will be dependent either on the premium or on the sum payable under the lease or period/periods of lease.

Every document which is to be registered should be presented by: *(a)* the concerned person himself or *(b)* the representative or the agent of such a person duly authorized. The language of a document presented for registration should be in a language commonly used in the district existing in the State. The Registering Officer is empowered to refuse to register a document if it is presented for registration in a language which is not commonly used in the district unless the document is accompanied by a true translation into a language commonly used in the district and also by a true copy. It is always necessary that the description of the property is mentioned in a separate schedule, preferably with maps or plans, so as to enable the Registering Authority to make notes in the books to be preserved. The description should mention the area of the property, the number of the property, the boundaries of the property, the streets on which it is situated, along with the name of the village, Taluka, district. The City Survey Number, with Hissa Number, if any, should also be mentioned.

Time frame for Registration of a Document

Any document other than a will has to be presented for registration within four months from the date of its execution. The term 'execution' means signing of the agreement. Under the present rules and regulations, all agreements in respect of a transfer of a immovable property have to be duly stamped.

under the provisions of the Bombay Stamp Act, before the document is presented for registration. If a document is not presented for registration within the prescribed time period of four months, and if in such a case the delay in presentation of the document does not exceed a subsequent period of four months, then the parties to the agreement can apply to the Registrar. The Registrar may on payment of a fine not exceeding ten times of proper registration fees admit the document for registration.

If the delay goes even beyond these additional four months the parties to the document execute a Deed of Confirmation confirming that the main deed is valid and binding upon them. By way of such a deed the transferor/s also confirm/s that he/they hold/s no right, title and interest in the property and the same is being transferred to the transferee/s. A copy of the main deed is annexed to this Deed of Confirmation. This is the only manner in which the lapse in registration can be rectified.

Verification of the Title of the Property

Normally the person purchasing the property has to ensure that the seller has a good and marketable title. In order to find out if the title of the seller is clear and marketable, one has to take search of the property. The search of the property has to be taken at the offices of the relevant Sub-Registrars normally 30 years search has to be taken. The purchaser can also ask copies of the documents lodged with the office of the Sub-Registrar by the seller. The objections pertaining to the title of the property can be easily verified after taking the search, for example: if the party has mortgaged and registered the documents with the Sub-Registrar of Assurances then it can be known only after taking the search of the property. After satisfying the title of the property the party should proceed with the transaction.

Let Us Sum Up

There is no licensing requirement for carrying out the profession of mortgage broker or mortgage advisor or home loan advisor. The concept of " home information pack" is new to our country. It is already introduced in UK. This pack contains important information about the property, condition and thus assists the buyers and sellers of property in concluding the deal. For home loan advisors, knowledge about time value of money and methods of computation of future value of investment, present value of maturity and future value of annuity etc. will help to answer any queries of client. Even by applying rule of 72, any one can find out in how many months the amount will double. For this, divide the number 72 by given percentage, you get the answer. For example, if the rate of interest is 12% divide 72 by 12, you get answer as 6. So at 12% rate, the amount will double within 6 years.

The capital gain refers to profit on sale of capital assets. Land, building, securities, units of mutual funds are all capital assets. There is provision of enhancing value of cost of acquisition by applying cost inflation index (CII) factor taking into consideration CII for the year of purchase and year of sale. The general rate of long term capital gain tax is 20%. There are certain ways whereby capital gain is exempt from tax e.g. if the capital gain is invested in certain specified securities (e.g NHAI bonds) the tax rates for individual, woman and senior citizen needs to be referred and hence it is necessary that up to date rates needs to be kept handy. The knowledge about the equated monthly instalment and amortization schedule is *sine quo non* for taking home loan decisions. The use of EXCEL Program helps to find out EMI quickly. The documents such as sale deed are required to be registered with respective State Government authorities. The knowledge of formalities of registration, stamp duty computation and payment of registration fee etc. is needed to each home loan advisor and keeping note of changes in this field will be helpful.

Check Your Progress

1. Fill in the blanks by selecting suitable word given in the bracket.

   (i) A rupee .... is worth more than a rupee................ (tomorrow, today)
   (ii) By applying Rule 72, rupee will double in nine years if the rate of interest is.........................% p.a. (18%, 9 %, 8%, 6%)

(a). The registration fees for registration of documents in Maharashtra is approximately .... % of the consideration of the document but subject to a maximum limit of Rs. (3%,2%,1%, 50,000, 30,000, 20000)

(b) Interest at 15% p.a. means monthly interest at.....................%

2. State whether the following statements are true or false :

(i) In India, mortgage advice profession is carried out without any regulations.
(ii) By applying Rule 72, rupee will double in nine years if the rate of interest is ....% p.a. (18%, 9 %, 8%, 6%)
(iii) Cost Inflation Index from 2000-01 to 2006-07 and other information is given below

(i) 406, 426, 447, 463, 480,497 and 519.
(ii) Mr. Sukumar bought a house in 2001-02 for Rs. 3 Lakh and sold the same in 2006-07 for Rs. 700,000. Calculate the capital gains.

3. Select the correct statement from the following.
The documents relating to the following transactions of immovable properties are required to be compulsorily registered :

(a) Gift
(b) Lease of immovable property where period is more than one year
(c) Instruments which create any right in an immovable property of a value of more than one hundred rupees.

Answer:

(i) (a) above
(ii) (a) (b) above
(iii) all of the above
(iv) None of the above

Answers to Check Your Progress

1. (i) Today, tomorrow (ii) 8%

(iii) 1%, 20000
(iv) 1.25%
2. (i) True
(ii) 8%
(iii) Rs. 334508
3. (iii) all of above

Terminal Questions

1. Can anybody start working as mortgage advisor?
2. What is a time frame for registration of a document?
3. Prepare a Loan Calculator and Loan amortization schedule with following data :
   (i) Loan amount Rs. 800000
   (ii) Loan period: 20 years (240 months)
   (iii) Rate of interest 9.75%
4. Write a short note on 'Information Pack'. Is the requirement mandatory in our country?
5. What is Equated Monthly Instalment (EMI), how it is calculated with the help of EXCEL program.

UNIT 23 VALUATION OF REAL PROPERTY

STRUCTURE

23.1 Introduction
23.2 Who does Valuation?
23.3 Land with building
23.4 Life of Structures
23.5 Sinking Fund

Keywords Terminal
Questions

23.1 INTRODUCTION

Valuation means assessment of the worth of an asset or property. The worth or value of a property is based on the income and other advantages that will accrue from the property in future. It is distinct from cost, which refers to the actual amount spent in producing an asset. Price is the cost of production ***plus*** profit of the producer. Price depends on demand and supply of a commodity and rises or falls accordingly. Cost is related to the past while value refers to the future. Thus, cost is not the same as value and price is not necessarily equal to value.

We attach value to things that are useful for satisfying our wants or needs. However, the utility of same asset varies from person-to-person. Again, the price of the commodity tends to be higher if it is available only in limited quantity (supply) while there are many buyers (demand). Another attribute of value is the transferability of the asset to the purchaser. Thus, a real property derives value if it possesses utility, scarcity and demand apart from transferability.

It may be noted that value undergoes change with passage of time because of change in demand and supply conditions, lifestyle changes, and physical deterioration due to wear and tear (depreciation).

23.2 WHO DOES VALUATION?

Valuation is a specialized area practiced by qualified engineers and architects who possess knowledge of building costs, awareness of market conditions and economic trends, developmental plans, legal statutes and provisions governing real property, rental income and outgoings etc. The Valuer is required to collect data on aforesaid aspects but as the information is not easily accessible and/or authentic particularly about demand and supply, the Valuer has to rely on his own experience and judgment in arriving at the fair market value! It is hence inevitable that there will be difference of opinion between two Valuers in respect of the value of same property.

The Income-tax Department grants registration to Valuers u/s 34AB of the Wealth Tax Act, 1957, on the basis of their technical background and experience. For the purpose, the Deptt. has classified Valuers under separate categories those for *(a)* immovable property, (/>) agricultural land, (c) plant & machinery *(d)* jewellery etc.

The Institution of Valuers, Delhi is a professional body that grants membership to practicing Valuers. There are several Banks/Financial Institutions, which require besides registration under Wealth Tax Act, membership/fellowship of the Institution.

Types of Real Property

Agricultural land: Agricultural land means land capable of being used for farming or for raising plants or trees that carry value. The factors that influence the return from agricultural land are—

(a) Location
(b) Soil quality
(c) Availability of water & electricity
(d) Size of holding
(e) Clear Title of land
(f) Access by road and approaches
(g) Cottage or Farm house, fencing and gates (7i)
Types of crops that can be cultivated

Valuation of agricultural land is done by following two methods -

Income Capitalisation Method: The income is determined by assuming that the land is rented on crop-sharing basis. The net annual income is arrived at after deducting the expenses incurred such as local taxes, cost of maintenance, cost of inputs, insurance etc. and the amount is then capitalized at an appropriate rate of interest to get the value of land.

Capitalised value means the amount of money required today to get a certain fixed income in the form of annual instalments over a very long time (perpetuity). The present value of future annual income is obtained by multiplying it by a factor called 'Years Purchase* (YP). The factor or multiplier is so called because it represents the purchase price for the yearly income. It is obtained from Present Value tables and for annual income in perpetuity (asset that does not depreciate), it is equal to 1/i where 'i' is the rate of interest.

Sales Statistics Method: In this method, the valuation is based on the comparable sale value of similar agricultural land located in the vicinity of the land to be valued. The factors generally considered for comparison are:

1. Size of holding
2. Physical features, roads, fencing, cottages, soil quality etc.
3. Title of land and conditions of letting out for cultivation

Urban land

Urban open lands could be put to residential or industrial use and their value depends on their potential for development through construction of appropriate structures. The factors that have a bearing on value of vacant land are:

1. Location - nearness to schools, shops, entertainment, transport, medical, recreation facilities, police station, etc.
2. Size, shape and level - there is larger demand for plots of certain sizes in particular locality. Similarly, plots of irregular shape or at lower than road level carry lower value.
3. Soil quality, water availability - low bearing capacity of soil increases the cost of foundation.
4. Frontage & depth - Street frontage adds to value while disproportionate depth reduces value of plot.
5. Restrictions on development - Land with higher FSI commands higher price. *FSl or Floor Space Index* (also called Floor Space Area - FAR) refers to the ratio of total built-up area inclusive of all floors to the area of land on which the building is constructed. It is determined by local authority and varies for different areas or different buildings in the city. Available FSI refers to the difference between the permissible FSI and the FSI utilized.
6. Encumbrances - such as easement rights, unauthorized hutment dwellers etc. - The value of land with encumbrances is much less compared to land with no encumbrance. Valuation of open land is done by following methods—

Comparative Method: The value is determined on the basis of a fair rate for land situated in the vicinity as reflected from various recent sale-purchase transactions. The Valuer has to draw on his experience while using this method, as the land rates as per sale deeds do not often reflect the actual rate. Land value in urban areas is a function of the collective demand for real property, both present and future.

Rent Capitalisation Method : First, a comparable property in nearby area on rent is used as benchmark and the capitalised value is calculated by multiplying the net income by Years Purchase. Next, the replacement cost of the building is worked taking into account the quality of construction etc. and its present value is worked out by charging suitable depreciation. The value of land is obtained by subtracting the latter from the capitalised value.

The net rental income, on an average, varies from 4% to 6.5% depending on the location for residential property and from 6% to 9% for commercial property.

Belting Method: It is adopted for big size plots with lesser frontage and more depth. The land is divided into several belts running parallel to the frontage and progressively lower rates are taken for belts farther from the frontage.

23.3 LAND WITH BUILDING

The methods used for valuation of land with building are:

Comparative Method: The Town Planning Deptt. generally adopts the Comparative Method for estimating the value of land with building because the property is generally sold as a single piece *i.e.* land with building. The term composite rate is used to indicate the rate of land together with the structure erected on it. The rate is determined by collecting information on sale rates of nearby similar properties in recent past. The method is used for valuation of residential flats and office units in multi-storied buildings in urban areas. The Apartment Ownership Acts have been framed by Slate Governments to give a marketable title to the purchasers of the premises as residence, office, showroom or godown.

Rent Capitalisation Method: The rental income is the rent actually paid when the property has been let out in the recent past *vis-a-vis* the date of valuation. However, the actual rent may not always represent the fair rental income in cases where the tenant has paid some lump-sum amount upfront or the property is newly constructed etc. When the property is self-occupied or vacant, the rental value is estimated by comparison to the rent received from similar properties in the locality. One must look into the terms of letting, the floor area, date of letting etc. for making a reasonable comparison.

The method of valuation, as already discussed, consists in deducting the outgoings from gross income to get the net income. The multiplication of net income and YP worked out for the useful life of the structure or in perpetuity gives the capitalized value. The formula for YP for a particular number of years is given by:

1 x (1 + /)"

- 'i' is the rate of interest and 'n' is the number of years. The YP for income in perpetuity is given by -1/i.

Valuation based on profits: In cases of property which is used for conducting trade or business, like hotels, cinema houses, restaurants etc., the valuation is done on the basis of capitalized value of the net profit as reflected in the books of account of the business entity. The net profit is capitalized by multiplying it by the YP for certain number of years or in perpetuity, for a rate of return pertinent to the specific business.

Valuation based on cost: The present cost of building is estimated with prevalent rates taking into account the type of construction, age and condition of the building and appropriate depreciation is charged to get the depreciated value. The value of land is worked out on the basis of current rates after making due allowance for the encumbrance factor. The total value of property is worked out by adding the two.

Encumbrance factor refers to the value imposed on the land due to the type of structure erected on it because it is the earning capacity of the building that determines the value of the land. The type of building puts a constraint on deriving the full economic value of land and thus encumbers the land.

This method is generally adopted in cases where sale instances are not available for comparison. The method is suitable for such type of properties as hospitals, police stations, libraries, town halls, temples, mosques etc. The valuation may be required for purposes of fire insurance etc.

Development Method: This method is based on the potential value of the property if it is developed in the best possible manner by making necessary modifications. The property may be open land or land with building. The cost of additions and alterations is estimated and the difference between the estimated increase in capital value and the estimated cost of additions etc. represents the potential value. This method is useful for properties, which possess hidden value on account of development or re-development possibilities.

Valuation of specialized buildings: Buildings erected to serve specific purpose such as bars, breweries, hotels, motels, cinema houses are valued by specialists having experience of market practices and rules that apply to the particular trade. The business can be pursued only after a license is obtained from the authorities. When the business is sold as a going concern, one has to take into account the value of intangible assets such as monopoly, goodwill, competence of management etc. apart from the value of the premises.

Valuation is based on capitalization of average net profit over past couple of years at appropriate rate of interest. This method is also known as the balance-sheet method. The rate of interest for capitalization should represent not only the normal rate of return for the type of business but also the risks and uncertainties involved in it. The valuation exercise in respect of cinema houses or hotels requires a proper assessment of gross income from the business and also the shops & service establish-ments which have been leased out space in the premises. Likewise, an estimate of direct and overhead expenses including taxes has to be made to arrive at net income. The Valuer needs to have knowledge of occupancy rates, management quality, standard of accommodation and other facilities available like parking lot, lifts, garden etc. for making a reasonable assessment of value.

23.4 LIFE OF STRUCTURES

A Valuer is required to make an estimate of the future life of the building during which it can yield an assured income, while carrying out the valuation of land with building constructed on it. A building loses capital value with passage of time due to wear & tear, advent of new construction technology and provision of improved amenities in new buildings etc. The durability of the structure is estimated on the basis of materials used in construction, maintenance, climatic conditions etc. Normally, the life of buildings varies from 40 years to 80 years. The useful life of a building can be extended by proper upkeep and maintenance of the property, making suitable additions and alterations to structure to improve its strength and durability etc.

23.5 SINKING FUND

At the end of life of the structure *i.e.* when it ceases to yield desired income, a property has to be replaced or rebuilt so that the income may continue for further period. The fund set aside for the purpose of recovering the original capital is called sinking fund. The amount to be regularly set aside out of annual income to create the sinking fund depends on the compound interest it is supposed to earn over the life of the structure. The sinking fund factor is the amount that accumulates to Re. 1 if invested at specified rate of interest for certain number of years. It can be obtained from Valuation Tables. The factor for redemption of Re 1 at the end of 25 years @ 5% compound interest is 0.021 from the table *(see* Appendix). Thus the sinking fund for redeeming original capital of Rs. 15 lacs will be 15,00,000 x 0.021 = 315000.

In actual practice, separate provision for sinking fund is not done but the capitalized value is obtained by referring to dual rate Valuation Tables to determine the multiplying factor (YP) based on income for a specified period (life of building) at particular interest rate and redemption of capital at another rate of interest. Thus the YP or present value of Re 1 per annum for income @ 10% rate of interest and redemption of capital @ 5% rate of interest for a period of 25 years is 8.27 as per the tables *(see* Appendix). In other words, if a property is purchased for Rs. 8,00,000, its capitalized value will be 8.27 x 8,00,000 = 66,16,000.

Depreciation

Depreciation means loss in value. A building loses value due to deterioration in its physical condition as a result of usage (wear & tear), effect of climatic conditions, poor structural design or workmanship. An estimate of the useful life of the building is made after which it will become unserviceable and depreciation is charged accordingly so that accumulated depreciation becomes equal to the original investment at the end of its life.

A building also loses value due to obsolescence. There is continual improvement in construction technology and architecture and new buildings provide more comfortable living conditions by providing better amenities such as modular kitchen, wash basins, hot and cold water, geyser, lift, better ventilation etc.

There are several methods to calculate depreciation but the following two methods are usually adopted—

Straight Line Method : In this method, the depreciation is allocated uniformly over the life of the property and is generally adopted for tax purposes and preparing financial statements. The annual depreciation is given by:

n

D is annual depreciation, C is

original cost,

S is salvage value (value that property may fetch at the end of useful life), n is life of

building in years.

Written Down Value (WDV) Method: In this method, it is assumed that the property will lose value by a constant percentage of its value at the beginning of the year. Thus, the amount of depreciation goes on reducing every year because while depreciation is charged at fixed percentage, the capital value of asset decreases by depreciation charged every year. The object is to charge higher depreciation in initial years when the asset yields higher income due to low cost of repairs & maintenance and lower depreciation in later years when cost of repairs goes up. This method is also called the Declining Balance Method and is generally adopted by industrial units because of advantage of lower income-tax. The WDV of an asset can be found out by the formula -

$$WDV = C(1 - p)^n$$

C being original cost, n being life in years, and p being the percentage at which depreciation is charged. Here, salvage value is assumed as zero.

Summary

Valuation of real property is a specialized area. It calls for technical knowledge related to structural design, construction materials, architectural aspects etc. as well as cost of construction based on estimate of items of work, quantity of materials & rates, labour rates, cost of electrical fittings, plumbing and water supply and many other costs associated with building construction. It also requires knowledge of various sanctions and approvals required from civic authorities and the rules pertaining to permissible FSI, parking facilities, provision of lifts etc. Further, it calls for familiarity with incidence of taxes and levies, statutes and legal provisions such as the Apartments Act, Stamp duty. Registration fees and the documentation for transfer of clear and marketable title to the purchaser. The Valuer must also keep track of the demand and supply conditions, which influence market value such as changes in interest rates on housing loans, high/low disposable income, increase/decrease in rentals, Development Plan for the City etc.

Depreciation refers to the decrease in value of property due to physical deterioration, obsolescence, changes in neighbourhood (new buildings with better amenities coming up) etc. The normal life of buildings (CPWD manual) is 75 years for RCC framed structure, 55 years for Load bearing wall structure and 30 years for semi-permanent structure. Salvage value is the estimated cost of material when the structure is demolished at the end of its life. It is normally taken as 10% of the actual cost of building. Depreciation is usually charged by Straight Line method or Written Down Value method.

There are several methods for valuation of real property and though valuation in not entirely a mathematical exercise, some of these make use of mathematical tables. Broadly, valuation is done by (/) Comparative method, *(ii)* Rent capitalization method, *(iii)* Profits capitalization method, *(iv)* Replacement cost method and (v) Development method.

Valuation tables are available and facilitate determination of capitalized value for different interest rates and number of years. Tables are also available for dual rates of interest - one for rental income and the other for sinking fund.

Keywords

Transferability; FSI/FAR; Capitalisation; Years Purchase; Encumbrance factor; Depreciation; Sinking Fund; Building life; Frontage & Depth; Potential Value

Check Your Progress

Question 1: A newly constructed building stands on a plot costing Rs. 100000. The construction cost of building is Rs. 2000000 and the estimated life of building is 66 years. The investor wants a 5% return on land cost and 8% return on the construction cost. Calculate the annual rent to be charged if annual repairs cost 0.5% of cost of construction and other outgoings equal 30% of gross rent. The co-efficient for sinking fund at 3% for 66 years may be taken as 0.005.

Return on land cost = 5% of 100000 = 5000

Return on construction cost = 6% of 2000000 = 120000

Total Income desired = Rs. 125000 (a)

Let gross annual rental be 'r'

Outgoings: Annual repairs = 0.5% of 2000000 = 10000 Other outgoings

= 30% of r or 0.30 r Amount towards sinking fund = 0.005 x 2000000 =

10000 Hence, net income = r - 0.30 r - 20000 (b)

Equating *(a)* and *(b)*, 0.70 r - 20000 = 125000

$$r = \frac{105000}{0.70} = \text{Rs } 150000$$

$$\text{Hence, rent per month} = \frac{1500(H)}{} = \text{Rs. } 12500$$

Question 2: A temporary structure has been constructed at a cost of Rs. 120000. Assuming its salvage value as Rs. 30000 at the end of 6 years, determine the amount of depreciation for each year by Straight Line method and WDV method at 15% per annum.

$$\text{Straight line method: } \frac{C-S}{n} = \frac{120000-30000}{6} = \text{Rs. } 15000$$

At the end of 6 years, total depreciation is Rs. 90000 and book value is 120000 - 90000 = 30000 (salvage value)

l/n

WDV method p-u~

30000V/n
12000) = 1 1-

= 1 - 0.7936 = 0.2064 The following table shows depreciation chart @ 20.64%

Age	Depreciation for the year	Accumulated depreciation	WDV
1	24770	24770	)5230
2	19650	44420	'5580
3	15600	60020	59980
4	12380	72420	17600
5	9820	82220	37780
6	7780	90000	30000

Thus, the WDV at the end of 6 years is Rs. 30000, which is the salvage value of the property.

Question 3: Find out the encumbrance factor and value of the usable FSI from following particulars of the property -

Land area - 533 m^2

Total built-up area - 205 nr

Permissible FSI - 1

Rate of construction cost - Rs. 5000 per m^2

Rate of land cost - Rs. 2000 per m^2

Desired rate of return - 9%

Usable carpet area - 155 m^2

Monthly Rent on carpet area basis - Rs. 50 per m^2

Solution

Cost of construction = 205 x 5000 = 1025000 Cost of

FSI used = 205 x 2000 = 410000 Total cost = 1435000

Desired Yield @ 9% = 1435000 x 0.09 =129150 Estimated

Yield = 50 x 155 x 12 = 93000 Usual outgoings = 1/6 of

yield = 93000/6 = 15500 Net annual yield = 77500 Hence,

encumbrance factor = 77500 = 0.833 93000

Usable FSI = 533 - 205 = 328 m^2

Value of usable FSI = 328 x 0.833 x 2000 = 546448

Terminal Questions

1 What are the factors that have influence on market value?
2 Explain the procedure adopted for valuation of property by Rent Capitalisation method?
3 What are the type of buildings for which the valuation is based on profits and what are the points to be noted?
4 What arc the reasons for functional obsolescence of buildings?

5 What factors should be considered for assuming a certain rate of interest for capitalization of income?

References

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2. Depreciation of Real Estaste by O.P Khosla (Journal of Institution of Valuers, May 2007)

Appendix

Annual sinking fund for redemption of Re. 1 capital

Illustrative table

Years	*Rate per cent*		
	3	4	5
25	0.027	0.024	0.021
30	0.021	0.018	0.015
40	0.013	0.011	0.008
50	0.009	0.007	0.005

Present Value of Re. 1 allowing return on capital @ 10% p.a. and redemption of capital @ 5% p.a. Illustrative table

ears	*Redemption of capital at %*		
	4.5	5	6
15	6.75	6.83	
20	7.58	7.68	
25	8.17	8.27	
30	8.59	8.69	

REVERSE MORTGAGE

The average life span of an individual in India has been steadily increasing over the years. The increase in longevity is amplified by the fact that the average life expectancy of an individual which was 42 years in 1947 had increased to 64 years in 2008. A variety of reasons like, improved standards of living, better health care facilities, etc. are attributed to this. Although, the increase in life expectancy of an individual speaks volumes of the country's progress socially, it has however brought along with it new economic challenges for the senior citizens.

Unfortunately, the social security blanket available in the developed countries is not there in India to the extent desired. Therefore, the erosion in savings due to rising cost of inflation, the absence of social security or old age pension, fall in the real value of pension when received and the rising cost of health care have not augured well for the senior citizens and have made sustenance difficult for them. Besides other social issues like nuclear families, migration of children or being childless, have also contributed significantly to the economic struggle of the senior citizens.

In a majority of the cases, it has been observed that they have property which however is non-income generating. These people have often pooled their life savings in the creation of their wealth - i.e., real estate, without having sufficient liquidity to care of their day to day requirements. While the value of the property has been spiraling, so has the cost of living. The senior citizens, many times, are therefore left with little option but to sell their property or move out to maintain their living standards or to meet their medical exigencies.

The economic paradox faced by the senior citizens in India today was witnessed in the West in the 1920s - 1930s in the wake of the Great Depression. It was against this background that the idea of Reverse Mortgage Loan took shape in the United Kingdom in 1929. The Reverse Mortgage in vogue today, has evolved over the years from the developed countries especially, USA. It is equally applicable in India in the present environment although the concept is still in its infancy. *Reverse Mortgage loan (RML) as a financial product is therefore to be perceived, understood and appreciated in the context of the necessity for additional income by the senior citizens.*

Reverse Mortgage Loan, seeks to generate income from the property owned and resided in by the senior citizens to enable them to lead an independent and dignified life. For these citizens, it is an additional mechanism to supplement their existing sources of income, while at the same time remaining the owners of their property and continuing to occupy it. Besides, they are also freed from the burden of repaying the loan / servicing the interest.

Under the scheme, a senior citizen- aged above 60 - (borrower), mortgages the self occupied residential property belonging to him / her to a banker (lender), who on assessment of the market value of the property will make a periodic payment to the borrower during his / her lifetime. The borrower does not have to repay the loan or interest to the lender and can continue to occupy the property. The loan (including accumulated interest) is repaid from the proceeds of the sale of the property, on the death of the borrower/ in the event of the borrower leaving the property permanently. The mortgage may also be released if the loan and interest is repaid by the heirs/borrower.

It is pertinent to note that for taxation purposes, Reverse Mortgage, does not imply transfer of the property and the income received by the borrower would also not be treated as 'income'. A borrower, under reverse mortgage, shall, however, be liable to income tax (in the nature of tax on capital gains) only at the point of sale of the mortgaged property by the lender for the purposes of recovering the loan. All payments under RML shall be exempt from income tax under Section 10(43) of the Income-tax Act, 1961.

Differentiating between Mortgage and Reverse Mortgage

In a normal housing loan, where the property being purchased is mortgaged to the lender, the borrower avails a loan to begin with and at that point of time, his stake in the property purchased is low. As the regular EMI is paid on due dates, the loan amount reduces and his stake in the property increases. However, in Reverse Mortgage, the position is exactly the reverse. Under RML, the borrower initially retains a high stake in his property and receives a regular cash flow. Over time, when the loan amount increases, his stake in the property reduces.

Reverse Mortgage Loan - Salient features

The scheme was introduced in India in 2007 and made applicable with effect from April 01, 2008. Banks like State Bank of India, Central Bank of India etc have issued guidelines under RML. The basic guidelines regarding the scheme have been framed by National Housing Bank, a subsidiary of Reserve Bank of India; the details of which are available on the website of NHB. The salient features of the scheme are briefly elucidated below:

- A senior citizen who is above 60 years is eligible for a reverse mortgage loan against his own and self occupied residential property. He / She can continue to occupy the house. The borrower will not be called upon to service the loan during his / her lifetime. The loan amount may be used by the borrower for varied purposes including up-gradation/ renovation of residential property, medical exigencies, etc. However, use of RML for speculative, trading and business purposes is not permissible.
- Married couples will be eligible as joint borrowers subject to the condition that one of them is above 60 years and the other not below 55 years.
- The property should have a clear title and should be free from encumbrances. The residual life of the property should be at least 20 years.
- RML is not available against the security of commercial property.
- The owner of the residential property and his/her spouse are generally joint borrowers and the surviving borrower is allowed to retain the property till his / her death.

- The loan amount will be based upon the market value of the property and could range from 60% to 90% of the value of the property depending on the age of the borrower (s); with the interest rate being market driven.
- The loan installments could be paid through monthly/quarterly/half-yearly/annual disbursements or a lump-sum or as a committed line of credit or as a combination of the three. As per the guidelines, the maximum monthly payment is pegged at Rs. 50,000.00 p.m. with the maximum lump sum payment being restricted to 50% of the eligible loan amount subject to a limit of Rs. 15 lakhs, to be used for medical treatment. The balance loan amount would be paid periodically.
- The maximum period of the loan is 15 years. If the borrower outlives the maximum loan period, he/ she can continue to retain the property and need not repay the loan or service the interest. However, the periodic payments under Reverse Mortgage will cease and interest will continue to accrue till the death of the borrower or till he / she moves out of the property. In such an eventuality, the loan will be liquidated from the sale proceeds of the property.
- The usual charges in regard to the appraisal fee, documentation charges, etc. have to be borne by the borrowers. The borrower is required to insure the property at his own cost and is also liable to pay the taxes and statutory charges to the authorities concerned regularly.
- The banker (lender) is free to decide the periodicity of valuing the property with such valuation being at least once every five years. The quantum of loan may undergo revisions based on such revaluation of property at the discretion of the lender.
- All reverse mortgage loan products are expected to carry a 'no negative equity' or 'non-recourse' guarantee. In simple words, this means that the borrower(s) will never owe more than the net realizable value of their property, provided the terms and conditions of the loan have been met.
- The borrowers)/legal heir(s) can also repay the loan with accumulated interest and have the mortgage released without resorting to sale of the property. No charges will be levied if the loan is prepaid.

Formula to Calculate the Periodic Payments under RML

The formula to calculate the periodic payments, as available in the website of NHB, is as under:

Installment Amount = $(PV*LTVR*I)/((1+I)^n-1)$ Where, PV =

Property Value; LTVR = LTV Ratio;

n = No. of Installment Payments;

I = the value of I will depend on Disbursement Frequency selected.

A Hypothetical Example

e of the property	50,00,000	Rs 50,00,000
Amount		90%
Tenor	ears	15 years
of interest		10.50%
thly installment	9651.	Rs 10,368
terly installment	29,414.	Rs 31,638
ly installment	,25, 895	Rs 1,36,116

The spread of Reverse Mortgage, in the western countries has been very good. The scheme has however been a slow starter in India. As per a report published in the Business Standard on May 24, 2010, according to NHB, as on March 31, 2010, around 7000 reverse mortgage loans for Rs 1,400 crore have been sanctioned. Although the numbers, per se, appear to look reasonable, there is still a lot of room for higher off take of loans under RML. In order to provide an impetus, certain improvements have been made in the scheme like annuity linked plan assuring lifetime payments even after the completion of the term, higher annuity without lump sum loan option etc.

Some of the reasons for the scheme not being as successful as envisaged could be due to lack of awareness of the product, inadequate marketing, disputed title deeds, etc. Hopefully, these bottlenecks will be removed paving the way for a better and brighter future for the senior citizens of our country.

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