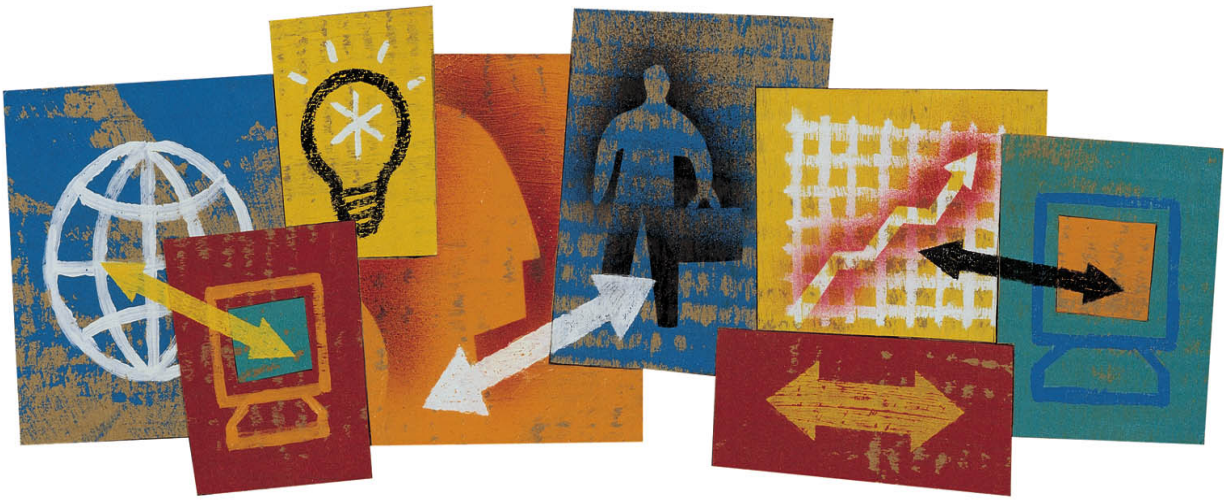

L1 Course in Retail Banking
Banking

Version : 1.0
Date : 20- Oct - 2005

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1 Scope of the Document

The current document seeks to introduce the basics of retail banking. As we shall see in subsequent sections, retail banking is just one of the entire gamut of banking activities, ranging from wholesale to investment banking.

In retail banking, we shall be particularly concerned with liabilities' banking. While emphasizing on the US market, we would limit our focus to bank products like accounts, deposits, instruments, payments, delivery channels, etc. There is also a brief mention of asset products like overdraft.

It is imperative that we explain that what does liability and asset mean, with respect to a bank's balance sheet. Liability components of a bank's balance sheet are those where the bank has to make some future payments. Essentially, these components have the potential to negatively affect a bank's liquidity. Term deposits, savings account deposits, etc. would thus fall under this category, as the bank has an obligation to make a payment back to the customer and depositors.

Asset components, on the other hand, are items which give earnings to the bank in the form of interest income, etc. and which have the potential of positively affecting a bank's liquidity. These would include items like the various kinds of loans that a bank offers.

As mentioned before, in this document we shall be primarily focusing on the liabilities side. In addition to the different kinds of products, we shall also take a look at the present retail banking scenario, the changes that are happening in the industry, regulatory and compliance requirements, etc.

It is hoped that the current document will help the beginner to gain a thorough understanding of the basics of banking; while helping the expert to brush up his/her fundamentals.

2 Introduction to Retail Banking

2.1 TYPES OF BANKS

There are two kinds of customers that a bank deals with. One- an individual and two - a corporation or business. As far as banking needs are concerned, these two entities have very different objectives. While the individual's requirement from bank would be to perform simple banking transactions like deposits & withdrawals and safekeeping of savings (with a bit of interest income thrown in); the corporation's prime requirements from bank would be to perform banking transactions like payments, trade related transactions, borrowings etc. Due to these differences in expectations by customers, banks may have separate arms to deal with individuals and corporations. While the retail division focuses on the individual customer, the wholesale or corporate banking division focuses on corporations or businesses. For e.g. your relationship with Citibank would be that of a retail customer – while that of Cognizant's, would be a corporate customer.

The investment banking division of a bank – as the name suggests – manages the investments of its clients. The usual clients of an investment bank are corporations; however, individuals also can be a client sometimes. The investment bank invests in various markets on behalf of the client and then distributes the profit earned from these investments to the client. These banks generally charge a fee based on the amount of investment managed and for other services. The different types of investments include stock market instruments, money market instruments, etc and the derivatives thereof. These days, most banks have an investment banking arm. However, some of the most well-established and renowned investment banks are Lehman Brothers, Morgan Stanley, Deutsche Bank, etc.

2.2 RETAIL BANKING

Retail banking is typical mass-market banking where individual customers use local branches of banks. Services offered include: savings and checking accounts, mortgages, personal loans, debit cards, credit cards, and so forth.

Retail banking can also be divided into various deposit /liability products including checking, savings, and time-deposit accounts such as certificates of deposit as well as various asset-based products, such as auto lending, credit cards, mortgages, and home equity loans. These assets products are referred as Consumer Lending. Big banks are likely to be in all of these businesses, and smaller ones mainly focus on deposit gathering while offering mortgages and home equity loans.

Industry experts estimate that there are about $5 trillion in deposits in the U.S. market. Since there is no credit risk associated with taking in deposits, banks need less capital to run this business than, say, mortgage lending. The proper amount of capital required, according to one of the estimates is about 1%, which translates to about $50 billion for the industry. The return on this relatively small investment, meanwhile, is 35% to 50%, or a minimum of $18 billion for the industry, making it a very profitable business.

In contrast, the total outstanding balances in the credit card industry amount to about $1 trillion. Since this business is riskier, it requires more capital to run, and the resulting profits are about $12 billion to $13 billion for the industry.

However, there is a reason why credit card lending appears to be more of a moneymaker than deposit gathering. The business is concentrated among the biggest banks: The top 10 lenders hold 85% of the credit card balances. The business of deposit gathering, meanwhile, is split up among a large number of banks. The numbers indicate there is ample opportunity to generate significant profits simply by gathering deposits-but it also means facing a lot of competition.

While investment banking and commercial lending are related to high value deals, retail banking is associated with low value transactions - the sums of money involved in any one transaction are likely to be in the hundreds and thousands but not millions of dollars.

For years, retail banking has been viewed as a commodity business. Interest rates paid on deposits often differ so little from bank to bank that they are almost meaningless to consumers. Also, aside from signage, most bank branches tended to look alike, with their teller windows on one-side and platform desks on the other.

In the past couple of years, however, bank managers have been opening their eyes to greater possibilities in retail banking. A few factors have played into this new attitude. One is the huge hit to investment banking and trading that many banks took at the end of the dot-com boom. New York-based J.P. Morgan Chase & Co. is a prime example of an institution trying to decrease its reliance on investment and trading income by expanding into retail banking. Towards this, it also acquired Chicago-based Bank One Corp., a retail banking stalwart in the Midwest in 2004.

3 Regulatory Bodies and Banking Landscape

3.1 FEDERAL RESERVE ACT, 1913

The act is to provide for the establishment of Federal Reserve banks, to furnish an elastic currency, to afford means of rediscounting commercial paper, to establish a more effective supervision of banking in the United States, and for other purposes.

On December 23, 1913, the Federal Reserve System, which serves as the nation's central bank, was created by an act of Congress. The System consists of a seven member Board of Governors with headquarters in Washington, D.C., and twelve Reserve Banks located in major cities throughout the United States.

3.1.1 The Board of Governors of the Federal Reserve System

The primary responsibility of the Board members is the formulation of monetary policy. In addition to monetary policy responsibilities, the Federal Reserve Board has regulatory and supervisory responsibilities over banks that are members of the System, bank holding companies, international banking facilities in the United States, Edge Act and agreement corporations, foreign activities of member banks, and the U.S. activities of foreign-owned banks.

The seven members of the Board of Governors of the Federal Reserve System are nominated by the President and confirmed by the Senate .The seven Board members also constitute a majority of the 12 -member Federal Open Market Committee (FOMC).

3.1.2 Federal Open Market Committee

The Federal Open Market Committee (FOMC) is the most important monetary policymaking body of the Federal Reserve System. It is responsible for formulation of a policy designed to promote economic growth, full employment, stable prices, and a sustainable pattern of international trade and payments. The FOMC makes key decisions regarding the conduct of open market operations—purchases and sales of U.S. government and federal agency securities—which affect the provision of reserves to depository institutions and, in turn, the cost and availability of money and credit in the U.S. economy. The FOMC also directs System operations in foreign currencies.

The FOMC is composed of the seven members of the Board of Governors and five Reserve Bank presidents. The president of the Federal Reserve Bank of New York serves on a continuous basis; the presidents of the other Reserve Banks serve one-year terms on a rotating basis.

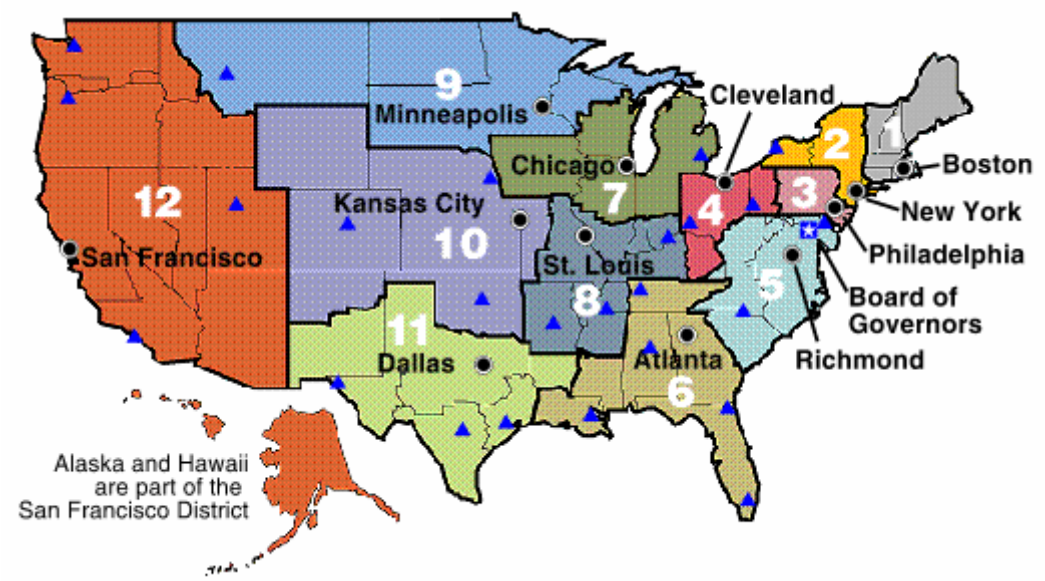
3.1.3 Federal Reserve Banks and Branches

Federal Reserve Banks were established by Congress as the operating arms of the nation's central banking system. Many of the services provided by this network to depository institutions and the government are similar to services provided by banks and thrift institutions to business customers and individuals. Reserve Banks hold the cash reserves of depository institutions and make loans to them. They move currency and coin into and out of circulation, and collect and process millions of checks each day. They provide checking accounts for the Treasury, issue and redeem government securities, and act in other ways as fiscal agent for the U.S. government. They supervise and examine member banks for safety and soundness. The Reserve Banks also participate in the activity that is the primary responsibility of the Federal Reserve System, the setting of monetary policy.

For the purpose of carrying out these day-to-day operations of the Federal Reserve System, the nation has been divided into twelve Federal Reserve Districts, with Banks in Boston, New York, Philadelphia, Cleveland, Richmond, Atlanta, Chicago, St. Louis, Minneapolis, Kansas City, Dallas, and San Francisco.

Twenty-five Branches of these Banks serve particular areas within each District.

The map shows locations of the Reserve Banks and their Branches, along with District boundaries and assigned District numbers.



Board of Governors of the Federal Reserve System, Washington, D.C.

Federal Reserve Bank city

Federal Reserve Branch city, by District

As required by the Federal Reserve Act of 1913, each of the Reserve Banks is supervised by a board of nine directors who are familiar with economic and credit

conditions in the district. Similarly, each of the twenty-five Reserve Bank Branches has a board of five or seven directors who are familiar with conditions in the area encompassed by the Branch.

3.1.4 Charter

A charter is an agreement that governs the manner in which the bank is regulated and operates. It authorizes the organization of the bank by either the state or federal agency.

The agency that charters the bank is primarily responsible for protecting the public from unsafe banking practices. It conducts on-site examinations to make sure the bank's financial condition is good and that the bank is complying with banking laws. State charters and federal charters typically do not differ too much in the way the bank conducts business. They do, however, differ in other areas. For example, in Florida, a state bank is not required to be a member of the Federal Reserve System, while federally chartered banks are. Also, state-chartered banks are regulated by state agencies, while federally chartered banks are regulated by federal agencies.

3.2 FEDERAL DEPOSIT INSURANCE CORPORATION (FDIC)

One of the important implications of the Act was the introduction of the FDIC insurance. The Federal Deposit Insurance Corporation currently guarantees checking and savings deposits in member banks up to $100,000 per depositor. In order to receive this benefit, member banks must follow certain liquidity and reserve requirements. Checking accounts, Negotiable Order of Withdrawal (NOW), Money Market Deposit Accounts, Savings Accounts, Certificates of Deposits(CDs) are typically covered by this insurance. Stocks, bonds, mutual funds, etc. are not covered under this scheme.

The similar corporation for Credit union is NCUA

3.3 THE OFFICE OF THE COMPTROLLER OF THE CURRENCY

The Office of the Comptroller of the Currency (OCC) charters, regulates, and supervises all national banks. It also supervises the federal branches and agencies of foreign banks. Headquartered in Washington, D.C., the OCC has four district offices plus an office in London to supervise the international activities of national banks.

The OCC was established in 1863 as a bureau of the U.S. Department of the Treasury. The OCC is headed by the Comptroller, who is appointed by the President, with the advice and consent of the Senate, for a five-year term. The Comptroller also serves as a director of the Federal Deposit Insurance Corporation (FDIC) and a director of the Neighborhood Reinvestment Corporation.

In regulating national banks, the OOC has the power to:

- Examine the banks
- Approve or deny applications for new charters, branches, capital, or other changes in corporate banking structure

- Take supervisory actions against banks that do not comply with laws and regulations or that otherwise engage in unsound banking practices. The agency can remove officers and directors, negotiate agreements to change banking practices, and issue cease and desist orders as well as civil money penalties
- Issue rules and regulations governing bank investments, lending and other practices

3.4 THE OFFICE OF THRIFT SUPERVISION

The Office of Thrift Supervision (OTS) is the primary regulator of all federally chartered and many state-chartered thrift institutions, which include savings banks and savings and loan associations that belong to the Savings Assurance Insurance Fund (SAIF) (which is under the control of the FDIC). A successor to the Federal Home Loan Bank Board, the OTS was established as a bureau of the U.S. Department of the Treasury on August 9, 1989, and has four regional offices located in Jersey City, Atlanta, Dallas and San Francisco. OTS is funded by assessments and fees levied on the institutions it regulates.

More specifically, the OTS primarily aims to:

- Improve the availability of credit and other financial services by encouraging safe and sound lending investment
- Maintain competitiveness of the thrift industry to ensure its safety and soundness

The OTS ensures that all thrift transactions are in keeping with the various laws and regulations like the Home Owners' Loan Act, BSA, USA PATRIOT Act, etc.

3.5 TYPES OF BANKING INSTITUTIONS

Credit unions, savings and loans, mutual funds, and brokerages offer checking and savings services similar to what retail banks offer. Before we discuss banks in more detail, here is a brief discussion of these other options:

3.5.1 Credit Unions

Credit unions are non-profit, member-owned, financial cooperatives. They are operated entirely by and for their members. When a customer deposits money in a credit union, he/she becomes a member of the union because his/her deposit is considered partial ownership to the credit union. To join a credit union, a customer ordinarily must belong to a participating organization, such as a college alumni association or labor union.

While the accounts are similar to bank accounts, the names are different: share draft accounts (like checking accounts), share accounts (like savings accounts), and share certificate accounts (like certificate of deposit accounts). For nearly all credit unions, the National Credit Union Share Insurance Fund insures most of the deposits up to $100,000. Interest rates tend to be higher and fees tend to be lower than at commercial banks, because they exist to serve their member-owners rather than to maximize profits.

On the downside, credit unions usually have very few branch offices and ATMs. However, to compensate for this, in most states credit unions have formed surcharge-free ATM networks among themselves.

3.5.2 Brokerage

Another substitute for a bank account is a cash-management account at a brokerage. A customer will earn money-market rates, which will usually be significantly higher than the interest the bank would pay. The fees will generally be less than what the bank would charge, and the fees might be waived entirely if the customer has a substantial portfolio at the brokerage. If the customer overdraws the account, the interest rate will be lower than what the bank would charge, and in addition it's usually tax-deductible because it's considered margin interest. The customer will be able to perform all the basic banking functions, such as check writing and using a Visa debit card at any ATM. However, there are a few downsides. Very few brokerages have ATM networks, so when the customer uses an ATM the customer will be charged by that ATM's owner and possibly also by the brokerage's bank partner (if the brokerage itself isn't a bank). Also, as with credit unions, brokerages lack some of the bells and whistles that commercial banks offer. Some brokerages don't allow the customer to drop by a branch to deposit checks, some don't offer automatic bill paying, and some don't accept checks written to the customer from someone else.

3.5.3 Mutual Funds

A final banking alternative is a money market account at a mutual fund company. They offer basic features such as check writing, but lack a lot of the other services banks offer. The rates tend to be significantly higher than those offered by banks. However, the accounts aren't FDIC insured against losses.

3.5.4 Banks

Although banks offer a wide variety of accounts, they can be broadly divided into the following categories:

- Savings accounts
- Checking accounts
- Money market deposit accounts, and
- Certificates of deposit accounts

All these type of accounts are insured by the FDIC (in most cases, up to $100,000 per account).

3.5.5 Thrift Institutions

A thrift institution (savings and loan association) is a financial institution which specializes in accepting savings deposits and making mortgage loans. They are often mutually held (often called mutual savings banks), meaning that the depositors and borrowers are members with voting rights and have the ability to direct the financial and managerial goals of the organization. It is possible for such a bank to be stock-based

and even publicly traded. This means, however, that it truly no longer is an association and depositors and borrowers no longer have any managerial control.

3.6 KEY RETAIL BANKS IN USA

The following table ranks the top 10 Retail Banks in the US on the basis of the size of their assets. (As on March 2004, all figures in USD million)

Sl. No.	Bank. Name	Total Assets	Total Deposits
1	Citigroup Inc.	1,317,877	499,189
2	J.P. Morgan Chase & Co.	1,120,668	502,826
3	Bank of America Corporation.	1,016,247	573,356
4	Wachovia Corporation.	410,991	232,338
5	Wells Fargo & Company	397,354	248,369
6	U.S. Bancorp	192,093	118,964
7	SunTrust Banks Inc.	148,283	96,661
8	National City Corpn.	128,400	77,122
9	ABN AMRO North America Holding Co.	127,154	53,289
10	HSBC North America Inc.	125,950	86,248

3.7 MERGERS & ACQUISITIONS IN RETAIL BANKING

Financial institutions continue to regard acquisitions as a valid growth strategy, with the largest firms getting even larger: Wachovia and First Union, Fleet and Bank of America, and JP Morgan Chase and Bank One. The same trend is present in Europe and Asia, and the ability to cross and up-sell intelligently and profitably, be it to the corporate customer or retail customer (consumer), remains high on bankers' agendas. History also shows that deals beget deals. Recent mega-mergers, such as Bank of America with Fleet Boston, and J. P. Morgan Chase with Bank One, could well trigger a new round of intense global M&A activity as banks attempt to buy growth or cut costs by increasing scale. At the very least, banks will have to consider their M&A options to stay abreast of the competition, and window-shopping for opportunities often leads to buying.

The dominance of the US and Europe in the current global financial services landscape means that most European and American banks enter new markets outside their region through transatlantic M&As. The Royal Bank of Scotland, for instance, made twenty-six US acquisitions from 1988 through 2004, and in the process has become the world’s fifth largest bank by market capitalization. The Royal Bank of Scotland is not alone in its interest in the US market, which is attracting foreign suitors because of its large size, profitability, and high level of fragmentation. These primary factors also ensure that for now, at least, we expect US banks to see more incoming than outgoing transatlantic M&As.

A fragmented domestic market, such as the US, Italy, or Spain, where nine to twelve major banks control 50% of the market, clearly provides plenty of scope for consolidation. In developing markets such as France and Germany, with six to eight key players accounting for a 50%-80% market share, the number of retail banks is still decreasing as the market consolidates. In heavily consolidated markets, such as Canada, Belgium, and the UK, four or five major players hold 80% of the market. Regulations in such countries often impede further domestic consolidation, and banks may opt to look further at cross-border or transatlantic opportunities.

Half of the top fifteen European banks are reportedly looking at US merger targets. However, domestic mega-mergers in the US, such as the Bank of America deal with Fleet Boston, or J. P. Morgan Chase with Bank One, have some clear ramifications for future transatlantic deals on both seaboards. European banks with US operations will undoubtedly be affected by changes in the competitive landscape, such as Bank of America's success in developing a presence in nearly every US regional market. While competitors may benefit in the short term by picking off any disaffected customers these mega-mergers create, they will inevitably face even more intense competition and could be forced to expand their own geographic reach.

US targets can be expensive. Bank of America's decision to pay a 42% premium over Fleet Boston's share price indicates that US banks are unlikely to sell themselves cheaply, especially as signs of a global economic recovery emerge. The bar has been raised for acquisition prices in the US, and this could create a strong deterrent to European banks considering US partners, despite the favorable exchange rate they enjoy today.

Citigroup appears to be the only large US bank currently looking for merger opportunities in Europe. Due to the fragmented nature of the US market, most US players are focusing on domestic consolidation as their immediate priority. Yet unless US regulators increase the 10% limit on a bank's market share of US retail deposits, expanding players like Bank of America will find it difficult to pursue further large US mergers. As the market evolves, US banks could choose instead to look to Canada for cross-border deals**.**

4 Retail Banking Products

Retail Banks receive money from the customers (deposits) and also lend money to the customers (loans). The money received form the customers are kept in the bank through various types of accounts and deposits. The money is lent to the customers through various products like mortgages, personal loans, student loans etc. This chapter covers the generic features of the product and various products like Savings account, Checking account etc.

These products are different from one another in terms of interest rate offered by the bank and liquidity (the convenience to withdraw or use funds in the account as and when required by the customer) and other facilities.

4.1 GENERIC FEATURES AND FACILITIES

The products offer some or all of the features and facilities that are detailed below. Banks earn revenue by charging for the features and /or facilities offered in a product.

- Interest Rate

Generally, banks pay interest to depositors for placing money in the bank. The interest rate offered will depend largely on the term of the deposit and the withdrawal options. If there is an option to withdraw funds from the account at any time, then the interest rate offered will be less.

- Liquidity

Liquidity refers to liquidity option available to the customer. In certain type of accounts, Customer can withdraw funds at anytime of the day, any amount and any number of times a day. So, higher the liquidity, lower will be the interest rate. Broadly, there are two variations with regard to liquidity a) products that have defined term and so funds cannot be withdrawn in between the term b) funds can be withdrawn at any time

- Minimum balance

Minimum balance refers to the minimum amount that should be maintained in the account. Products that stipulate higher minimum balance wither pay higher interest and /or offer more features and facilities.

- Check

Checks are instruments used to withdraw funds from the account or to make payment to another individual/ business etc. Certain products allow unlimited use of checks while others restrict the number of checks used in a period.

- Deposit Slip

Deposit Slip is used to deposit cash, check into the account.

- Statements

Statements are provided to customers detailing all the transactions performed in the account for a specific time period. Banks provide statements free of cost or charge the customer depending on the product. Statements can be issued monthly, quarterly or in any other frequency. Incase the customer requests for a statement in between the statement cycle, customer can be charged for such a request.

- Payments

Payments refer to transferring funds from one bank account to another. Payment can be made through checks or through wire transfer. Wire transfer is electronic way to transfer funds and the details are covered in Payments chapter. There can be restrictions on the number of payments allowed in a product.

- ATM Card

Banks offer ATM card to withdraw funds from account and also perform certain other transactions like check deposit, balance enquiry etc through ATMs.

- Debit Card

Debit Cards are provided for an account and the card is used for performing purchases in retail outlets.

- Credit Card

Credit Cards are issued independent of the regular bank accounts like savings account, checking account etc. Credit cards are also used for purchases but unlike a debit card wherein the bank account gets debited immediately upon a transaction, in credit card, the card company provides a credit. The credit offered to make the purchase will have to be paid by the customer to the card company within a defined time period.

- Internet Banking

Internet Banking facility is offered for customers to perform various transactions like balance enquiry, funds transfer, ordering checks etc in the internet. This reduces the need for visiting the bank.

- Telephone Banking

Like internet banking, telephone banking allows customers to perform transactions over phone. The transaction will be authenticated using the PIN number.

- Mobile Banking

Mobile Banking allows customers to receive certain alerts for some important transaction happening in the customer account. Some banks also offer mobile banking with all the features of internet banking.

- Overdraft Protection

Overdraft protection, colloquially known as bounce protection, is a financial service offered by banking institutions primarily in the United States. Overdraft protection advances money to cover a check written on an account that does not have sufficient funds. This prevents the check from bouncing, which in general carries negative financial consequences in the way of large fines and reduced spending limits.

4.2 PRODUCTS

The products offered to the customers will vary between countries. However the underlying principles remain the same. The products are mix and match of the features and facilities mentioned above.

- Demand deposits /accounts
    - Checking Account
    - Negotiable Order for Withdrawal (NOW)
    - Super NOW
- Savings Account /Deposits
    - Savings Account
    - Money Market Deposit Accounts
    - Automatic Service Transfer Account
- Certificate of Deposits – Term Deposit
- Investment Retirement Account (IRA)
    - IRA
    - Roth IRA
    - Spousal IRA

Each product addresses certain requirements of customer. The detailed features of the products are elaborated in this chapter.

There are also other variations of these products and packaged specifically to target a particular segment. For example: the student checking account is specifically designed for students and will have a mix and match of the above features.

Similarly Express accounts are designed for people who prefer to bank by ATM, telephone or personal computer, this account usually boasts unlimited check writing, low minimum balance requirements, and low or no monthly fees. However, the customer pays fees for using a teller. These accounts are especially popular with students and younger customers who are on the go and don't want to spend a lot of time on banking transactions. Lifeline accounts offer the basic features of checking account with a low fee tariff structure.

4.2.1 Demand Deposits

A demand account (or demand deposit, demand deposit account) is a deposit account held at a bank or other financial institution, the funds deposited in which are payable on demand. The primary purpose of demand accounts is to facilitate cashless payments by means of check, bank draft, direct debit, electronic funds transfer, etc.

A demand account is commonly known as:

- a checking account (United States banks)
- a current account (United Kingdom banks and India)
- a check account (New Zealand banks)

There are various flavors of demand deposits like

- Standard checking accounts
- Negotiable Order for Withdrawal (NOW)
- Super NOW
- Automatic Service Transfer Account

4.2.1.1 Standard Checking Accounts

Standard Checking accounts doesn’t pay interest, allows unrestricted liquidity and stipulates a minimum balance. The product is used extensively by individuals and business for managing the day to day banking operational needs. Hence in such an account, there will be deposits, withdrawals, payments and all other transactions. The product depending on the bank may charge account maintenance charge and offer the above mentioned facilities like internet banking, check facility, statements, deposit slip etc.

Typically, the format of a check consists of date, the party to whom it is payable, the amount that is payable, the identification of the bank it is drawn upon and the account number of that bank, and a signature or other identification indicating the check was authorized by the depositor. While in many cases, checks are more and more being displaced by electronic transactions including direct deposit, ATM, credit card purchases, billions of checks are still written every year in the United States alone.

Depending on the credit worthiness of the customer, banks provide the facility of overdraft to the account. These accounts are referred as Overdrafts. An overdraft is an instant extension of credit from a lending institution. Hence the customer can use the funds of the bank (overdraft) over and above the customers own funds in an account. The customer is required to pay interest on the outstanding balance of the loan much like any other loan.

There are various types of overdraft depending on the purpose for which the overdraft is provided. Broadly, the overdraft can be secured or unsecured. Incase of secured overdraft, customer offers some security (collateral) to the bank to increase the credit worthiness. The security can be like raw materials, finished goods, work in progress, and receivables. Incase of unsecured overdrafts, as the name suggests, customer will not be able to offer any security. Generally as there is no security, the interest rate for unsecured overdrafts will be higher than secured overdrafts.

4.2.1.2 Negotiable Order for Withdrawal (NOW)

In some cases, checking accounts may pay interest. Checking accounts that pay interest are sometimes referred to as Negotiable Order for Withdrawal or NOW account in order to differentiate them from the older 'standard' checking account.

4.2.1.3 Super NOW

Super NoW are accounts that pay higher interest rate than NOW but also stipulate a higher minimum balance.

Some banks package the product and market it to specific groups like Students, small businesses, salaried people etc. Depending on the need of the specific groups, certain features may be offered and also charged accordingly. Increasingly, products are being created based on the channels through which the account will be operated. For example Internet based checking account will not allow customers to walk into the branch to perform a transaction.

4.2.2 Savings Deposit / Accounts

Savings Deposits are accounts maintained by banks, savings and loan associations & credit unions. As the name suggests, these accounts are treated as “Savings“ and hence are interest bearing accounts. The variants of the savings product differ in interest rate, flexibility to withdraw funds using checks etc.

Some variants of savings products are:

- Regular Savings Account
- Money Market Savings Account
- Automatic Service Transfer Account

4.2.2.1 Regular Savings Account

In these accounts, withdrawals are allowed, but do not have the flexibility of using checks to do so. Funds in these accounts cannot be used directly and so will have to be transferred to transactions deposits (or checkable deposits) for performing any further transactions.

Some savings accounts have a passbook, in which transactions are logged in a small booklet that the customer keeps, while others have a monthly or quarterly statement detailing the transactions. Some savings accounts charge a fee if the customer's balance falls below a specified minimum.

Besides the fact that the customer will be less likely to spend it, putting the money in a savings account is safer because it is insured (up to $100,000) through the Federal Deposit Insurance Corporation (FDIC). This means that even if the bank or credit union goes out of business (which is very rare!) the customer's money will still be there. The FDIC is an independent agency of the federal government that was created in 1933 because thousands of banks had failed in the 1920s and early 1930s. Not a single person has lost money in a bank or credit union that was insured by the FDIC since it was constituted.

Interest on savings accounts is usually compounded daily and paid monthly. Sometimes, but not always, banks charge fees for having a savings account. The fee may be low -- like a dollar a month -- or it may be higher or it could even be based on the customer's balance. Some of the characteristics of a savings account include:

- Fees and services charges on the account
- Minimum balance requirements (Some banks charge a fee only if the customer doesn't keep a certain amount of money in his/her account at all times)
- Interest rate paid on the balance
- Each month, the bank (or credit union) sends the customer a statement of his/her account either in the mail or by e-mail depending on the preferences. The statement will list all the transactions as well as any fees charged to the account and interest that the money deposited in the account has earned.

4.2.2.2 Money Market Deposit account

Money Market Deposit Account is a variance of the savings deposit/account. These accounts invest the balance in short-term debt such as commercial paper, Treasury Bills, or CDs. The rates they offer tend to be slightly higher than those on interest-bearing checking accounts, but they usually require a higher minimum balance to start earning interest. However the interest rates will depend on the performance of the investments made using these finds.

These accounts provide only limited check writing privileges (three transfers by check, and six total transfers, per month), and often impose a service fee if the balance falls below a certain level. Another difference is that, similar to a checking account, many money market accounts will let the accountholder write up to three checks each month.

Like other bank accounts, the Federal Deposit Insurance Corporation (FDIC) insures the money in a money market account.

4.2.2.3 Automatic Service Transfer Account

Automatic Service Transfer Account is a variance of savings product where in funds will be transferred from savings to checking account automatically when checks are issued on the current account. Hence this product offers higher interest rate on the savings account and also the flexibility like check book of the checking account.

4.2.3 Term Deposits

Term deposits are generally for a certain period of time and pay higher interest rate than checking and savings account. The customer will have the option to withdraw the funds during the term of the deposit and incase the customer chooses to withdraw the funds, the bank may pay a reduced interest rate.

4.2.3.1 Certificate of Deposits

Certificate of deposit or CD is, in the United States, a time deposit, a familiar financial product, commonly offered to consumers by banks, and credit unions.

Such CDs are similar to savings accounts in being insured by the FDIC for banks or by the NCUA for credit unions and thus virtually risk-free; they are "money in the bank." They are different from savings accounts in that the CD has a specific, fixed term often three months, six months, or one to five years and, usually, a fixed interest rate. It is intended that the CD be held until maturity, at which time the money may be withdrawn together with the accrued interest. There may be a penalty for early withdrawal, so this type of account is generally not used if the customer thinks that money may be required before the time period is over (the "maturity date").The interest rate is generally more when the term of the deposit is longer and the interest rate is more than that offered for savings account.

4.2.3.2 Recurring Deposits

There are other types of deposit products that are offered in different market. One such product is recurring deposit that is not available in the US market. This product is offered in some of the European market like UK and India. In this product, a certain sum of money is deposited in a frequency, usually month, for a period of time, like a year or two, and the customer receives a total amount including the interest at the end of the term.

4.2.4 Individual Retirement Accounts (IRA)

A self-directed, tax-deferred retirement investment account established by employed workers who earn a salary, wage, or self-employment income. An IRA account can be with a bank, mutual fund, insurance company, or another trustee.

Apart from the retirement accounts that are established by the individuals, there are retirement plans where in both the employer and employee makes contribution. Some of the plans are 401(k), 403(b), 457 plans.

- 401(k) plan is the regular corporate sponsored retirement ;
- 403(b) plan is a retirement plan for University, civil government, and not-for-profit employees. It has the same characteristics and benefits of a 401(k)
- 457 plan is for public employees and the plan is held in trust by the State of North Carolina

The retirement plans and the IRA essentially encourage individuals to save more for life after retirement by offering tax exceptions to these plans and accounts.

Some of the retirement accounts are explained below:

4.2.4.1 Traditional IRA

Deposits for traditional IRAs are tax deductible and the investment earnings in the account are not taxable until withdrawn. Different rules apply depending on the type of IRA account. Money is deposited before tax, money accumulates tax free on earnings until withdrawn at retirement, at which point the money is taxed.

4.2.4.2 Roth IRA

A Roth IRA is an individual retirement account (IRA) in the United States that provides tax-free growth. Money is taxed before deposit, and then accumulates tax-free on the earnings, and can be withdrawn tax-free. As with all IRAs, there are specific eligibility and filing status requirements required by the U.S. Internal Revenue Service. A Roth IRA's main advantage is its tax structure. Contributions are made post-tax, but the growth is tax free and does not require individuals to pay taxes again on this money.

It is commonly believed that the advantage of a Roth IRA over a traditional IRA is its tax-free growth. But in fact, given the same effective pre-tax contribution each year, the results are the same. This is because the money that would have been taxed post-growth is effectively taxed pre-growth, and the growth is proportionally less. The real advantage is that the actual contribution limits are the same for a traditional IRA and a Roth IRA, so an individual can contribute more, in pre-tax dollars, to a Roth IRA than to a traditional IRA.

It is named after its chief legislative sponsor, the late U.S. Senator William Roth.

4.2.4.3 Spousal IRA

An Individual Retirement Account (IRA) established by a working spouse for his or her non-working spouse. Spousal IRAs were created by the Tax Reform Act of 1976.

There are also other type of IRAs like Conduit IRA, SEP IRA(Self employed) etc.

Starting with the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA), many of the restrictions of what type of funds could be rolled into an IRA and what type of plans IRA funds could be rolled into were significantly relaxed. Additional acts made some further relaxations of restrictions. Essentially most retirement plans can be rolled into IRAs after meeting certain criteria, and most retirement plans can accept funds from an IRA.

IRAs can be funded with most types of securities, and some non security financial instruments. There are a few things that cannot be funded into an IRA. They include collectibles including valuable coins or bullion and life insurance. IRAs cannot generally hold real estate unless it is held as a form of security such as a real estate investment trust, or REIT.

The United States Supreme Court held on April 4, 2005 that IRAs are not subject to seizure during bankruptcy. They held that because rights to withdrawals are based on age, IRAs should receive the same protection as other retirement plans.

5 Retail Banking Instruments

Instruments are used to move and /or transfer funds from one account to another. The account can be of the same person or different individuals. Instruments are also modes of payment. Some of the common instruments are as follows:

- Check
- Cashiers check
- Certified Check
- Travelers Check

The above mentioned instruments are stored and tracked very diligently in banks. Banks maintain an inventory of all these instruments with number assigned to each instrument. The number helps to retrieve information like cleared instruments, uncleared instruments, lost and stolen instruments etc.

5.1 CHECK

A negotiable instrument is a specialized type of contract which obligates a party to pay a certain sum of money on specified terms. The two primary classes of negotiable instruments are as follows:

- Promissory Notes
- Bill of exchange

Promissory Note is a is a written promise by the maker to pay money to the payee; and

Bill of exchange is a written order by the drawer to the drawee to pay money to the payee. The most common type of bill of exchange is the check.

The only difference between a promissory note and a bill of exchange is that incase of promissory note ,the maker of a note to pays the payee personally, rather than ordering a third party to do so.

A check is a bill of exchange and is an instrument instructing a financial institution to pay a specific amount of a specific currency from an account holders specific demand account held in that bank. The receiver of the check is payee and the amount will be either credited into the payee account or the payee can encash the check from the maker's bank (drawer). The details of check processing are covered in the payments chapter.

5.2 CASHIERS CHECK

A cashier's check is a check issued by a bank on its own account for the amount paid to the bank by the purchaser. The check will also state the payee/beneficiary and the name of the party purchasing the check (the remitter). The check is received as cash since it is

guaranteed by the bank and does not depend on the account of a private individual or business. Cashiers' checks are commonly used when payment must be credited immediately upon receipt for business, real estate transfers, tax payments and the like. A draft drawn on a bank and payable on demand.

A Cashier’s check is a draft in which the bank is both the drawer and drawee. A Teller’s check is a draft drawn by one bank on another bank

Demand Draft and Pay order are instruments that are similar to Cashiers check. In case of Pay order, both the drawer and drawee banks are within the same clearing zone while demand drafts can also be paid outside the clearing zone of the drawer bank. Pay order and demand drafts are terminologies used in India.

5.3 CERTIFIED CHECK

A check certified by a bank to show that sufficient fund is available in the account for the value of the drawn check.

5.4 TRAVELERS CHECK

A traveler's check is a preprinted, fixed-amount check designed to allow the person signing it to make an unconditional payment to someone else as a result of having paid the issuer (usually a bank) for that privilege. As traveler's checks can usually be replaced if lost or stolen, they are often used by people on vacation in place of cash. The use of credit cards has, however, rendered them less important than they previously were; there are few places that do not accept credit cards but do traveler's checks – in fact, nowadays, many places do not accept the latter.

Traveler's checks are available in several currencies such as U.S. dollars, sterling, and euros; denominations usually being 20, 50, or 100 of whatever currency, and are usually sold in pads of five or ten checks, e.g., 5 x €20 for €100. Traveler's checks do not expire, and unused checks can be kept by the purchaser as long as the purchaser wishes until it is spend .

The purchaser of a supply of traveler's checks effectively gives an interest-free loan to the issuer, which is why it is common for banks to sell them "commission free" to their customers. The commission, where it is charged, is usually 1% of the total face value sold. The largest volume issuer of traveler's checks is American Express, the first to develop the product in the late 19th century.

6 Payments

Payments refer to method of transferring funds from one account to another account. To perform this transaction the most commonly used method is payment by check. However due to recent technology developments, payments are also performed electronically.

6.1 CHECK CLEARING AND PROCESSING

Checks are written orders the Bank customers use to tell the bank or other depository institution to pay money or to transfer funds from his/her account to the check holder. The check collection system in the United States is efficient, but the collection process a check goes through may be rather complicated.

Funds on local checks must be made available within two business days according to the Expedited Funds Availability Act of 1987. Non-local checks must be made available within five business days. Certain circumstances permit longer holds due to the high risk of fraud, such as new accounts, deposits over $5,000, repeatedly overdrawn accounts and/or emergencies.

A check written on a particular bank and cashed by or deposited into the same bank would be handled and processed within that bank. Checks of this type—called “on-us” checks—account for nearly one-third of all checks. The remaining two-thirds are known as “transit checks” because they must move between different banks, sometimes passing through several in different parts of the country.

A check includes the names of the payer and the payee, the account number, amount of the check, and the name of the paying financial institution. The MICR line at the bottom of the check enables high-speed reader/sorter equipment to process checks. Before financial institutions process checks, they encode the amount of the check in magnetic ink at the bottom of the check.

6.1.1 Check Clearing

Check Clearing refers to the movement of a check from the depository institution at which it was deposited back to the institution on which it was written and the corresponding movement of funds in the opposite direction.

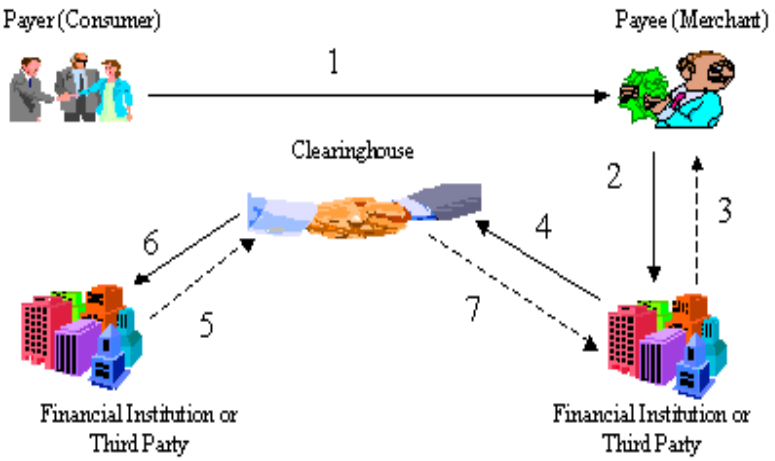
Financial institutions clear and settle checks in different ways depending on whether the checks are “on-us” checks (checks deposited at the same institution on which they are drawn) or interbank checks (the payer and payee have accounts at different financial institutions). On-us checks do not require interbank clearing or settlement. Interbank checks can clear and settle through direct presentment, a correspondent bank, a clearinghouse, or other intermediaries such as the Federal Reserve Banks.

Financial institutions can also clear checks through a Federal Reserve Bank or an independent clearinghouse, where they have formed voluntary associations that

establish an exchange for checks drawn on those financial institutions. Typically, financial institutions participating in check clearing houses use the Federal Reserve's National Settlement Service to effect settlement for checks exchanged each business day. There are approximately 150 check clearinghouse associations in the United States. Smaller depository institutions typically use the check collection services of correspondent banks or the Federal Reserve Banks.

The following diagram depicts the typical interbank check clearing and settlement process through a Federal Reserve Bank or clearinghouse. The solid lines depict the flow of information and the dashed lines represent the flow of funds.

In step 1 the consumer uses a check to pay a merchant for goods or services. The merchant, after authorizing the check, accepts the check for payment. At the end of the day, the merchant accumulates the checks and deposits them with its financial institution for collection (steps 2 and 3). Depending on the location of the paying institution, the funds may not be immediately available. For deposited checks payable at other financial institutions, the merchant's financial institution uses direct presentment for processing or sends the checks to a Federal Reserve Bank, clearinghouse, or correspondent bank (steps 4 and 6). The check or an electronic presentment file is sent to the consumer's financial institution, and the financial institution's account at the correspondent, clearinghouse, or Federal Reserve Bank is debited (steps 5 and 7).



6.1.1.1 Correspondent Banks

Most banks maintain accounts at other banks for the purpose of collecting checks. A correspondent bank accepts checks from the bank with which it has a relationship and processes those checks the same way it processes those for its depositors. It credits the depositing bank's account and forwards the checks to the bank on which they were drawn.

6.1.1.2 The Federal Reserve's Check Collection Network

The Federal Reserve is the largest nationwide processor of transit checks, handling about a quarter of all checks in the United States at 45 Federal Reserve check-processing facilities across the country.

All financial institutions that accept deposits can purchase Federal Reserve check collection and other payments services. The Federal Reserve is required by law to charge these institutions a fee for its services to cover its expenses. But the Fed's large volume of checks, extensive automation, and speedy processing allow it to keep check collection costs and prices low.

Checks are moved efficiently across the country from one Federal Reserve check processing region to another using the Fed's check relay network, an air and ground transportation network of private vendors managed by the Federal Reserve Bank of Atlanta. The Reserve Banks also are linked electronically to a settlement fund that keeps track of the districts' net balances as they exchange checks for settlement.

6.1.1.3 Clearing House

Banks in large cities often form associations called clearinghouses for exchanging checks drawn against the members. A clearinghouse may have fewer than a dozen members, but these banks are usually the largest in the area. Clearinghouse members group the checks of other member banks, exchange them at a specified time each day, and settle accounts with each other. Clearinghouses can often collect and process locally drawn checks faster and more efficiently than do intermediary services, such as correspondent banks and the Federal Reserve's check collection network.

The clearing process, while highly structured, is in theory, quite simple. Member banks exchange checks, coupons and other certificates of value among themselves, after which the Clearing House records the resulting charges to their accounts. Entries are posted on the books of the State Federal Reserve Bank to settle any differences. Settlement is prepared each business day at 10:00 a.m. after approximately three million pieces of paper have been presented for payment.

The Clearing House also facilitates exchanges among non-member banks. Through the City Collection Department, non-member institutions can gather their checks and other items, which are presented to the Clearing House by member banks and the Federal Reserve Bank, and pay for the items received.

The essentially simple process of exchange and settlement, however, has been complicated in recent decades by the sheer volume of transactions now involved and the variety of new payment instruments developed to meet the needs of American commerce and facilitate U.S. integration into the world economy. To maintain its traditional efficiency while minimizing risk, the New York Clearing House turned to electronic technology. The electronic checks and check clearing is discussed later in the section

6.1.2 Check Processing

As part of check processing, some of the important processing features like check return, handling returned checks, stop payments, cashing of checks without a ban account are discussed.

When a Check Is Returned

Not all checks move easily through the check collection system, however. Sometimes a check is returned to the bank where it was first deposited. Approximately 251 million checks are returned or “bounced” each year, according to the Federal Reserve. This is 0.6 percent of total check volume. The average value per returned check is $701.
A check may be returned for a number of reasons and some of them are listed below:

- Insufficient funds in the check writer’s account;
- An improper endorsement or date;
- An error in the magnetic ink code imprinted on the check when the check was first deposited;
- An alteration in the handwritten information on the check that is not initialed by the check writer;
- Difference between the amount in figure and words
- Improper signature of the check writer
- A stop-payment order issued on the check;
- A hold placed on the check writer’s account.

If a bank refuses to honor a check, the check must be returned to the bank where the check was first deposited within a certain period specified by law.

Dealing with Problem Checks

Every time a bank cashes a check or accepts a check for deposit, it is taking a risk. Some types of checks—such as U.S. Treasury checks—carry a very high guarantee of payment and so pose little risk to the accepting bank, especially if an established customer presents these checks.

The degree of risk to the bank is greater for checks presented by new customers because the risk of fraud is greater. Personal checks are riskier to banks than other types since they are more likely to bounce because of insufficient funds.

Banks try to guard against fraud by following verification and identification procedures. They also establish policies to minimize losses from bounced checks.

Banks are protected from some risks by a federal law that allows them to limit a customer’s access to funds for a specified period after a check is deposited. The maximum time a bank may limit access to these funds varies with the type of check. Except in certain circumstances, funds from U.S. Treasury checks and some types of on-us checks must be made available for withdrawal by the following business day. Next-day availability may also apply to state and local government checks and certified and cashier’s checks if specified deposit requirements are met. For a personal check,

the maximum time a bank can put a hold on the funds varies according to whether the check is drawn on a local or a non-local bank.

Stop Payment Orders

Under certain circumstances, a check writer may want to stop payment on a check. A stop-payment order is an instruction from the check writer to her or her bank that a particular check—such as one that has been lost or stolen or was made in payment for a transaction that is now being disputed—should not be paid.

A check writer may request a stop payment in person, by telephone, or in writing. Many banks require written confirmation of a telephone request. The order should specify the check number and the exact dollar amount. Banks usually charge a fee, which varies from bank to bank, for this service.

How to cash a Check without having a Bank Account

People who don't have a bank account often have a hard time cashing checks they receive, even Social Security, unemployment, or other kinds of government checks. Although some states have laws requiring banks to cash such checks for anyone who provides proper identification, in most states banks have the right to refuse to cash any checks for non-customers.

A person without a bank account has a few options for cashing checks.

- Providing proper personal identification, present the check at the bank on which it is drawn. The bank must either pay the check or refuse to pay it before the close of the business day.
- Ask a friend or relative who has a bank account to endorse the check and cash it. If the check is bad, though, your friend or relative's account will be debited for the check's amount.
- Use a check-cashing service. Many of these services will not cash personal checks, which they consider too risky. Most require a photo identification and will charge a fee, sometimes based on the type and amount of the check. Few states regulate check-cashing services, so fees can vary widely.

6.1.3 Electronic Checks

An electronic check is a transaction that starts at the cash register with a paper check for payment, but the payment is converted to an electronic debit, which is processed via the ACH network. Thousands of retailers are offering this service, and hundreds of thousands of checks are being converted everyday from paper checks to electronic checks.

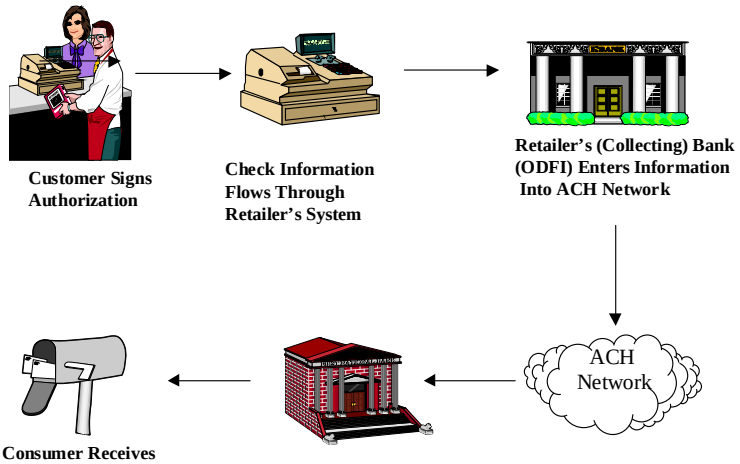
This new electronic check conversion service offers retailers, financial institutions and consumers an efficient new method to handle payments at the point of purchase. The consumer still hands a check to the retailer – but the retailer hands the check back after

capturing payment information, obtaining authorization from the customer and stamping the check VOID. Then the payment flows through the national automated clearing house network (ACH) to the check writer's account.

Specifically, here's how an electronic check payment flows:

- The customer hands the retailer the check intended to pay for the purchase. Currently, only checks drawn on consumer accounts can be converted.
- The retailer determines that the check is eligible for conversion and then runs the check through a magnetic ink character recognition (MICR) reader.
- MICR encoded information, the routing number, account number and check serial number, is captured by the MICR reader. In addition, the retailer keys in the payment amount and the name of the retailer is either keyed in or added by the reader.
- The retailer may choose to run the payment information, including the retailer's name, through an internal or external database to authorize, verify or guarantee the payment, to determine if the routing number can be used for ACH payments, or to determine if the customer's address is on file.
- After the customer information is recorded and if used, approval by the database is obtained, the terminal prepares a written authorization, which is then signed by the customer. The authorization must contain specific information specified in the NACHA Operating Rules, which are the rules under which the ACH Network operates.
- The retailer or its processor formats the payment information as an ACH debit entry.
- The payment is included in a batch of ACH entries transmitted to the retailer's bank. The bank transmits the batch of payments to the ACH Network, which routes each payment to the bank on which the converted check is drawn.
- The paying bank posts the check (debit) to the customer's account, and the customer receives information about the payment on their statement.

Point of Purchase (POP) Check Conversion



The Electronic check service has several benefits both for the consumer writing it and for the financial institution processing it. Some of the major benefits are

- It results in faster and less paper-intensive collection of funds.
- It helps to improve efficiency in the deposit process for retailers and their financial institutions.
- It stems the growth of paper check processing.
- It benefits consumers by speeding checkout, providing more information about the transaction on their account statement, and removing the consumer from any negative file much quicker
- It enhances collection of checks that bounce for NSF or uncollected funds because collection can be started more quickly than with paper checks.

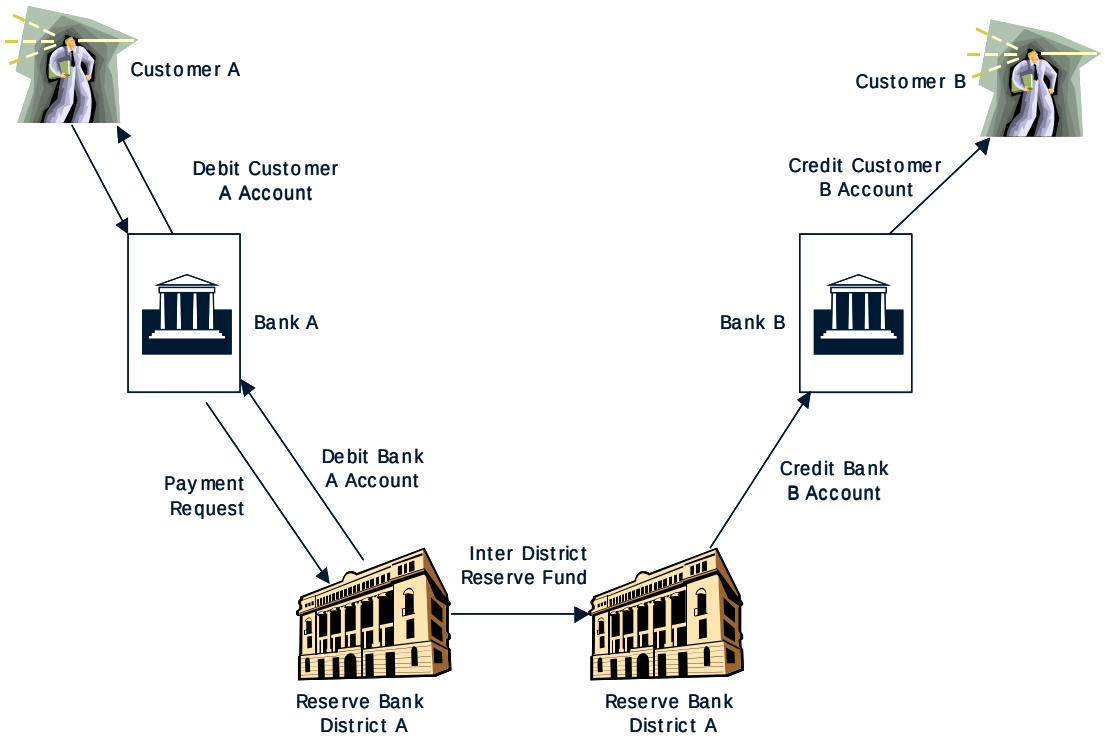
6.2 WIRES / FUND TRANSFER SERVICES

A wire transfer is a transaction that a customer can initiate via her bank, authorizing the bank to transfer funds across a network administered by hundreds of banks around the world. A wire transfer provides for immediate, irrevocable availability of funds by eliminating the uncertainties of mail and check collection time. There are wire transfer networks / systems that are only domestic, others that are international.

6.2.1 FEDWIRE

Fedwire stands for Federal Reserve Wire Network. It is a high-speed electronic communications network that links the Federal Reserve Board of Governors, the 12 Federal Reserve Banks and the 24 branches, the U.S. Treasury Department, and other federal agencies. Fedwire enables transfer of funds throughout United States. It is used by Federal Reserve Banks and Branches, the Treasury and other government agencies, and some 9,500 depository institutions. Fed wire operates 18 hours a day (to be changed to 21.5 hours). The average transaction amount is $3.5 million, approximately 120 million Fedwire transfers per year, i.e. ~330,000 per day. The main users are US banks, US treasury, The Federal Reserve and International banks.

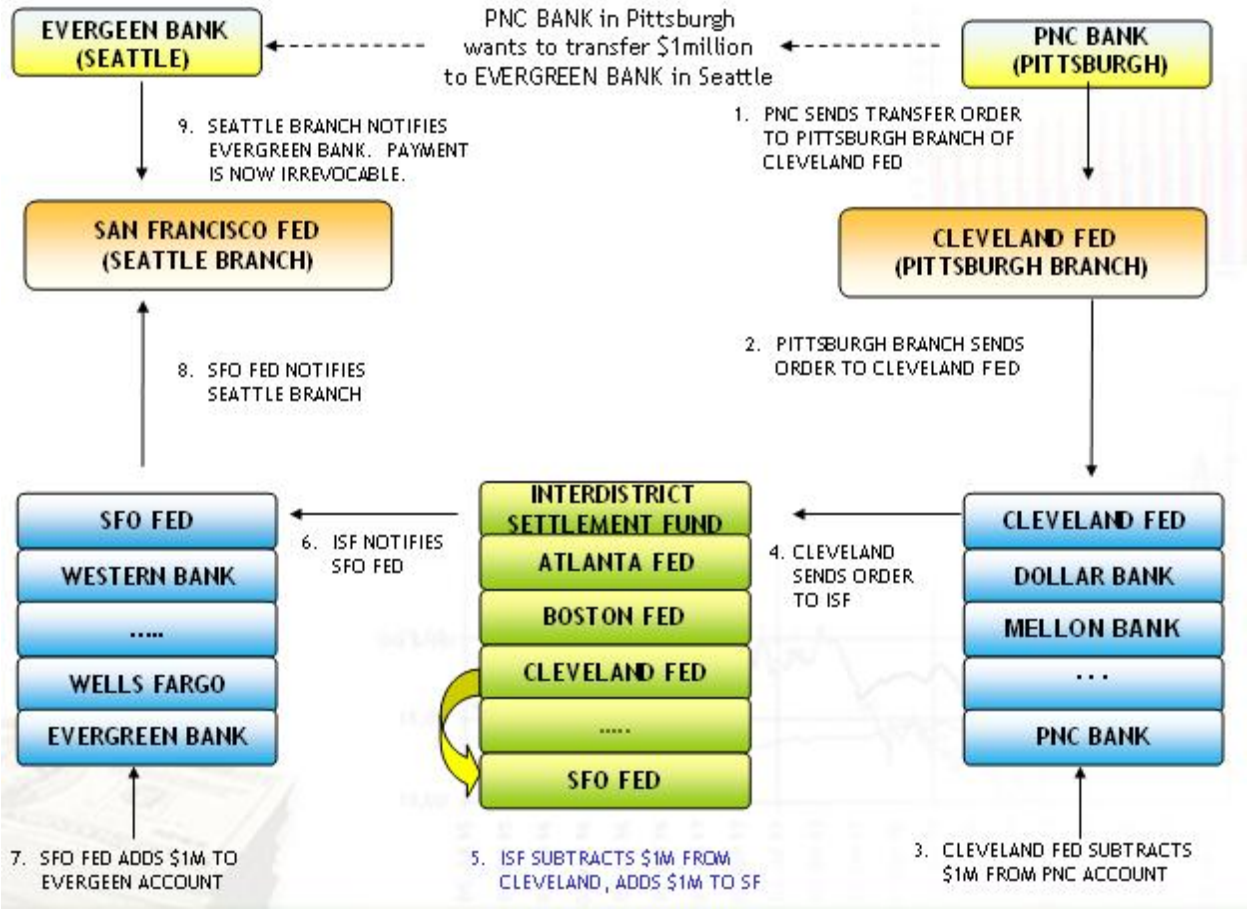
A Fedwire is an electronic transmission. The transmission contains inter-bank codes that are changed continually, a reference number, the names of the sending and receiving banks, the transfer amount, and the name and account number of the sending account holder and the receiving account holder.



Fedwire is used for all large dollar time-sensitive payments and funds transfers between reserve banks. The following diagram depicts a typical FEDWIRE transaction.

Transactions sent through FEDWIRE are domestic, where the beneficiary, and often the originator, is located in the US. All participants maintain an account at their local Federal Reserve district bank. All movements of funds are between these accounts. It is a Real Time Gross Settlement Systems (RTGS) in that it settles each transaction individually rather than accumulating transactions and settling on a net basis.

How Fedwire Works?



6.2.2 CHIPS

CHIPS, Clearing House Interbank Payments System, is the premier bank-owned payments system for clearing and settling large value payments. CHIPS is a real-time, final payments system for U.S. dollars that use bi-lateral and multi-lateral netting for maximum liquidity efficiency. CHIPS is the only large value system in the world that has the capability of carrying extensive remittance information for commercial payments. CHIPS processes over 267,000 payments a day with a gross value of over $1.37 trillion. It is a premier payments platform serving the largest banks from around the world, representing 22 countries worldwide.

6.2.3 SWIFT

The Society for Worldwide Interbank Financial Telecommunication (SWIFT) runs a worldwide network by which messages concerning financial transactions are exchanged among banks and other financial institutions. As of December 2001, it linked over 7000 financial institutions in 194 countries and estimates that it carried payments messages

averaging more than six trillion US dollars per day. SWIFT network is used for transfers across different countries and in all currencies.

SWIFT is a co-operative society under Belgian law, owned by its member financial institutions with offices around the world. SWIFT's headquarters are located in La Hulpe near Brussels. It was founded in Brussels in 1973, supported by 239 banks in 15 countries. It started to establish a common language for financial for financial transactions and a shared data processing system and worldwide communications network. Fundamental operating procedures, rules for liability, etc. were established in 1975 and the first message was sent in 1977.

6.3 NON - US PAYMENT NETWORKS

Some of the other payment networks in UK and Europe are explained below

6.3.1 CHAPS

The Clearing House Automated Payment System or CHAPS is a British company which offers same-day sterling and euro fund transfers. CHAPS is a member of the trade organization The Association for Payment Clearing Services (APACS).

A CHAPS transfer is initiated by the sender to move money to the recipient's account (at another banking institution) where the funds need to be available (cleared) the same working day. There is no requirement of a pre-printed slip containing the recipient's details. Unlike checks, the funds transfer is performed in real time, removing the issue of float or the potential for the payments to be purposefully stopped by the sender, or returned due to insufficient funds, even after they have appeared to have arrived at the destination account.

CHAPS is used by over 400 financial institutions. In 2003, over 51,000 billion pounds sterling was transferred this way. CHAPS transfers are relatively expensive, with banks typically charging as much as 25 pounds for a transfer. The cost of fast transfers and the slow speed of free transfers (such as BACS) is sometimes a subject of controversy in the UK.

The CHAPS Euro network connects to the TARGET for European Union RTGS.

6.3.2 BACS

BACS is a UK scheme for the electronic processing of financial transactions. Direct Debits and Direct Credits are made using the BACS system. BACS payments take three working days to clear: they are inputted to the system the first day, processed on the second day and cleared on the third day.

BACS started in 1968 as the Inter-Bank Computer Bureau, set up to develop electronic transfer of funds between banks and avoid the need for paper documents as part of the

money transfer process. In 1971, it changed its name to Bankers Automated Clearing Services. A telephone service, BACSTEL was introduced in 1982, reducing the need for magnetic tapes. More banks joined in 1985, and it shortened its name to BACS Limited.

On 1st December 2003, BACS Payment Services Limited (BPSL) was split from BACS Limited. BPSL is a non-profit body with members from the banking industry which promotes the use of automated payment schemes and governs the rules of the BACS scheme. BACS Limited owns the infrastructure to run the BACS scheme. BACS Limited was permitted to use the BACS name for one year, and later became Voca Limited in 2004. It is based at Rickmansworth at Hertfordshire.

Since 2003, BACS has been moving from the telephone based BACSTEL service to an internet-based service, BACSTEL-IP, which is claimed to be quicker and more secure. All BACS users, including businesses that make payments to their suppliers or operate their staff-payroll electronically, will be required to move to BACSTEL-IP by the end of December 2005 or return to using checks.

6.3.3 SEPA

The Single Euro Payments Area (SEPA) is a EU directive, the establishment of which would enable individuals and enterprises to transfer the single currency swiftly, cheaply and safely, throughout the euro area, thus reaping the full benefits of the Economic and Monetary Union (EMU) and of the Single Market in general.

In 2002, the SEPA also became a reality for retail cash payments with the introduction of euro banknote and coins. The last step is to extend the SEPA to cover retail cash-less payments.

6.3.4 TARGET

TARGET consists of fifteen national real-time gross settlement (RTGS) systems and the European Central Bank (ECB) payment mechanism (EPM), which are interlinked so as to provide a uniform platform for the processing of cross-border payments in Europe. TARGET is more than simply a payment infrastructure; it offers a premium payment service which will overcome national borders between payment systems in the European Union (EU).

TARGET was developed to achieve three main objectives:

- to provide a safe and reliable mechanism for the settlement of cross-border payments on an RTGS basis;
- to increase the efficiency of intra-EU cross-border payments;
- to serve the needs of the European System of Central Bank (ESCB)'s monetary policy.

7 Retail Banking Channels

The landscape of retail banks has changed dramatically over the past 10 years. Shifting customer demographics and developments in new technology are bringing major changes to retail banking. Throughout the world, financial service providers are looking towards a new concept of 'anytime, anywhere, anyhow' banking, which demands that retail banks of the future find better ways of delivering a complete set of lifestyle-based financial services which simplify their customers' lives and allow them more personal time — an increasingly precious commodity.

Financial institutions are looking to improve their delivery of product and service through the most cost-effective means. Traditional brick and mortar offices are being replaced with convenience centers or in-store outlets, ATM, telephone banking, Internet and other less expensive options.

7.1 THE EMERGENCE OF NEW CHANNELS

Historically, individuals have interacted with their banks by visiting the nearest branch. Some transactions may have involved the transfer of documents by post and perhaps the wealthiest and most important customers may have been able to solicit a response by telephone. However, as with most industries, the face-to-face approach prevailed. Many of today's financial services organizations still rely on legacy systems that were established in that customer environment.

In the 1970s the automated teller machine (ATM) began to proliferate. Machines that were connected via networks to a bank's central computers and used a plastic card with a magnetic strip to identify customer accounts soon replaced early off-line versions.

By the early 1990s, dedicated call centers were providing bank customers with a range of services and by the mid to late 1990s Internet banking was becoming popular. Now, even more channels for the delivery of financial services are emerging, including third generation mobile telephony devices and digital television.

As technology makes the dissemination of information easier, an increasing variety of distribution channels are starting to make the source of retail banking products transparent. The ever-increasing use of multiple retail banking delivery channels is helping banks to provide their customers with fast, easy ways to manage their finances. Customers are now banking more than ever on their home PCs and at ATMs that provide them with convenient hours and access. However, this increased use of multiple, easily accessed banking capabilities has not necessarily steered customers away from more traditional means like branches and call centers. Instead, the availability of new retail banking channels has created a more versatile, multi-channel using consumer with higher expectations of its financial services provider.

There is now a process of choice for the retail-banking customer; which delivery channel to use and for which banking transaction. The retail banking industry today is using

delivery channels, which range from branch banking, telephone banking, ATM banking, Internet banking to mobile banking and interactive TV.

What's in it for the bank?

The promise of lower transaction costs, increased sales productivity, and more convenient service has lured banks into setting up new delivery channels. Earlier, vast brick and mortar branch network had been considered as an inherent advantage of established banks and new entrants were at a huge disadvantage vis-à-vis the established players in terms of customer reach. However, post 1990s new players are effectively taking on the branch network advantage of the established players by optimally leveraging technology and cost-effective delivery channels.

Banks may invest heavily in new delivery channels, but the success and sustainability of these channels critically lie in the ability to convert that investment into lower distribution costs. The steps to be followed in making a new distribution channel successful:

- Understand customers' current channel/transaction behavior and their underlying attitude
- Use sophisticated experimental customer research to assess the economic impact of tactics designed to change that behavior;
- Develop an integrated channel migration plan which blends economic and non-economic incentives to ensure that right initiatives are targeted at the right customers;
- Protect sales effectiveness by utilizing the ability of non-branch channels to select amongst prospects and differentiate the marketing message;
- Design non-branch channels to emphasize personalized interaction to counteract decreased loyalty among remote customers;
- Develop tracking mechanisms to allow you to assess and revise your migration strategy on an ongoing basis.

The retail banking industry today is using delivery channels, which range from branch banking, telephone banking, ATM banking, Internet banking to mobile banking and interactive TV.

7.2 BRANCH BANKING

Throughout much of the last decade, retail banks have re-engineered their organizations to improve efficiency and move customers to lower cost, automated channels, such as ATMs and Internet Banking. However, banks are now realizing that one of their best assets for building profitable customer relationships is the branch — branches are in fact a key channel for customer retention and profit growth.

Today 70% of customers use more than one contact channel, but as channels proliferate, customers remain loyal to branches. According to a Financial Insights report, 51% of customers say they prefer branch banking. As a result, the industry is renewing its focus on the branch level, looking for ways to integrate branch activities with other banking channels, boost productivity, enhance customer service, and cut costs.

Today, U.S. banks are enthusiastically announcing the opening of hundreds of new branches – 550 over three years at Bank of America, 100 over five years at JPMorgan Chase, and 250 this year alone at Washington Mutual.

In addition to a blurring of distinctions between channels, revitalized branch networks have re-emerged as combined centers for advice-based product sales and service, as well as more traditional banking transactions. Customers want more than just a place to complete transactions. They want a full-service center for all their needs -- from banking products to brokerage services.

To maximize the value of this resource, banks are transforming their branches from transaction processing centers into customer-centric into financial sales and service centers. This transformation helps to achieve bottom line business benefits, such as increased customer profitability, retention of most profitable customers, increased branch revenue, increased staff productivity, and reduced operational costs.

Functions of a Branch

The branches of a bank are generally authorized by regulators to perform all the normal banking functions, which a bank is permitted to perform. The banking activities in a branch can vary from simple retail tractions to a complex foreign exchange transaction or a trade transaction depending on the branch. Some of the functions of the branch are listed below:

- Account Opening
  - All types of account like Savings, Current, Time deposits
- Account Maintenance
  - Cash transactions – Cash deposit, cash withdrawal
  - Account transfers
  - Renewal of time deposits
  - Monitoring of account balances and transactions
- Lending Money
  - Whole-sale Lending
  - Retail Lending
- Remittances
  - Mail transfers, Telegraphic transfers, electronic funds transfer, Demand Drafts etc
  - Payments through checks
- Safe Box Facility
  - Safe Keeping of Valuables
  - Fee based income

- Foreign Exchange Business
  - Money exchange
  - Issuance of Travelers Checks
  - Fund based as well as non fund based financing for Foreign Trade like Letters of credit, Bill Discounting, Foreign exchange cover etc

Retail Banking Operations Model

The activities of a retail bank can be classified into front office operations and back office operations. Front office operations are typically those which involve direct interfacing with the customer. On the other hand, back office operations are processes and systems which support the functioning of the front office.

Right from the time a customer opens an account with a bank, the relationship is managed through various activities carried out in the front and back offices. In fact, the mere act of getting customers involves a thorough coordination between the various arms of the bank.

Within each of the offices, the tasks can be categorized into:

- Customer Acquisition
- Customer Servicing and Relationship Management

The following section outlines the different front office functions and their associated back office functions (with special emphasis on activities pertaining to deposits and accounts and does not exhaustively cover the mortgage processing activities).

Some of the functions mentioned as Back office can be performed in the front office depending on the volume of transactions. For example, some banks opens the account in the front office.

Front office

As mentioned above, the front office involves direct interaction with the customer.

Customer Acquisition	
Sales	❑ Customer contact ❑ Sales lead managers ❑ Selling prompts to existing customers ❑ Marketing and selling campaigns
Account Opening	Interaction with the customer to explain the product and obtaining signatures and documents and first step in “know your customer”(see section 9.3) by asking basic questions about the customer’s background

Customer Servicing and Relationship Management	
Accounts	Types of accounts supported: ❑ Checking Accounts ❑ Demand deposit accounts (DDA) ❑ Savings ❑ Time deposits
Customer & Account Service	Teller applications usually offer the following types of features and functions: ❑ Customer identification ❑ Branch-office locator ❑ Customer and account inquiries ❑ Multiple transactions for single customer – Single window concept ❑ Interfaces to third-party fraud and signature verification applications ❑ Interfaces to check-order vendors ❑ Transactions
Transactions	Teller functionality includes the following types of transaction processing for supported accounts. The front office accepts customer orders and requests for the same. ❑ Cash advances ❑ Currency and coin orders ❑ Deposits, including commercial deposits ❑ Fee collection ❑ Foreign currency exchange ❑ Payments ❑ Stop payments ❑ Transfers ❑ Wire transfers ❑ Withdrawals

Back office

The back office processes and systems ensure a smooth functioning of the front office.

Customer Acquisition	
Sales and Customer Relationship Management	❑ Account and contact histories ❑ Bank information and fee schedules ❑ Business rules definition for cross-sells ❑ Campaign management(back office details) ❑ Complaint reporting and tracking ❑ Customer profile and relationships ❑ Decision tracking ❑ Lead generators ❑ Marketing and sales planners ❑ Online analytical processing tools ❑ Profiling ❑ Referral processing ❑ 360 degree view of the customer ❑ What-if calculations
Account Opening	❑ Customer and account opening, incase of new customer ❑ Account Ownership - Accounts can be opened by individuals and business entities. Incase of individuals, it can be owned by one person or by multiple people. If the account is owned by one person, then it is referred as Single owner account and if more than one person owns the account, then it is referred as Joint accounts. ❑ Capture of Signature and customer photo ❑ Validation of Customer - KYC (Know Your Customer). This includes details like Customer Signature, Customer credit history, validation with the restrictive name database etc. ❑ Account Operating instructions -The account operating instructions specify the rights for each person holding the account. For example, husband

	and wife can own the account. The operating instruction can be such that checks can be signed by either husband or wife or both. It can also be that both will have to necessarily sign the check. Incase of minor holding the account, it is mandatory to have a guardian who will act on behalf of the minor for the welfare of the minor. Once the minor becomes major, then the major can start operating the account. Similarly for business entities, certain people in the organization will be authorized to operate the account with amount based restrictions.

Customer servicing and Relationship Management	
Accounts	Types of accounts supported: ❑ Checking Accounts ❑ Demand deposit accounts (DDA) ❑ Savings ❑ Time deposits
Customer & Account Service	The back end processing of the following is offered by teller operations. ❑ Multiple transactions for single customer – Single window concept ❑ Interfaces to third-party fraud and signature verification applications ❑ Interfaces to check-order vendors ❑ Transactions
Transactions	Teller functionality includes the following types of transaction processing for supported accounts. The back office does the execution of customer orders and requests. ❑ Bait list log which tracks cash used to populate each cashbox and automatically totals and balances cashbox ❑ Cash advances ❑ Currency and coin orders ❑ Deposits, including commercial deposits ❑ Foreign currency exchange

	❑ Payments ❑ Stop payments ❑ Transfers ❑ Wire transfers
Peripheral Support	❑ Interfaces to a variety of peripherals enable the teller to automate some tasks. Peripherals to which teller applications interface include: ❑ Check and money order printers ❑ MICR readers ❑ Magnetic stripe readers ❑ Passbook printers ❑ Personal identification number (PIN) pad ❑ Teller cash and coin dispensers ❑ Check image and data capture devices

Multi Branch Banking

Banks are now looking to provide "Multi Branch Banking" service to customers through a network of the Bank's branches. Under this service, the customer of one branch is able to transact on her account, from any other networked branch of the Bank.

Typical services provided through "Multi Branch Banking" include

- Cash Deposits
- Cash Payments
- Transfer of funds
- Balance Inquiry
- Marking Stop Payment of a Check

7.3 ATM BANKING

The U.S. payments system is going through a period of rapid change. Paper checks are increasingly giving way to electronic forms of payment, which themselves are being transformed as new products, new players, and new industry structures arise. Some of the most dramatic changes are being seen in the automated teller machine (ATM) and debit card industry.

Installation of ATMs has been particularly rapid in recent years. ATM growth was 9.3 percent per year from 1983 to 1995 but accelerated to an annual pace of 15.5 percent

from 1996 to 2002. Much of the acceleration is due to placing ATMs in locations other than bank offices. These off-premise ATMs accounted for only 26 percent of total U.S. ATMs in 1994, but now account for 60 percent.

On the debit card side of the industry, growth has been extremely rapid in point-of-sale (POS) debit card transactions. With an annual growth rate of 32 percent from 1995 to 2002, POS debit is the fastest growing type of payment in the United States. Today it accounts for nearly 12 percent of all retail non-cash payments, a fivefold increase in just five years.

Automated Teller Machines (ATMs) have made banking available 24 hours a day, 7 days a week. ATM banking is also considerably cheaper than other methods of payment, such as issuing checks or doing transactions over the counter inside the bank. A banking customer gets access to an ATM by means of a card, which is issued when he/she opens a bank account such as a checking account or a savings account. Banks can substitute cheaper ATM transactions for more expensive human teller transactions because their customers are willing to use the machines, which are more convenient because more banks are placing machines on the network.

ATMs were the first electronic banking service to be introduced to consumers. ATM and debit card transactions take place within a complex infrastructure. To the consumer and merchant, they appear to be seamless and nearly instantaneous. But, in fact, a highly complex telecommunications infrastructure links consumers, merchants, ATM owners, and banks. The common attribute of all ATM and debit card transactions is that the transaction is directly linked to the consumer’s bank account—that is, the amount of a transaction is deducted (debited) against the funds in that account. An ATM card is typically a dual ATM/debit card that can be used for both ATM and debit card transactions. Many ATM/debit cards offer the consumer both types of debit card transactions, online and offline.

Apart from the monthly service fee that is charged on a customer’s bank accounts, he/she may also be charged a fee for every transaction done at an ATM. But it is a lot cheaper to bank at an ATM than it is to do your banking at a teller inside the bank. This is the banks' way of encouraging consumers to use ATMs. Fees vary between banks and according to the type of transaction. For cash withdrawals and cash deposits, the fees depend on the amount involved in the transaction, while there tend to be set fees for account payments and money transfers, irrespective of the amount involved. Mini statements and balance inquiries are generally free if you use your bank's own ATM network (it doesn't have to be the ATM outside your specific branch), but a fee is charged for these transactions at the ATMs of other banks because your bank will have to pay the other bank because you used the other bank's ATM.

There are three types of ATM systems: proprietary, shared/regional, and national/international.

- A **proprietary system** is operated by a financial institution that purchases or leases ATMs, acquires the necessary software or develops it in-house, installs the system and markets it, and issues cards of its own design (proprietary systems are less prevalent today).

- A **shared/regional system** is a network that comes into being when customers of one or more financial institutions have access to transaction services at ATMs owned or operated by other financial institutions. A common type of sharing is the joint venture with other financial institutions, featuring common access and cooperative control.
- A **national/international system** is also a network, one that enables an ATM machine in New York to connect with another in Los Angeles. Through service agreements with regional and proprietary networks, national networks link ATM machines coast to coast.

Typical services provided through ATMs include:

- Cash withdrawal against Account ATM/ Credit/ Debit Card: The maximum amount that can be withdrawn in a day is restricted by the respective bank guidelines
- Money Transfer between accounts: An individual can transfer money between his/her different accounts.
- Cash/ Check Deposits
- Utility Bill Payments
- Balance enquiry /Account Statements
- Marketing: Advertising new products from Banks/ Others.
  - Cross-selling. ATMs can help market bank products such as home mortgages and insurance policies.
  - One-to-One marketing. ATMs can be used for customer relationship management (CRM) strategies.

ATMs also provides additional options like selection of language of choice, change of pin code, request for new check books, drafts etc.

Kiosk Banking/ Super ATM's/ Web ATM's:

With advancement in technology and increased acceptance of ATM banking, banks have tried to explore further interactive options to enhance the user experience while transacting through the ATM terminals. Super ATM's, Kiosk Banking and Web ATM's have been born out of such experiments. These terminals serve as a multi function machine going beyond the basic cash deposit withdrawal features of the standard ATM's. Among other things, the new ATMs are capable of cashing checks, printing statements, copies of canceled checks and maps and issuing money orders, postage stamps or phone cards. Also certain ATM's are Web-enabled, providing the customers convenience of online banking without having to use the Internet.

7.4 INTERNET BANKING

Internet banking enables a customer to do banking transactions through the bank's website in the Internet. This is also called virtual banking, or net banking, or anywhere banking.

For banks, the biggest advantage is reduced operational costs, compared to any other form of banking distribution channel. Against $1.07 for branch banking, it costs only $0.13 in Internet banking. It is still cheaper than ATM where the cost is around 0.30 cents. The additional advantage is that the bank need not invest in infrastructure and staff management. Internet banking essentially encompasses two broad aspects, “PC Banking” and “Internet Banking”.

“Transactional web sites” are defined as bank web sites that allow customers to transact business. This may include accessing accounts, transferring funds, applying for a loan, establishing an account, or performing more advanced activities.

“PC Banking” allows an owner of personal computers to access account information using a modem connection to a traditional bank or financial service provider’s corporate computer network. This access allows consumers to transfer funds within an established bank, to pay bills, and to transact other traditional financial services without entering a traditional branch office.

“Internet banking” is similar to “PC banking” in that it allows the delivery of traditional financial services to customers through a home PC. What differentiates “Internet banking” from “PC banking” is the nature of the financial institution delivering the services to customers, and the importance of the public Internet to the provision of these products to the customers. Traditional banks have historically used private networks to deliver services to customers through personal computers or via the telephone. Internet banks may not possess a physical branch network at all. Instead, these entities may operate secure network servers in a variety of locations, with only a small number of human personnel to handle customer queries. Internet banks may deliver financial services to customers from almost any location, and to almost any location, thus posing potentially onerous tasks for regulatory authorities.

Internet banking allows banks to minimize transactions costs in their business operations. Transactions costs - the costs of delivering products (e.g., checking and savings account services, credit and debit cards) to their customers - are a significant drag on profit margins in business and reduce the overall efficiency of an enterprise. Costs fitting into this category include the expense of buildings, personnel, and whatever physical infrastructure is necessary for the delivery of retail banking services through a network of branches. Because Internet banking notionally requires a lower personnel level for the delivery of basic financial services, it offers a potentially dramatic reduction in bank operating costs and a parallel potential increase in profitability.

Typical services provided through Internet Banking include

- Account Services

- ❑ Check up-to-date account balance summaries & running totals
- ❑ View / download / print transactions or statements & request paper statements
- ❑ Verify deposits and withdrawals
- ❑ View / Cancel Direct Debits

- Contact customer service / Get your queries answered
- Receive alerts when
  - Account balance crosses a threshold limit
  - Account becomes overdrawn
  - CD is about to mature
  - Check clears / account debited / credited
  - A new statement is available
  - A transfer fails

- Payment Services
- Transfer funds between your accounts
- Transfer money to a different account
- Schedule future transfers
- Make loan / mortgage payments
- Make bill payments
- Schedule automatic recurring bill payment
- Set up new Payees and Standing Orders
- Stop checks, Order new check books

Advantages of Internet Banking:

- Convenience – Always up Banking sites, available 24*7 on the click of a mouse
- Ubiquity – Anywhere, anytime account access
- Transaction speed – Faster than Branch / ATM Banking
- Efficiency – Access & manage all accounts at one go
- Effectiveness – Access multiple services & sophisticated tools including account aggregation, stock quotes, rate alert, portfolio management programs etc.

Account Aggregation

- Account aggregation allows a customer an aggregate view of all his/her accounts onto one Web page
- The customer logs onto a Web site, enters a user name and password, and sees information from several sites, each with its own user name and password
- The data is collected and displayed in a format that the customer may choose
- Many of the Banks offer this facility through their web sites

- Can also be accessed through YODLEE, the company that provides this technology to most Banks
- Banks view this as a value added service, no additional charges

Risks Associated with Online Banking

- The services provided are governed by the vendor (hardware and software) provided by the vendors. The risks associated with the functionality of vendor products used in internet banking are among the risk pertaining to online banking.
- Security and data integrity when data is transferred over on the internet for online banking.
- Authentication, Identity Verification, and Authorization over on the internet has more complexities than in other channels of banking
- Permissibility, Compliance, Legal Issues, and Computer Crimes

7.5 TELEPHONE / MOBILE BANKING

Phone Banking enables one to conduct virtually the entire spectrum of banking transactions without traveling to and from the bank. It greatly helps banks in reducing time for transaction, reducing activities in banking branches and of course save money. With phone banking, banks are equipped to deliver true 24 hours services and 7 days in a week, 365 days a year, number of transactions could be done by tipping your customers' fingers executed through phone. Timeless, borderless and very efficient to deliver are the characteristic of phone banking services.

Tele banking can be carried out through an ordinary mobile phone. m-Banking (Mobile Banking) is provided by the Bank, in association with cellular service providers. Mobile Banking could either be done through SMS or WAP. In SMS m-Banking, the customer does not call the bank. Instead, he/she keys in short key words, on the mobile and transmits this information to the Bank via SMS. The Bank responds to this SMS enabling the customer to get the required information without any manual exercise. Unlike SMS m-banking, WAP enabled m-banking, actually allows the customer to log on to the bank's website and perform transactions, similar to Internet banking.

Typical services provided through Telephone / mobile Banking includes:

- Perform inquiry on accounts, Check account balances
- Fund Transfers
- Request for Check book / Statements / Demand Drafts
- Make bill payments
- Stop checks
- Arrange standing orders

8 Fee based Services

Although bankers still talk of "relationships," their services have been unbundled. Each service must stand alone as a profit center. This results in higher costs for banking services formerly provided as either part of the relationship or subsidized by other high-margin services. As a result of the banking industry's intense competition, rapid rate of product development, evolving technology, and continuing consolidation, most Banking businesses have started to offer several fee based services which were earlier being provided as part of the overall relationship with a customer. These fee based services today account for a substantial portion of a Bank's revenue.

Bank Management sets fees and charges for banking services to ensure that the bank is adequately compensated for the services it provides. When setting fees and charges, Bankers take into consideration the possible exposure to loss, which may be incurred for providing the service, the effort required of the Bank and the amount of time required performing the service properly. Some of the more common fee based services being offered by Banks to retail customers today are described in this section. Although most of these services are related to Payments they can broadly be categorized under the following broad headings

- Account Management
- Investment Advisory Services
- Instruments
- Payments
- Collection Services (Lock Box)
- Other Services (Safe Box / Utility Payments)

8.1 ACCOUNT MANAGEMENT

Fee charged on Accounts

The average price of maintaining a bank checking account is currently about $200 a year. Although different Banks may offer a customer the same services in terms of the accounts they support and the facilities provided through those accounts, the fees that may be charged may differ considerably from one Bank to the other. So for customers it makes sense to take a close look at the fees associated with the account, and try to estimate what it will cost. When comparing the expected fees of one account with another, a customer must also factor in any difference in the interest rate the two accounts offer. If one account pays sufficiently higher rates than another, it might more than offset the additional fees that account charges. Here are some of the most common fees associated with Bank accounts:

- **Maintenance fees:** Some Banks may charge a small annual fee for maintaining the customer's account. Certain other Banks may not charge any maintenance fee at all. The maintenance fee might also vary from customer to customer for the same Bank. A customer might even be able to get a free checking account, if the customer uses direct deposit for the paychecks, if the customer is a shareholder of the bank or if bank branch visits and/or transactions are limited.

- **Low-balance penalty:** While most Banks offer "free" checking if the customer maintains a substantial balance (the customer is though paying the opportunity cost of tying up his/her money in a low- or no-yield account while the bank lends it out at a hefty interest rate) some other Banks might charge a penalty if the account balance falls below a pre-defined threshold. The threshold limit might be based on the account's average daily balance, the lowest balance in the month, or the balance on a certain day of the month, so it is up to the customer to satisfy the threshold criterion so that there is no low-balance penalty for his/her account.

- Checking Accounts
  - Minimum balance requirement - $ 50 to $ 100 average daily balance
  - If the customer does not maintain the minimum required balance Banks may charge about $ 10 to $ 15 a month for maintaining a checking account
- Interest Bearing Checking & Money Market Accounts
  - Minimum balance requirement - $ 200 to $ 500 average daily balance
  - If the customer does not maintain the minimum required balance Banks may charge about $ 10 to $ 15 a month for maintaining a checking account
- Savings Accounts
  - Minimum balance requirement - $ 50 to $ 100 average daily balance
  - If the customer does not maintain the minimum required balance Banks may charge about $ 3 to $ 5 a month for maintaining a checking account

- **ATM surcharges, "Foreign" ATM fees:** Banks may also charge their customers for ATM usage. In most cases, if the customer is using an ATM, which is not owned by the Bank, the Bank charges a surcharge, part or all of which is paid by the Bank to the Bank owning the ATM. Generally varies from $ 1 to $ 5 per withdrawal. Other fees charged are(Most of these are charged only if the customer is using an ATM other than its own bank's ATM):
  - Statement request from ATM – Small fee ranging from 0.5 $ to 2 $ per request
  - Deposits made at an ATM – Most Banks allow a fixed number of deposits per month depending on the type of account maintained. Beyond the minimum number of deposits, Banks charge a small fee of $ 2 to $ 5 per deposit
  - Balance enquiries – Depending on the Bank the fee varies from $ 0.5 to $ 1 per enquiry
  - Most of the other services at an ATM are charged at a nominal rate
  - ATM Card replacement fee

- **Returned check:** A Bank may also charge a Customer for a check that has been presented by the Customer, if the check bounces.

- **Bounced check:** If a Customer has written a check for an amount, which cannot be covered by the available funds in the customer's account, an insufficient funds fee (NSF) will usually be imposed by the Bank. The only recourse to this is if the Customer gets an overdraft protection.

- **Overdraft protection:** Instead of getting charged for bouncing a check, overdraft protection will in effect provide the account holder with an instant loan. The interest rate charged for the overdrawn amount is the fee for utilizing this feature and will be extremely high, but if it is paid off quickly it is usually much less expensive than the bounced check fee.

- **Check printing:** Some banks offer free checks for first-time account holders, account holders with a large minimum balance, senior citizens, students, and certain others. Most of the other Banks, however, charge a small fee for making checks available to the customers.

- **Per-check charges:** Some Bank accounts include a certain number of checks per month and charge a fee for the number of checks used above the free check limit.

- **Closed account:** Some banks charge a fee if the Customer closes an account that hasn't been utilized for a sufficiently long time (usually two years).

- **Direct Deposit Slips:** If the customer uses a deposit/withdrawal slip for the cash deposit or withdrawal, a fee is charged.

- **Others**

- Excessive Transaction Fee – A nominal amount per statement cycle for exceeding the authorized number of Money Market or Savings Account transactions per statement cycle
- Duplicate Statement Fee – Usually a $5 to $ 10 charge if the customer requests a duplicate statement from the Bank
- Inactivity Fee – A nominal amount if the average minimum balance is not maintained and if there is no account activity for a specific period of time
- Not Sufficient Funds (NSF) Fee – Typically $15 to $ 25 per item
- Stop Payment Fee – Typically $10 to $25 per request. A fee is also charged if the customer wants to start using his/her account again
- Foreign Currency Charges – If the customer requests payment in foreign currency a small fee is charged

8.2 INVESTMENT ADVISORY SERVICES

Retail Banks also provide Wealth Management services to some of their designated affluent customers. Within this spectrum Banks provide relationship-based advisory, sales, service and product solutions to the full spectrum of wealth-building clients. Banks deliver a wide selection of investment products and services - full-service brokerage, discount brokerage, asset management, private banking, trust services, and a broad selection of investment and credit services through its branch-based sales force.

The Investment Advisory Services programs in Banks are generally designed keeping in mind the needs of customers who seek distinct financial solutions, information and advice on various investment avenues. Banks have dedicated financial consultants at their branch offices who provide need based advisory services to the customers. These financial consultants design and implement a unique asset allocation strategy for each customer that is determined based on the customer's investment objectives, which could be any of the following

- Capital Appreciation
- Reliable Income
- Wealth preservation

These financial consultants periodically review the customer's portfolio to help the customer weather economic and market changes, and also leverage possible growth opportunities.

In addition to providing these Investment Advisory Services, Banks also cater to the needs of customers by providing tailor made solutions through the various products they have on offer. These products / services may include one or more of the following

- **Stocks -** If the customer wishes to implement a portion of his/her investment plan using individual stocks, the financial consultant can recommend equities, or analyze the existing portfolio and make recommendations.

- **Bonds –** The financial consultant would advise to invest in a broad array of fixed income products including U.S. Treasury and Federal Agency bonds, corporate bonds, municipal bonds and mortgage backed securities.

- **Mutual Funds –** The financial consultant can recommend mutual funds selected by the Bank's mutual fund research team using a proprietary mutual fund screening and selection model.

- **Annuity and Insurance Services -** To assist the customers in tax and retirement planning, the financial consultant provides alternatives from many of the industry's annuity providers. Help is also provided in addressing protection, estate planning and other insurance related concerns through insurance programs, available from firms evaluated and approved by the Bank's Insurance Group.

- **Managed Mutual Fund Portfolios -** Through the bank's managed mutual funds portfolio program, the consultant determines asset allocation strategy that best matches with the customer's long term needs and attitudes toward risk, and structures a professionally managed mutual fund portfolio.

- **Professional Portfolio Management -** The consultant works with the customer to combine a mix of investments with appropriate strategies tailored to suit the customer's specific needs to help the customer grow and preserve his/her assets.

- **Retirement Planning Services -** The financial consultant works with the customer to establish the appropriate tax-advantaged retirement account for either business or personal use, including IRAs, SEP-IRAs, Qualified Retirement Plans and Money Purchase and Profit Sharing plans.

The Banks earn fees for each transaction as a percentage of the value of the transaction from the seller of the products such as the Insurance Company, Asset Management company etc and could charge the customer as well for the advice rendered based on the value of the portfolio.

8.3 INSTRUMENTS

Banks charge the customer for various instruments that the Bank provides towards effecting transfer of monies from the customer to any beneficiary. The charges levied by the Bank depend on the type of Instrument as well as the amount of monies that is transferred. The instruments that are used for this purpose are

- Bank Drafts
  - Most Banks do not charge a fee if the amount is drawn from the customer's account with the Bank
  - Domestic Currency Bank Drafts
    - A specific percentage of Draft amount or about $ 1-2
  - Foreign Currency Bank Drafts
    - $ 15 - $ 25
- Certified Check
  - Most Banks charge about $ 5 to $ 7 per check. If the amount is high the fee is a specific percentage of the check amount
- Cashier's Check
  - For Bank customers – free for some account types although there is a limit on the number of such checks. Beyond the limit there is a fee of $ 2 to $ 4 per check.
  - For non-customers – fee varies from $ 2 to $ 4

The salient features of this instrument are dealt with in Section 5 of this document.

8.4 PAYMENTS

Banks charge the customers for wire transfer authorizing the bank to transfer funds across a network administered by hundreds of banks around the world. Banks charge the customers on a per transaction basis with a floor price. The charges could either be based directly on the amount transferred or be based on slabs that are pre-defined by the Bank. Banks normally use the following Wire Transfers:

- FEDWIRE
- CHIPS

The working details of these are covered under the Payment section.

8.5 COLLECTION SERVICES - LOCKBOX

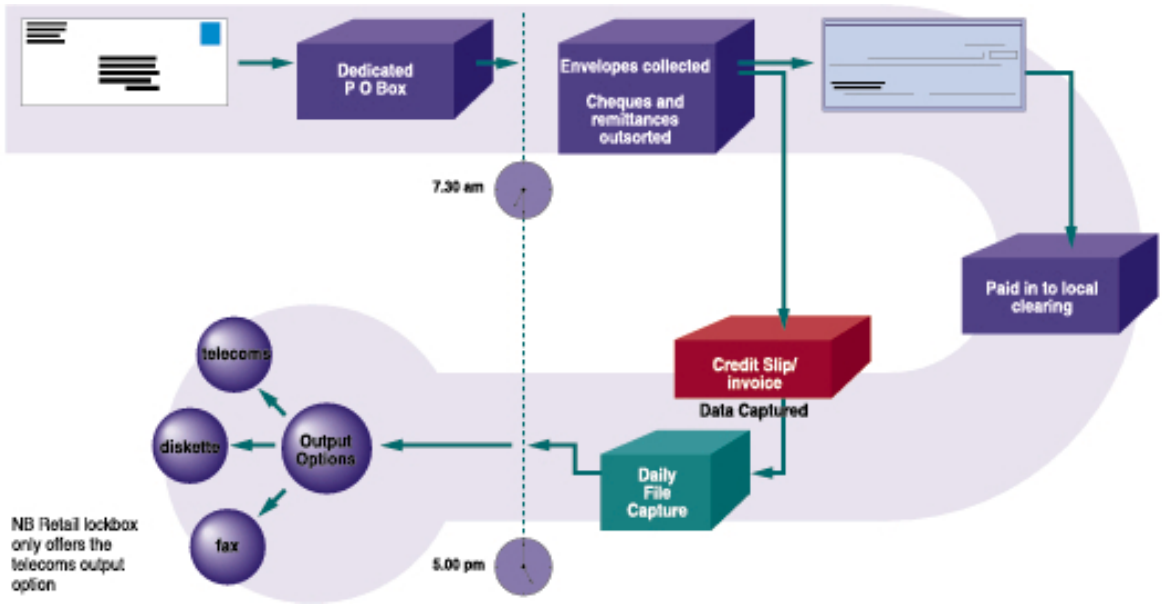
Using lockbox banking is a cash flow improvement technique in which the Bank has its Clients' payments delivered to a special post office box instead of the business address. The difference between this special post office box and a regular post office box is that only the Bank's Clients' payments are delivered to the box. Instead of the Client picking

up the payments, the bank's couriers have a key to the post office box, and they remove its contents and deliver the payments to the bank. The bank opens the payments and then processes the payments for deposit directly into the Client's bank account. Depending on the nature of the business, the contents of the Clients' lockbox can be removed and processed once a day, or more often if required.

The Client can establish lockboxes in several different post offices or cities. A basic rule is that lockboxes should be set up nearest to the Client's customers to reduce the amount of time between the customers' mailing their payments and the deposit into the Clients' bank account.

Lockbox banking accelerates the payment and deposit portion of the Clients' cash conversion period in two different ways. First, lockbox-banking cuts down on any postal delays caused by having the Clients' customers' payments delivered to your business address. Mail delivered to the Client's place of business entails some extra sorting so that the mail gets into the hands of the correct carrier, not to mention the added time it takes the carrier to actually deliver it to the Client's address. Second, using a lockbox shortens the amount of time necessary to process the Clients' customers' payments, by having the Clients' bank open the payment envelopes and deposit them directly into the Clients' bank account. Since the payment processing is done at the bank, the Clients' customers' payments are received and deposited all within the same day. If the Client were to do this work himself it can delay the deposit of the payments anywhere from one to two days (depending on how long it takes you to process the customers' payments for deposit, and to actually make the deposit at the bank).

A sample Lockbox process is described below:



Typical Lockbox fees

- Lockbox Postage $ AT COST
- Lockbox Monthly Fee $ 76.86
- Lockbox Fax Fee (per page) $ 1.14
- Lockbox per Item $ 0.28
- Lockbox Copies (per page) $ 0.18
- Lockbox Keyed Data per Field (numeric) $ 0.06
- Lockbox Keyed Data per Field (numeric) $ 0.06
- Lockbox Monthly Electronic Transmission $ 31.67
- Lockbox Monthly E-Mail $ 31.67

8.6 SAFE BOX

A Customer may lease a safe box from a Bank for safekeeping valuables, important documents, securities etc. Safe box services offered by Banks feature high safety, privacy and convenience. Usually Banks maintain a safe box warehouse, which is built according to the standards for a bank vault. The Banks lease the boxes to customers with no obligation of confirming the amount and the value of the goods.

Safe box holders may visit the Bank vault at any convenient time during the Bank's business hours, with their safe boxes being at their full disposal. The Bank disregards the contents of the safe box, its rights not applying to such contents. In providing this Service, the Bank charges fees for holding safe boxes in accordance with the applicable fee schedule and depending on their size.

Typical items that can be protected in a safe box with a Bank include, but are not limited to:

- Lease Agreements
- Birth Certificates
- Confidential Items and Documents
- Income Tax Records
- Insurance Policies
- Jewelry
- Loan Documents
- Property Deeds
- Stock Certificates
- Savings Bonds
- Trust Documents

8.7 UTILITY PAYMENTS

A customer may use Bill Pay facility that is offered to pay all bills pertaining to various utility services such as telephone, electricity, insurance as well as certain local taxes. The features of this facility are:

- Setting up one-time or recurring payments.
- Hassle Free payment of bills
- View pending and recent payments and up to 6 months of payment history.
- In case of online bill payments
    - Get email alerts to manage payments.
    - Track expenses with personalized reports.

The Bank generally clubs this service as a value add to one of the various packages that it offers or it may charge a fee for this service depending on certain criteria such as maintaining a minimum amount in the checking account.

9 Regulatory requirements

9.1 THE GLASS-STEAGALL ACT

The Glass-Steagall Act of 1933, enacted by Roosevelt, attempted to make banking safer and less prone to speculation. It was a reaction to cope with the economic problems that followed the crash of 1929.

The key provisions of the Act were:

- Separating the activities of the banks and securities firms
- Introduction of the FDIC insurance
- Inclusion of 'Regulation Q', which prohibited paying interest on commercial demand deposits and capped the interest rate on savings deposits

This Act was primarily to tide over the financial crisis of the period, and the provisions of separating banking and securities' activities were repealed by the Gramm-Leach-Bliley Act.

More details of FDIC is covered in Chapter 3

9.2 GRAMM-LEACH-BLILEY ACT

On November 4th, 1999, the 106th Congress passed the Gramm-Leach-Bliley Act. It is landmark financial services legislation and addresses a wide range of issues. It aims to significantly modernize the delivery of financial services to customers, by changing the regulatory structure of financial service providers and rationalizing some of the ways in which they do business.

Central to the Act are the provisions repealing portions of the Glass-Steagall Act of 1933 and the Bank Holding Company Act of 1956, to facilitate affiliation among banks, securities firms, and insurance companies. These changes have permitted financial conglomerates to cross-sell a variety of financial products to their customers ("one-stop shopping"). The Act addresses permissible structures for the resulting organizations and how they will be regulated. It incorporates various kinds of consumer protections, including provisions addressing the privacy of personal financial information and community reinvestment.

What does the Act do?

At a very high level, this Act:

- Repeals portions of the Glass-Steagall Act of 1933 and the Bank Holding Company Act of 1956 to facilitate affiliation among banks, securities firms and

insurance companies – permitting financial conglomerates to cross-sell a variety of financial products to their customers
- Provides for umbrella regulation of the resulting financial holding companies vested in the Federal Reserve
- Preserves the role of federal and/or state bank, securities and insurance regulators over their respective functions inside financial holding companies
- Allows national and state banks to create financial subsidiaries for diversification into insurance sales
- Provides consumer safeguards for proper disclosure of terms and conditions, privacy and against fraudulent access to consumer information

Implications of the Act

This Act is generally expected to enhance capital formation. Because of the range of provisions, it will affect financial service providers ranging from the largest multi-product financial organizations to the smallest, community-based institutions; state and federal financial regulators; community groups; and, especially the individual consumers of financial services.

At Cognizant, we are mainly concerned with what implications will the Act have on the service providers viz. the banks and financial institutions. One of the major implications of this Act would be to accelerate and facilitate merger and acquisition deals where like kind of financial service providers consolidate by merging across industry lines. At the same time, the legislation also has provisions to enhance the viability of smaller, community-type providers.

9.3 ANTI MONEY LAUNDERING

9.3.1 Anti- Money Laundering

In federal law, money laundering is the flow of cash or other valuables derived from, or intended to facilitate, the commission of a criminal offence. It is the movement of the fruits and instruments of crime. To prove money laundering, the U.S. Government must establish that the defendant (1) conducted or attempted to conduct a financial transaction involving property constituting the proceeds of specified unlawful activity, (2) knew that the property involved in the financial transaction was the proceeds of unlawful activity, and(3) either (a) acted with the intent to promote the carrying on of specified unlawful activity or (b) knew that the transaction was designed in whole or in part either (i) to conceal or disguise the nature, location, source, ownership or control of the proceeds of specified unlawful activity or (ii) to avoid a transaction reporting requirement under state or federal law.

In short, it is hard to imagine too many transactions that would not potentially fall under the scanner. Thus, every institution should take adequate measures against money laundering. An effective anti-money laundering program consists of the following:

- development of internal policies, procedures and controls,

- designation of a compliance officer,
- establishment of an ongoing employee training program, and
- arrangement of an independent audit function to evaluate the program and ensure its effective operation.

Federal authorities, on their part, attack money-laundering through regulations, international cooperation, criminal sanctions, and forfeiture. The USA PATRIOT Act, bolsters federal effort in this area.

Know Your Customer

This is the fundamental principle of all anti-money laundering initiatives. Much of the goal of money laundering is to obscure the true ownership and control of the proceeds by keeping the identity of the other party hidden. In the financial community, this translates into substantial requirements for gathering information about and fact-checking the identity of clients when they open an account. Such due diligence may involve performing internet-searches, visiting the client's offices and obtaining references, as well as reviewing audited financial statements and annual reports.

The Office of Foreign Assets Control(OFAC) within the Treasury Department maintains a watch-list of entities and individuals, including terrorists, with whom U.S. companies and citizens cannot legally do business.

Procedures for getting to know one's customer will necessarily vary depending on the nature of transactions and the assessment of the risk that transactions might involve tainted proceeds. Most situations will call for at least checking out potential customers in order to confirm that they are who they say they are and that they have legitimate funds.

To achieve the above Anti money laundering norms and also to do KYC validations, banks interface to OFAC validation systems at the time of account opening and also at the time of payments. The OFAC check is to ensure that the payer and the payee are not in the black list.

Anti Money Laundering systems helps to keep track of basic transaction details like the transactions amount, the cumulative amount of transfers over a period of time, transactions following a pattern over a period of time etc. These checks and validations are both on online real time basis and off line mode.

9.3.2 USA PATRIOT ACT

Congress passed the USA PATRIOT Act (Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism Act of 2001) in response to the September 11, 2001 terrorist attacks. It vests the Secretary of the Treasury with regulatory powers to combat corruption of U.S. financial institutions for foreign money laundering purposes.

Even prior to this legislation, the Treasury Department already enjoyed considerable authority to impose reporting and record-keeping standards on financial institutions

generally and with respect to anti-money laundering matters in particular. For instance, under the Currency and Financial Transaction Reporting Act, anyone who transports more than $10,000 into or out of the US, must report that fact to the Treasury Department. Banks must file suspicious activity reports (SARs) with the Treasury Department's Financial Crimes Enforcement Network (FinCEN) for any transactions involving more than $5,000 which they suspect may be derived from illegal activity. The current Act, among other things, seeks to expand the authority of the Secretary of Treasury over these reporting requirements.

Implications of the Act

As a consequence of this Act, US financial institutions will be required to:

- Maintain more extensive records and submit additional reports relating to participants in foreign financial transactions with which they are involved
- Secure beneficial ownership information with respect to accounts maintained for foreign customers
- Adhere to "know-your-customer" requirements concerning foreign customers who use "payable-through accounts" held by the US entity for foreign financial institutions
- Keep identification records on foreign financial institutions' customers whose transactions are routed through the foreign financial institution's correspondent accounts with the US financial institution
- Honor limitations on correspondent or payable-through accounts maintained for foreign financial institutions

9.4 CHECK CLEARING FOR THE 21ST CENTURY ACT (CHECK21 ACT)

The Check Clearing for the 21st Century Act (Check 21) was signed into law on October 28, 2003. Check 21 is designed to foster innovation in the payments system and to enhance its efficiency by reducing some of the legal impediments to check truncation. The law facilitates check truncation by creating a new negotiable instrument called a substitute check, which would permit banks to truncate original checks, to process check information electronically, and to deliver substitute checks to banks that want to continue receiving paper checks. A substitute check would be the legal equivalent of the original check and would include all the information contained on the original check. The law does not require banks to accept checks in electronic form nor does it require banks to use the new authority granted by the act to create substitute checks.
When a check is "truncated," that means an image is created from the original paper check and the original paper check is then removed from the check collection or return process. Under Check 21, the truncating bank has two possible options.
Option 1 does not require any sort of agreement between the parties. Option 1 allows a "substitute check" to be sent to a recipient, in lieu of the original paper check. The "substitute check" is a crucial component of the new law. A substitute check is a paper reproduction of the original check. To qualify as a substitute check, the reproduction must:

- Contain an image of the front and back of the original check;
- Bear a MICR line containing all the information appearing on the MICR line of the original check;

- Conform, in paper stock, dimension, and otherwise, with generally applicable industry standards for substitute checks; and
- Be suitable for automated processing in the same manner as the original check.

Option 2 allows data taken from the MICR line of the original check or an electronic image of the original check to be sent to a recipient in lieu of the original check, so long as there is an agreement between the parties to allow it. [These "agreements" may be between multiple parties, rather than individual bank to individual bank. For example, there may be a network agreement, or clearinghouse rules that constitute the "agreement.]

Obviously, the efficiency of the payment system will not be greatly enhanced if parties in the chain insist upon paper. If a recipient demands paper, a substitute check must be created and couriers will be needed to transport the item from point A to point B. If an image can instead be exchanged, it can be digitally transported, with resulting savings in time and money.

If a bank must produce a substitute check (because the next person in the chain refuses to agree to accept an image), it will incur costs as a result, so it is anticipated that an institution required to produce a substitute check will want to be compensated with a fee. Check 21 is applicable to all deposit accounts.

While Check 21 applies to all deposit accounts, there are special protections built into the Act for consumers. One protection is a notice/disclosure that consumer depositors must be given. The second protection consists of an expedited process for recrediting the account of a customer who makes a covered claim relating to a substitute check. The law mandates that the notice to consumer customers cover two areas: the legal equivalence of a substitute check and a description of what the consumer’s expedited recrediting rights are in the event of certain problems with substitute checks.
The second component of the consumer protection measures in Check 21 is an error resolution/ investigation procedure, which revolves around substitute checks, and problems that a consumer may experience with them. Its goal is to resolve errors in a speedy manner so that the customer is not wrongly without the use of disputed funds for an extended period of time. In order for the procedure to apply:

- It must be a consumer making a claim for expedited recredit;
- The claim must be in connection with a substitute check
- Not an image, not a copy, not an original;
- The bank must have charged the consumer's account for a substitute check that was provided to the consumer;
- The consumer must make a claim in good faith;
- The claim must be made before the end of the 40-day period beginning on the later of l) the date on which the statement was mailed or delivered; or 2) the date on which the substitute check was made available;
- The customer must have suffered a loss; and

- The production of either the original check or a better copy of the original must be necessary to determine the validity of the claim;
- The claim must relate to one of the following two grounds:
    - The check was not properly charged to the consumer's account; or
    - The consumer has a warranty claim with respect to the substitute check.

Proper grounds for claims

There are only two permissible grounds a consumer may use to invoke the expedited recrediting procedure. The consumer must allege in good faith either that the check was not properly charged to the consumer's account, or that the consumer has a warranty claim with respect to the substitute check. In terms of the first basis, the customer may seek to prove the item was not actually drawn on his/her account, for example, and mistakenly debited to it. In terms of the consumer asserting a warranty claim, it is crucial to understand the nature of the substitute check warranty. The substitute check warranties are contained in Section 5 of the Act. Under that section, the substitute check warranties are made:

- By a bank that transfers, presents or returns a substitute check and receives consideration for the check warrants, as a matter of law, or
- To the transferee, any subsequent collecting or returning bank, the depositary bank, the drawee, the drawer, the payee, the depositor and any endorser

Timing for the consumer's claim

A claim for expedited recrediting under Check 21 must be submitted by the consumer before the end of the 40-day period beginning on the later of the date the statement, which contains the relevant information, was mailed or delivered to the consumer, or the date on which the substitute check is made available to the consumer. Interestingly, the statute offers an extension for "extenuating circumstances," giving the consumer a longer period of time in which to make a claim in the event of extended travel or illness of the consumer.

Required content for claim

There are four required components for a proper claim:

- The consumer must describe his/her claim, explaining why the substitute check was not properly charged to the account or what the warranty claim is with respect to the check;
- There must be an allegation that the consumer suffered a loss, and the consumer must estimate what the loss amount is;
- The consumer must state the reason why production of either the original check or a better copy is necessary to determine the validity of the charge to the consumer's account or the warranty claim; and
- Sufficient information must be provided to allow the bank to identify the substitute check and investigate the claim.

9.5 ELECTRONIC FUND TRANSFER ACT (REGULATION E)

The Electronic Fund Transfer Act (EFTA), as implemented by Regulation E (12 CFR 205), provides a basic framework establishing the rights, liabilities and responsibilities of participants involved in electronic fund transfers to and from consumer asset accounts.

The term “electronic fund transfer” (EFT) generally refers to a transaction initiated through an electronic terminal, telephone, computer, or magnetic tape that instructs a financial institution to either credit or debit a consumer’s asset account. Examples of asset accounts include a consumer checking, savings, share, or money market account held by an institution and established by the consumer primarily for family, personal, or household purposes.

The types of transfers covered by the Act and Regulation include those initiated through an automated teller machine (ATM), point-of-sale terminal, automated clearinghouse, telephone bill-payment plan, or home banking program.

The EFTA and Regulation E prescribe a variety of rules governing EFTs including restrictions on the unsolicited issuance of ATM cards and other access devices; disclosure of terms and conditions of an EFT service; documentation of EFTs by means of terminal receipts and periodic account statements; limitations on consumer liability for unauthorized transfers; procedures for error resolution; and certain rights related to preauthorized EFTs. A recent interim rule amending Regulation E permits the electronic delivery of those disclosures and other information required to be provided in writing by the institution, as long as the consumer agrees to such delivery by electronic means.

Regulation E does not affect certain types of transfers, including: (i) any transfer of funds originated by check, draft or similar paper instrument; (ii) wire transfers through Fedwire or similar wire transfer system; or (iii) any transfer of funds initiated by telephone communication between a customer and a financial institution making the transfer.

10 Trends in Retail Banking

Banking is known worldwide for predictable business practices and measurable evolution. At the same time, the industry is facing sweeping and unprecedented change. The lines between financial service segments are blurring, creating new opportunities while exposing institutions to new channels. Customers demand new levels of personal service and expect it fast. The competition is only a mouse click or street corner away.
These issues, compounded by mega-mergers, decreasing margins, regulatory changes, and fierce competition, have lead to some very tough challenges for the banking industry. Some of the key trends in retail banking include:

10.1 EMPAHSIS ON DELIVERING SERVICE THROUGH THE BRANCH

More banks are recognizing that the branch is still the cornerstone of retail banking. As banks focus their efforts on growing revenues through sales of more complex higher-margin services and products, they are finding that the branch is the most effective delivery channel. The direct personal interaction provided at the branch creates the best environment for selling these products. Banks' ability to leverage the branch, however, has been impeded by legacy systems and outdated applications that are no longer sufficient to support innovative delivery strategies. Consequently, in order to successfully harness the branch's sales potential, banks will increasingly implement upgrades in branch technology.

10.2 MULTI-CHANNEL INTEGRATION

Multi-channel integration is garnering the attention of a growing number of banks. Although it is far from becoming a mainstream exercise, it is moving away from the early-adopter phase to being a feasible initiative for most banks to undertake. The question is not if but when. Second-wave adopters are moving gradually, due to the complexity and cost of integration. Many of these banks are gaining additional fortitude to move forward by relying on third-party solution providers. Internet banking and call center platforms are proving to be ripe targets for integration.

10.3 INCREASED EMPHASIS ON CHECK IMAGING

With the signing of Check 21 into law, the full potential of check imaging technology can be realized. Check processing in the U.S. is at an historical watershed. Check imaging, which had an ignominious start in the 1990s, has been staging an incredible comeback driven by economic and technological factors. It began generating ripples in the late 1990s with re-pass image capture and is currently propelling a tidal wave, which will sweep in check truncation and image exchange.

10.4 IMPROVEMENTS IN INTERNET BANKING

Banks are increasingly convinced that Internet banking's ROI can extend beyond simple cost-to-serve equations and direct revenue models. Driven by enhancements in Internet banking's user-friendliness, Internet banking's ROI now encompasses generating revenues indirectly by improving customer satisfaction with Internet banking, which in turn, has proven to translate into greater customer retention and higher balances. Banks' demands also include lowering cost-to-serve through self-service features with broad appeal (e.g., check image access and e-statements) and customer support features that not only improve customer service representatives' effectiveness but also their efficiency (e.g., online chat).

10.5 INCREASED AUTOMATION OF THE LOAN PROCESS

As interest rates inch up, banks are scrambling to develop marketing and technology strategies geared towards maintaining strong growth in originations. Next-generation solutions will provide users with greater work process automation capabilities and better integration with third parties, thereby eliminating many of the manual processes still in place today. A large portion of the typical loan process is still conducted via phones and faxes, creating bottlenecks and unhappy customers, who expect greater speed. New solutions will also be better integrated with the front end, creating greater straight-through processing.

10.6 INCREASED FOCUS ON THE SMALL BUSINESS MARKET

Until recently, small businesses have been chronically underserved by banks. The classic example is the application of a retail Internet banking solution to serve these businesses, which has been the leading cause of low adoption to date. Banks, however, are increasingly recognizing they could garner a larger share of small businesses' financial services spending if they implement appropriate technology. In an effort to better serve them and attract their business, banks will deploy at an increasing rate Internet banking solutions built specifically for small businesses. Small business online banking adoption is therefore expected to grow beyond its current 12 percent level to reach over 20 percent by 2005.

10.7 INCREASED SPEND ON COMPLIANCE SOLUTIONS

Much confusion regarding the USA PATRIOT Act and its implied affect on the banks has resonated through the banking industry over the past two years. Today, however, the confusion has subsided as final regulations have been posted for many sections of the Act and speculation is no longer needed. Although a clearly defined roadmap is still missing for financial institutions, we are beginning to see banks revise or implement their compliance procedures. Banks will focus on solutions that will assist them in detecting money laundering both at the account and transaction levels. Much emphasis will also be placed on ID verification procedures to assist them with correctly identifying and authenticating their customers across channels.

10.8 BANCASSURANCE

Bancassurance in its simplest form is the distribution of insurance products through a bank's distribution channels. In concrete terms bancassurance describes a package of financial services that can fulfill both banking and insurance needs at the same time. It takes various forms in various countries depending upon the demography and economic and legislative climate of that country. Demographic profile of the country decides the kind of products bancassurance shall be dealing in with, economic situation will determine the trend in terms of turnover, market share, etc., whereas legislative climate will decide the periphery within which the bancassurance has to operate.

The motives behind bancassurance also vary. For banks it is a means of product diversification and a source of additional fee income. Insurance companies see bancassurance as a tool for increasing their market penetration and premium turnover. The customer sees bancassurance as a bonanza in terms of reduced price, high quality product and delivery at doorsteps. Actually, everybody is a winner here.

By leveraging their strengths and finding ways to overcome their weaknesses, banks could change the face of insurance distribution. Sale of personal line insurance products through banks meets an important set of consumer needs. Most large retail banks engender a great deal of trust in broad segments of consumers, which they can leverage in selling them personal line insurance products. In addition, a bank’s branch network allows the face-to-face contact that is so important in the sale of personal insurance.

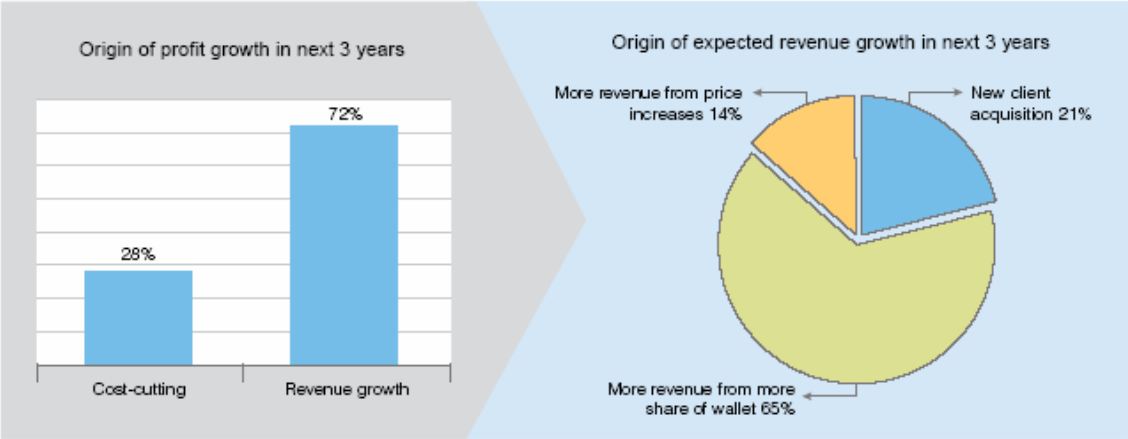
Another advantage banks have over traditional insurance distributors is the lower cost per sales lead made possible by their sizable loyal customer base. Banks also enjoy significant brand awareness within their geographic regions, again providing for a lower per-lead cost when advertising through print, radio and/or television. Banks that make the most of these advantages are able to penetrate their customer base and markets for above-average market share.

Other bank strengths are their marketing and processing capabilities. Banks have extensive experience in marketing to both existing customers (for retention and cross selling) and non-customers (for acquisition and awareness). They also have access to multiple communications channels, such as statement inserts, direct mail, ATMs, telemarketing, etc. Banks' proficiency in using technology has resulted in improvements in transaction processing and customer service.

Distribution is the key issue in bancassurance and is closely linked to the regulatory climate of the country. Over the years, regulatory barriers between banking and insurance have diminished and has created a climate increasingly friendly to bancassurance. The passage of Gramm-Leach Bliley Act of 1999 in US has further stimulated the growth of bancassurance by allowing use of multiple distribution channels by banks and insurance companies.

10.9 FUTURE OUTLOOK

After an early part of the decade focused on cost-cutting, retail banks have reaped most of the easy wins and adapted their organizations to a faster pace of change. Most banks now feel that while continuing to monitor costs closely to avoid any slippage, they now need to concentrate on growth. In mature markets, excluding mergers, 80% of future revenue is expected to come from existing clients, and only 20% from new client acquisition. Further, banks also recognize that in mature markets, increasing share of wallet from the individual customer is a prime revenue driver. Hence, taking a structured relationship approach is very critical.



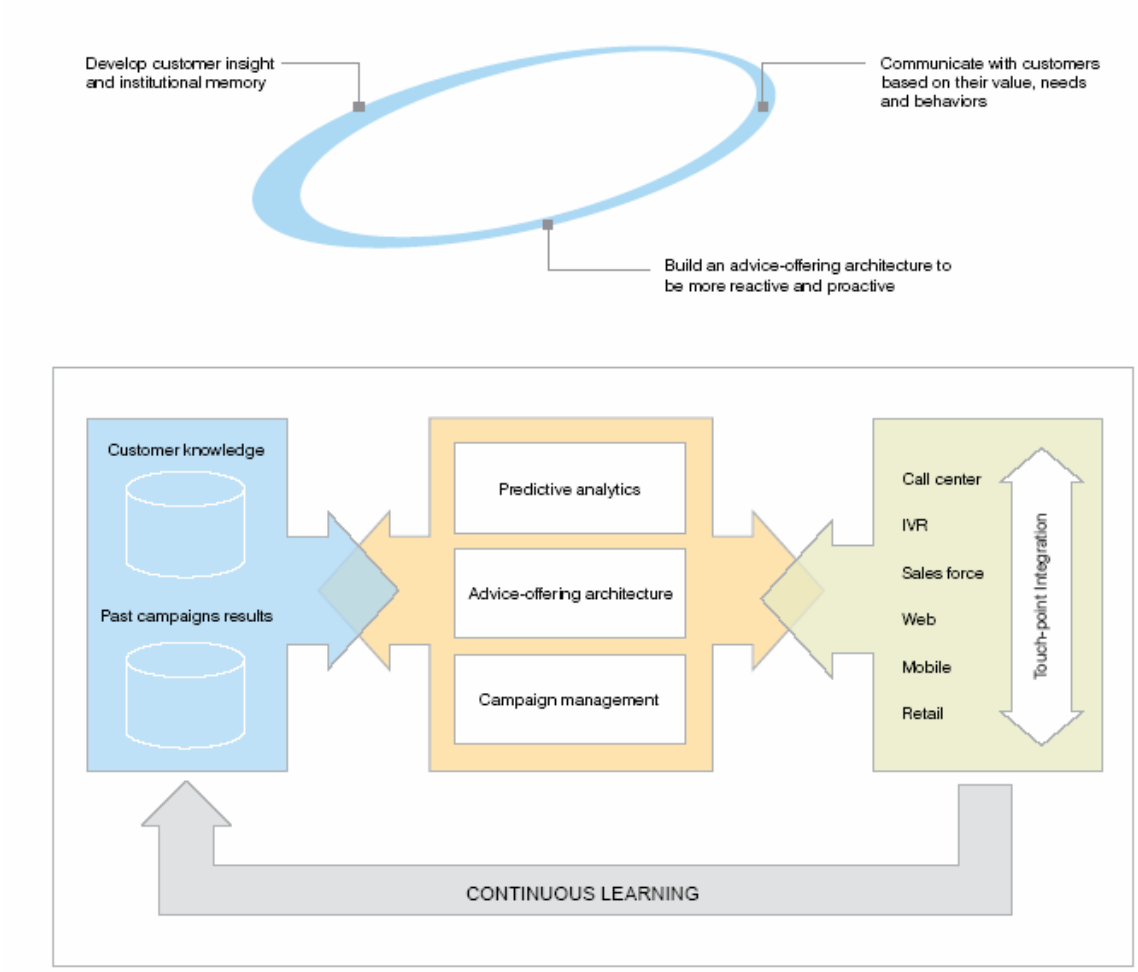
Source: Capgemini interviews with 23 banks in mature markets, Q4 2004 and Q1 2005.

10.10 IT IMPERATIVES

In view of the above, banks might be expected to adapt their tools accordingly. A relationship approach implies a greater reliance on advisory services. Thus, it would become imperative for the banks to obtain a complete integrated view of the client's situation, a good measure of client potential, and an accurate record of the client's past interactions with the bank, including through other channels.

In a client-needs-driven relationship, flexibility and a holistic view are essential. Flexibility is necessary to enable customization of product bundling and pricing, and to allow for accessing products across all product lines based on identified client needs.

A holistic customer experience, viz. customer having access to online channels, which empowers them to get advice and act on their own, is a must. This requires an adaptive architecture for synchronized data exchange.



Source: Capgemini analysis, 2005.

Developing customer insight and “institutional memory” is also critical. This includes records of processes executed for the client, a record of client preferences and past interactions through all channels.

11 Glossary

Asset	Anything owned which can produce future economic benefit
Liability	Something which is owed to another party
Retail banking	Banking, with individual as the customer
Wholesale banking	Banking, with corporations as customers
Stock	Also referred to as 'share', it is a share of ownership in an organization
Bond	A debt security, wherein the issuer owes the holder a debt and is obligated to pay the holder the principal and the interest
Mutual funds	A professionally managed fund wherein investors pool in their money and thus share the risks, as well as, the rewards
Bancassurance	Insurance products sold through banks
Mortgages	Loans given to customers for purchase of house
Student Loans	Loans given specifically to students for the purpose of education
Personal Loans	Loans that are given to customers without a specific purpose. These loans carry higher interest rate as there is no security offered by the customer
Credit Worth	Credit worth is the risk rating of the customer. The credit rating is done based on various factors like the previous credit behavior, financials, collateral
Collateral	Security provided by the borrower to the bank for availing a loan
MICR	MICR is a process by which various details of the check like the drawer bank, amount etc will be read through a reader. The reader will convert the bar code into digital form.
Real-time Gross-Settlement	Settlement of transactions as and when they are ordered rather than running a batch process at the end of the day.
Banknotes	A piece of paper money (especially one issued by a central bank)
Remittance	The sending of money (usually at a distance)
Debit	The process of deducting money from someone's account
Credit	The process of addition (deposit) of money to some1's account
Drawer	One that draws an order for the payment of money.
Drawee	The party on which an order for the payment of money is drawn.
Payee	Is the receiver of the check
Wholesale Banking	banking referred to Corporate needs
Investment	The purchase of a financial product or other item of value with an expectation of favorable future returns. In general terms, investment means the use money in the hope of making more money
Liabilities	A liability is a financial obligation, debt, claim, or potential loss
Derivatives	A financial instrument whose characteristics and value depend upon the characteristics and value of an underlying, typically a commodity, bond, equity or currency. Examples of derivatives include futures and options
Commercial lending	A bank loan to a company. Also called commercial credit or Business credit
Commodity	A product which trades on a commodity exchange; this would also include foreign currencies and financial instruments and indexes
Rediscounting	Commercial paper that is discounted a second time

Commercial paper	An unsecured obligation issued by a corporation or bank to finance its short-term credit needs, such as accounts receivable and inventory. Maturities typically range from 2 to 270 days. Commercial paper is available in a wide range of denominations, can be either discounted or interest-bearing, and usually have a limited or nonexistent secondary market. Commercial paper is usually issued by companies with high credit ratings, meaning that the investment is almost always relatively low risk
Monetary policy	The regulation of the money supply and interest rates by a central bank, such as the Federal Reserve Board in the U.S., in order to control inflation and stabilize currency. Monetary policy is one the two ways the government can impact the economy. By impacting the effective cost of money, the Federal Reserve can affect the amount of money that is spent by consumers and businesses
Edge Act	Banking legislation allowing National Banks to perform foreign lending through government-chartered subsidiaries
Cash reserves	Cash deposits, short-term bank deposits, money market instruments, and Treasury Bills.
Redeem	The return of an investor's principal in a security, such as a bond, preferred stock or mutual fund shares, at or prior to maturity
Neighborhood Reinvestment Corporation	The Neighborhood Reinvestment Corporation, created by Congress in 1978, provides training, grants, and technical support to the neighborworks network. Neighborworks® America, local neighborworks organizations and Neighborhood Housing Services of America make up the neighborworks system, which has successfully built healthy communities since 1978. Together, with national and local partners, neighborworks creates new opportunities for residents while improving communities.
Money-market Rates	Prevailing rate in money markets
Market capitalization	Market capitalization represents the aggregate value of a company or stock. It is obtained by multiplying the number of shares outstanding by their current price per share. For example, if XYZ company has 15,000,000 shares outstanding and a share price of $20 per share then the market capitalization is 15,000,000 x $20 = $300,000,000
M&As	Merger and Acquisition activities
Direct deposit	The deposit of funds directly into a bank account as a form of payment. Common uses for direct deposit include paychecks and tax refunds
Compounded daily	The process of calculating interest and adding it to existing principal and interest at finite time intervals, such as daily, monthly or yearly
Demographics	Socioeconomic groups, characterized by age, income, sex, education, occupation, etc., that comprise a market niche
Call centers	Customer care center where in customer call up to get their queries answered.
Stock market Instruments	Stock market instruments are regular shares, bonds and other derivatives which are traded in a stock market

Legacy systems	Old systems that run on mainframes
Direct credits	Money deposited by the payee directly into the beneficiary account