

LAFFERTY

Retail Banking

INSIDER

INTELLIGENCE TO BANK ON FOR THE GLOBAL
RETAIL BANKING INDUSTRY



Microfinance launches into new frontiers

MICROFINANCE STARTED out as providing loans to low-income consumers in the form of microcredit. However, the industry has matured rapidly and is now becoming more commercial, with industry players working toward scaling up and broadening the range of financial services on offer.

Retail banks have increasingly become involved in microfinance and are learning from microfinance institutions (MFIs). Banks are learning how to serve a customer base they have previously ignored, while MFIs are learning how to become more efficient and offer services on a mass scale.

As microfinance evolves, those involved in the industry are seeking ways to make their services more sustainable and are increasingly pursuing profit. Where previously the pioneers of microcredit were only concerned with alleviating poverty, many new entrants to the field argue that its long-term viability comes through profitability.

Cutting costs

MFIs are principally focused on keeping their costs low in the current environment. Although microfinance rates and gross margins are typically high, the cost of distribution is also elevated, leading to a focus on costs. Brigit Helms, an expert in microfinance and CEO of Unitus, a non-profit organisation that tackles global poverty through microfinance, comments: "As MFIs scale up and expand the range of services offered, particularly in rural areas, they need to continue to keep costs low in order to stay viable. Honing operational efficiencies, especially in cash management and customer acquisition processes, can lead to significant savings and can radically expand services."

Another trend in microfinance is the shift away from its origins in making small loans, and the expansion into offering other financial services to the poor. Stuart Rutherford, the founder of SafeSave, which provides basic banking services to Bangladesh's low-income population, comments: "Microfinance offers money management services to poor people in ways that suit their budgets, cash flows and lifestyles. It may have started as loans for poor people to run micro-enterprises, but it is – or should be – much broader than that," he tells *Lafferty Retail Banking Insider*.

Inspirational intentions

The microfinance movement is typically thought of as being pioneered by Professor Muhammad Yunus, the founder of Grameen Bank. He began by offering small loans to groups of women in Bangladesh with the intention of lifting them out of poverty. His success has been copied by numerous other organisations, and in recent years there has been a discussion of the degree to which microcredit can alleviate poverty. Critics argue there is no conclusive research that shows that lending to poor people helps them out of poverty, and much of the evidence that has been presented is anecdotal. Few studies have isolated the variables and have used satisfactory research methodologies. If a borrower becomes more wealthy, for example, it is difficult to assess whether it is because of the microcredit they were extended, or because of other factors such as them being more entrepreneurial.

When asked if microfinance alleviates poverty, SafeSave's (continued on page 3...)

HIGHLIGHTS

- Major potential exists in Latin America's retail banking market and the outlook for 2010 is positive **4**
- Davy Warnez of BNP Paribas Fortis speaks to *LRBI* about the impact of the financial crisis **6**
- Managing and defining risk in retail banking requires a comprehensive enterprise-wide strategy **8**
- Customisation offers retail banks a unique opportunity to attract and engage consumers **10**
- Doubts are emerging about whether ING Direct can sustain its culture of innovation **11**
- Databank: regional indebtedness levels **12**

Lafferty Group
One Lyric Square
London
W6 0NB
United Kingdom
t: +44 (0)20 3008 8415
f: +44 (0)20 3008 8426

EDITORIAL

Michael Lafferty

Editor-in-Chief
e: michael.lafferty@lafferty.com
t: +44 (0)20 3008 8415

Ronan McCaughey

Editor
e: ronan.mccaughey@lafferty.com
t: +44 (0)20 3008 5268

Jane Cooper

e: jane.cooper@lafferty.com
t: +44 (0)20 8876 0195

SALES & ADVERTISING

Sadeek Varacchia

Head of Sales
e: sadeek.varacchia@lafferty.com
t: +44 (0)20 3008 8420

PRODUCTION

Tom Brown

Sub-editor
e: tom.brown@lafferty.com
t: +44 (0)20 3008 5269

Lafferty Retail Banking Insider is a publication of Lafferty Group. All rights reserved.

Strictly no photocopying is permitted. It is illegal to reproduce, store in a central retrieval system or transmit, electronically or otherwise, any of the content of this publication without the prior consent of the publisher. All subscribers are entitled to online access to the current issue and to an archive of past issues via our website www.lafferty.com. For enterprise licenses, please contact Evelyn Hunter-Jordan on +44 (0)20 3008 5283 or evelyn.hunter-jordan@lafferty.com.

While every care is taken to provide accurate information, the publisher cannot accept liability for any errors or omissions.

No responsibility will be accepted for any loss occurred by any individual due to acting or not acting as a result of any content in this publication. On any specific matter reference should be made to an appropriate adviser.

Lafferty Ltd is a company registered in England and Wales.

© Lafferty Ltd 2010

Company Number: 04621222

LETTER FROM THE EDITOR

Dear Readers,

Improving the way risk is defined, managed and monitored is the most pressing priority for the retail banking industry in the current economic and regulatory environment (see pages 8 and 9). Financial investment in risk governance is certainly growing, and it is estimated that the annual cost of implementing risk governance frameworks at major financial institutions worldwide is set to exceed \$100 billion in 2012 – double the figure for 2006.

While banks are investing more in risk management, it seems some are struggling with integration. At the end of the day, the success of any risk management system depends on the culture within the bank, combined with sophisticated IT systems and processes.

Banks making the most radical changes appear to be those that have been particularly affected by the crisis, but even in those markets that have been more insulated, retail bankers recognise the value of learning lessons from the crisis.

BNP Paribas Fortis, the new name of Fortis Bank, is no stranger to change (see pages 6 and 7). Since joining forces with BNP Paribas – which owns a 74.9-percent stake in the bank, with the Belgian state holding the majority of the remainder – it appears that the financial institution and its team have settled down after a period of flux. However, the damage inflicted by the crisis on the banking sector's reputation has been highly concerning.

'Back to basics' is a theme advocated by many banks and financial commentators as the panacea for regaining consumers' trust. There is also some debate in the industry about the value of innovation, with many commentators calling for banks to become 'boring'. Yet innovation is the lifeblood of the retail financial services industry and can be seen in new trends like account personalisation (see page 10).

Innovation can also be seen in the microfinance sector, as banks begin to recognise that serving low-income consumers can be both profitable and have the socially desirable consequence of providing financial services to the unbanked or underbanked – the ultimate win-win. New technology certainly helps, yet, ironically, the microfinance movement with its intense focus on customer relations, could provide the template for future 'back to basics' retail banking.



Ronan McCaughey

Editor
e: ronan.mccaughey@lafferty.com
t: +44 (0)20 3008 5268

Forthcoming Conferences

1st Lafferty Global Retail Financial Services Summit for China 2010

Beijing

24-25 March 2010

Managing Towards a Consumer Economy

Lafferty World Series of Retail Banking and Consumer Finance Conferences *Global Perspective, Local Insight*

Lafferty World Series – Portugal	Lisbon	05 April 2010
Lafferty World Series – Austria	Vienna	07 April 2010
Lafferty World Series – Germany	Frankfurt	09 April 2010
Lafferty World Series – Czech Republic	Prague	10 April 2010
Lafferty World Series – Hungary	Budapest	12 April 2010
Lafferty World Series – Poland	Warsaw	14 April 2010
Lafferty World Series – Romania	Bucharest	16 April 2010

(... continued from page 1)

Rutherford answers: “Yes, but not as a ‘magic sky hook’ that automatically lifts people out of poverty. Money management services are fundamental services for all of us, rich and poor, in the way that education and health services are. Just as with education and health, if you have good money management services to hand, your chances of achieving a better life increase. Microfinance is a ‘platform builder.”

Dean Karlan, a professor of economics at Yale University who specialises in the area of microfinance, comments that microcredit is not a panacea in the fight against poverty: “The evidence so far from rigorous impact evaluations shows some limited benefits for some individuals, but not system-wide benefits to all recipients. The bar was set very high for what advocates wanted microcredit to accomplish.”

In other areas of microfinance – such as savings and insurance – the evidence of helping the poor is a little more conclusive. Karlan says: “The limited evidence we have to date done with rigorous evaluations are showing larger impacts on average than the credit programmes did, but this is early and the evidence is limited.”

Helms comments: “There has been a lot of debate about whether microfinance truly helps people escape poverty. The core concept behind microfinance is extending financial services – primarily credit, but also savings and other services – to a segment of the global population that is currently shut out. Just think about what your life would be like with no bank account, no safe way to save, no credit card, ATM or access to loans for buying a home, no insurance to protect you from life’s risks. It is a pretty bleak picture. Microfinance breaks down the barrier of exclusion and gives poor people a small toehold to start building financially stable lives. We know it works. Now the challenge is to scale up while bringing even more services to increase financial security like insurance or remittances.”

The focus of the microfinance sector has gradually moved towards savings programmes. One example is SafeSave, founded by Rutherford in 1996 in Bangladesh, which emphasises savings rather than loans for business because of the belief that people have more fundamental financial needs than running their own business. When asked to explain the difference between his approach and that of Grameen and the origins of microfinance, Rutherford says: “Grameen emphasises loans for poor-owned microenterprises. SafeSave’s ambition is more modest and broad: SafeSave wants to be the partner of choice for poor people who want to manage their money better. This

‘The core concept behind microfinance is extending financial services – primarily credit, but also savings and other services – to a segment of the global population that is currently shut out’

Brigit Helms, Unitus

means helping them stretch small and irregular incomes to achieve more goals, respond to emergencies, acquire life-enhancing assets, build reserves for life-cycle needs like health, housing and education, and – where appropriate – build businesses.”

Rutherford comments that there is a trend in the industry toward broadening services away from the original emphasis on enterprise loans to general-purpose lending, savings, insurance and money transfers. There is also a trend of more players getting involved in the industry, including retail banks and investment funds (see *LRBI 2008/18, pages 10 and 11*).

Another key factor that is driving change, Rutherford says, is the opportunities offered by mobile

technology. Karlan agrees that mobile banking is a key trend and notes with the increasing focus on profit, mobile banking will be able to lower transaction costs. “However, there is a risk that lower transaction costs will also make it harder for individuals to avoid temptation consumption. Thus, with the electronification of payments we would ideally also see innovation in product design to help individuals achieve personal and household goals, and not succumb to their own or their spouse’s whims,” he notes.

Helms notes that another trend likely to occur is increasing amounts of commercial capital moving into the more stable and better understood segments of the market.

Retail banks are increasingly involved in microfinance, and India’s ICICI Bank has often been cited as an example of a retail bank that is successfully operating in this area. In Rutherford’s view, few players have entered the space: “However, developing technology may change this. For example, mobile phone banking helps reduce the distinction between ‘on-premises’ and ‘off-premises’ banking, offering banks an easier way to deal directly with clients.”

Helms comments on the best path forward for retail banks in this area: “The market is huge, with half of the world’s population falling into the underserved or unserved customer segment. To be successful, retail banks need to develop business models that work best for their circumstances. In some cases, this might mean forging strategic alliances with microfinance institutions. In other cases, banks might create specialised business units with products and services to serve this market segment, either directly or through the organisations already working in microfinance. ICICI Bank in India is one example, as both capital investor and partner providing operational support for several MFIs. We have seen that with scale, serving the working poor can be both profitable and beneficial to combating global poverty.” ●

Latin America's rich seam of opportunity

Latin America's banking sector was in better shape at the start of the financial crisis following economic shocks in the past. This was due to factors including policy reforms and improved fiscal management. Although the region has not been spared the impact of the downturn, the sector is set to recover in 2010 and consolidation is likely to increase.

Ronan McCaughey reports

Latin America has weathered the global economic crisis relatively well from a macro-economic viewpoint.

Growth rates in the region typically averaged approximately 5 percent during the 'bonanza' years of 2004 to 2008, and overall GDP is expected to have shrunk by 3.6 percent in 2009. Nevertheless, an OECD report forecasting Latin America's economic outlook for 2010 points out that Latin America's economies are rebounding from the shock more rapidly than the majority of developed economies. Figures from the World Bank project that the region will experience a recovery of 2.4 percent in 2010.

Jeff Dayton-Johnson, a senior economist and head of the Americas desk at the OECD development centre, says that Brazil, Columbia and Peru have performed best in Latin America during the crisis. In contrast, Argentina, Venezuela and Mexico are forecast to have had less satisfying growth in the immediate term.

Data on officially recorded remittance flows underlines the severity of the economic downturn in Mexico, for example, as it is one of the top recipients of migrant remittances among developing countries. Figures issued by the World Bank in November 2009 showed that remittance flows to Mexico fell by 13.4 percent in the first nine months of 2009 on a year-on-year basis. However, the report points out that the decline in remittance flows appears to be bottoming out in most Latin American countries.

Dayton-Johnson says: "This crisis has really hit the economies of Latin America

hard. However, the expectation is that most economies will grow again in 2010. The outlook is better today than it was in the crisis of the 1980s."

He adds: "Going into this crisis, virtually all of the countries in the region had already put their fiscal houses in order in terms of deficits and debt management. This meant that they had a lot more scope to use fiscal policy as a tool for macro-stabilisation."

Iñigo Vega, a banking analyst at brokerage house Iberian Equities, explains that 2009 was a tough year

'Profit margins are much higher in Latin America than in other developing markets, and banks are still making a lot of money'

**Iñigo Vega,
Iberian Equities**

for banks in Latin America, particularly Mexico. Despite this, Vega believes that the Latin American banking sector is robust and poised to bounce back in 2010.

He says: "Profit margins are much higher in Latin America than in other developing markets, and banks are still making a lot of money. Non-performing loans, which started to gear up at the end of 2008, have already peaked and are now falling. On average, NPLs peaked in Mexico in June 2009 and in October 2009 in Brazil."

Encouraging credit data highlighted by Iberian Equities substantiates Vega's comments. This data reveals that the Mexican banking system's NPL ratio fell 27 basis points in December 2009 to 3.07 percent – compared to 3.86 percent in May 2009. By large institutions in Mexico, BBVA Bancomer recorded the largest drop of 33 basis points in NPL ratios per asset class.

Growing optimism about the state of the Latin American banking sector is also borne out by Santander's results for 2009, in which its attributable profit for the sector rose to \$5.3 billion in 2009, an 11-percent rise compared to 2008.

Consolidation has characterised Latin America's retail banking industry in recent years, driven by the entry of foreign players into local financial systems. Furthermore, a report published by the Economist Intelligence Unit in 2008 noted that a total of 27 percent of survey respondents said that retail banking competition is expected to increase further in Latin America – compared to 15 percent in corporate banking.

Much of the M&A activity has been centred in Brazil – as demonstrated by the merger of Itaú and Unibanco, which was approved by the Brazilian Central Bank in February 2009. Similarly, Banco do Brasil acquired Banco Nossa Caixa in March 2009. These transactions come at time when the Economist Intelligence Unit report has identified Brazil as the most attractive market, with 71 percent of financial services executives identifying it a leading investment destination, followed by 43 percent for Mexico and 38 percent for Argentina.

Spain-based Santander took advantage of Brazil's growth potential and the low penetration of banking products and services, as in August 2008 its Brazilian unit acquired Banco Real. Santander subsequently floated 18 percent of its Brazilian unit, Banco Santander Brasil, in October 2009 – the largest financial IPO

of the year – raising €4.76 billion (\$6.5 billion) in capital and generating €1.42 billion (\$1.9 billion) in capital gains.

More recently, Brazil's Banco Bradesco signed a memorandum of understanding with Ibi México in January 2010. The deal offers Banco Bradesco an opportunity to move into a market with significant potential for growth in consumer finance. Ibi México has a credit portfolio of 1.3 billion Mexican Pesos (\$100 million), shareholders' equity of 566 million Mexican pesos (\$44 million) and more than 1 million credit cards. Both companies expect to conclude the deal by 30 March 2010, subject to approval.

Citi is another major player in Latin America and in late 2009, the future of Citi's Mexican subsidiary Banamex became the focus of speculation after Mexican senators reportedly asked the country's Supreme Court to rule on whether Banamex would be breaking the law by being partly owned by the US government. The US government currently owns a significant stake in Citi.

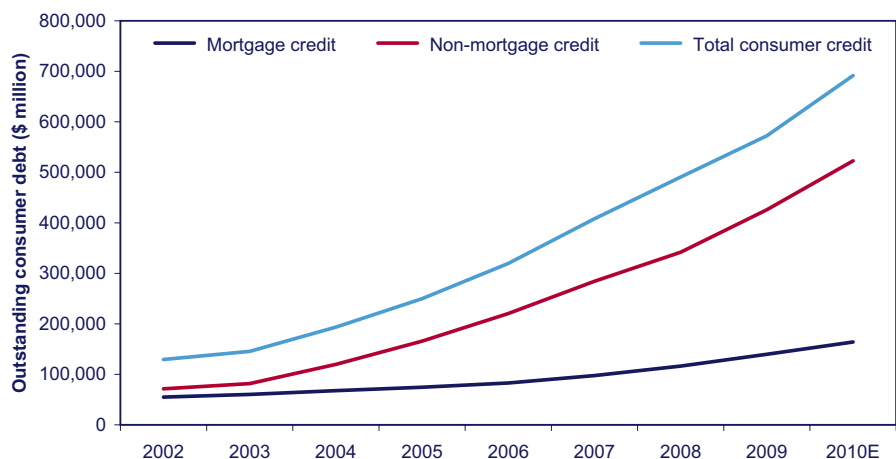
A spokesman for Banamex said: "Citi does not want to sell Banamex. It is part of its retail business model and is not for sale."

Major growth potential exists in Latin America's retail banking market, particularly given that less than 30 percent of the region's population has access to financial services.

As a result, microfinance in Latin America is an expanding industry with a large growth potential. For example, a report by the World Savings Banks' Institute (WSBI) says microfinance loan average values are typically \$783 in Latin America, compared to \$187 for Africa.

A long-term commitment to mobile banking and mobile payments technology offers banks a considerable opportunity to build partnerships with telcos and retailers in reaching the region's large unbanked sector. Banamex has been a leading player

Latin American: outstanding consumer debt



Source: Lafferty Cards and Consumer Finance

in this area and in February 2009 it launched a mobile banking service called Banca Móvil with Mexican wireless services provider Telcel.

A spokesman for Banamex says that the financial institution has made further progress in enabling Mexico's unbanked and underbanked population to access financial services by collaborating with small businesses like convenience stores.

These businesses offer basic financial facilities – such as paying utility bills and money transfers – on behalf of Banamex, which has resulted in a network of more than 4,000 outlets across Mexico.

A further mobile money innovation occurred in September 2008, when Visa announced the availability of remote mobile payments in Brazil in partnership with Banco do Brasil. This was the first programme of its kind in Latin America and allows Banco do Brasil's Visa cardholders to pay with their mobile device and confirm the transaction via a text message.

In spite of these developments, Manuel Orozco, senior associate and director of remittances and development at US-based policy centre the Inter-American Dialogue, argues that mobile money transfer services have a long way to go before they take off in Latin America: "The Latin American money transfer market is very different to other markets. It is not focused on mobile technology at this point, as the

adoption of mobile technology has to do with circumstance and culture. There is so much hype about the technology without any understanding of the actual application when it comes to cash transfers. There is more development in card-based payments in Latin America than in mobile payments."

The forces of globalisation have significantly impacted Latin America's retail banking sector in recent years in terms of restructuring and a series of takeovers and acquisitions. Banks in the region also appear to have learnt the lessons of hyperinflation, and a succession of past economic crises have enabled them to remain relatively resilient in the current economic downturn.

Brazil, Mexico and Argentina are set to remain the most attractive markets for retail banking for the foreseeable future, with Brazil a clear leader due to its favourable macroeconomic outlook.

As Pedro Malan, a former Brazilian finance minister, says: "The globalisation of consumer patterns and aspirations has acted as a stimulus towards social mobility. This is an extraordinary opportunity for banks and their business. Latin America will offer fertile ground for expansion strategies." ●

For further information regarding Lafferty Group research, please contact Sadeek Varacchia on +44 (0)203 008 8420 or sadeek.varacchia@lafferty.com

Fortified for the future

Fortis Bank ended a long period of uncertainty for its customers and employees when it joined forces with BNP Paribas in 2009 in light of the financial crisis. Davy Warnez, head of value propositions daily banking at BNP Paribas Fortis, tells **Jane Cooper** how the financial institution has dealt with the change to concentrate on the importance of customer relationships

Can you briefly summarise the recent changes in ownership at Fortis and the current structure of the bank?

In 2007, the consortium of Royal Bank of Scotland, Banco Santander and Fortis took over ABN AMRO. Due to the worldwide financial crisis, Fortis ran into trouble and in 2008, almost one year after the takeover, and our part of ABN AMRO and the activities of Fortis in the Netherlands - that is the bank and insurance divisions - were sold off to the Dutch government.

The Luxembourg and Belgian activities were taken over by BNP Paribas and the respective governments. Since 12 May 2009, BNP Paribas has been the majority stakeholder in BNP Paribas Fortis (formerly Fortis Bank in Belgium) and BGL BNP Paribas (formerly Fortis Bank in Luxembourg), and has had a stake of 25 percent in AG Insurance (formerly Fortis Insurance Belgium).

Have all these changes been confusing for the staff?

We went through a lot of changes – firstly through the integration process with ABN AMRO, then we had to separate from not only ABN AMRO, but also from the activities of Fortis in the Netherlands. Then we had to go through another integration process with BNP Paribas. Despite all these changes and uncertainty, the spirit among the people within the bank has been very good.

There were not that many changes in personnel during this time. However,

due to the nationalisation in the Netherlands, we were cut off from our colleagues with whom we were working on mutual projects.

Have these changes been disruptive in terms of the day-to-day running of the bank and your interaction with your customers?

What was disruptive was that because of the financial crisis, customers lost faith in the banking system in general.

There has been a re-focus on customer relationships, with relationship managers and branch staff – together

‘The financial crisis has had a big impact on the image of people working in the financial industry, with the media portraying bankers as dishonest and even as thieves’

with the central services – working hard to inform our clients, listen to their concerns and find solutions for them.

The financial crisis has had a big impact on the image of people working in the financial industry, with the media portraying bankers as dishonest and even as thieves.

Is there a feeling within the bank that the situation is now settling down?



Davy Warnez, BNP Paribas Fortis

Thanks to the very human and structured approach of BNP Paribas, my personal impression is that the situation has started to settle down, and we are looking to the future mindful of the lessons learnt from the past.

Combined with the 3.9 million clients in the two new home markets – Belgium and Luxembourg – the group will have 14 million clients in its retail network in Europe. By optimising the production and distribution with the newly created competence centres in Belgium – corporate and transaction banking Europe, global factoring, trade finance and cash management – the future looks very promising.

What have been the most significant changes that you have noticed in your role?

We really had to move ‘back to basics’ with banking in 2009, hence the focus on deposits.

The second big change has been the importance of rewarding loyal customers. We need to find the right rewards for our customers to promote loyalty. In my opinion, there was too much focus on acquiring new clients by giving them special conditions. Of course it is important that we have to stay focused on new clients, but the right balance has to be found between rewarding new and existing customers.

In the area of cards and payments, preparing to become compliant for

the PSD (Payment Services Directive) and SDD (SEPA – Single Euro Payments Area – Direct Debit) were the main activities in 2009.

On top of this, specifically for BNP Paribas Fortis, there was the brand repositioning centred around the five promises that we have made to our customers: BNP Paribas Fortis is the bank that listens to its customers; BNP Paribas Fortis is the bank that is accessible for its customers when and how they want; BNP Paribas Fortis is the bank which gives transparent information; BNP Paribas Fortis is a partner for its clients' projects; and BNP Paribas Fortis is the bank that is actively engaged.

Every action – such as communication campaigns or the launch of a new product – is tested against these five promises. We see them as our five commandments.

Do you think that the Fortis brand, in the minds of the public and your customers, is still associated with the troubles of the financial crisis?

As Fortis was the first bank in Belgium to be hit by the financial crisis, the Fortis brand is still not clear of the stigma of the crisis.

We also have to be aware of the distinction between BNP Paribas Fortis and Fortis. Fortis involves insurance activities and is quoted on the Belgian Stock Exchange; BNP Paribas Fortis represents banking activities and is part of BNP Paribas.

Can you give an example of a recent product innovation that you have introduced?

Last year we launched Maestro online, which makes e-commerce via Maestro-branded payment cards possible. As most transactions on the internet are carried out via a credit card, we launched Maestro online to give clients who do not have a credit card – such as the youth segment or who do not want a credit card – the ability to make transactions over the internet.

Within BNP Paribas Fortis, one of the focus points for our professional and small-business market is the enterprise-entrepreneur relationship. For that market, in the domain of daily banking, we launched the American Express Gold Duo Card. This is a packaged offering that combines a Gold credit card for private usage and

a Gold credit card for professional usage. By having two cards offered in one package, the customer has the advantage of being able to easily separate their professional from their private spending.

In 2009, the focus was on making our offerings available online, as well as providing the opportunity to apply for these products online. We wanted to offer solutions for our self-directed potential customers.

Can you give an overview of the retail banking market in Belgium and explain what are the major issues there for retail bankers?

The retail banking market in Belgium has four big players: BNP Paribas Fortis, Dexia, ING and KBC, as well as some smaller niche players. Before the crisis, most retail customers had only one bank; since the crisis, most customers spread their deposits and business over several banks. The challenge will be to remain the primary bank of our existing customers and become the main bank for new customers.

This can only be done if customers regain their confidence in the financial system. One of the major challenges at the moment is that customers in Belgium still do not feel comfortable with financial institutions. We – together with the Belgian financial community as a whole – have to regain that confidence.

Looking at the payments market, we can say that Belgium is a real debit country, with almost all Belgians having a debit card in their pocket. These debit cards are mostly co-branded Maestro and BCMC (Bancontact Mister Card) cards. Belgians are less fond of credit cards. Credit cards in Belgium are mostly

deferred debit cards. For low-value payments, Belgium has the Proton solution.

When it comes to the payments market, I see four major challenges that we have to turn into opportunities. First of all, there is disintermediation, which is all about the rise of new payment providers outside the traditional banking circuit, such as telcos or internet players like PayPal or PingPing.

We have to team up with these providers to find win-win situations.

The second challenge is the pressure on interchange and hence the profitability of the cards business. In these interchange discussions, the true social cost of cash has to be taken into account.

Third is fraud management. If we want to convince people to use their cards for any transaction, we have to work on solutions to halt fraud.

Nothing is more frustrating than being abroad with a credit card that has been preventively blocked because of the potential risk of fraud. Recent cases of skimming further underline the need to find solutions for fraud.

Finally, there is SEPA. This will not only have an impact on the existing local payment schemes that have to make the decision whether to become SEPA-compliant or not, but will also enhance competition as new players will enter the market. ●

‘A major challenge ... is disintermediation, which is all about the rise of new payment providers outside the traditional banking circuit, such as telcos or internet players’

Re-engineering risk management systems

Retail banks are re-evaluating every aspect of risk management following the turmoil triggered by the financial crisis and growing regulatory pressure. Banks will continue to apply many traditional risk-management tools in 2010, but these will be enhanced by more-sophisticated tools as financial institutions seek to develop an integrated view of risk. **Ronan McCaughey reports**

Risk management is moving to centre stage in the global retail banking industry in the wake of the vulnerabilities exposed by the financial crisis.

The chain of events since 2008 stunned even the wisest industry observers, leading to a number of bank bailouts, unprecedented turbulence in financial markets and reduced liquidity. It also exposed the fragility of the capital markets and underlined the most valuable asset for any financial institution – confidence.

Given this context, global retail banking industry executives increasingly recognise that implementing effective risk-management systems and models is critical in order to regain the trust of consumers, shareholders and, arguably most importantly, regulators.

A report published in December 2009 by Ernst & Young surveying the industry's progress on the implementation of recommendations by the Institute of International Finance (IIF) emphasised this theme. Most respondents reported progress on board and senior management involvement in sponsoring reviews in their banks, with a core focus on the cause of losses. For example, 81 percent of banks said governance and risk appetite was the main issue for them, with liquidity risk in second place at 61 percent. The majority of banks also revealed a keen interest in measures for enhancing risk controls and governance, with greater reporting requirements around gap assessments and remedial action.

One general pattern to emerge from the survey is that banks in countries such as

Japan and Sweden that had experienced previous crises up to 20 years ago were less exposed this time around due to previous substantive reviews of risk governance and appetite.

Patricia Jackson, head of Ernst & Young's prudential advisory practice in Europe, Middle East, India and Africa, says that the crisis has led to many banks rethinking risk governance.

Jackson says: "The focus is on a top-down, enterprise-wide approach to risk management, with risk reporting to the board moving to a more regular

'The focus [for banks] is on a top-down, enterprise-wide approach to risk management'

**Patricia Jackson,
Ernst & Young**

quarterly or monthly basis. Banks are also stress-testing for the implausible as a direct result of last year's events. No scenario is deemed impossible."

The latest evidence indicates that industry executives have identified many of the vulnerabilities exposed by the financial crisis and are working on processes to eliminate them. However, the rules of the game in risk management are highly unlikely to dramatically alter in 2010. Instead, 'doing the same, but better' will be the key trend for the next 12 months.

Retail banks typically assess and manage risk within four core areas:

credit risk, market risk, liquidity risk and operational risk.

In terms of credit risk, Phil Cotter, credit services managing director at Experian, says the tools used by major banks prior to the credit crunch provided a very accurate picture of where the risk lay. While the same rules still apply, the most advanced lenders are now taking steps to enhance and add greater levels of granularity to their credit scoring methodologies. Cotter says: "Traditional credit risk methodologies will continue to be widely used in 2010, but they will be enhanced with additional data sources and used more innovatively across the credit lifecycle."

He adds: "We are also seeing an increased focus on implementing the kind of sophisticated capabilities traditionally used in the credit application process deeper into the credit lifecycle. Clients want greater insight into each customer's total exposure; they want rapid alerts to key changes in customers' circumstances so that they can act quickly and compliantly; and they want to improve the efficiency and effectiveness of their collections departments."

Nic Orton, vice president for analytic services at FICO, says that lenders are putting a greater focus on using all the data available to them. This involves both internal and external information – from every level of the business – in order to gain a more informed measure of the likelihood of default, or profitability, for a given customer.

Orton says: "Whether it be when setting the price term and amount at the point of origination, managing a customer's ongoing limit on a revolving product, or even setting the actions at different stages of the collections and recoveries processes, banks are considering how to target their decisions more accurately and precisely."

In the current economic environment, pre-delinquency is a key concern for financial institutions, which are

increasingly blending internal and external data sources to help understand and engage with those at the highest risk of becoming delinquent.

Cotter says: "With more cases entering collections than ever before, departments are under massive strain, putting a premium on effectiveness and efficiency."

A key characteristic of the financial crisis was the inaccurate and ineffective management of liquidity risk. As a result, international banks are under regulatory pressure to demonstrate they have a clear strategy in terms of liquidity risk management, with much attention being given to Spain's counter-cyclical provisioning model.

Proposals published by the Basel Committee in December 2009 aimed at strengthening global capital and liquidity regulation are likely to significantly impact banks worldwide, and a fully calibrated set of standards are expected to be phased in.

The proposals include the introduction of a global minimum liquidity standard for internationally active banks that includes a 30-day liquidity coverage ratio requirement underpinned by a longer-term structural liquidity ratio. The framework also includes a common set of monitoring metrics to assist supervisors in identifying and analysing liquidity risk trends at both the bank and system-wide level.

Damage to a bank's reputation, such as a major fraud, is also a key risk in the current economic environment. Michelle Weatherhead, head of business services at ACI Worldwide, says that banks are investing significant time and resources in combating fraud and financial crime: "Banks are looking at integrating fraud systems within their payment systems. Traditionally, banks have had fraud protection engines attached to their retail payment systems, but they are now looking to extend that to other payment forms."

Banks are also undertaking increased customer profiling, as well as

monitoring customers' transactions patterns for 'unusual activity'. Weatherhead says: "Banks have been doing this for a while, but now they are making sure that the profiling is done in real-time."

The issue of bankers' bonuses has also sparked heated debate in recent months. For example, a report by Sir David Walker in 2009 recommended greater pay transparency in large banks.

Jane Leach, a partner at KPMG and head of its risk department, says: "One of the biggest changes is the cultural

'With more cases entering collections than ever before, departments are under massive strain, putting a premium on effectiveness and efficiency'

Phil Cotter, Experian

change within organisations. Banks want risk managers to be challenging and they want risk management to be more influential in decision-making. Hard lessons have been learnt and they are not going to be forgotten."

International retail banks also appear to be relying less on traditionally accepted risk-measurement tools, such as Value at Risk (VaR) in the post-credit crisis environment. VaR is a technique used to estimate the probability of portfolio losses based on the statistical analysis of historical price trends and volatilities.

Ernst & Young's Jackson says: "There is also more focus on risks not in the models, and it is definitely something banks are looking at. However, the problem is that the regulatory structure is not yet set, so it remains to be seen to what extent this is slowing the path of change on the systems side.

Technology can play an important role in facilitating an enterprise-wide risk management procedure. For example, software solutions are widely available to banks that identify changes in customer behaviour patterns across multiple accounts, and can recognise attacks from fraud

schemes, such as identity theft, phishing, account takeover, fraud and money laundering.

Vaughn Collie, a director and risk specialist at Account, warns that some banks are trying to implement technology solutions to deal with risk management, but without revisiting their processes and controls.

Collie recommends that banks critically analyse and enhance controls before implementing appropriate technology to support these processes to achieve the optimal benefit. "One of the key challenges is for the technologies

and processes to cross organisational boundaries and make sense of disparate processes and data sources," says Collie.

The financial crisis exposed significant vulnerabilities in the global banking sector and as financial institutions migrate towards recovery, a 'culture shift' is occurring as risk managers become more influential in retail banks' decision-making. The acute emphasis on risk management is also leading to a focus on leveraging insights, data and capabilities across bank departments to produce 'connected' decisions.

Banks that can harness this data to help them make better, more consistent and faster decisions will undoubtedly have a competitive advantage. As Orton says: "Aligned with the expanding levels of data, banks should and are continuing to look for new models and methodologies that enhance and support their actions and decisions. They need to move away from models that predict an outcome towards a new level of performance with tools to support enhanced decision analytics. Systems that harness data across an organisation and allow proper decision-management principles will

Customisation reaps rewards

Retail banks have moved away from the 'one size fits all' approach to their products, especially as a wave of mass customisation is hitting other industries.

Whether consumers are ordering a coffee, downloading tracks onto their iPod or updating their Facebook page, individuality and the personalisation of products has become the norm. The challenge for banks, however, is in differentiating their offerings when their competitors are also offering similar customisation tools.

Banks also have to decide on the degree to which the process is customer- or bank-driven; they need to decide whether customers dictate what they want, or whether they merely offer customers more options to choose from.

Technology that enables customers to choose the terms of their products has been useful in attracting new savings customers – especially at a time when retail banks have turned their attention to gaining deposits. For example, South Africa's Capitec Bank has given customers the freedom to personalise the terms of their savings accounts.

Sam Kilmer, vice president for market development at Harland Financial Solutions – a provider of technology to financial institutions – notes that there is a range in how banks apply the tools of personalisation. He argues that the trend has, in part, been brought about by a greater need by banks to monitor their customers' behaviour due to compliance and fraud prevention.

Kilmer says: "Ensuring that employees and customers follow proper controls has resulted in more personalisation. For example, in branch automation or credit management systems, a typical bank is now tracking and analysing much more information about their customer's transactions and interactions than in the past. This certainly allows for better customer dialogue, but also demonstrates to institutional

management and regulators that the bank knows the customer and knows the controls."

He adds: "Self-service solutions, such as online banking, cash management, and mobile banking, are also driving personalisation as consumers appreciate techniques such as customised alerts and naming the description they see on their accounts. Moreover, allowing customers to customise the look and feel of their landing pages, for example, is another way to reduce the risk of phishing and other scams."

Examples of banks that use such devices include Malaysia's AmBank. Its Family First solution provides 'special savings accounts', whereby up to ten savings accounts can be personalised

'Banks that neglect personalisation trends now will sacrifice online – and possibly mobile – banking customers later'

Stessa Cohen, Gartner

with names that are unique to each customer – such as 'my holiday', 'kids' education', or 'new kitchen'.

Another Malaysian bank, EON Bank, allows customers registered with the bank's online banking service to personalise their accounts by renaming the various products that are on offer, such as the current/savings account, fixed deposits, credit card and mortgage. They can even choose their own colour theme for their online banking pages.

Some banks create more products that they then try to offer to certain segments of their customer base. The bank, in effect, is personalising the service by offering different customers different products, but not actually

allowing the customer to dictate the features of the product.

With the introduction of Web 2.0 technology, which allows online users to interact with a website, there is the opportunity – and expectation – that customers can choose what they want. Angus Hislop, director of Finance Consulting Group, describes this new environment as 'next-generation web'. In a report for Cisco, he writes: "No longer content to consume passively what is offered to them, consumers wish to take an active part in the development of products and processes." He gives the example of an initiative offered by ING in India called Pickuradvisor, where customers get to choose their own financial adviser after reading the biographies.

Banks that do not adapt to this change in consumer behaviour are likely to lose customers. A survey by Gartner in July 2009 concluded that banks need to do more about account personalisation. The research found that younger customers in particular value customisation. "Customers want to personalise their experiences, analyse their transaction and payment data so they can better manage their money, pay bills and transfer funds. Banks want to sell customers more products. Banks that neglect personalisation trends now will sacrifice online – and possibly mobile – banking customers later," Stessa Cohen, research director at Gartner, commented at the time the report was released.

If accounts are personalised, banks are more likely to keep their customers engaged. On the question of whether it is profitable for banks to use personalisation technology, Kilmer comments: "Personalisation techniques in both employee- and customer-facing systems, given the risk management and marketing benefits, are profitable. Based on our experience with more than 6,500 financial institution clients globally, we believe it is a benefit to both the customer and the financial institution." ●

Questioning the vision of ING Direct

ING Direct led the growth of direct banking in the late 1990s, turning it into a mass-market business and challenging the status quo to become a major innovator. However, some industry analysts are questioning whether ING Direct's pioneering culture and distinct brand will suffer following ING Group's restructuring plan and management changes.

Instead of building or purchasing branch networks, ING Direct's success has been based on exporting its direct banking expertise from Postbank in the Netherlands. ING Direct had 22.2 million customers in nine countries by the end of 2008 – including the US, the UK, Germany and Australia. This was achieved by offering a limited range of financial products, with savings and mortgages at the core, primarily via direct channels such as the internet, telephone or mail.

ING Direct has built up significant barriers to entry because of its low-expense base and trusted brand. Its first full year of profit came in 2003 when it reported a pre-tax profit of €151 million (\$205 million) – which rose to €694 million (\$943 million) of pre-tax profit in 2006.

Nevertheless, the financial crisis has impacted ING Direct, and particularly its US operation. This resulted in an overall loss of €1.1 billion (\$1.5 billion) in 2008 after impairments of €1.8 billion (\$2.5 billion) had to be recognised due to accounting rules on asset-backed securities.

Speaking to *LRBI*, a senior ING insider says: "ING Direct suffered because of its US investments. Excess savings growth was ploughed into residential mortgage-backed securities. Nobody could have foreseen the uncertainty that arose in the market during 2008 and the lack of liquidity, which led to the prices dropping by 45 percent."

Under pressure to repay the Dutch state for its capital support during the crisis, as well as addressing the European

Commission's (EC) requirements for viability and fair competition, ING Group – which ING Direct is part of – announced in October 2009 that it is to separate its banking and insurance operations.

EC requirements mean that ING Group needs to divest all of its insurance and investment management operations. ING Group also needs to divest ING Direct USA by the end of 2013.

ING Group responded to the crisis by announcing a 'back to basics' strategy that involves integrating its banking operations. Subsequently, the group is bringing its traditional retail banking business and ING Direct together for closer collaboration. A spokeswoman for ING Group says: "While maintaining

"The novelty [of ING] has worn off and it is not remarkable anymore"

**Adrian Tschoegl,
The Wharton School of the
University of Pennsylvania**

their status as individual businesses, this structure will allow them to increase co-operation and take full advantage of each other's strengths and expertise."

LRBI understands that ING Direct will retain its name and branding as part of the convergence. However, the ING insider warns that ING Direct's culture of independence could be threatened by being part of a larger retail banking entity.

At an operational level, the ING insider explains that best practice in areas such as marketing will be shared more between ING Group's retail bank business and countries where ING Direct is based. "They say they are not going to be merging retail banking operations, but there will be closer co-operation and at head office level," says the source. ●

Internal management changes have also altered the makeup of ING Direct. Former ING Direct CEO Dick Harryvan – credited with building ING Direct into the world's leading direct bank – retired on 1 January 2010. At the same time, Eli Leenaars took up the position of CEO of retail banking direct and international at ING, while Brunon Bartkiewicz, who headed ING Bank Slaski in Poland, took responsibility for ING Direct's businesses in Spain, France, Italy and the UK.

Carl Holsters, honorary chairman of the board of Bank van De Post – Banque de La Poste in Belgium, notes that negotiations with the EC will have absorbed a lot of the resources of ING Group's management, which may have diverted their focus.

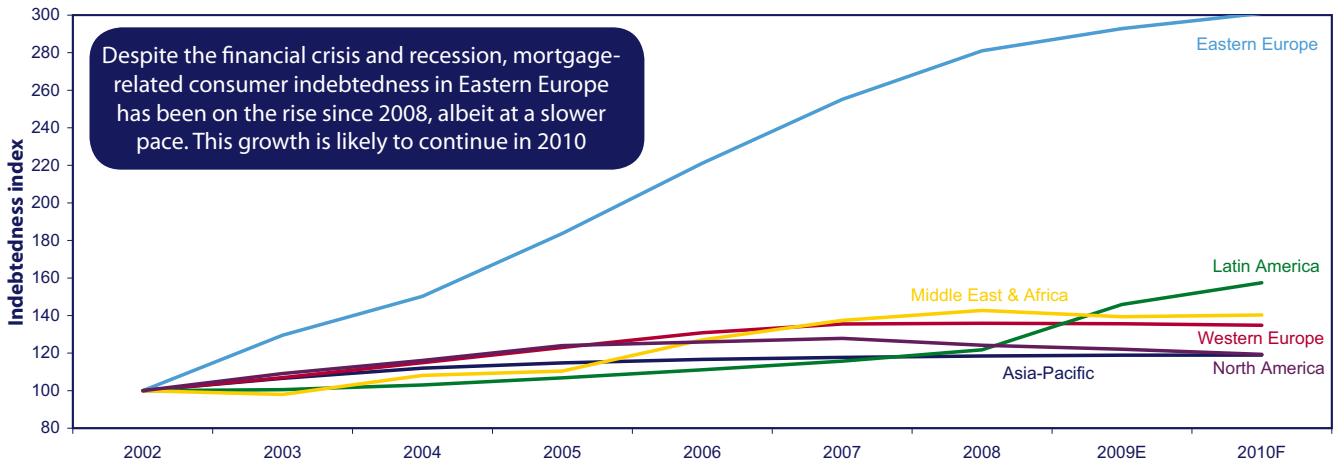
Adrian Tschoegl, a lecturer in management at the Wharton School of the University of Pennsylvania, also argues that ING Direct has gone from being "unique" to being "unusual" in recent years: "The novelty has worn off and it is not remarkable anymore." To recapture its reputation for innovation, Tschoegl says ING Direct should roll out initiatives, such as multi-currency accounts particularly for frequent travellers.

Hans Eysink Smeets, managing partner of Dutch-based Eysink Smeets Business Consultants, presents an alternative view, saying: "ING Direct is just plodding on focusing on structural changes, and under the circumstances it is doing pretty well. The issues of product or format innovation are not a top priority at the moment. In the current environment, nobody is interested in these things."

ING Direct benefits from the solidity and stability provided by being part of ING Group, and its success has always been based on simplicity and transparency. Whether its ambition for innovation and its distinct brand and culture will change following the restructuring process remains to be seen. ●

Databank: regional indebtedness levels

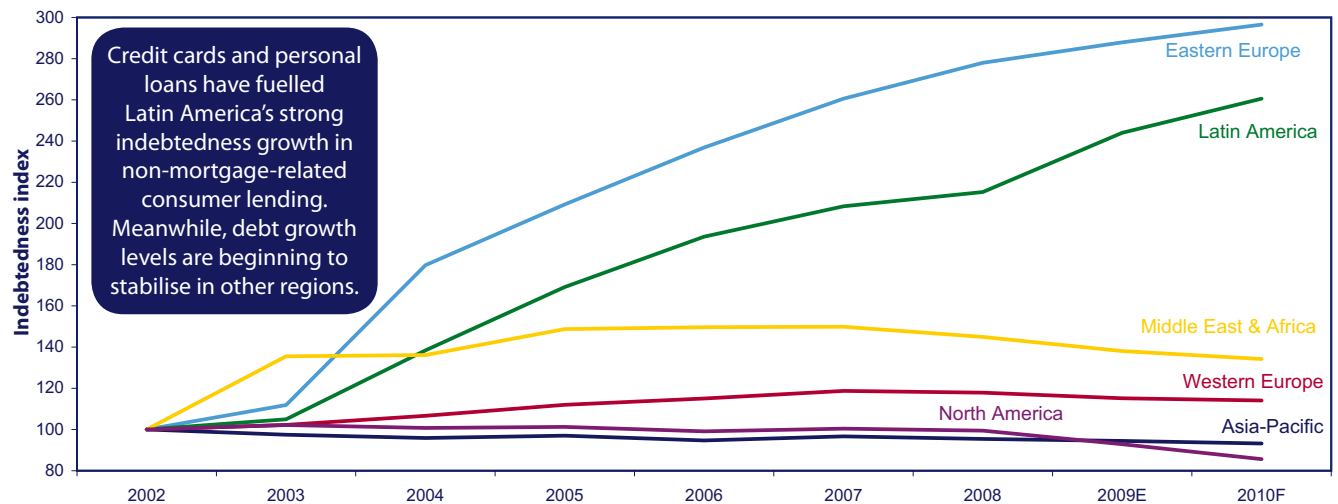
Global: mortgage-related consumer indebtedness indexed by region 2002-2010F



Note: index linked to 2002 = 100

Source: Lafferty Cards and Consumer Finance

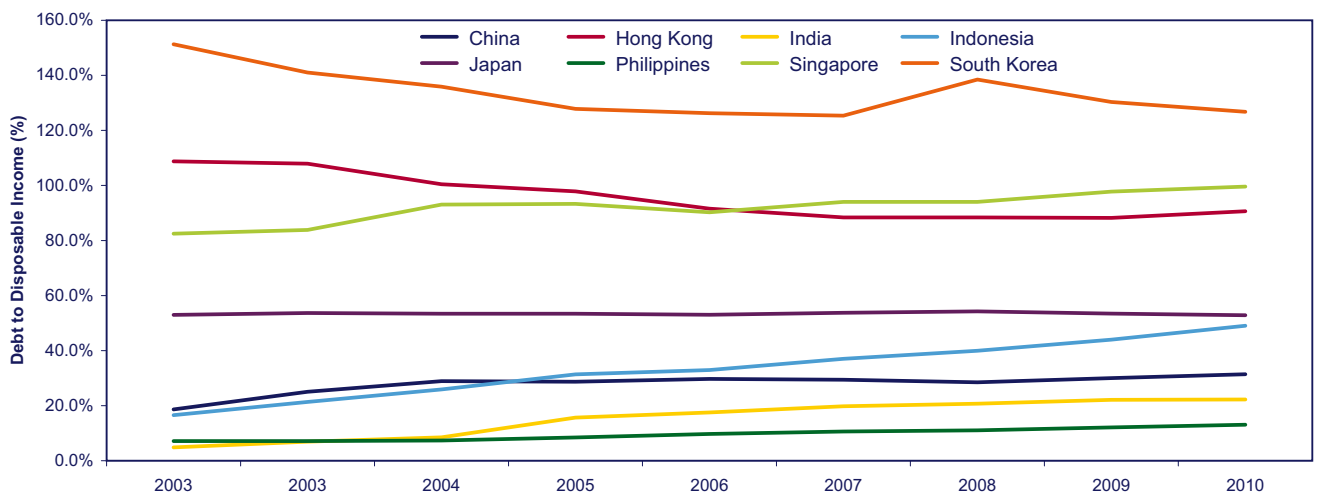
Global: non-mortgage-related consumer indebtedness indexed by region 2002-2010F



Note: index linked to 2002 = 100

Source: Lafferty Cards and Consumer Finance

Asia Pacific: debt to personal disposable income for selected countries



Lafferty World Cards Intelligence

Lafferty Global Retail Financial Services Summit - China 2010

Managing Towards a Consumer Economy

24 - 25 March 2010 | Beijing, China

There lies a sleeping dragon. Let him sleep, for when he awakens, he will shake the world

Whilst the definitions may vary from communism to socialism with 'Chinese characteristics', nothing changes the fact that when it comes to modern-day global banking, China is the biggest and most spectacular story in town. In a relatively short period of time, a country perceived as an economic backwater for most of the 20th century has now emerged as an economic powerhouse and leading global player. Some aspects of its rise - massive investments in infrastructure projects, industrialisation, and export led manufacturing growth - mirror previous Asian stellar economies, but its potential domestic market adds an unparalleled dimension.

Lafferty is drawing on its unparalleled global experience in the field of retail banking and cards to bring together expertise from around the world to the first Lafferty Global Retail Financial Services Summit for China from 24 - 25 March 2010. The event will be held at the prestigious China World Hotel in Beijing. The event signifies the launch of Lafferty in China and establishes a number of pragmatic work streams in 'Managing Towards a Consumer Economy'; including Cards (Prepaid), Microfinance, Auto Finance and Mobile Payments.

Key themes:

Stimulating consumer demand

Creating a responsible, sustainable banking industry
The role of consumer lending in the modern economy
Mastering the challenges in today's environment
Strategies for surviving and thriving in turbulent times

Working with the regulators

Regulatory strategies in action
Learning from the Japanese experience
Regulatory strategies in action
A Greenfield experience
A European player in the China market
Cooperation is the name of the game

Controlling risk in a buoyant economy

Responsible practices in a controlled environment
Choosing the right customers
Learning from global experience
Avoiding boom and bust

The future is the consumer - the way ahead

ICICI is a believer
China Merchants Bank is an innovator
Cetelem/Societe Generale has a vision
Managing the biggest retail company in the world: Lessons from China Mobile
Relationship banking is the future

Who should attend?

CEOs/MDs
Heads of distribution
Heads of retail banking
Heads of retail strategy
Heads of IT
Heads of cards
Heads of marketing

Regulators
Heads of consumer banking
Heads of product development
Heads of channel management
Heads of strategic planning
Heads of consumer lending
Heads of business development

Heads of mobile banking
Heads of sales
Consultancy firms
Heads of debit
Technology partners

For further details about Lafferty Global Retail Financial Services Summit China 2010, please contact:

China Office: Marc Howells on +86 138 1191 6443 or marc.howells@lafferty.com

London Office: Matthew George on +44 (0)20 3008 4649 or matthew.george@lafferty.com