

Banking Systems

second edition



CENTER FOR FINANCIAL TRAINING

Banking Systems

second edition



Center for Financial Training



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Banking Systems, 2nd Edition
Center for Financial Training

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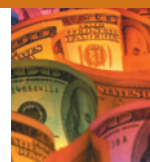
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ABOUT CFT

Center for Financial Training (CFT) is a network of more than 25 centers throughout the country that provide career-enhancing training solutions to the financial services industry. Through innovative

educational formats, CFT is the training partner for financial institutions that helps improve performance to meet the needs of tomorrow's challenging business environment.

INSIDE THE STUDENT EDITION

CLIMBING THE LADDER

explores careers in banking.

climbing the ladder

From Web Content Consultant to Documentation Manager

While his children slept on the flight bringing them home from a hectic week at a Florida amusement park, Reza reflected on his career. After college, he had accepted a position at a diversified financial institution. Working as a web marketing consultant for the annuity and mutual funds division, he was responsible for developing and executing online marketing initiatives. Reza supported multiple products that were advertised on a variety of websites. He developed web content and designed site layouts. Ensuring that the written and visual elements complemented each other and functioned smoothly were a critical part of this position.

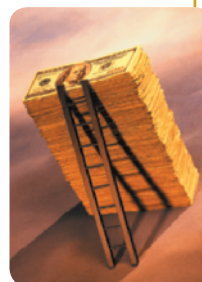
Reza had realized that job security could be improved by having a broad base of experiences developed by working in a variety of areas. An expanded personal network was another advantage of multiple positions.

Next Reza had accepted a job as an implementation technical consultant in the credit card division. Reza was responsible for assessing data technology needs, file specifications, and delivery methods. He streamlined processes and met with internal customers to determine electronic reporting formats for products.

Realizing that he wanted to move higher in the organization, Reza routinely reviewed internal job postings for supervisory positions. He had been delighted to pass the rigorous interview process for a job as a business technology supervisor in his company's trust division. In this role, Reza was responsible for application systems analysis and programming activities. After leading teams to conduct feasibility studies and time and cost estimates, Reza assigned members of his group to complete various components of the projects.

Reza's stellar reputation as an effective supervisor had led to a job offer as a network security manager. His team was responsible for developing systems and procedures that protected host and network systems from unauthorized access. He managed the creation of firewall security standards and intrusion detection procedures. The team perpetually evaluated the information technology (IT) infrastructure to identify new areas of risk.

After the birth of his twins, Reza had decided to scale back on his hours at the office. By working in his current position as an online training documentation manager, Reza was able to work from home three days a week. The flexibility in his schedule helped him and his wife manage childcare needs. In this position, Reza is responsible for overseeing the content development of online training courses, updating existing online courses, and writing and maintaining operational procedures.



Upper Rungs to Consider

Now that his children were older, Reza realized it was time to find a challenging onsite position. Management positions that Reza planned to look for included technology integration, IT project management, and network operations.

Preparing for the Climb

Over the course of a long career, are there ways to occasionally scale back to handle temporarily demanding life needs? What is the best way to stay involved in your field to make it easy to reenter the field?

PHOTO: iStock

GOALS

outline the main objectives of the lesson.

TERMS

lists the new terms defined in the lesson.

9.4

goals

- + Identify the root causes of the 2008 financial crisis.
- + Discuss self-regulation and its effects.

terms

- + risk averse
- + risk preferer
- + credit default swap (CDS)
- + speculation
- + synthetic financial product

The 2008 Financial Crisis

Banking Scene

Gloria Velez has had a successful few years running her own business. She has some extra money she'd like to invest. Although traditional investments, like CDs, are comforting to consider because of the low risk and guaranteed interest rate, she'd prefer to make more money faster. Gloria's heard about a great way to make money with credit default swaps. Although they sound lucrative, she's a little concerned about the uncertainty associated with them. What factors should she consider before making this investment?

THE PROFIT MOTIVE

Most people are interested in making money. Some people rely on traditional ways to produce income, which include working for a corporation, directly selling products or services to individuals or companies, or through making investments. If someone is risk averse, he or she would

BANKING SCENE

provides a motivating introduction to the lesson.

SPECIAL FEATURES ENHANCE LEARNING



flat world...

The International Impact of the Mortgage Crisis

Just as a stone thrown in a pond makes a ripple effect throughout the water, the U.S. mortgage crisis has sent shockwaves through financial systems across the globe. In April 2008, the International Monetary Fund (IMF) estimated that the U.S. subprime mortgage crisis could cause global losses of about \$1 trillion. The euro zone is the second largest economy in the world. In June 2008, the euro zone experienced an inflation rate of 4 percent. The central bank of the euro zone had targeted inflation to be about 2 percent. By July 2008, European banks with investments in securities backed by U.S. mortgages suffered losses.

There was a tightening of European lending and a rise in European interest rates as a result of these losses. Countries that exported products to the U.S. received fewer orders because U.S. consumers had less money available to spend on nonessential items.

Think Critically Investigate current ramifications of the mortgage crisis online. In this age of global financial interdependence, what steps can individual economies take to shield themselves from financial exposure due to investments in other countries?

FLAT WORLD provides international banking connections relevant to today's current events.

tech talk



TECH TALK

provides information about new technology that is being used in banking.

Fannie Mae DU and Freddie Mac LP

As underwriting of mortgage loans becomes increasingly automated, government-chartered agencies that work with private lenders have developed tools for their lending clients. Fannie Mae's Desktop Underwriter (DU) and Freddie Mac's Loan Prospector (LP) are two automated systems that are helping streamline the underwriting communications between agencies and the client lenders.

The desktop programs are based on statistical models of FHA underwriting data to create an automated scoring system specifically designed with FHA criteria in mind. As a result, these customized automated underwriting systems streamline the often cumbersome process of working through the agencies and the FHA. The systems are FHA approved and can return a routine underwriting decision and conditions within an hour. Lenders enter data from their own sites, using a standard Residential Loan Application. Although they are not the only ways to get FHA approval for Fannie Mae and Freddie Mac funds, these two software programs are the wave of an interconnected future in underwriting.

Think Critically What type of information had to be factored into the DU and LP programs in order for them to be reliable? What are some elements of the underwriting process that make it difficult to automate?



Ethics in Action

According to reports throughout the media, Senator Chris Dodd, Chairman of the Senate Banking Committee in 2008, received interest rate reductions on two of his mortgages held by Countrywide. One rate reduction resulted in an annual interest savings of \$2000. The other rate reduction resulted in a \$17,000 reduction over the life of the loan. In June 2008, Senator Dodd indicated he had solicited multiple rate quotes from lenders and was unaware of any special treatment.

Think Critically

What extra precautions are required of a politician during financial transactions? What probing questions would be wise to ask to avoid the appearance of favoritism?

ETHICS IN ACTION

provides a real-world situation where students decide an ethical action.



branching out

Aisling

Banks have had branches in nontraditional locations, like grocery stores, for well over a decade. In addition to providing convenience to customers, these branches need to work to stay prominent in customers' minds. A variety of creative marketing approaches have been used by personnel at nontraditional branches. At one Ohio bank, tellers take to the supermarket aisles to interact with customers. By telling customers that they can receive \$100,000 if they can identify the name of the bank

located in the store, customers are prompted to recall the bank's name. If they correctly identify the name of the bank, the teller then gives them a \$100,000 candy bar. Undoubtedly, receiving the candy sweetens their experience!

Think Critically How would you react if your grocery shopping experience included an individualized marketing effort by a bank? Do you think this is an effective way to engage customers?

BRANCHING OUT

presents interesting and unique ways bank and companies provide banking services.

skills that pay dividends

Understanding Consumer Motives

People have a variety of reasons for buying products and services. Some of these reasons are based on thoughts and some are based on feelings.

Banking is a basic need in modern society. Intellectually, most people understand that they need a bank to deposit a paycheck, to hold their funds, to provide various checking and savings accounts, and to provide ATM services. How a bank is chosen depends on the personality and values of the customer.

An analytical customer may do a lot of research to compare products, service levels, and costs among competing banks. If an analytical customer values cost effectiveness and efficiency, they may select the bank that provides the best combination of both. This analytical customer takes a detached, objective approach to decision making.

Some customers take a more emotional approach when choosing a bank. A customer who either lived through the depression or who is worried about the lasting impact of the 2008 credit crisis may place a high premium on the security of their funds. This customer may gravitate to a bank with personnel that convey a strong sense of financial knowledge and financial responsibility. During banking transactions, this customer may often seek reassurance that their funds are safe.

A customer with a strong need either to feel like part of a community or to do business with people they know socially may place a higher premium on banking where one can develop strong personal relationships. This customer may not thoroughly comparison shop and may select, instead, to choose a bank where they feel they can trust the people they know.

When interacting with customers regarding product or service selection, ask them to rank what is most important to them in their selection process. Their answers will reveal whether they are more analytical, emotional, or a combination of both. Using their responses to frame your discussion, emphasize the qualities of your products or services that are most important to them. For example, efficiency- and value-driven customers might be influenced to buy from you if they hear about all of the free online services offered by your bank. Socially oriented customers might like to hear about outings to pro baseball games sponsored by your bank.

Customers make post-purchase evaluations. Followup with customers after a purchase to see if there's anything you can do to improve their satisfaction.



Develop Your Skill

In small groups, assign the role of an analytical customer and a social customer to group members. Assign the role of a bank representative, focusing on specific bank products, like a checking account or a CD, to other group members. The bank representatives should try to sell each type of customer their product by first asking the customer to list their decision priorities and then by framing the discussion around those priorities. Reflect on how the approaches and conversations are different based on the personality type of the customer. Be prepared to share your findings with the class.

SKILLS THAT PAY DIVIDENDS

presents skills that are necessary for success in the banking industry.

SPECIAL FEATURES ENHANCE LEARNING

NET BOOKMARK

incorporates Internet activities into every chapter.

NETBookmark

All across America, families are being touched by the mortgage crisis. Access www.cengage.com/school/pfinance/banking and click on the link for Chapter 8. The Hope Now Alliance is an alliance of mortgage-related industries and service providers that is focused on keeping homeowners in their homes. The Treasury Department and HUD supported the formation of this alliance to help stabilize the mortgage market. Use the site to learn more about FHASecure and Project Lifeline. How can these programs help troubled homeowners?

www.cengage.com/school/pfinance/banking

Banking Math Connection

Private mortgage insurance (PMI) rates may vary, but a typical PMI rate is $\frac{1}{2}$ of 1 percent of the borrowed principal. The formula for calculating the monthly PMI cost is

$$\text{Rate} \times \text{Principal} \div 12 = \text{PMI}$$

Calculate the monthly PMI cost for a principal balance of \$140,000.

Solution

If PMI were required for a principal of \$140,000, the calculation would be

$$\begin{aligned}\text{Rate} \times \text{Principal} \div 12 &= \text{PMI} \\ 0.005 \times \$140,000 \div 12 &= \$58.34\end{aligned}$$



BANKING MATH CONNECTION

provides worked examples that reinforce and review math concepts.

interesting facts

NeighborWorks America was founded by Congress during the 1970s to support community-based revitalization. Their Home Ownership Centers provide mortgage assistance to underserved buyers. ■

INTERESTING FACTS

provides an interesting fact about the topic.

COMMUNICATE

provides activities to reinforce, review, and practice communication skills

“communicate”

Interview someone who experienced either the Great Depression firsthand or a recent FDIC takeover of a financial institution. Find out ways that people coped with the economic crisis. Write a short report on what you learn and what your interviewee thinks should be learned from bank failures.

ONGOING ASSESSMENT

✓ checkpoint

List five loan products that were developed to support loosened loan qualification standards.

CHECKPOINT

Short questions within lesson to assist with reading and to assure students are grasping concepts.

assessment 8.5

Think Critically

1. What motivated lenders to shift from funding mortgage loans from locally held deposits to funding mortgages with Wall Street financing?
2. Strong relationships within a community help bankers increase their customer base. How would ongoing, personal relationships with customers impact a bank's decision regarding qualifying customers for appropriate loans?
3. Review the description of a AAA bond rating online. What do you think is an appropriate rating for a subprime mortgage-backed security?
4. Look for SIVA, SISA, NINA, or No Income, No Asset, No Employment loans online. Are they still available? List reasons explaining their current level of availability.

Make Academic Connections

5. **COMMUNICATION** The Humane Society, recognizing that the mortgage crisis is preventing people from keeping their pets, has instituted a grant program to help agencies reach out to pet owners with ideas for keeping their pets. These pets are suffering downstream effects of the mortgage crisis. What other parts of society, either living entities or businesses, are being affected by the crisis? Prepare a chart describing the affected entities and how they are affected. Share the chart with the class.
6. **THE RIGHT DECISION** During July 2008, the *Cleveland Plain Dealer* featured three local lending institutions that were in solid financial condition despite the mortgage lending crisis. They shared a common trait of maintaining conservative lending standards. The names of these banks are Valley Savings, First Federal of Lakewood, and Third Federal Savings. Research these banks online to see how they are doing today. How do you think their conservative approaches affected their longevity?

CHAPTER ASSESSMENT Contains Chapter Summary, Vocabulary Builder, Review Concepts, Apply What You Learned, and Make Connections

chapter 8 assessment

Chapter Summary

8.1 Mortgage Lending

- A. A mortgage is a note secured by real property.
- B. Mortgage lenders provide many types of loan products for buying a home.

8.2 Mortgage Loan Processing

- A. Monthly mortgage payments to lenders usually consist of principal, interest, taxes, and insurance (PITI).
- B. Six steps in the mortgage approval process are application, documentation, underwriting, drawing documents, closing, and recording.

8.3 Mortgages and the Law

- A. Consumer protection legislation applies to mortgage lending as well as other loans.
- B. Lenders must comply with numerous housing-specific laws.

8.4 Government-Backed Loans

- A. The government backs some loans by guaranteeing to repay the lender if the borrower defaults.
- B. Mortgage programs like FHA loans, VA loans, and others make loans possible to people who might not otherwise qualify.

8.5 The Mortgage Crisis

- A. Historically, mortgages were a sound, safe investment because they provided a reliable, steady income stream.
- B. The mortgage crisis was caused by a combination of factors including an increased demand for mortgage-backed securities, lowered lending criteria, and bond ratings that were issued without due diligence.

Vocabulary Builder

Choose the term that best fits the definition. Write the letter of the answer in the space provided. Some terms may not be used.

1. Value of loan compared to value of asset
2. Prepaying part of the interest to get a lower mortgage rate
3. When banks refuse to lend in certain neighborhoods
4. Mortgage with changing interest rate
5. A note secured by real property
6. A value equal to 1 percent of loan principal
7. A mortgage in which the entire remaining balance of the loan is due in one single payment
8. Principal, interest, taxes, and insurance
9. Conventional mortgage
10. When the amount owed on a home is more than the current value of the home

- a. adjustable rate mortgage
- b. balloon mortgage
- c. buy-down mortgage
- d. escrow
- e. Fannie Mae
- f. fixed rate mortgage
- g. foreclosure
- h. Freddie Mac
- i. Ginnie Mae
- j. loan-to-value (LTV)
- k. mortgage
- l. mortgage-backed securities
- m. mortgage origination
- n. negative equity
- o. PITI
- p. point
- q. redlining
- r. shared appreciation mortgage (SAM)

Review Concepts

11. What is a mortgage?

12. What is a foreclosure?

Apply What You Learned

25. Under traditional circumstances, why does obtaining a mortgage initiate the most thorough credit review most consumers will ever undergo?

26. What factors does a lender judge in order to assess consumer capability?

Make Academic Connections

29. **BANKING MATH** Calculate the PMI (private mortgage insurance) for a principal balance of \$125,500. Assume the PMI rate is $\frac{1}{2}$ of 1 percent of the borrowed principal.

30. **TECHNOLOGY** Use the Internet to learn more about the impact of technology on the real estate and mortgage industries. Prepare an oral report on what you learn.