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Thank you and goodbye – ending customer relationships and its significance

DAVID LIM

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DAVID LIM | Senior Consultant, Capco

ABSTRACT

In today's world of increased regulation, scrutiny, and cost cutting, financial institutions are under pressure to ensure their client portfolios have the appropriate level of risk and return. Financial services firms need to be clear on their client selection and exit management strategies to drive revenue growth through new and existing relationships, whilst in parallel, ensuring risky and uneconomical clients are managed accordingly.

Managing risky or uneconomical clients is a challenge that many institutions face, and most are fully cognizant of just how reputationally damaging it can be when not done in the most client sensitive way.

Why would or should client relationships be terminated in the first place? What benefit can these organizations gain from ending relationships with their clients? How can this be done in a sensitive way?

This article looks at key considerations for financial institutions and the challenge of terminating relationships with existing clients. Moreover, it explains why ending relationships with existing clients should be an important part of an organization's agenda and how they can position themselves to do this in a sensitive and sensible manner. The article additionally explores how terminating relationships can best be done to reduce the reputational risks presented to them.

1. INTRODUCTION

In today's world of increased regulation, scrutiny, and higher operational costs, financial institutions are under pressure to ensure that their client selection and exit management strategies help drive revenue through developing new businesses, onboarding, and building strong relationships with customers, while at the same ensuring risky and uneconomical clients are managed accordingly.

This is not an easy task, as informing clients that their business is no longer wanted is often met with confusion, frustration, and resentment. Clients are more likely to understand and accept when a financial institution refuses to on-board them as a client, but are less forgiving if, after years of what they feel is valuable business, they are told that their business and relationship is no longer wanted.

This is a challenge that many institutions face, and most are fully cognizant of just how reputationally damaging it can be when not done in the most client sensitive way.

Why would or should client relationships be terminated in the first place? What benefit can these organizations gain from ending relationships with their clients? And, how can this be done in a sensitive way?

This article will look at the key considerations for organizations and the challenge of terminating relationships with existing clients. Moreover, it explains why ending relationships with existing clients should be an integral part of an organization's agenda and how they can position themselves to do this in a sensitive and sensible manner. The article further explores how terminating relationships can be done in such a way so as to minimize the reputational risks associated with such a decision.

2. WHAT IS CLIENT SELECTION AND EXIT MANAGEMENT?

Client selection is the strategy and approach that defines which clients a firm should engage with (on-board or build new relationships with), retain (continue to develop relationships with existing customers), or exit (ending the relationship with the existing client) based on a risk assessment of the client against the firm's risk appetite range or profitability criteria. Client size, the products the institution has, location, credit rating, and risk rating, are just some of the key aspects that should be incorporated with an organization's client selection strategy.

Client "exit management" is the governance and execution of off boarding clients. As part of this process, financial institutions must ensure that all accounts, products, services, and ultimately, relationship, associated with the client is closed once the client has been communicated to and a timeframe has been agreed.

Financial institutions may choose to "exit" or end a client relationship due to many reasons; anti-money laundering (AML), fraud, anti-bribery, corruption, sanctions exposure, reputational risk, non-profitability, and so on. To support this, financial institutions must have a suitable client selection and exit management framework.

3. WHY ARE CLIENT SELECTION AND EXIT MANAGEMENT IMPORTANT?

As financial institutions continue to grow, so does their client portfolio. With this increase, financial institutions must ensure relationships with clients are well managed to drive revenue and growth. Clients that do not generate enough business to cover their respective overheads impact the organization's bottom line. Financial institutions must consider how these unprofitable clients should be managed.

From a commercial perspective, establishing a solid client selection and exit management framework allows financial institutions to:

- Focus on expanding and building stronger relationships, product offerings, and commercial value with their profitable clients, by reducing the proportion of non-profitable clients.
- Reduce the cost of ongoing maintenance, remediation, and renewal exercises required to meet organizational and regulatory standards.
- Prioritize new clients and businesses that are better aligned to their risk range or profitability criteria. This is of paramount importance due to the ongoing cost of onboarding. A study conducted by Forrester Consulting, which measures the time, costs, and challenges involved in on-boarding institutional clients estimates that on-boarding can cost as much as U.S.$25,000 per client, with the average cost calculated at U.S.$6,000.[1] While U.S.$6,000 per new institutional client may not appear to be significant, when applied across different regions and locations

[1] http://bit.ly/2wgseuM

Table 1: Fines paid by major financial institutions in 2017.

FINANCIAL INSTITUTION	PENALTY	2017	REASONS
Credit Suisse	SGD$0.7 mln	May	The Monitory Authority of Singapore (MAS) imposed financial penalties for breaches of MAS Notice 626 – Prevention of Money Laundering and Countering the Financing of Terrorism.
United Overseas Bank	SGD$0.9 mln	May	
Citi Group	U.S.$97 mln	May	Willfully failing to file SARs
Bank of Ireland	€3.15 mln	May	Persistent breaches of Irish anti-money laundering and combating the financing of terrorism regulations.
Coutts & Co (Hong Kong branch)	HK$7mln	Apr	Breaching AML and terror finance laws.
Allied Irish Banks	€2.3 mln	Apr	Suspicious activity reports (SARs) and client due diligence (CDD) failings
Deutsche Bank	£163 mln	Jan	Serious AML failings
Deutsche Bank	$425 mln	Jan	Serious AML failings

it can become a very large figure indeed.

As Renato Ndokaj stated in his three-part blog on financial crime,[2] increased regulation aimed at tackling financial crime, including, but not limited to, AML, fraud, anti-bribery, and corruption, means that financial institutions must have greater visibility, ownership, and accountability of the risks held within their portfolio.

Financial institutions are continually adapting to these convoluted banking regulations, while at the same time trying to meet commercial pressures. A survey by Thomson Reuters, focusing on the cost and complexity of implementing Know Your Customer (KYC), found that financial institutions spend an average of U.S.$60 million to meet their KYC and Customer Due Diligence (CDD) compliance requirements, with some spending as much as U.S.$500 million.[3]

Institutions that can establish a strong client selection and exit management framework can reduce the costs, which can become quite steep, associated with clients that present financial crime risk or reputation risk to the firm. For example, In January 2017, Deutsche Bank was fined £163 GBP million by the U.K.'s Financial Conduct Authority (FCA) and U.S.$425 million by U.S. regulators over alleged trading schemes with Russia that operated from 2011 until early 2015 and resulted in laundering U.S.$10 billion out of Russia.[4] Whilst this fine was the largest financial penalty the FCA, and its predecessor FSA, has handed out for AML controls failings, Deutsche Bank are not alone. Financial institutions across the globe paid fines ranging from U.S.$500k to U.S.$500 million in 2017. Table 1 presents some of the fines paid by major global financial institutions.

4. THE GOAL

Client selection and exit management will vary from institution to institution, however, the end goal will typically be the same. Financial institutions should seek to develop relationships with clients that are low in cost and high in returns. Those who are deemed too costly (from both a monetary or non-monetary perspective) or have too low returns to retain the relationship should be considered for exit. Figure 1 presents the client management matrix that financial institutions need to consider.

Clients that are both low in cost and low in return and those who are high cost and high return would need further discussion and consideration before an exit decision should be made. Factors to consider include:

- Is further business expected in future?
- Is the client aware of the account (for accounts with

[2] http://bit.ly/2uTmqbc; http://bit.ly/2w0CjwJ; http://bit.ly/2tUjXfe
[3] http://tmsnrt.rs/2qm0thC
[4] http://on.ft.com/2jPJ65U

no transactions or revenue)?

- What would the impact of exiting the client in one location have with the overall relationship footprint?

Firms should articulate why the relationship should be retained and determine whether the benefits outweigh the costs.

Depending on the size of the organization, financial institutions need to decide whether to use a systematic or a manual process to determine whether a given client should be exited.

A systematic process that makes decisions based purely on commercial value may result in a near term increase in efficiency and cost savings, but it may also lead to reputational damage, which in turn could translate into long-term revenue losses. Given today's highly interconnected world, with online reviews as important in the eyes of many as the views of experts, an avalanche of complaints from unhappy long-term clients is not in the best interest of the organization.

In contrast, a highly manual and thorough review process for each exit case may put additional resource and cost constraints on the organization, and may offset

Figure 1: The client management matrix

		COST	
		LOW	HIGH
RETURN	LOW	Decision to be made	Exit
	HIGH	Retain	Decision to be made

Costs include monetary and non-monetary

any expected financial gains.

Consequently, to terminate the accounts of non-profitable clients, financial institutions need to institute a systematic process that considers multiple factors, and not base its decision solely on financial inputs. They also need to ensure that there are sufficient controls and governance in place to allow for appeals and exceptions.

Due to its sensitive nature, potential exit cases related to financial crime or risk appetite should be put through a thorough review and discussion process. The risk of

falsely exiting a client relationship due to suspected financial crime is too high and could outweigh the benefits.

5. STAGES OF CLIENT SELECTION AND EXIT MANAGEMENT

To confirm clients are assessed, selected, and fully exited within a prescribed timeframe or framework, financial institutions must ensure they have sufficient controls and frameworks in place. At a minimum, a framework must be established and implemented to allow for the various stages or phases of an exit.

Table 2 outlines the fundamental stages required for client exits and the key considerations organizations must consider.

6. ESTABLISHING A SUITABLE FRAMEWORK

Both external and internal variables have a significant factor in determining the client selection and exit management strategy. There are, however, some fundamental steps that most financial institutions can or should adopt. This includes, but should not be limited to: goal and objectives, analysis and design, target and interim solution, implementation, and the transition to business as usual. Table 3 provides some consideration for each step.

Whilst frameworks can be used to address most cases, there will inevitably be scenarios that would not be covered. One example of this could be dividend accounts. Could a client account whose balance relates to dividend issued to shareholders be closed? The ultimate beneficiary owner to these funds are the underlying shareholders, not the client. Another example could be lack of client information, where no address or point of contact can be established, or they are out of date, but funds remain on the account. How and where would these funds be remitted to? Where would the relationship termination be sent to? When such events occur, these would need to be dealt with on a case by case basis. Appropriate follow ups and resolutions should be documented, as should the procedures.

Table 2: Fundamental stages required for client exits

STAGE OR PHASE OF EXIT	KEY CONSIDERATIONS	CONSIDERATION ACROSS ALL STAGES
Trigger/notification of potential client exit cases	• Identification of trigger sources • Systematic versus manual? • Do all stakeholders know how to notify potential client exits and to whom?	• How is information on terms of reference, procedures, policies, and framework shared or made available? • Who is notified or involved and at what phase and why? These include regulatory, compliance, relationship managers, financial crime, and banking or business heads. • Are there clear roles and responsibilities across different business areas and teams? • What is the governance and oversite model? Does something exist in each country of operation? • What is the exceptions management process? • Is there an end-to-end service level agreement across all stakeholders?
Building the information or case for discussion and decision-making	• Where are information sourced from? • How is information identified and shared across different business areas, such as retail banking, banking, securities? • Information assurance process?	
Decision-making and governance	• Approach – systematically or manual? • Governance – frequency and attendees? • How are client exits categorized? • Who's responsible for deciding and what's the escalation process when there is conflict?	
Execution on confirmed exit cases and reporting management information (MI)	• How does communication work (internal and external)? • Exit execution assurance process? • Escalation framework for breach in exit? • What level of MI can be produced?	

Table 3: Important steps for client exiting

OBJECTIVE/GOAL	ANALYSIS/DESIGN	SOLUTION/FRAMEWORK	IMPLEMENTATION/ EMBEDDING	BUSINESS AS USUAL
Scope • Retail banking/ institutional clients? Both? • Country, regional, or global? Approach • Regional teams? • Commitment from? • Governance committee? KPI and success criteria • What does success look like? • Increased profitability from clients? • Reduced operational costs?	Organization structure and operating model • Client footprint? • How are clients supported? Current practices • Process documents versus actual process adopted? • Technologies supporting process? • Communication internally and externally? Internal & external risks/ issues • Regulatory issues? • Regional or country issues?	Target state, interim state, and minimum viable solution • Technology to be developed and those ready to be used? • Process updates and gaps exiting in country or region? • Resources and support • Exceptions framework and issue management	Stakeholder engagement • Which stakeholders to include at which phase of the engagement? Gaps current state versus interim/target state • What model will be adopted? Training and sign off • Which medium to use for training? "Go live" approach • Phased? • "Big bang"? Communication • How will process, policy, and procedure updates be communicated internally?	Governance and oversight • Frequency? • Attendees? • Terms of reference? Testing and continuity management • Test scope? • Frequency? Escalation and exceptions • Methodology and template? • Approval? Continuation and development • Change manage process?

Table 4: Potential internal challenges

THEMES	OVERVIEW
Legacy systems	Through mergers and acquisitions, over time, the systems acquired and developed by financial institutions have become so complex that maintaining them presents significant operational costs and upgrading these systems would require a substantial amount of investment that would impact a firm's entire operating model. A study from NTT DATA Consulting, for example, revealed that financial institutions spend an average of 75%– 80% of their systems budget on maintaining legacy core deposit banking systems.
Poor data quality	Constantly changing requirements from regulators, business models, and product and service offerings by financial institutions has led to further enhancements and data attributes adding to the already complex system architecture embedded in organizations. As such, there is still a heavy dependency on people within organizations to validate data. For example, without the suitable data repository or source, identification of a unique client across multiple locations and business lines can be a challenging task. Is client "ABC123 Limited" in Hong Kong the same as client "ABC123 Ltd"? Exiting the relationship with the wrong client will impact the client experience and, even more concerning, may hinder the settlement of trades and transactions. Any financial institution making such mistakes may face reputational damage as well as financial penalties.
Obligations and contractual agreements	Long-dated transactions that cannot be novated, for example, also presents problems for the exits process. While other accounts and services may be blocked or closed, unless the trade can be novated the financial institution must meet the agreement and will only be able to close the account once the trade matures.

7. KEY CHALLENGES

While a minimum standard can be prescribed at a high level, most organizations will face unique challenges relevant to them. Though some organizations may have vigorous controls and may have some competitive advantages, the complex structure and nature of big financial institutions today means that there are inherent issues that may hinder the design, implementation, and running of a robust client selection and exit management framework.

Table 4 provides an overview of some of the internal challenges faced by organizations.

In addition to internal organizational challenges, financial institution also faces external challenges, such as local banking regulations that may impact their client selection and exit management strategy. In Malaysia, for example, clause 133 (1) of the Financial Service Act (FSA) 2013, stipulates that "133. (1) No person who has access to any document or information relating to the affairs or account of any customer of a financial institution, including the financial institution or any person who is or has been a director, officer, or agent of the financial institution, shall disclose to another person any document or information relating to the affairs or account of any customer of the financial institution"[5].

Depending on the scope or framework, this may present difficulty for organizations when implementing a global client selection and exit management model. If information cannot be shared on the client due to local regulations, would AML and sanctions be detected? If local exit decision was made, how would this be communicated and what impact would this have on the client relationship with other countries or regions?

8. COMMUNICATION

Prior to, during, and post exit decision communication is fundamental to any client selection and exit management strategy. This is the most important part of the process, since it ensures that the all the people who need to be informed internally are, and the message is clear and uniform across all departments when communicating with the clients whose accounts have been, or is about to be, terminated.

Internal communication, whether it is the relationship manager providing the client information to support or reject an exit decision, or the back office operation team closing the accounts, is crucial to ensure exits are appropriately managed. Internal communication should include, but is not limited to, KYC, AML, relationship managers, product owners, compliance, legal, and operations.

External communication is equally, if not more important than internal communication. Clients that have been confirmed as exit or to be exited, should be notified in an appropriate manner with clear explanation and rationale provided. As part of the discussion or notification clients must be given sufficient timeframe to make alternative arrangements. This may be through the form of a meeting, informal conversation, email, or a combination of the three. Formal communication and follow up, through a letter for example, should also be provided. These may be required for audit purposes, for example, and in such cases can be used by both parties.

9. CONCLUSION

Financial crime continues to be a key focal point for regulators and financial institutions alike. In addition to this, non-profitable clients continue to increase as organizations grow over time, adding unnecessary costs. Financial institutions need to provide sufficient investment into their client selection and exit management strategy to tackle these challenges.

Careful deliberation must be undertaken with regards to client selection and exit decision prior to the exit management. This article outlines the goal for organizations, key considerations, and the approach to client selection. However, financial institutions must choose an approach and framework that is fit for purpose for their organizations. Instituting an effective process and framework would enable financial institutions to better understand how new, or existing clients, align with their organization's profitability criteria and risk appetite.

As for the client exit management process itself, even with a developed strategy or framework, improved data quality, technological enhancements, and updated processes, human interaction is still a key dependency. To support any framework, all stakeholders must be engaged and understand their roles and responsibilities across the lifecycle of the client engagement. Communication plays a huge role in increasing or jeopardizing the success of a firm's client exit management approach.

The client selection and exit management landscape is still an evolving and challenging area. Failing to embed an efficient and robust strategy can negatively impact an organization (both monetarily and reputationally). Getting this right early on, however, will be very valuable. Financial institutions that can navigate through this landscape and gain competitive advantage will be able to reduce their exposure to high risk clients, mitigate their book of work (and therefore operational costs), and shift their focus to building better relationships with clients who better fit the organization's profitability criteria and risk appetite range.

[5] http://bit.ly/2w4XSfy

ABOUT CAPCO

Capco is a global technology and management consultancy dedicated to the financial services industry. Our professionals combine innovative thinking with unrivalled industry knowledge to offer our clients consulting expertise, complex technology and package integration, transformation delivery, and managed services, to move their organizations forward. Through our collaborative and efficient approach, we help our clients successfully innovate, increase revenue, manage risk and regulatory change, reduce costs, and enhance controls. We specialize primarily in banking, capital markets, wealth and investment management, and finance, risk & compliance. We also have an energy consulting practice. We serve our clients from offices in leading financial centers across the Americas, Europe, and Asia Pacific.

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