

# Einstein on Private Banking

## As simple as possible but not simpler

Front office processes in private banking are becoming increasingly complex. Regulations around cross-border sales, suitability and KYC (know your client) – to mention just a few – are among the reasons for this increase. In cross-border sales, for example, the bank must meet the regulatory requirements of multiple jurisdictions, including client domicile, advisor location and booking centre location. To remain competitive, or perhaps just to stay in business, private banks must come to grips with complexity.

According to cybernetics, the complexity of a system is measured by its variety, that is, the number of possible, distinguishable states the system can have. Let us apply this conception to the front office sales process and pre-sale suitability checking. For each sale, data from the product, the client profile and the client portfolio need to be combined and checked against the suitability criteria. The more details in products and client profile, the more possible combinations and the greater the variety.

Another source of complexity is the number of client contact points across multiple geographies, multiple channels, multiple products, and multiple lines of business. Increased contact points translate into more variety and render the coordination of the overall sales process more complex. Increased contact points also result in duplication between specialist sales forces; the more complex the client's portfolio, the more specialized the sales force must be.

For many years, private banks pursued business growth with little regard for the increase in complexity that accompanied it. Today, the combination of business variety and massive regulatory requirements forces banks to rethink their adopted strategies. How can they reduce complexity?

- Analysing the product portfolio: Analyse the lifecycle of each product and identify 'end-of-life' products (i.e. products that have been on the shelf for a long time, that have low transaction volume and that are held in very few client portfolios). These products add to the variety of the product catalogue, the bank needs resources to keep them alive, but they are no longer profitable. Periodic analysis of the product catalogue should identify these products. Then, they should be cleared (along with their related processes and systems).
- Restructuring the pricing approach: Review the complexity of the pricing setup and limit pricing options outside of the standardized pricing. Clean up existing special conditions as much as possible and move them into the new standard.
- Getting rid of clients with small portfolios: Redefine the minimum amount of assets for your private banking clients. Identify the accounts with holdings below the bank's limit. Keep those that have a connection to eligible accounts and eliminate the rest.

### **The cross-border challenge**

Mr. Wong, an entrepreneur from Shenzhen, likes to have an advisor based in Melbourne and requests his assets to be booked in Singapore. This combination of client domicile, advisor location and booking centre requires the bank to comply with the jurisdictions of China, Australia and Singapore. Complexity reduction is about filtering and selecting. The bank has to decide which jurisdictions it wants to work with. All banks must be compliant with global regulations, but they also need to be compliant with the regulations of the jurisdictions with which they interact.

The decision should be based on a balance between driving the business and staying compliant. Driving the business means focusing on those business areas where the core competencies of the bank enable 80% of revenue to be generated with 20% of effort. Such focus helps reduce the complexity to a controllable level.

On the technical side, complexity must be controlled by standardizing core functionality. Since the local nature of regulations challenges standard solutions, finding the greatest common functional denominator is essential. Another approach is balancing automation and manual tasks. It may be cheaper to deal manually with some specific cases than to set up an automated process.

### **Conclusion**

If the bank gives in to every request for doing business without concern for the impact on competencies, resources, processes and systems, cost explosion and dispersal will result. However, reducing the complexity of a system, or in our case an organization, might also destroy the system, its important characteristics and its capabilities. In the extreme case, the bank does business in one jurisdiction, sells one product and serves one client segment. In this scenario, complexity is greatly reduced, but so are the revenue streams.

This is where Einstein's warning comes to mind that 'things should be made as simple as possible but not simpler'. Simple systems do not have higher-order capabilities; if the environment is complex, the simple system cannot cope. In our case, if an organization lacks variety, it might not be capable of handling demanding clients, rich products, tough competition or multifarious markets. Hence, the challenge is to find the right balance between business drive and complexity reduction.