Client Selection for Regency Bank - Abridged

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In January 2010, Regency acquired from Continental Bank a portfolio of 2,000 clients, worth $80 million in annual revenues. Continental Bank offered primarily retail banking services and was a subsidiary of the large U.S.-based bank Continental Group, the third largest financial services firm in the states. This $64 million acquisition was the largest portfolio of corporate cards ever sold in Canada. Many analysts speculated that this deal had been undervalued as Continental Bank was exiting the Canadian market.

Previous to 2010, Regency offered corporate expense cards to its corporate clients, but the bank was not well known for this type of product. Although Regency hoped to recoup the costs of the acquisition within three years, one of the main objectives was to expand the bank's presence in this area and ultimately be the national leader in corporate cards.

Corporate cards were typically divided into two types: classic travel cards and professional cards. Classic travel cards were typically used by employees to expense any travel-related purchases such as flights, hotels and meals. Professional cards were more often used by the procurement and administrative divisions of firms for smaller, more frequent purchases such as office supplies and repeat orders of parts for manufacturing.

The professional card project was a pilot migration project for the larger travel cards portfolio to ensure that the travel cards would migrate smoothly. The professional card portfolio was worth almost $10 million in annual revenues at time of acquisition, while the travel card portfolio was worth $70 million.

Operational Considerations

Regency Bank expected to charge clients one per cent of total annual spend, plus a flat rate of $5,000. This was the bulk of the revenue that a client generated for the bank, although there were a few other services that could be provided, such as audit services. These services were typically billed separately, and so are not important for the migration decision.

The professional card portfolio acquired from Continental Bank contained 210 clients. However, Regency Bank neither expected nor desired to retain all these clients. It was suspected that not all cardholders were sufficiently profitable to keep on as clients, and there was also speculation that some clients were too risky, especially considering that, in terms of its risk strategy, Regency was quite conservative compared to the U.S.-based Continental Bank.

total

Regency Bank expected migration costs, including human resources, technology and administration, to total $500,000 of a fixed component, plus $2,000 per account. Ongoing annual operating costs were estimated at $200,000 plus $1,500 per account. The cost to total issue a card was estimated to be $45, and the annual cost to service a card was $40.

Clients could be divided into three levels of complexity in terms of reporting needs, card requests and amount of service required. Level 1 clients typically did not require any special attention and were expected to be satisfied with Regency's bank standard level of service (i.e., they were estimated to cost the bank $2,000 to migrate onto Regency's platform and $1,500 annually to operate).

Level 2 clients typically required the expanded reporting tools and were expected to need some additional guidance in account handling in order to remain satisfied with Regency Bank. Level 2 clients were expected to cost Regency Bank an additional $3,000 to migrate over ($5,000 total), and an additional $500 in annual service costs ($2,000 total).

Level 3 clients were those who were expected to require special reporting needs, card personalization and a high level of client interaction. Level 3 clients were expected to cost an additional $5,000 ($7,000 total) in up-front costs and $1,500 ($3,000 total) in annual service costs.

Because Continental Bank was based in the United States, while Regency was a Canadian bank, the two banks had different risk ratings as well differing risk appetites. Regency had a stronger security rating and would normally accept only those accounts with a maximum risk rating of 5; accounts that had a rating of 4 or below were preferred.

The main risk was that a corporate client would default on their card account, and this was measured by an annual likelihood (probability of default). The cost of a default was defined by the number of months of charges that eventually would be written off. These risks were different for each risk rating.

Rating	Risk of Default	Number of months
7	10%	6
6	5%	4
5	3%	3
4	2%	3
3	1%	3
2	0.5%	3
1	0.1%	3

10% car number

Regency bank estimated that there would be a natural attrition rate of 10 per cent of client accounts across all client levels on a per annum basis. Internal analysts predicted that annual spending and number of cards on each account would grow at a mean rate of eight per cent and 10 per cent per annum, respectively. Further analysis revealed that these growth numbers could fluctuate with a standard deviation of one per cent. s.d 1%

8% expense

Regency Bank will evaluate the migration based on a three-year payback, rather than a more detailed net present value calculation. In other words, the sum of all revenues over the first three years of operating the professional card portfolio should exceed the sum of all costs for the first three years. The bank is unsure about how limiting the number of clients migrated would affect the three-year payback.

There is an Excel file with a list of the 210 potential clients. For each there is a risk rating and a complexity level. Continental Bank provided the total spend and the number of cards for the previous year. Regency Bank would expect those numbers to include the normal growth in the first year of servicing a client (and similarly in year two and three).

Assignment

a.) Describe a simulation model to evaluate the attractiveness of one potential client over the first three years. cash flaw simulation details

b.) Assume that Regency Bank will migrate all of the potential clients. Build a three-year simulation model to evaluate this decision. best result

c.) If Regency Bank were to only accept customers of a particular risk level (or better), what is the best risk level to use for the migration decision? How many customers would be migrated, and how much better is it than migrating all the customers.

d.) Regency Bank is not sure how to incorporate the complexity level or the size of the client in deciding whether to migrate a client or not. Create a simulation experiment to consider different policies for migration based on risk, complexity and size. What is the best migration strategy for the bank? How many clients would be migrated?

not only mean sd also like tail distribution

the profile should not be to risky