

Financial Services

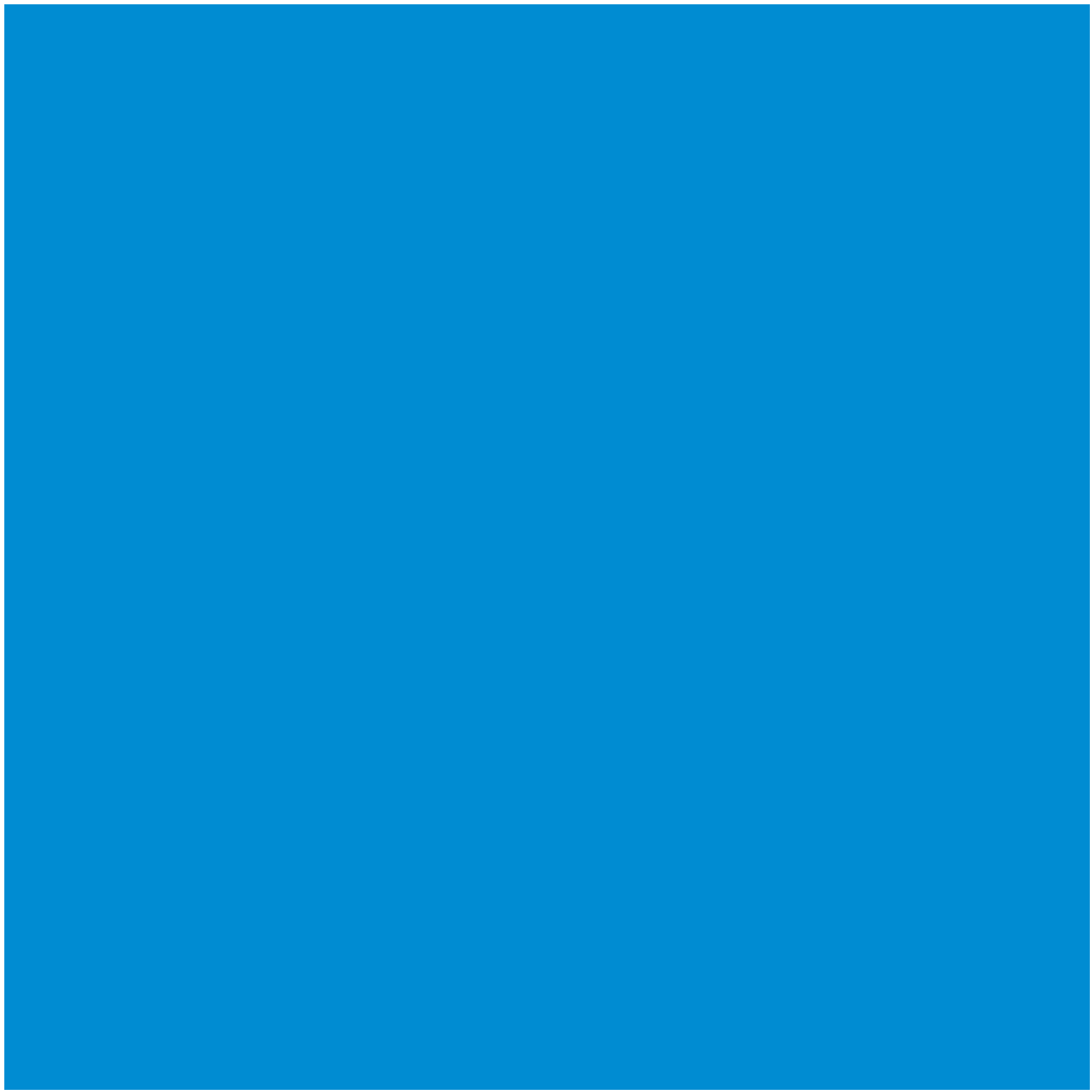
Re-engineering the organisation:

Managing talent in the day after tomorrow*



*connectedthinking

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No turning back

Combating the worst financial crisis in living memory was never going to be easy, and immediate survival and associated cost reduction have therefore been the primary priorities for most financial services organisations. However, as the financial system stabilises, many firms are now beginning to look at how to adapt their strategy to the fundamentally different business, capital and regulatory environment that is emerging from the turmoil.

What most come to realise, having examined their businesses in the light of these new realities, is there is no going back to the pre-crisis situation. Like it or not, tough decisions are therefore unavoidable. Some agile firms will be able to steal a march on their competitors, while institutions that fail to recognise the scale of the changes may fall by the wayside. The list of leading companies in each financial sector could look very different in five years' time.

Forward-looking firms recognise that a different set of skills, smart deployment of talent and the realignment of compensation structures will be critical to their ability to address the demands of this new financial world order. Indeed, the sooner firms identify their changing talent needs and put appropriate strategies and structures in place, the stronger the position they will be in to stabilise their businesses and take advantage of potential opportunities.

With capital requirements and the cost of capital likely to be far higher than before, many leading companies are also looking at how to re-engineer their businesses to create a sustainable lower-cost delivery model. This includes stripping out needless complexity and creating a more streamlined organisation, with the potential shake-up in staff deployment, performance objectives and career development this is likely to entail.

As regulation tightens and customer expectations continue to increase, success is also likely to depend on staff's ability to develop and apply the necessary compliance understanding, risk

management expertise and relationship management skills. As tight regulation and tough market conditions diminish the opportunities for short-term trading returns, the smarter financial institutions are already looking at how to attract and nurture people with the mindset and ideas to create value over the long-term. Indeed, what companies define and seek out as 'talent' may be transformed as a result and the former stars of the banking and other financial sectors may not necessarily be the right people to take the industry forward. For organisations that have undergone large-scale lay-offs, there are the further (not to be underestimated) challenges of how to re-engage their workforce and function effectively with fewer people.

A particular dilemma is how to reward people when compensation policies are facing a tighter rein. There will be greater emphasis on appropriate adjustment for risk and a viable balance between short- and long-term performance-related pay. Ultimately, the commitment and behaviour of the people within the financial services industry will be critical in rebuilding the trust of consumers, markets and governments, without which investment, growth and profitability will not recover.

'Financial institutions must look beyond mere survival mode, accept that the facts have changed and focus on achieving a sustainable competitive strategy in this new environment.'¹

¹ *The day after tomorrow: a PricewaterhouseCoopers perspective on the global financial crisis*, published by PricewaterhouseCoopers in February 2009.

Building on our market observations and some of the themes raised in 'The day after tomorrow: A PricewaterhouseCoopers² perspective on the global financial crisis' (see box), this report examines how leading financial services organisations are gearing their talent strategies to the unprecedented market conditions and changing realities facing the sector. Written by PricewaterhouseCoopers HR specialists from around the world, the report is the latest in our series examining the key talent

management issues facing the financial services sector. It includes both the immediate HR priorities and forward-looking perspectives on talent, organisation and compensation that companies are exploring as they shift their focus from survival mode to sustainable strategy. Clearly there can be no one-size-fits-all approach. For example, trading businesses are likely to face different demands from retail-focused operations in certain areas and such distinctions are reflected in the report.

A vision for the future of financial services

'The day after tomorrow: A PricewaterhouseCoopers perspective on the global financial crisis' provides a vision of how financial services organisations can address the key issues for survival and success. It starts from the premise that systemic problems require systemic solutions and charts how organisations can build a more sustainable business model capable of adapting to the seven key developments cited in the report:

- A new financial services model for a new world
- The shift in global power towards the East
- The renaissance of classic banking
- The pursuit of 'zero risk' regulation
- Government 'inside the tent'
- Unprecedented fiscal pressure
- From survival mode to sustainable strategy

² 'PricewaterhouseCoopers' refers to the network of member firms of PricewaterhouseCoopers International Limited, each of which is a separate and independent legal entity.

Overview

Ready for the upturn: Many leading firms are seeking to simplify and streamline their businesses as part of a more sustainable low-cost delivery model capable of making better use of limited capital and enabling them to compete more effectively. In turn, aligning workforce planning with strategic objectives would help to ensure that the business is equipped to meet evolving customer expectations and capitalise on the opportunities in the upturn ahead.

The skills to succeed: In a more regulated and risk-averse climate, many financial services organisations are seeking to create a more sustainable balance between commercialism and risk management, financial innovation and relationship-building, short- and long-term value creation. The attributes of their leaders may also change as growth slows, margins become tighter, and social and political engagement become more crucial.

Balancing risk and reward: Many financial services organisations are looking at how to adjust compensation to promote a more sustainable balance between risk and reward. Many are also seeking to embed these changes within the organisation by aligning the restructuring of rewards with changes in strategy and desired behaviour and developing an appropriate balance between financial and non-financial performance indicators. Without this alignment, there is likely to be a conflict between what gets paid and what gets done.

Effective governance and organisation: The financial crisis has underlined the importance of building compensation and performance management into effective governance structures. As a result, a number of financial services organisations are seeking to strengthen the scrutiny, independence and ability to challenge that are the cornerstones of effective risk management, and to ensure that this is supported by an appropriate system of reporting, appraisal and remuneration.

In search of growth: As conduits and facilitators for trade and investment, financial services will follow global trade flows and the accelerating development in the East. However, the returns may take time to materialise. Experience indicates that relationship building and a patient long-term mindset will be critical for success.



Ready for the upturn

Many leading firms are seeking to simplify and streamline their businesses as part of a more sustainable low-cost delivery model capable of making better use of limited capital and enabling them to compete more effectively. In turn, aligning workforce planning with strategic objectives would help to ensure that the business is equipped to meet evolving customer expectations and capitalise on the opportunities in the upturn ahead.

With business confidence still fragile and more job cuts coming through the pipeline, it might appear premature to begin looking above the parapet towards the recovery. Yet smart companies recognise that this is the very time to examine how the business model needs to adjust and are already looking at what capacity and capabilities will be needed to compete in what, for many firms, will be an unfamiliar business environment. Indeed, the current situation offers unprecedented opportunities – as Rahm Emanuel, White House Chief of Staff, has said: ‘Don’t waste a good crisis.’³

The overriding challenge (and indeed opportunity) is how to deliver sustainable savings and improvements in operational efficiency. Within capital market businesses, in particular, there was a tendency to consign cost control to the back burner amid the surge in revenue growth. Now that profits are down and capital is constrained, many companies are looking at how to re-engineer their operations, especially in sophisticated areas of the business that demand considerable valuation, settlement and risk management support and where compliance costs are set to increase markedly in the wake of the financial crisis. Many leading companies are also looking at how to reduce overheads and realise potential synergies through the development of product ‘hubs’ and greater use of centralised service centres and other sourcing options. We believe that further savings could be achieved through a more aggressive approach to product rationalisation, reducing needless management layers and

identifying opportunities for integration and consolidation in areas such as reconciliation. Streamlining and simplification can not only cut costs, but also strengthen control and oversight.

The corollary of redundancy and re-assignment, however necessary for the survival and long-term success of the business, is the creation of what, in many cases, is an anxious and disillusioned workforce. Experience invariably shows that productivity dips in the aftermath of such upheaval and uncertainty. Staff may be unclear about their roles, especially if they are being asked to take on responsibilities from laid-off former colleagues. People tend to act more defensively, for example by holding on to information, jealously guarding client contacts or telling superiors what they think they want to know. Job cuts may also have taken away some of the informal networks that are so crucial in getting things done and solving day-to-day problems.

Experience indicates that the first and most important step towards re-engagement is defining a clear strategy for survival and growth and mapping out what talents and capabilities are required to deliver it (later sections of this paper look at what forward-looking companies are doing to identify, reward and govern these evolving talent requirements). Where companies have been successful in re-connecting with staff and galvanising them for the journey ahead, one of the most important factors has been the willingness of senior management to come out onto the ‘shop floor’ and explain the strategy for the business and how retained staff fit into the changes ahead. Experience also

³ Wall Street Journal webcast, 21.11.08.

suggests that executives should seek to clarify the behaviour, responsibility and accountability expected within what is likely to be a culturally and organisationally changed company. The ability to re-inspire the workforce is critical in sustaining productivity now and ensuring that the company is ready to respond swiftly and decisively when the eventual upturn arrives. Moreover, if morale is still low when business in the sector picks up, good people will, as always, take this as their cue to jump ship.

‘The winners from the crisis will be those that do what is required for survival, but also adapt to the realities of a new world.’¹⁴

In our view, one of the most important aspects of preparing for recovery is likely to be a strategy for identifying and responding to the signals that will herald its arrival. This includes a clear idea of the key engines of revenue growth and how they can realise these opportunities. The upturn could be as rapid as the slide into recession, so organisations do not want to be caught off guard.

A number of companies are looking at how to use the analysis of when the upturn is coming and what will drive growth to help form the basis of a strategic workforce plan. This includes ensuring that any short-term staff reductions do not impede their capacity to meet long-term customer expectations and business objectives. They are also seeking to ensure they have the right people for a very different environment. This includes the technical capabilities and behavioural skills such as leadership, relationship-building and the ability to work across different cultures. As opportunities for quick-fire trading returns recede, smart firms recognise that they need people who can identify fresh sources of business and build these up over the long-term.

As a number of financial services organisations move away from high risk-reward strategies towards a simpler and more sustainable ‘back to basics’ approach, the people with the skills to make this work may not have been the leading performers of the pre-crisis market. Companies may therefore need to look deeper into the organisation to identify, nurture and reward the potential stars of tomorrow. Many of the ‘rainmakers’ and top traders of before may, of course, continue to prosper in the new environment, though the objectives, incentives and oversight that govern their work may need to be adjusted to take account of the new regulatory and risk management procedures.

While recruitment freezes have been a common response to the downturn, now may be the time to consider where and how to resume selective recruitment. As companies adjust their skills map, some hiring may be required to fill the gaps. New people also offer fresh ideas and motivation, the stimulus of which will be just as critical if the downturn persists as if it is short-lived.

Innovative financial engineering will naturally continue to be at the heart of capital markets business, and as business begins to pick up companies are looking at how to ensure they have the right people in the right place to realise emerging opportunities in areas such as debt restructuring. Despite the setbacks of recent years, attracting and retaining the innovators and other high flyers that are in the competitive vanguard of any successful business will continue to be critical. Many have left to create boutique operations as their former groups become more risk averse or cannot guarantee the capital to support their endeavours. There may therefore be a strong business case for developing more private-equity-style operations within larger groups that provide attractive opportunities and rewards for such rainmakers, while ensuring that their operations are embedded into the overall strategy, governance and risk appetite of the enterprise.

¹⁴ *The day after tomorrow: a PricewaterhouseCoopers perspective on the global financial crisis*, published by PricewaterhouseCoopers in February 2009.

The skills to succeed

In a more regulated and risk-averse climate, many financial services organisations are seeking to create a more sustainable balance between commercialism and risk management, financial innovation and relationship-building, short- and long-term value creation. The attributes of their leaders may also change as growth slows, margins become tighter and social and political engagement become more crucial.

The financial world is being transformed. In particular, many organisations are shifting from an inward-looking originate-to-distribute model towards a greater focus on business support and other fundamentals of the real economy. While innovation will continue to be critical, risk, compliance and relationship skills will also be crucial.

‘Unsustainable, overleveraged structures will be replaced with simpler and more transparent forms of banking, and some activities may be subject to limitations in a new model that represents a renaissance of ‘classic banking’.’⁵

Across the market, companies are looking to ascertain whether they have enough people with the necessary balance of innovation, risk, compliance and relationship skills, and gearing their training and recruitment to bridging any gaps. As we described in the earlier section, many of the people who are most suited to the new environment within mainstream banking may have had a low profile or been locked within slow-track career paths. It is recognised that identifying, valuing and nurturing such people will require a cultural shift and a clear lead from the board to ensure that HR, line managers and others at the forefront of hiring, appraisal and promotion understand how the talent map has changed.

The ability to attract bright young recruits has clearly been affected by the financial crisis. The image of banking and other financial services has also been tarnished by the public anger over excessive bonuses and reckless risk-taking. Restoring trust and re-engaging with society will therefore be critical at a time when new graduates (‘millennials’) are looking for careers with meaning and interest rather than just financial reward.⁶ The back-to-basics business model could provide the solution by reinforcing the critical importance of financial services to the fabric of everyday life in areas ranging from business start-ups and job creation to the realisation of home ownership, secure retirement and other cherished ambitions.

The new financial order is also likely to call for a new breed of executive. The ability to lead will be a crucial skill in itself as firms seek to re-inspire a potentially demoralised workforce and guide the organisation towards what may be an unfamiliar strategic path. As part of their strategic re-evaluations, many firms are also looking at how to combine a more incremental approach to growth overall, which demands attention to detail and the ability to spot what may be narrow gaps in the market, with the ability to manage risk in the high-profit deal-making areas of the enterprise. Media savvy and political engagement skills will be at a premium now governments are exerting greater influence and financial services is under the spotlight. One of the key challenges is balancing the need to restore profitability with the expectations of being a responsible corporate citizen.

⁵ *The day after tomorrow: a PricewaterhouseCoopers perspective on the global financial crisis*, published by PricewaterhouseCoopers in February 2009.

⁶ *Managing tomorrow's people: The future of work to 2020*, a report published by PricewaterhouseCoopers in December 2008 (www.pwc.com/managingpeople2020).

Balancing risk and reward

Many financial services organisations are looking at how to adjust compensation to promote a more sustainable balance between risk and reward. Many are also seeking to embed these changes within the organisation by aligning the restructuring of rewards with changes in strategy and desired behaviour and developing an appropriate balance between financial and non-financial performance indicators. Without this alignment, there is likely to be a conflict between what gets paid and what gets done.

Amid the furore over excessive rewards, curbs on compensation have become a focus for regulation across the globe. The resulting emphasis on creating a sustainable approach through risk-adjusted remuneration and deferred compensation, underpinned by good governance of remuneration, represents sound underlying principles. A number of leading firms are augmenting this approach with a balanced scorecard of non-financial measures that seek to reward teamwork, risk awareness and other favourable attributes, alongside financial performance. Within capital market businesses, in particular, there is growing recognition of the importance of clear measurement of and personal accountability for the value contribution of trading desks and, where possible, individual traders.

The immediate dilemma is how to satisfy growing regulatory and other stakeholder demands without losing sight of the need to create a compensation structure that reflects and promotes the strategy of the firm. Quick fixes such as blanket curbs on bonuses can assuage the critics for now, but are unlikely to be beneficial or sustainable in the long-term. Moreover, many firms may still be working out how their strategy is going to change in light of the financial crisis and therefore it may be too soon to make wholesale changes. Clearly, different types of business also demand particular approaches to compensation. It is therefore important to establish sound underlying principles for

remuneration, while allowing sufficient flexibility to take account of evolving strategies and particular types of commercial operation.

The fundamental challenge in the long term is how to reward and motivate staff who have become accustomed to sizeable cash bonuses when there is no longer the stakeholder approval to support this, and when the basis for allocating variable pay is set for considerable change. Striking the right balance between short- and long-term performance-related pay will therefore be critical. Staff may need to accept smaller amounts of cash today to allow for risk and uncertainty in return for a greater share of long-term risk-adjusted rewards. Many companies are also looking to introduce a more equitable balance between basic and variable compensation in the wake of the financial crisis, arguing that if base salaries are too low and staff are therefore relying on meeting incentive targets to make up for the shortfall, this could encourage excessive risk-taking.

‘Problems arise when you try to recognise performance at a level below which you can measure risk.’⁷

Compensation structures and the balance of financial and non-financial performance measures upon which they are based naturally vary to reflect the particular role and position within the business:

⁷ *The day after tomorrow: a PricewaterhouseCoopers perspective on the global financial crisis*, published by PricewaterhouseCoopers in February 2009.

Executives: In our experience, one of the attributes that marks out the most effective companies is how closely the scorecards of senior executives are aligned to strategic objectives. Share options have remained important despite the currently reduced value, though longer duration is likely to be a feature of some countries regulation.

Front office: Similarly, a feature of companies that have weathered the financial crisis most successfully and are now geared for growth is how closely rewards reflect the cost and risk-adjusted profit attribution. Economic profit measures would allow for appropriate risk-adjustment, with the performance of the portfolio or individual trader tracked and linked to deferred compensation. In practice, however, some of the information and analysis this demands may present systems and accounting challenges, so firms will need to drill down as far as management information is obtainable and reliable. In many of the most successful companies, financial measures are augmented with rewards for teamwork, information sharing and other key aspects of business development and control.

Risk and compliance: At present, a significant proportion of the rewards for control teams are geared to the profitability of the frontline business. This can create an inherent conflict of interest in which control teams may not want to challenge front office personnel as this could have a negative impact on their bonus potential. This highlights the importance of independent appraisal and compensation. While some companies are keen to promote

mutual understanding and a more risk-aware culture by encouraging greater movement between control and business teams, it is critical to ensure that such cross-overs do not compromise the ultimate independence of the risk management function.

The key underpinning for an effective reward structure is increasingly seen as its integration into the enterprise risk management (ERM) framework. Tying compensation to risk-based performance objectives can provide a powerful lever for instilling risk awareness in the decision-making and underlying culture and behaviour of the enterprise – what gets paid gets done.

Leading companies also recognise the importance of ensuring effective oversight, challenge and accountability. A number of remuneration committees are looking to strengthen governance by focusing on pay arrangements across the enterprise rather than just within the board. With compensation in the spotlight, this may also be a good juncture to review the composition of the remuneration committee to ensure it encompasses an appropriate mix of skills and experience. Creating a formal firm-wide governance structure, which brings in the remuneration committee and input from HR, compliance and risk management, would help to ensure there is appropriate and demonstrable oversight of the determination of rewards within the business. Indeed, being able to demonstrate that reward structures are appropriately calibrated and governed will be crucial in strengthening stakeholder confidence in the business.

Making the change

Clearly, any restructuring of rewards represents a significant change management challenge and cannot be achieved overnight. Key steps include:

- Developing relevant and transparent performance indicators
- Explaining to staff what is required of them and how they will be assessed
- Convincing staff that the new approach can enhance long-term rewards for them and the business
- Ensuring that there is a clear line of sight between performance, reward and career progression
- Explaining the direction of and rationale for change to external stakeholders

Effective governance and organisation

The financial crisis has underlined the importance of building compensation and performance management into effective governance structures. As a result, a number of financial services organisations are seeking to strengthen the scrutiny, independence and ability to challenge that are the cornerstones of effective risk management, and to ensure that this is supported by an appropriate system of reporting, appraisal and remuneration.

The financial crisis exposed fundamental weaknesses in the governance of a large number of financial services organisations. In contrast, anticipation and management of the crisis has generally proved far more effective within companies where staff at all levels of the business are able and indeed encouraged to challenge key decisions, even if this goes against the prevailing strategic grain, and control teams are able to maintain the necessary independence to provide effective scrutiny and oversight and ensure that management takes appropriate account of their input and concerns.

Embedding risk officers within business teams can provide valuable opportunities for monitoring and control. However, market best practice indicates that they should ultimately report to a centralised risk function, which has the final say over their appointment, performance appraisal, remuneration and career progression. Without this independence, their input can be ignored by line managers. In the worst-case scenario, staff may even be discouraged from raising objections as this may affect their pay or promotion prospects. Where this independence was maintained, firms were in a better position to raise concerns and relinquish or hedge potentially problematic assets before the financial crisis and the subsequent write-downs took full hold.

The crisis has also underlined the importance of aligning governance and risk management through more effective board-level understanding, oversight and accountability. The key to this is good information and timely communication, backed up by training for non-executives and other board members who may not be sufficiently conversant with complex products and risk analysis.

‘In future, risk management culture must be strengthened by designing organisational structures with risk at the centre and aligning compensation structures accordingly.’⁸

These more systematic governance structures are likely to be a key focus for regulation. Just as importantly, they make sound business sense by helping to underpin a more informed basis for strategic decision making and providing boards, investors and rating agencies with the assurance that risks are appropriately understood and controlled (‘no gaps and no surprises’).

⁸ *The day after tomorrow: a PricewaterhouseCoopers perspective on the global financial crisis*, published by PricewaterhouseCoopers in February 2009.

In search of growth

As conduits and facilitators for trade and investment, financial services will follow global trade flows and the accelerating development in the East. However, the returns may take time to materialise. Experience indicates that relationship building and a patient long-term mindset will be critical for success.

While it is easy to lose sight of longer term trends during a crisis, the underlying forces shaping the future of financial services have not changed. One of the most important developments is the faster growth in the leading developing economies relative to their G7 counterparts. A rebound in Asia is likely to be one of the main engines of recovery and long-term growth in the financial services sector.

Asia exemplifies the classic banking model, with high savings rates, low borrowing, a long-term view of business and an emphasis on the importance of longstanding personal relationships. As the many international companies that have sought to develop a presence in these markets have come to recognise, building these relationships and nurturing the business that flows from them requires people with patience, cultural insight and local market understanding. A balance of expatriate and local personnel will continue to be the norm for now, especially as the skills pool within financial services is still not big enough to meet demand. However, developing talent from within Asian markets rather than bringing people in from outside is likely to be the most sustainable and cost-effective long-term path.

The growing global reach of Chinese, Indian and other Asian financial groups creates a different challenge. Experience of international management is still in short supply within these countries. Secondments to Europe and the US will be crucial in gaining the experience and developing the informal networks that are so important for future leaders of international groups. They could also become a prized element of joint venture arrangements.

‘The shift in economic and political power from the West to the East is a long-term shift and will bring with it a completely different pattern of investment, consumption and global trade.’⁹

Ageing populations in developed markets present a further frontier for growth. The development of this market emphasises the importance of relationships. Expertise in areas such as tax planning, portfolio management and overseas real estate will become key differentiators.

⁹ *The day after tomorrow: a PricewaterhouseCoopers perspective on the global financial crisis*, published by PricewaterhouseCoopers in February 2009.

Building a sustainable future

The future of financial services will not be like the past. A new financial order requires different talents and leadership. It also requires the shift in culture, rewards and career progression that will embed these changes in the organisation. In our view, the following attributes are likely to mark out the most effective talent management strategies and equip organisations to overcome the challenges ahead:

- Developing an efficient and cost-effective delivery model
- Aligning workforce plans with long-term strategic objectives
- Sustaining recruitment to bring in new ideas and renewed drive
- Recognising and rewarding risk, regulatory and relationship competencies as core skills
- Developing a sustainable risk-adjusted basis for compensation
- Developing an appropriate balance between short- and long-term incentives
- Balancing financial with non-financial performance measures to promote desired behaviour
- Ensuring remuneration decisions are underpinned by robust governance structures
- Ensuring that management, appraisal and rewards for risk management personnel are segregated from the business
- Rebuilding public trust by encouraging staff to actively promote and take pride in the financial services sector's importance to the success of the economy

How can we help?

PricewaterhouseCoopers is helping financial services organisations to develop the capabilities they need to respond to changing regulatory requirements and challenging market conditions. Our dedicated financial services human resources team works closely with clients to ensure that key aspects of talent management, including recruitment, retention and reward, reflect and support the overall strategy of the business. Recent client projects have covered:

- Development of more controllable and lower-cost operational models
- Review and formulation of talent mapping and recruitment strategies
- Aligning HR management with enterprise risk management
- Development of sustainable risk-adjusted approach to compensation
- Development of balanced scorecards for financial and non-financial performance
- Development of talent metrics to help support succession planning and retention of high-potential staff
- Development of employee brand

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