KPMG

frontiers in finance

for decision makers in financial services
September 2008

FINANCIAL SERVICES

Appreciating people

Global banking and people management

An interview with Antony Jenkins, Chief Executive of Barclaycard

Bye-bye bonus?

Have we seen the end of reward schemes?

10 steps behind... but still in the lead

Pinky Lilani OBE on diversity today

AUDIT ▪ TAX ▪ ADVISORY

Introduction

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The constant challenge

“People are our greatest asset.” How many times have we heard business leaders say this? Despite the fact that such words can sound trite, or that they liken human beings to impersonal objects – a likeness perpetuated by the term ‘Human Resources’ – a company’s employees are indeed vital assets, to be developed and used along with other assets such as property, brand and customer base.

This edition of *frontiers in finance* is focused on people. It’s about welcoming human diversity and tapping into it. It’s about identifying talent and nurturing it. It’s about caring for staff and ensuring you have the right people for the challenges your business faces.

Take the first of these themes. Every self-respecting large corporation has a commitment to diversity, which means giving equality of opportunity to staff irrespective of sex, ethnicity, religion and other differences. Citibank, for example, defines diversity as “a culture where the best people want to work, where people are promoted on their merits, where we treat each other with dignity and respect, and where opportunities to develop are widely available to all – regardless of differences”[1]. In this issue, we take a look at progress with diversity in 2008.

We examine the likelihood of IFRS implementation in the US and the effects of this major change on every aspect of an organization, starting with its people. People represent the key priority in ensuring successful adoption for many change management projects. We delve into the health and potential future of Basel II, and the opportunities for investment as part of our emerging markets series.

With the market turmoil of the last year, we’ve seen many businesses facing greater risks, but this reinforces the view that maintaining a focus on your people is the key to realizing success. I believe it’s the choices you make in leading your organization and managing your people, whether in respect of their skills, rewards, culture or diversity that will ultimately determine the winners and losers in the business world.

Brendan Nelson
Vice Chairman, KPMG in the UK
Global Chairman, Financial Services

1. ‘Diversity at Citi’, www.citigroup.com, August 2008.

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For your information

Topics

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Topics: We are the champions

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fyi

Coming up

The Global Skills Convergence

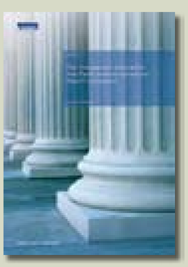
In *The Global Skills Convergence*[1] best-selling author and Partner at KPMG in Australia, Bernard Salt argues that the developed world will pass through a demographic fault line at the end of this decade. The US, the UK, Western Europe, Australia and especially Japan are exposed to the impact of more baby boomers exiting the workforce than Generation Ys entering the workforce. In contrast, much of the developing world including some Arab and Latin American nations as well as India, continue to offer rising pools of talent. The predicted outcome is an acceleration in the global flow of skilled and unskilled workers, such as from Mexico to the US, India to Australia or Philippines to the UAE.

Indeed, Salt argues that this is no more than an extension to the argument by Thomas Friedman in *The World is Flat* (2004) that the dismantling of political barriers, the evolution of technology and the globalization of business led to a 'flat world'. The next step in a truly flat world is for talent to flow seamlessly from areas of oversupply to areas of undersupply. As globalization accelerates and the impact of the demographic fault line begins to show up, business must be prepared for the resulting challenges.

In looking at the corporate response, interviews were conducted with HR directors of a number of multinational organizations to understand how they were dealing with labor market challenges and the need to shuffle talent globally, especially into emerging markets. What follows is a picture of global businesses embracing diversity, cultivating local talent and pursuing new opportunities in new markets.

1. 'The Global Skills Convergence: Issues and Ideas for the Management of an International Workforce', KPMG International, September 2008. See www.kpmg.com for details.

Enhancing Risk Management for financial institutions in China



A new report from KPMG in China entitled *Risk management priorities for Asia Pacific Financial Institutions: Basel II and Beyond*, examines the various factors, Basel II included, which are driving institutions to enhance their risk management.

While Basel II is widely accepted as providing a sound blueprint to guide institutions in developing their risk management, the recent sub-prime crisis has raised some concerns about its efficacy and whether other risk management areas, for example liquidity, should now be given priority over Basel II implementation. Skills shortages and data limitations also impose challenges for institutions to adopt the more advanced approaches under Basel II.

Some of the most successful institutions will be those that get their risk management priorities right and align them closely with their business needs, while also integrating a robust risk management framework into their systems and controls.

Investment opportunities in Asia

A safe haven from the credit crisis?

Asia has been insulated from the worst effects of the economic slowdown in the US and Europe, thanks to increasing economic independence and inter-regional trade. The economic resurgence in the regional powerhouses of China and India has supported investment opportunities, particularly property investment which grew by 27 percent to US$121 billion in 2007 in Asia, and continues to build[1].

The credit crisis has reduced the options in traditional western markets and accelerated the flow of capital into Asian property from outside the region; not only from the US and Europe, but Australia is also becoming a big investor in the region.

In June 2008, the private equity fund manager MGPA, partly owned by Australia's Macquarie Bank, launched a global fund that will invest mostly in Asia. It has secured US$3.9 billion in equity for Asian investment, giving it a potential buying power in the region, with leverage of US$15.6 billion.

The establishment of Real Estate Investment Trusts (REIT) in Asia in 2001, has proved a resounding success, providing real flexibility to invest in different properties, in different locations with a variety of lease terms and tenant profiles. There is huge opportunity in Asia for investment, and currently these trusts are outperforming their American and European counterparts. With returns well above average, this trend is set to continue.

1. 'Surviving or Thriving? Trends in Global Real Estate 2008', KPMG International, 2008.

Changing ways of communicating

Social networking sites are a phenomenon that has taken over! Sites such as Facebook, MySpace and LinkedIn are changing the way we manage our networks both socially and professionally.

Many businesses have now realized that these sites can provide benefits to their employees through improving communication, engaging employees and even as a recruitment tool, particularly as the need to attract Generation Y increases. How is your business dealing with the changing demands of recruitment and talent management?

According to www.ft.com (July 11, 2008), understanding the new spheres of communication can open up opportunities to attract and engage employees which means greater productivity, and thus contributes to better business performance.

Upcoming

October 13, 2008

2008 Annual Meetings of the IMF and World Bank
Washington D.C.

November 3, 2008

PDP: Risk Management & Investment Banking
Washington D.C.

November 10, 2008

Fund Forum USA 2008
Key Biscayne

November 11, 2008

Reactions Global Insurance Conference
New York

November 20, 2008

IIF-ISB conference: Enhancing the Resilience and Stability of the Islamic Financial System
Kuala Lumpur

The rise and rise of infrastructure funds

The credit crisis does not appear to be unduly affecting the rise of global infrastructure funds, with the combined worldwide total reaching US$312 billion in 2007, leaping from US$225 billion in 2006, and almost two thirds of this coming from new fund entrants[1]. The top twenty funds alone now contain over US$130 billion of assets under management.

The progress has been particularly rapid in Europe, with value of European acquisitions growing from less than US$2 billion in 2003 to over US$44 billion in 2006. Furthermore, the number of funds has risen from just 10 in January 2003 to 58 in July 2007. And the appetite is still strong, as demonstrated by the recent 2008 launch of funds from ING (US$2 billion) and Morgan Stanley (US$4 billion)[2].

Traditionally owned and developed by the state, infrastructure is now so costly that it is proving beyond the means of the public sector. The Organisation for Economic Co-operation and Development (OECD) estimates that a massive US$70 trillion is needed for infrastructure development worldwide and there is wide acceptance of the need for private sector involvement.

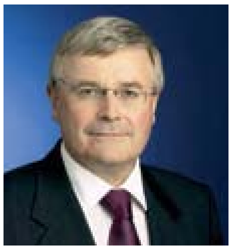
As a long lasting asset, infrastructure is an attractive proposition particularly for pension funds looking for longer-term yields. Virtually every investment bank now has an infrastructure fund while financial institutions, in search of more cross-border deals, are finding these funds a useful way to move into new markets.

1, 2. 'Surviving or Thriving? Trends in Global Real Estate 2008', KPMG International, 2008.

In conversation with…

Antony Jenkins

The right team is the key to implementation



David Sayer

Barclaycard is one of Europe's leading credit card businesses, with an extensive international presence in the United States, Asia-Pacific and Africa. Barclaycard can be used to pay for goods and services in over 29 million outlets and to withdraw cash from more than 600,000 cash machines and banks worldwide. Recently, Chief Executive Antony Jenkins talked to David Sayer about his approach to people management.

"The second quality I look for in people is a relentless focus on execution. As I have said, implementation is everything in business, and I need people who will do their utmost, and more, to ensure that effective action follows strategy and planning."

When I was approached with an offer to take over the leadership of Barclaycard, I had some reservations initially. My first job after graduation had been as a management trainee with Barclays – I had always been interested in banking – and I spent five years with the bank. But I became steadily more frustrated with the rather slow and bureaucratic way we did things in those days and eventually left to join Citigroup in search of a more dynamic and innovative culture.

Of course I knew that Barclaycard was one of Europe's leading consumer lending businesses, with more than 10 million UK cardholders and 8.8 million cards in issue outside the UK. From its launch in 1966, Barclaycard has grown to become the UK's most recognized brand in financial services. In addition, it is a rapidly expanding global business, with operations in over 50 countries on four continents.

However, what impressed me when I started to look seriously at the prospect was the immense cultural change which had taken place in the business over the last 20 years. In recent years, Barclaycard has recovered much of the sense of product innovation, customer focus and industry leadership which characterized its origins 40 years ago in creating a new product category. Once again, Barclaycard is shaping and recreating the credit card and payments industry. The challenge – and the opportunity – to help implement the company's strategy over the coming years was too great to pass up.

Implementation is the key concept here. Throughout my career, I have been heavily influenced by two convictions. The first is that turning sound strategy into effective action is the essential factor in achieving competitive advantage and business success. Developing the right strategy is important. But I believe you have to devote just as much time and effort to planning how to implement it. Implementation is critical, and I spend an inordinate amount of time on ensuring it succeeds.

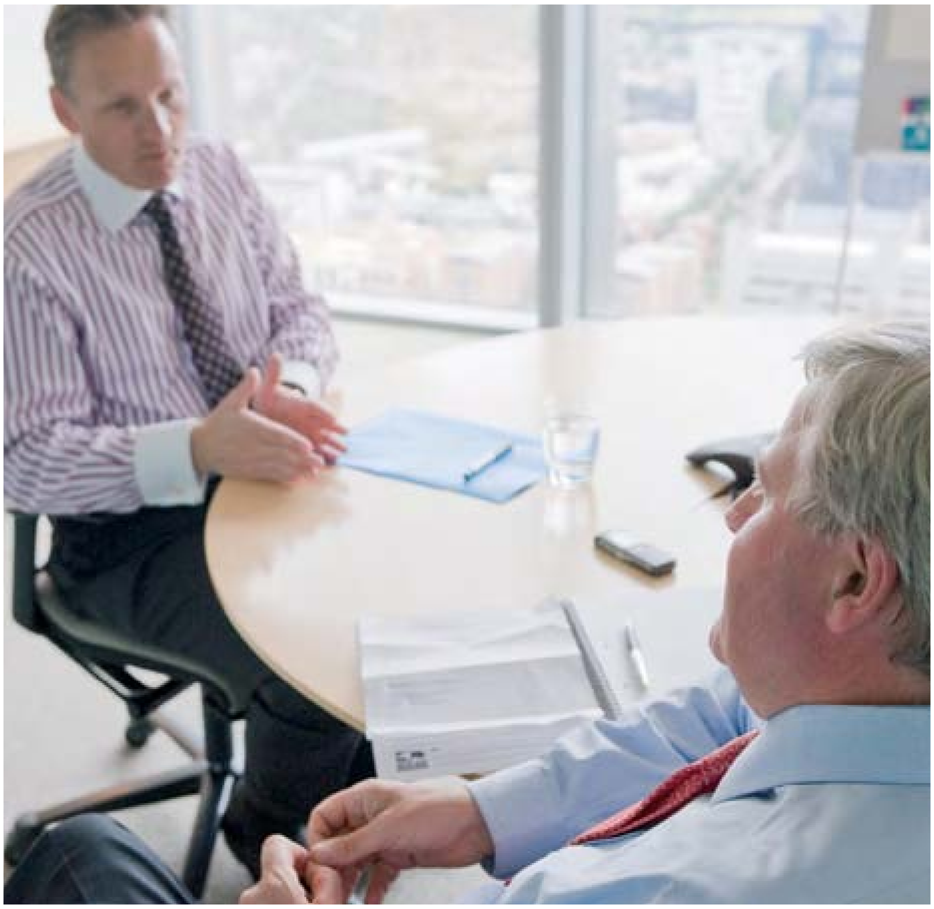
In turn, the second conviction which guides me is that leadership and people management are the key to implementation. So getting the right people in the right places with the right processes behind them is my number one priority. This is more of an art than a science. But there are three qualities I always look for in people.

Firstly, domain expertise is of course essential. I believe the days when a good all-rounder could step into most senior management roles have largely gone. Business is too complex, too sophisticated these days, and demands specialist expertise. But there is also a paradox here. For very senior positions, domain expertise across the whole field of responsibility is an impossible requirement. Nobody can be an expert in everything. So I look to ensure that members of my team have true expertise in one or two areas they're responsible for, and have particularly strong deputies to balance the other areas.

The second quality I look for in people is a relentless focus on execution. As I have said, implementation is everything in business, and I need people who will do their utmost, and more, to ensure that effective action follows strategy and planning.

Finally, I look for a sense of collegiality. We have probably all known colleagues who are experts in their fields, and who are strong on delivery, but who leave a trail of casualties behind them. They are a major danger to the team ethic. I need people who can work collaboratively together.

Identifying and nurturing these qualities in junior staff is one of the most critical responsibilities of leadership. I believe you have to take decisions on the career paths of potential future leaders which build both breadth and depth early. And you need the right balance between the two. Barclaycard has highly ambitious global aspirations. My current executive team has the diversity, breadth and depth of experience to match those aspirations. One of my roles is to ensure that this is built on and enhanced for the future.



You cannot run a global business with a single cultural or business focus. A global business needs a management team with a global mindset. I have Filipino, American and British nationals running businesses in Barclaycard. They have expertise in fields such as consultancy and packaged goods as well as in the credit card business. I am proud of this mix of geographical and business backgrounds, and it's one of the reasons why I think we are in a strong position to continue to lead the industry and extend our international expansion.

From the start I've been convinced that the right place for Barclaycard is at the super-prime and prime end of the market. That's our brand strength and it's also economically the best place to be. So over the last couple of years we've restructured the business to underpin this. We've closed 3 million dormant accounts – experience tells us that customers tend to reactivate dormant accounts when they're facing particular financial difficulties, and we want to avoid unnecessary exposure to high risk. We've exited a number of businesses and repositioned others.

We have a portfolio of businesses which are growing at different rates, giving us an underlying stability. In the UK, we have the lending credit card brand Barclaycard, we have a point-of-sale card acquiring and we have a fledgling but growing partnerships business – for example we provide card products for Sky. Outside the UK, we have a US business, a business in Germany, a joint venture in Scandinavia and we're the No. 2 card issuer in South Africa.

Although these are independent operations, a key element of our strategy is to leverage our intellectual property and expertise across the group. For example, each month I receive a 300-page credit risk report from all markets we're active in, in exactly the same standardized format. We've built a really good relationship between the credit risk function and the operational function: it's a fluid and dynamic relationship which allows us to respond quickly to developments in the marketplace.

Overall, I think one of our great achievements over the last few years has been the way we have developed and deployed our intellectual capital in ways like this. So we've had a clear strategy. But to return to my original point, we've been relentless in executing it. And that has depended on people.

Antony Jenkins was appointed Chief Executive of Barclaycard in December 2005. He had previously spent 17 years with Citigroup Inc, where he most recently held the position of General Manager and Executive Vice President for Citi Brands. In this position he had full responsibility for most of Citi Cards business including Platinum, Universal Corp, AA Advantage, the AMEX relationship and Small Business. Antony began his career as a management trainee with Barclays Bank after graduation from Oxford University.

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Beyond the credit crisis: impact and lessons learnt for investment managers, a KPMG International report launched in July 2008, was based on a survey conducted amongst various types of investment managers and institutional investors across the globe[1]. Amongst a number of challenges stemming from the credit crisis, the report highlighted the worrying existence of a skills gap in the industry, Mireille Voysest looks at how this challenge can be addressed in order to stay afloat during the evolving credit crisis storm.

Beware the

The importance of skills

The survey revealed a general increase in the use of complex instruments and strategies, for example 61 percent of mainstream fund managers[2] and 71 percent of fund managers with over US$10 billion in total assets, said that they now manage complex strategies such as hedge fund strategies. These and other strategies require highly trained and talented specialists particularly 130/30 funds. The latter "are another way for talented fund managers to demonstrate their skills. If the risks are well communicated to investors and well understood they can be a great product" said the head of wealth management at an Asia-based bank. But, he cautions that specialized skills are needed, "the ability to buy the right stocks is a valuable skill, but shorting certainly requires additional capabilities".

Now, let's look specifically at risk management. One of the world's biggest fund of hedge funds (US$38 billion under management) has established that the selection of underlying managers is as important a risk factor as macroeconomic conditions, when it comes to managing risk in its portfolios. Their two-tiered approach consists of:

gap

- top down asset allocation decisions taken by an experienced four-person investment committee which has about 70 years' experience between them
- bottom-up process that starts with a rigorous quantitative analysis and is ultimately guided by the fund of hedge fund's ability to get a close-up view of the managers, having built up relationships with them over two decades of being in the hedge fund business.

Other key players give the same importance to skills in the risk environment. For example, the chief risk officer of an Australian bank, which manages over US$100 billion of infrastructure assets, illustrates the point that implementing risk controls is not necessarily evidence of the ability to manage risk, by saying:

"You can give investors all the numbers in your stress-tests. But as an investor, you will still ask: 'What type of person did the stress-test, under what conditions, and with what supervision?' The variables are endless."

Best practice risk management is reliant upon empowering the independent risk function to provide a challenge on the suitability of investments, ensuring that the fund stays within investment mandates, and that these investment mandates are sufficiently granular and focused to ensure that the fund's investment strategy is in line with the fund's risk appetite as defined by the investment prospectus. In order for this to work, funds need to retain and recruit qualified risk professionals and conduct more rigorous risk assessments of new investment opportunities. Risk management around liquidity matching between investor redemption terms and underlying assets needs significantly greater focus.

The availability of skills

So far this article has covered issues that many of us expected: that the use of complex instruments and strategies keeps rising and that these require specific skills. Now, this begs the question: are the necessary skills in place? The report reveals that this is not the case in all instances:

- one in five fund managers who, according to the survey, have invested in complex financial instruments, such as derivatives, CDOs or structured products, admit to having no in-house specialists with relevant experience of them
- a similar proportion (23 percent) of hedge fund managers admitted the same.

The survey also showed that investors are at greater risk still, with about one in three (32 percent) of the institutional investors that invest in instruments such as derivatives, CDOs or structured products saying they have no in-house experience for these. If the fund management industry is to retain the trust of investors, it would seem imperative for it to both develop the necessary skills and then offer these skills to investors.

The message is clear: it is necessary that fund managers make strategic investments in acquiring people with the right skill set, specifically when they seek to innovate. This means hiring and attracting the human capital that can streamline risk and governance processes, even if this entails paying for people with marketable risk and governance skills and scaling back expenditure on a small number of 'star' managers. This was aptly summed up by the global head of product development at one of the world's largest commercial and investment banks:

"People talk a lot about the 'war for talent', but I'm not sure war for talent is the best description of what investment firms are looking for. I think it is a war for knowledge and competence more than anything. With these attributes on your payroll, you'll do better than most."

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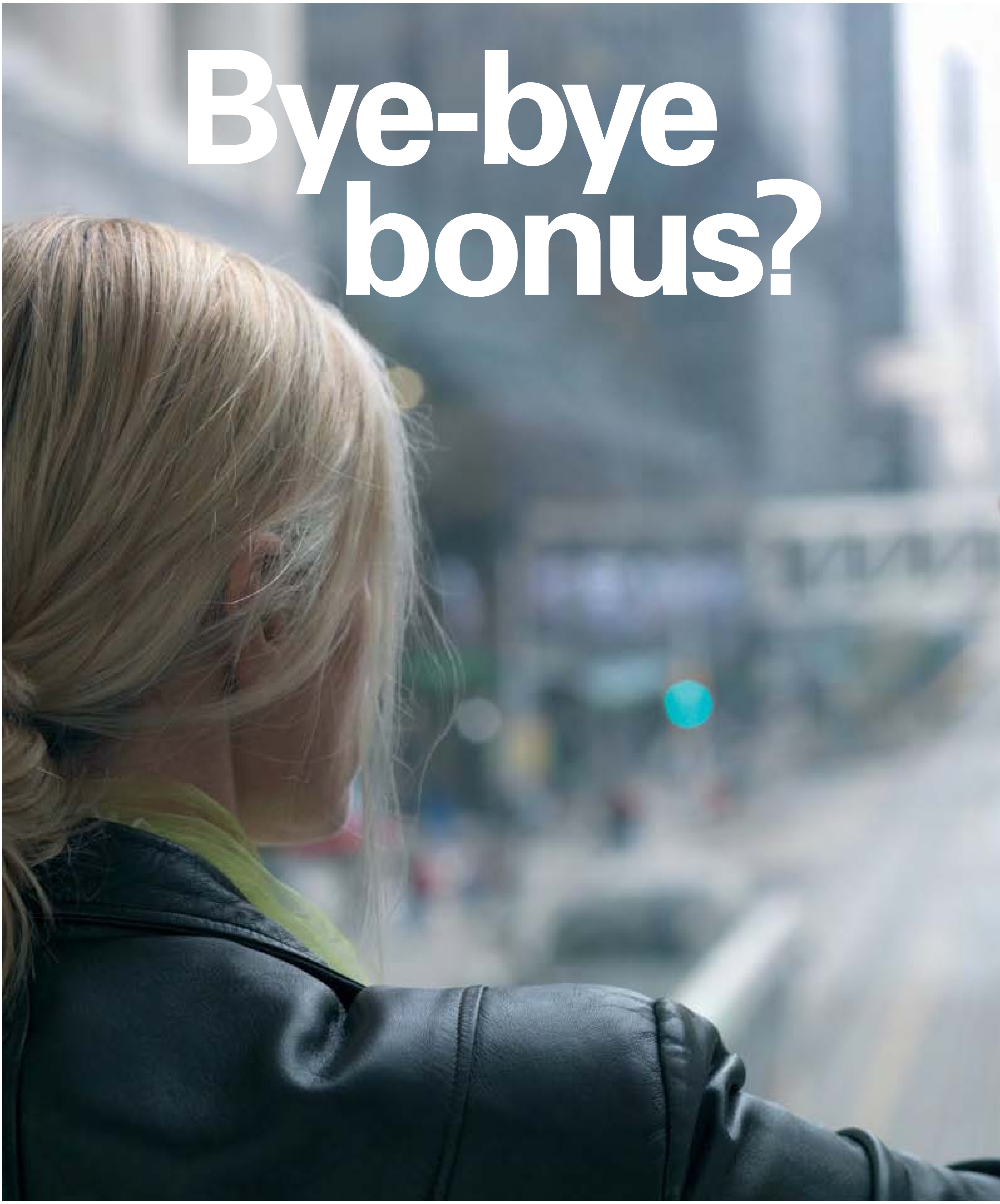
1. The report, produced by KPMG International in July 2008, in cooperation with the Economist Intelligence Unit, examines in detail for the first time how the fund flows, returns and reputations of investment managers have been impacted by the credit crisis and the economic conditions of the past 12 months. 333 respondents from 57 countries answered our online survey and 16 executives gave us their time for interviews.
2. Subset of respondents comprised of: fund and investment managers, retail fund managers and real estate funds.

Bye-bye bonus?



Mervyn Gunn

David Shammai

As the financial services industry continues to experience a period of uncertainty, the conventional wisdom concerning the role of annual bonuses, and pay structures more generally, is being questioned, as **Mervyn Gunn** and **David Shammai** report.

The annual cash bonus is a key variable element of remuneration in many organizations across the UK. While, for senior executives in many business sectors, the role of the annual bonus is outweighed by long-term incentives[1]; typically, annual bonuses are much more central to the remuneration strategy of companies in the financial services sector. Financial institutions have seen a large increase in their costs and an equally large decrease in their reported profits. On the back of the write-downs on sub-prime mortgages, the drying up of the inter-bank lending market and increasing bad debts, they have looked to cut cost. The easiest way for them to do this is to make smaller bonus allocations.

The industry has already witnessed a 16 percent decline in bonuses in UK financial institutions (from £8.8bn in 2006 to £7.4bn in 2007[2]); similarly, these figures have been mirrored on Wall Street. As the turbulence in the financial markets continues, in May 2008 the Centre for Economic and Business Research (CEBR) predicted that this year's bonuses – to be paid in early 2009 – will total £5.07 billion, a fall of 42 percent from 2006's near record £8.8 billion payout. Even more striking is the prediction that bonus levels will not recover to 2006/07 levels until 2011 at the earliest.

The pay structures in financial services organizations, particularly investment banks, have also been the subject of public criticism recently, including some comments that the conventional structure of the bonus systems has had adverse consequences. According to the Governor of the Bank of England for example, "institutions are now paying the price for rewarding huge risk-taking with the promise of large bonuses"[3]. Senior figures at the Financial Services Authority (FSA) and the Association of British Insurers (ABI) have also voiced concerns about certain aspects of the pay structures in the finance sector[4].

Against this somewhat challenging backdrop, we believe that many companies in the finance sector currently have a great opportunity to re-consider their bonus plans, re-examining both their structures and effectiveness.

The effectiveness of annual bonus plans

Many annual bonus plans are self-funded, and therefore are more likely to remain affordable if financial performance declines. However, companies still need to consider how to manage and meet their employees' expectations for bonuses, and even more acutely, how to use the reduced bonus pools most effectively. In our view, where companies intend to reduce their bonus spend, they would be advised to be more selective with payouts.

The ongoing turmoil in the financial services sector puts pressure on the current pay system, but in our view companies could benefit from using these circumstances to stimulate change.

Increased turnover among the less senior and lower performing employees is regrettable, but increased turnover among talented and high performing professional staff could seriously undermine a company's ability to achieve its strategy and goals.

The challenge for many organizations is that they do not know who their most talented and skilled professional staff are! In some cases, this is because line managers have paid 'lip service' to performance management. They have failed to differentiate between different levels of performance, to identify those with business critical skills, or to identify those who consistently out-perform others.

Therefore, a renewed emphasis on performance management is needed, starting with a better understanding of what 'performance' is. How much importance should companies attribute to the satisfactory performance of an individual's job? Is the bonus plan encouraging every employee to contribute to the achievement of the company's goals and objectives, be that in increasing revenue or in reducing costs? Should the bonus plan re-focus on this 'added value' element of an employee's contribution to the business?

In many cases, it is evident that the bonus should be focused on those adding value to the business.

Bonus plan structure

One of the key issues here is the perceived inherent risk of reward structures. One such concern is that 'upside only' incentives skew the alignment of interests of management and shareholders (the 'asymmetry of interests') and therefore potentially encourage excessive risk-taking. Another more specific concern is the perceived short-term nature of pay structures, which could in some cases contrast with long-term value creation.

Consideration should be given to the balance between performance and risk management. Excessive risk-taking could be an unintended consequence of a poorly designed conventional bonus plan – for example, the significant amounts that could be delivered under highly geared and uncapped arrangements, coupled with volatile financial performance, may encourage risk-taking in a way that is not compatible with the creation of long-term value.

One aspect of this issue is organizational. Companies should seek to ensure that appropriate delegations of authority and risk controls are in place to regulate the activities of those who might take excessive risks. Beyond the organizational aspect, we believe that this is something which should also be reflected in the design of the incentive plans. For example, the use of earnings-related measures without adjusting for risk could be one of the things leading to excessive risk-taking.

The need for a more long-term nature of incentives means KPMG member firms are already seeing growing interest among financial services companies in introducing deferral arrangements – with a few companies leading the way and already implementing them. These arrangements clearly have the advantage of introducing a more long-term dimension to the bonus. But they also have other attractive features, including the operational benefit of deferring the payments, the deferral of accounting charges, and in some cases possible mitigation of the tax charge by linking payout entitlement with long-term saving vehicles and salary sacrifice mechanisms.

At the same time, we note that some would view deferral mechanisms as not sufficiently radical in the circumstances, and wish to see them coupled with long-term performance measurement (for example, conversion of all or part of the entitlement into equity). We do however, expect that commercial reality will dictate a more pragmatic approach; otherwise organizations introducing radically different arrangements may run the risk of creating retention issues.

It is likely that if financial sector organizations fail to take steps to innovate to mitigate the risk inherent in the current arrangements, they may very well be imposed on them in one way or another[5].

The ongoing turmoil in the financial services sector puts pressure on the current pay system, but in our view companies could benefit from using these circumstances to stimulate change. Specifically, reviewing the role of annual bonuses could have the benefit of reducing costs and underpinning long-term value creation more effectively.

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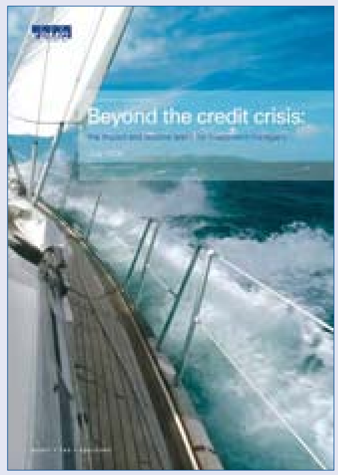
1. KPMG's Survey of Directors' Compensation, KPMG in the UK, September 2007.
2. http://www.guardian.co.uk, October 8, 2007.
3. Banks go from denial to reluctance on pay, Financial News, May 27, 2008.
4. ABI to review bonuses after reform calls, The Daily Telegraph, 6 May, 2008.
5. UK watchdog sharpens focus on bank bonuses, Financial Times, 21 May, 2008.

Beyond the credit crisis

The impact and lessons learnt for investment managers



KPMG's Global Investment Management practice, in cooperation with the Economist Intelligence Unit, recently launched the thought leadership focus paper for 2008 – *Beyond the Credit Crisis: the impact and lessons learnt for investment managers.*

This report is based on the online survey responses from 333 respondents from 57 countries as well as 16 interviews from senior executives in the industry.

Beyond the Credit Crisis: the impact and lessons learnt for investment managers, examines in detail for the first time how fund flows, returns and trust in fund managers have been impacted by the credit crisis and the economic conditions of the past 12 months. It investigates how, in the light of the challenges presented by the credit crisis, fund management firms are managing the increasing complexity of the instruments they use and the strategies they adopt.

To obtain a copy please either visit our website under: www.kpmg.com/financial_services
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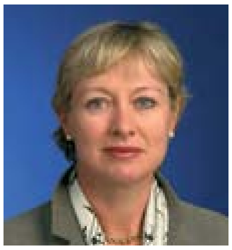
KPMG

10 steps behind... but still in the lead

In conversation with
Pinky Lilani OBE



Alison Halsey

Pinky Lilani OBE (Officer of the Order of the British Empire), is a chef, businesswoman, author, consultant and entrepreneur who has done more than most to promote the causes of gender and racial diversity. She is the founder of the Asian Women of Achievement Awards, the Women of the Future Awards and a range of networking and community initiatives. She recently spoke with Alison Halsey, a judge of the Women of the Future Awards 2006–2007, about her work.

Alison Halsey What drove you to become so involved in the field of gender and racial equality and to set up your various award schemes?

Pinky Lilani Unlike many people, I never had a strong vision of what I wanted to do. I came to Britain 30 years ago from India, recently married, and discovered I had to learn to cook and run a household. I didn't really think of pursuing a career – in India, Muslim women are not really encouraged to become educated and embark on a career because it makes them less attractive marriage partners. But after a while I began teaching people about Indian cookery, and then branched out into voluntary work in the Asian community. Asian culture tends to be very male-dominated, certainly in its public face. People used to ask me if I walked two steps behind my husband. In fact, I used to say that I walked ten steps behind, and then he didn't know what I was getting up to! Anyway, over time I discovered that there were all these impressive Asian women doing amazing things in business and the community, and getting no recognition for it. And as William James said, "The deepest principle in human nature is the craving to be appreciated". So in 1998 I had the idea of creating the Asian Women of Achievement Award.

Women and some minority groups tend not to push themselves forward, so business leaders have to take personal responsibility and make a genuine effort to find them.

AH I guess the time was right for it. Diversity was becoming a significant issue on the corporate agenda…

PL Yes, that's right. I was lucky enough to get some good sponsors, Cherie Blair (wife of former British Prime Minister) agreed to become a patron, and I was determined to find strong stories showing what Asian women were achieving and could achieve. We found an amazing range of success, from Asian women rappers to stand-up comediennes, opera singers and Meena Pathak, the co-founder of Patak's Foods. And you know what struck me? So many of these people said "Oh, I'm not worth this attention, nobody's interested". They had low self-esteem. But now lots of our winners have gone on to achieve even greater things.

AH And it has also become a great networking tool, you're not only getting people to believe in themselves, but also making the wider community aware of them?

PL Yes, the Queen recently gave a lunch for 200 women in business, and 14 of the guests were our award winners! You see a lot of it is about providing role models for other women, raising their aspirations. Asian women particularly, can be too self-deprecating. If we are to achieve much greater representation and visibility of women and minorities in the corporate world – which I firmly believe we must – we have to work on a range of different ways to overcome what holds them back.

Right: Pinky Lilani OBE, with British Prime Minister, Gordon Brown.

Far right: Pinky in her kitchen.

Opposite page: "Pinky Lilani OBE (Entrepreneur & Speaker)", Alison Instone '21 21st Century Women' ©2008. Reproduced with permission.

AH Do you think actual discrimination against women and minorities still exists in business?
PL Oh yes. A lot of it is subtle, and possibly not even conscious. But business people, especially at the senior levels, have a tendency to clone themselves. If they're all white men around a board table, and a vacancy arises, they'll tend to appoint someone who looks like themselves. Even if a woman makes it onto a board or into a top team, she can feel uncomfortable: people have said to me, "I felt I didn't belong there". And although a company may have a positive commitment to diversity, it's often superficial. People may say, "Oh yes, we have an Asian woman, or a Muslim, in our top team". But how well do they really know them? Do they socialize out of work? Do they visit each others' homes? If not, it's superficial. The benefits to be gained from genuine diversity of culture, background, experience and attitudes, especially in a globalized world can truly make a difference to business. I'm afraid a lot more still needs to be done, but its rewards are truly worth it.

AH Can I ask you about the vexed issue of quotas? It's a controversial subject, but do you think there should be specific targets for representation of women and minorities?
PL I do. Unfortunately, I don't think things will change significantly, fast enough, without it. It would make leaders look harder to find women who are as capable as men and deserve the recognition and the chance to fulfil themselves. We know they're there. Our awards have proved that. They simply need encouraging, mentoring. I know there is a danger of favoring weaker candidates just to fill a quota, and I wouldn't go as far as that, as far as positive discrimination. But I think you do have to have targets. Women tend not to push themselves forward, so leaders have to take personal responsibility and make a genuine effort to find them. And then of course, organizations have to make sure that the infrastructure is right to allow women to succeed, for example by paying proper attention to work-life balance.

AH Do you think more training is needed to bridge cultural differences in the workplace?
PL Yes, I'm convinced that proper training initiatives can raise awareness and help people to understand and respect and value cultural differences. But I think we need to be more creative in the ways we do this. For example, actually taking people to experience other countries and cultures can be incredibly powerful. People say that they are interested and willing to learn more, but they don't often do much about it. They tend to be very conservative, focusing on their small circle of acquaintances. All this does is reinforce the status quo. In fact, there's much greater benefit to be gained from exploring the outer limits of one's business and personal network, what the sociologist Mark Granovetter calls "the strength of weak ties". That's how you learn and develop and change. Companies aren't doing that.

The benefits to be gained from genuine diversity of culture, background, experience and attitudes, especially in a globalized world, can truly make a difference to a business.

AH But that needs investment over the long term.

PL And companies are too focused on the short term and the bottom line, especially in the financial services sector. Whereas in fact, it's building relationships which matters, and which pays off in the long term. That's what the *Women of the Future Awards* focus on, recognizing those women who may not have made it all the way yet, but have great potential. These are young entrepreneurs and businesswomen; forming networks and relationships with them now will pay off years in the future. We're lucky in that our sponsors recognize the need for long-term thinking and long-term nurturing in this area. It's the same inside a large organization. The long-term potential is two or three or four layers down. Women and people from ethnic minorities, especially, need champions. If you spot the people with real promise now, and encourage and mentor them, they'll never forget it.

AH Relationship development is especially important in financial services of course. Do you have any particular messages about diversity for big players in the financial services sector?

PL It has to come from the top, and it has to be genuine. There's still too much lip service paid to diversity. They have to be more creative, and find different ways of tackling the problem. And everyone has to be accountable. That's why, to go back for a second, I believe in targets. What gets measured gets done. For instance, Norway now has legislation requiring that 40 percent of company board members have to be women. Coming up to the deadline of December 2007, there was a massive rush to appoint women. So it worked. However, the proportion of women in executive management positions on boards in Norway, still remains much lower than the target, at 15 percent.

AH But surely women can't simply rely on taking advantage of quotas and targets?

PL Absolutely not. Minorities need to push for recognition too. As the saying goes, "The only thing you get without asking is an infectious disease!" So we have to make it easier for them to raise their profile, with initiatives like women's networks, which can be very powerful.

AH Are you encouraged by the progress that's being made?

PL I am. Attitudes have changed, and are still changing. It's much better, even though there's a lot of discrimination at all levels. My own experience has been very encouraging. But we need to keep pushing.

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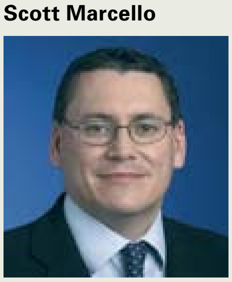
IFRS

It's not just about accounting

Scott Marcello



Gary Reader

The US is moving closer to general adoption of IFRS as the basis of public company reporting. A number of large corporations are already making plans to implement IFRS, and more are expected to do so following the SEC's recent announcement in August 2008. But IFRS implementation is much more than an accounting exercise. Fundamentally, it encompasses a broad range of changes impacting nearly every aspect of an organization and, as a result, should be carefully managed, as Scott Marcello and Gary Reader explain.

Changing accounting policies often requires changes to processes, systems, procedures and controls. In turn, this requires changes to the substance of employees' roles and responsibilities and, potentially, to the governance and organization of the Finance function.

Historically, listed US companies have been required to file financial statements according to US Generally Accepted Accounting Principles (US GAAP); and foreign private issuers preparing accounts on the basis of International Financial Reporting Standards (IFRS) have either had to use US GAAP in their Securities and Exchange Commission (SEC) filings or include a reconciliation between their published IFRS accounts and US GAAP. But the SEC in December 2007 announced that foreign private issuers can now report to the SEC on the basis of IFRS, without including a reconciliation with US GAAP.

The SEC has since taken the next step with its recent announcement to propose a roadmap for the adoption of IFRS for US issuers. Large US companies with global operations see a potential for achieving efficiencies in their finance operations if they can adopt a single global standard world-wide; in some cases such projects can also serve as valuable elements in overall finance transformation efforts. And reporting on the basis of a globally-accepted standard would facilitate comparison of reported results with international peers.

People and change management

Much of the comment and discussion on this topic has focused on technical accounting issues, the differences between the two sets of standards and the 'nuts and bolts' of adopting different definitions, conventions, approaches, and accounting policies. But from our member firms' experience of working with companies engaged in converting from one set of accounting standards to another, it has become clear that the switch to IFRS is not just an accounting issue. Adoption of IFRS is a major change management challenge for companies. And like many other major projects, it presents a broad range of challenges impacting people, systems and processes and each aspect must be carefully managed.

Changing accounting policies often requires changes to processes, systems, procedures and controls. In turn, this requires changes to the substance of employees' roles and responsibilities and, potentially, to the governance and organization of the Finance function. This calls for detailed project management and planning, the application of dedicated resources and talent, and a high level of senior management commitment to making the overall project a success. And each company's circumstances are different. Different structures, relationships with subsidiaries, consolidation processes and so on will require different treatment and present different challenges. Different parts of the group may currently be reporting on multiple bases of accounting. Ensuring the adoption of a comprehensive and consistent basis of accounts and consolidation throughout a global group will almost certainly involve varying degrees of systems, process and role re-engineering.

Some European subsidiaries of American corporations may already be reporting locally according to IFRS. But this may actually make the challenge greater in some respects. They may have adopted IFRS in ways which did not fully embed the new arrangements into their 'business as usual', relying on manual work-arounds for accounting processes and management reporting. Their processes and systems may not be consistent with those which need to be adopted for the corporation as a whole. Or, they may have adopted different accounting policies from those chosen by other subsidiaries. They will be understandably reluctant to revisit these issues and 'do IFRS' all over again. Overcoming challenges such as this will require effective communication, active project management, and training.

Strategy and project management

Large companies need to develop a clear strategy: for example, they should decide upon a fundamental approach as to whether to roll out fully IFRS-compatible systems and processes across the whole group all at once; or concentrate first on getting critical parts of the organization compliant, turning later to other areas.

A further challenge is that IFRS standards are not static but rather they continue to change. For example, efforts are under way at the moment

As real changes start to migrate into the organization, the same skills, expertise and resources are often needed, to ensure continuing reporting on the existing basis of accounting while introducing the new systems and processes.

to develop a comprehensive standard for insurance contracts, which could change current practice significantly. And since IFRS contains less application guidance than US GAAP, there are likely to be more situations where companies will need to apply significant judgments in their selection and application of IFRS accounting policies. Careful thought is essential in planning the implementation program and ensuring the new systems are sufficiently flexible and tailored to meet the requirements placed on them.

As with any major change program, implementing IFRS has to be managed while at the same time keeping existing processes and systems running effectively. While the two can be kept reasonably separate during the planning stages, as implementation progresses, the challenges become greater. As real changes start to migrate into the organization, the same skills, expertise and resources are often needed, to ensure continuing reporting on the existing basis of accounting while introducing the new systems and processes. Even if external support is sought, eventually the new arrangements have to be handed off to in-house staff.

In our member firms' experience, one of the most effective change programs aimed at implementing IFRS begins by establishing a broad and highly-experienced team, involving at the least senior executives and operational managers, internal audit and external auditors, IT and systems specialists. Additionally, many of the most successful efforts emphasize other important elements such as training and change management – recognizing the enormous impact that a change of this kind has on people at all levels.

All key stakeholders should be consulted over key accounting policy decisions. Experienced project management skills need to be assembled; people who understand the integration of all elements of the IFRS conversion project with the range of existing priorities and initiatives the organization already has in place. Finally, the people impact of change can often be underestimated. Roles will have been re-engineered. There will be new expectations. There may be a need to address capability gaps or to modify behavior. The conversion project will fail if these issues are not systematically addressed.

In view of the critical nature of accounting systems to any company's management of and reporting on operations, it is clear that moving to IFRS has to be approached as a major change management project; not just an accounting project.

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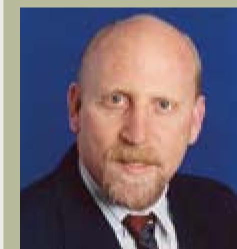
US IFRS: Is change imminent?



Paul Munter, Partner at KPMG in the US reviews the current status of IFRS in the US.

Financial services companies considering the move to IFRS should start considering their change programs now, following the SEC s decision in August 2008 to propose a roadmap for potential adoption of IFRS by US public companies. The proposal identifies milestones and directs the SEC staff to monitor progress between now and 2011. The goal is to be undertaking rulemaking in 2011 on the possible mandatory adoption of IFRS, on a phased in basis beginning with calendar year 2014 financial statements of large companies.

The proposal would also permit large US companies who are among the 20 largest companies in their industry, and have IFRS as the most commonly used GAAP among the peer group, to start using IFRS beginning with calendar year 2009 financial statements.

In deciding whether to mandate the use of IFRS, the Commission will be looking, at least in part, at experiences in other jurisdictions. It is perhaps significant that regulators in countries such as Canada and India have set targets around 2011 for IFRS implementation. It now appears more likely that many US public companies will be converting to IFRS over the next few years. Although some uncertainties remain, there are growing indications that the adoption of IFRS for US public companies is a potential outcome.

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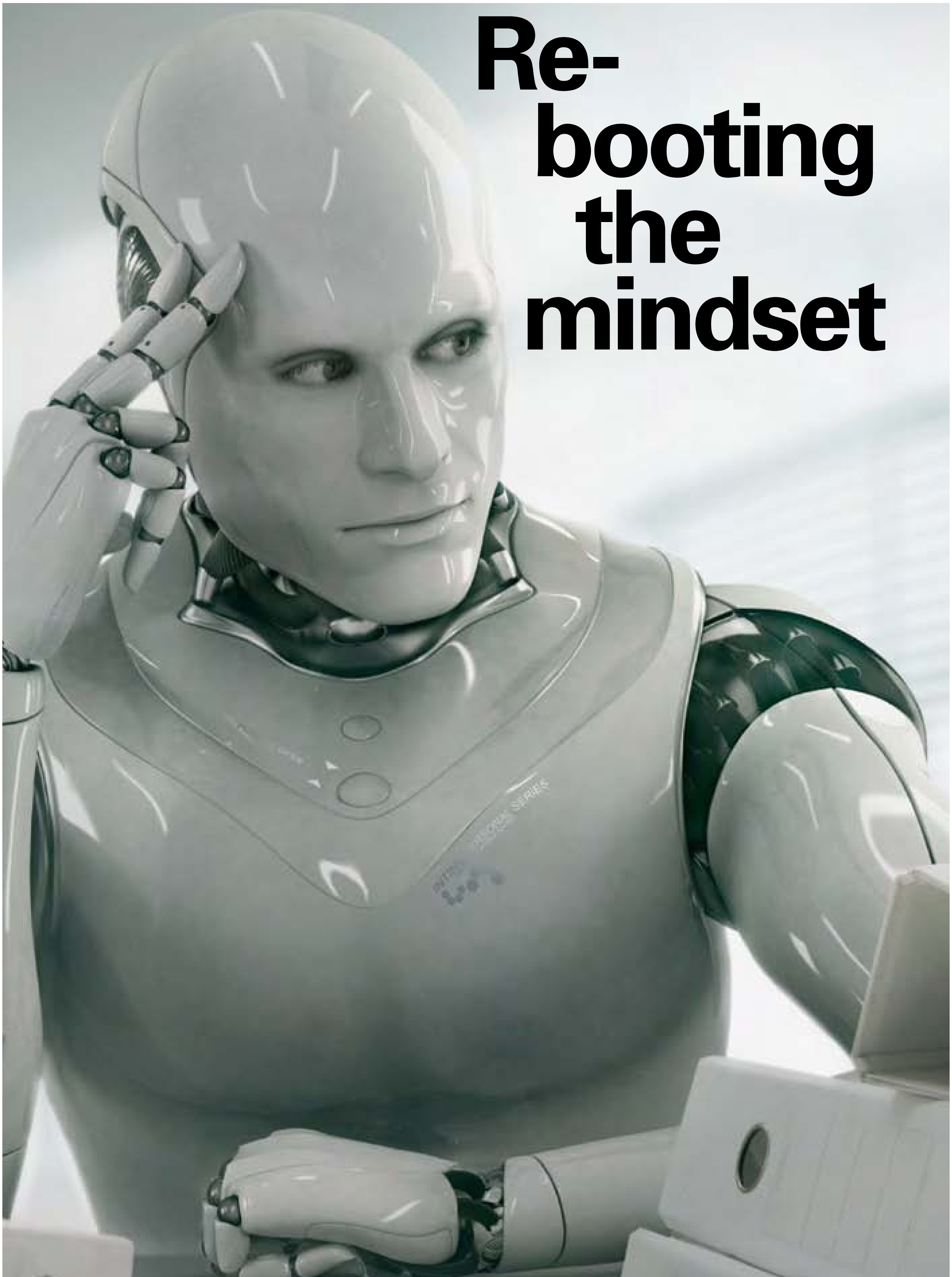
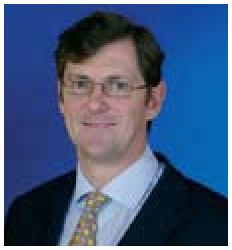
Re-booting the mindset





Martin Blake

Peter Outridge

Financial services companies are increasingly spending very large sums on replacing outdated and inefficient core systems. But all too often these fail to deliver the desired results. A key factor is failure to appreciate and manage the people aspects of major systems projects. Martin Blake and Peter Outridge explain.

As with all major change programs, it's the soft or people issues that can be hard to resolve.

Many companies, across all segments of the financial services industry, are embarking on large scale core systems replacement programs. Current systems are typically complex, poorly integrated legacy systems that have grown organically. The complex web of interfaces between different systems makes it costly to both support and adapt to market and regulatory changes. These systems are written in languages that are rapidly becoming obsolete and the right development resources are becoming harder to find. As financial services companies strive to improve customer service – and boost profits through more effective selling – they are finding the complex web of existing systems is expensive and cumbersome, resulting in operational inefficiency and significant additional overheads. They provide neither customers nor internal operations with the information or flexibility they need.

The case for change is given added urgency by recent developments in the financial services market. The asset management business is growing rapidly, and is likely to continue to do so with the increase in retirement savings. The amount of money flowing into banks, and the volume of transactions, are increasing, placing greater strain on existing systems. Regulatory changes place greater requirements on banks' management and reporting systems. Current systems are simply outdated and cannot cope.

But replacing core financial and management systems is expensive, very expensive. A large Australian bank has recently approved a business case for more than AUS$500 million to implement a new core system. And it goes without saying that such projects are immensely complicated. They often displace other initiatives in a concerted effort to channel resources to deliver value in the shortest timeframe possible. Nevertheless, they can typically involve sustained project management effort and resources over a number of years.

The big danger is that developing and introducing the program is approached and managed primarily as an IT project. Typically, a lot of effort is focused on developing new technology, ensuring the new systems interface effectively with each other and deliver the right outputs to meet business and customer needs. But while these are important, they are not the most challenging issues. As with all major change programs, it's the soft or people issues that can be hard to resolve.

A key challenge is to ensure that the change program delivers the desired behavioral changes. Introducing a new core system, however well-designed, streamlined and apparently effective, may prove a major waste of time and money if the desired behavioral changes are not realized: if data owners fail to ensure effective entry of cleansed data into the new system, if front-line staff fail to respond to the prompts and opportunities the new system provides.

New core systems impact on all operational staff and on many aspects of the customer experience. Both staff and customers need to be made comfortable with the new ways of interacting, brought into the process and kept informed throughout the change program. How do successful organizations manage the complexity of the people agenda while also managing the complexity of large scale systems change?

Figure 1 People and change

Pitfalls	Proven strategies
Wrong people involved in design	Interactive events designed to accelerate design of the end state Ensure there is a cross section of decision makers and doers
Initial involvement in design, then nothing	Ensure continued involvement of business users, leading change at the front line and driving
Wrong KPIs and no way to measure them	KPIs designed to measure the customer/staff behaviors that will deliver desired business benefits
Not understanding what customers value and will pay for	Invest in customer research and make it part of the business case
Not understanding what it takes to change the way people work	The business case should include the impacts and costs of transitioning to a new way of working

Source: KPMG International, August 2008

Key pitfalls

As KPMG member firms' work with clients who are at various stages of these changes, we observe a number of pitfalls that all organizations should beware of:

- **Failure to involve the right people** at the right stage of the development of the system requirements. It is critical to ensure that the solution is not only a technology-driven solution, which may fail to deliver the desired outcomes and leaves end-users and customers wanting for more.

- **Failure to maintain business involvement** beyond the initial phase of requirements definition. One of the challenges is to try to ensure that an effective change plan and stakeholder engagement plan can take people to the point where stakeholders feel confident and prepared to adopt the desired behaviors required for the Target Operating Model.

- **Not measuring the adoption of new ways of working.** The success of a large scale system implementation lies in the capacity of employees to change their behaviors and adopt the new ways of working. This can really only be measured by ongoing contact with key users. For example, are tellers in the branch actually following the new prompts from the system to try and sell the most profitable complementary products to customers? If such junior staff are not trained and incentivized appropriately, potential value from the new system can be lost.

- **Not understanding what customers value and will pay for.** As organizations expand their offerings and try to capture a larger 'share of wallet', adoption of a customer-centric approach is increasingly important. This often requires a significant shift away from historic product-centric ways of thinking and organizing. Ensuring this shift is successful requires a thorough understanding of what customers want and of the end-to-end customer experience.

- **Not understanding what it takes to change the way people work.** Staff can easily be disenfranchised if there has been inadequate planning and support to enable them to transition to new roles, and they feel their views have not been considered.

Two contrasting views of the customer need to be understood: the *inside out* view – what the organization believes the customer wants; and the *outside in* view – what the customer actually says they want.

Keys to success

There are a number of strategies which successful projects are adopting:

- They use new and innovative ways of involving business users, ensuring their understanding of the vision and their involvement in requirements definition. Useful methods include multi-day events where key stakeholders are brought together to address key issues the organization is seeking to resolve. These events help to ensure that participants actively contribute to and discuss the issues that are keeping people awake at night. They may not provide all the answers in one session, yet they can put the issues on the table, identify areas for further exploration and most importantly provide key stakeholders with an active voice. Communication and involvement reduces resistance and helps to ensure acceptance of the finished product.

- The use of extensive people networks throughout the business, involved in ongoing design sessions to help ensure affected groups have the opportunity to provide feedback and contribute to the final result. With multi-year, multi-million dollar programs, it is important to be prepared to revisit business needs as the program evolves.

- Business user networks provide deep insights into the readiness of an organization for change, where pockets of resistance may remain and how successfully the organization is adopting the change. Measuring the success of change should go far beyond a system and procedural compliance. Many successful organizations adopt a Balanced Scorecard that measures behavioral change across key dimensions critical to their success criteria. These measures will reflect business users' and customers' behavioral responses to change. Are they responding in a manner that will enable realization of the desired business benefits?

- Clear articulation of customers' wants and needs is essential to getting the customer-centric view correct. The true implication of this may often be overlooked. Two contrasting views of the customer need to be understood: the *inside out* view – what the organization believes the customer wants; and the *outside in* view – what the customer actually says they want. Being very clear about this distinction and making sure accurate data is to hand is key to developing the end-to-end customer experience.

- Effective planning for the transition to the Target Operating Model. In any systems-related change there will be impacts on roles and team functions that require effective planning and execution. As teams, functions and activities are wound down in one area, and potentially transferred to new teams and roles, it is critical to business continuity that all of the required activities are meticulously accounted for and a smooth transition to the target state is achieved. Failure to do this can result in significant stress on employee roles, disrupt the provision of services to customers, threaten business continuity and potentially damage the brand and shareholder value.

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As Mark Twain once said, "rumors of my death have been greatly exaggerated", so it is with Basel. With the modern day predilection towards change for change's sake, it is worth considering whether the old adage of "if it ain't broke, don't fix it" should hold true with respect to Basel II[1]. Having had the misfortune to be introduced in all its glory at a time when the banking industry was starting to face its biggest crisis for over 50 years, many are already asking what needs to be done to 'fix' Basel II. Is Basel II no more, has it ceased to be, has it expired and gone to meet its maker? Steven Hall explains.

Is Basel dead?

Temporarily uncertain of position

In my opinion, Basel II is not lost, just temporarily uncertain of its position. While Basel I is universally accepted as having been too simplistic and to have encouraged regulatory arbitrages of various persuasions, no commentator would argue that Basel II is a perfect response. In the same way that a camel is described as a horse designed by a committee, Basel II, designed over a prolonged period by a multi-national miscellany of interested parties, comes with its own lumps and bumps – liquidity risk and concentration risk being two such sticky out bits that never really seemed to "fit" within the neat prescriptive Pillar 1 framework. However, knee-jerk reactions to recent events won't help anyone. As with so many things, 'change in haste and repent at leisure' seems an appropriate warning.

Focused change

As industry commentators and politicians stand on the sidelines, there has been a need to make changes, for political reasons if nothing else. So far, these changes have been targeted at specific areas of perceived weakness in Basel II:

Liquidity risk

This has been a perennial feature of any discussion on banking and Basel over the past year, noted specifically because it was not explicitly covered in Basel II. Regulators could be forgiven for pointing out that Pillar 2 would, and probably should, have covered liquidity risk, and that any number of supervisory bodies had issued guidance and principles on liquidity risk over the past decade. But still, there is nothing like a good crisis for bringing such matters to the attention of senior management and the general public and ultimately capital is not the best lever to use for liquidity management anyway. Arguably, the challenges of implementing Basel had taken regulators' eyes off business as usual, to which liquidity management supervision in banks should be central.

The Basel Committee has therefore taken advantage of recent events to publish two papers in the last six months – an initial early one was not much more than a place-holder, a quick summary of the problems; the second adopts the now traditional principles-based guidance to such matters from the Committee (similar to its work on Interest Rate Risk in the Banking Book, Credit Risk management and Internal Audit arrangements). Although I am sure many people would agree that the guidance is a timely reminder and a less than gentle prod for banks and regulators alike, I find it hard to see much that is particularly new in it; it's certainly not 'rocket science'! Indeed that is the fundamental problem with liquidity risk – at a recent industry seminar, liquidity was described as being synonymous with confidence and it can be very hard to apply models to confidence.

Trading book and structured credit products

The other area that has been problematic over the past year has been the structured credit markets and the operation of the trading books. With the securitization markets dried up now for the best part of a year, it has given regulators a chance to examine (again) the approach to be used for the regulatory capital calculation. The old chestnut that has reared its ugly head once more is the issue of 'risk transfer' – have banks actually got rid of the risk when obtaining capital relief for their securitization transactions, and what will actually happen in extremis. The industry response to the latest EU proposals with respect to capital charges for credit transfer products is evidence of the difficult stand-off in which we now find ourselves.

Again, with excellent timing, the Basel Committee has published further guidance for the calculation of the incremental specific risk charges in the trading book[2]. Since the start of the year, this has evolved to cover event risk, spread change risks and not just pure default risk in a firm's trading portfolio.

No one would deny that the complexity of products now being traded, the desire of banks to push the envelopes of their trading books and the events of recent months have shown up the frailties in banks' VaR models, the breakdown of valuation and correlation assumptions and the need to explore the tails of distributions much more effectively. If you go back to when Basel II was first being developed, some of the products now being traded were just a twinkle in the trader's eye and so it is perhaps not surprising that the regulation has taken some time to catch up.

Looking forward

So to return to the title of this article – is Basel dead? I think it would be a shame to believe this, just as the US finally get round to implementing the Accord[3]. However, I don't think Basel is dead, I don't think Basel will ever die; what it will do is to evolve more organically and more fluidly than was perhaps originally considered – the days of being able to move from one standard Accord block of regulation to another 18 years later (following 5 to 7 years of consultation) are gone. Both regulators and banks should seek to respond more quickly, coherently and consistently to events in the market, without engaging in knee-jerk short-term fixes. It is a cliché but the world moves more quickly now; we live in interesting times, and regulation needs to be able to respond accordingly.
In doing so, we must make sure that we don't straitjacket business, constrain innovation and restrict further the functioning of the banking and capital markets.

If you go back to when Basel II was first being developed, some of the products now being traded were just a twinkle in the trader's eye and so it is perhaps not surprising that the regulation has taken some time to catch up.

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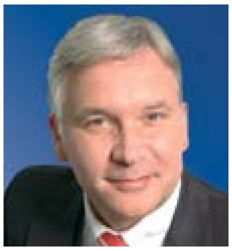
1. Bank for International Settlements, Basel Committee on Banking Supervision, International Convergence of Capital Measurement and Capital Standards, A Revised Framework, Update June 2006; introduced into the European Union via the EU's Capital Requirements Directive relating to the taking up and pursuit of the business of credit institutions (recast), June 2006 version. In the UK, the CRD is implemented as the FSA's Prudential Sourcebook for Banks and Investment Firms (BIPRU).
2. 'Guidelines for Computing Capital for Incremental Risk in the Trading Book', Basel Committee on Banking Supervision, July 2008.
3. On the 8 July the US Banking Agencies issued a joint statement on the Basel II Advanced Approaches Qualification process.



Markus Steitz

Gerben Schreurs

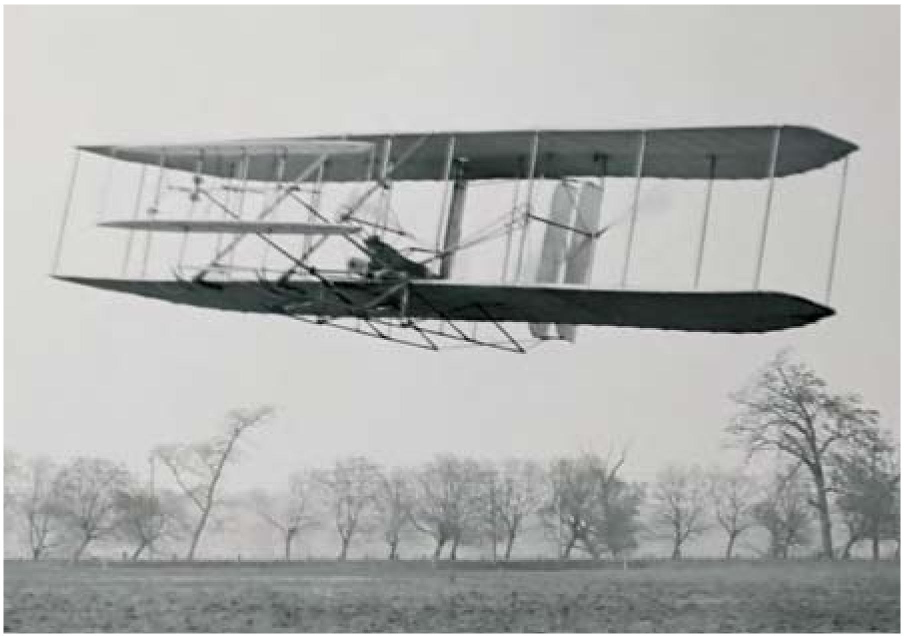
Christian Casaretto

Product innovation in the Investment industry

Faster, higher, stronger

...without the backlash

Time-to-market has become one of the key differentiators in the financial services industry, particularly in the investment management sector. However, fund and asset managers face a number of challenges in their efforts to achieve a better time-to-market. Recent KPMG research shows that fund and asset management firms should seek to adopt an integrated, enterprise-wide approach to product innovation[1].



The financial services industry is going through a period of major transition. Within the context of globalization and the widespread incorporation of technology, time-to-market for new financial instruments has dramatically shortened. In recent years, the volumes of sophisticated products released onto the market, means investment managers are losing market share to actively managed hedge funds and passively managed exchange-traded funds (ETFs). Alternative investments have now become more mainstream. "Organizations have sharpened their focus on risk issues, yet when it comes to launching state-of-the-art financial instruments, the once sharp-witted, critical focus seems to blur. Admittedly, this is hardly surprising given the huge complexity of financial instruments, systems and markets, and cross-border interdependencies" says Gerben Schreurs, KPMG in the Netherlands.

Managing a multitude of risks

Although risk is endemic to the financial services industry and risk management frameworks already exist to contain and mitigate the risks involved, fund and asset managers face quite considerable challenges in the product introduction process including:

Potential regulatory challenges:

- Compliance with international regulatory guidelines and local requirements (e.g. IFRS, Solvency II, MiFiD, UCIT III/IV, Derivative Regulation)
- Increasing requirements with respect to: reporting, corporate governance, risk management, accounting and taxation laws.

Potential economic challenges:

- Product profitability
- Fit product with market-demand
- Economies of scale.

Potential process-related technical challenges:

- Systematic pricing and valuation and correct treatment of complex products and derivatives in day-to-day business activities
- Service level agreements with clients and external service providers (custodians, fund administrators).

Additionally, fund and asset managers must manage non-financial risks, including reputation risks, information security and supply chain disruption.

Failing to meet the above mentioned challenges could have serious implications. It can lead to inaccuracies in valuation and inefficiencies in processing – to name but the least serious. One of the greatest challenges is creating an effective process to capture, account and report the information associated with new products being introduced onto the market. Integrated, well-structured and accurate product design is required to limit risks, eliminate reporting issues, secure market entry and enhance the overall process.

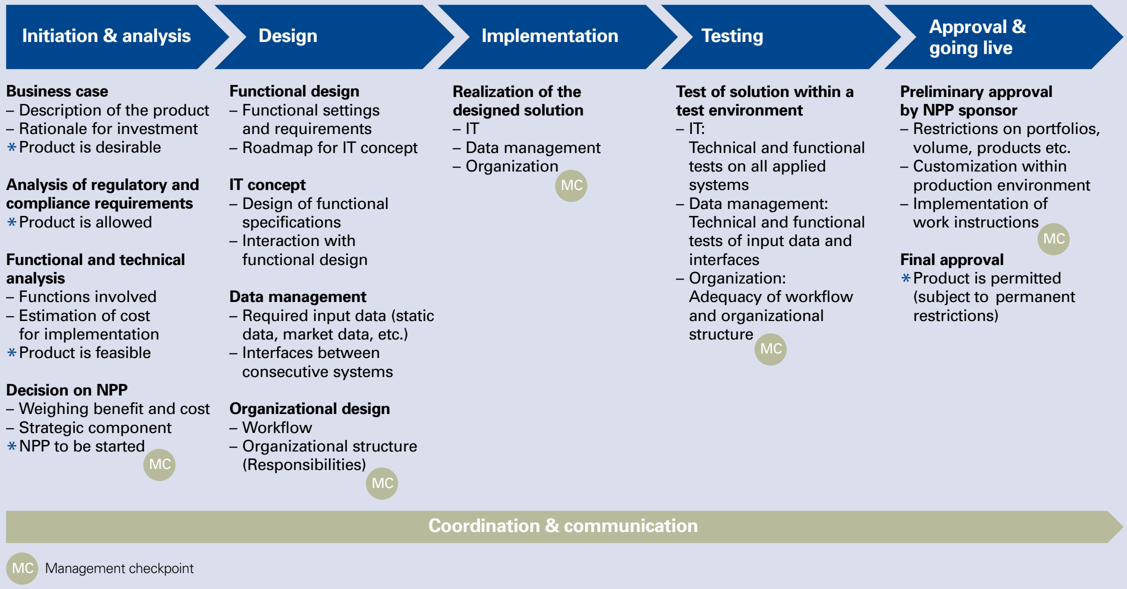
Re-evaluating risks

However, as always, practice differs from theory. According to the KPMG report[2] there is widespread sentiment that fund management firms should be re-evaluating what kind of business they are conducting and the risks they are running. Christian Casaretto of KPMG in Germany says, "The research found that while use of complex financial instruments is rising (57 percent of traditional fund management firms surveyed said they use derivatives in their portfolios), 50 percent of fund manager respondents admitted to having no in-house specialist with relevant experience of the complex financial instruments in which they have invested." Institutional investors revealed they are at greater risk still, with around one in three investing in these instruments saying they have no in-house experience of them.

Synchronizing internal processes

What's more, funds that can boast a well-structured, integrated or perhaps even holistic approach in product design will not be driven out of business. According to Christian Casaretto "Players aim for first mover advantage in a tightly knit, 'me too' financial arena. They need absolute trust that new products are well-designed and engineered and fully compliant. Internal processes as well as coordination and communication between front-, mid- and back-office should be synchronized and fully functional." If not, confidence

Figure 1 The New Product Process Phases



Source: Developed by the Global Development Project team, KPMG International, 2008

> "They need absolute trust that new products are well-designed and engineered and fully compliant."

can be eroded, resulting in negative impacts. Practice shows that internal processes are often not interconnected. There's a long list of challenges affecting many organizational areas which include:

- How to value illiquid products or derivatives and how to administer them?
- Are contracts fully compliant with (new) regulations?
- Does the product fit within the mandate?
- Is it aligned with existing IT systems and back office administrations?
- Have the risks been properly assessed, prioritized and communicated with the custodian, with brokers, with clients?

"This extends beyond organizational boundaries and therefore needs close scrutiny. An adequate product approval process has become a business imperative. In today's arena there should simply be no margin for error when it comes to product introductions" says Gerben Schreurs.

Trust has been eroded

The survey examines in detail how fund flows, returns and reputations of investment managers have been impacted by the credit crisis and the economic conditions of the past 12 months. Other results of the KPMG survey include:

- Investors do not have the same enthusiasm for complex products as fund managers, and the trust in fund managers has fallen as a result of the credit crisis
  - 70 percent of investors who answered the survey say that the credit crisis has reduced their appetite for complex products
  - 60 percent of respondents believe trust in fund managers has been eroded due to the effects of the credit crisis.

The good news is that, according to the survey, many firms interviewed are already responding to the new environment with a shake-up of internal processes and controls. Christian Casaretto comments, "Four out of ten respondents said they had already formalized their risk frameworks in the past two years and a similar number of respondents said that they plan to do so in the next two years. Risks should be reviewed periodically to re-examine possible sources of risk and changing conditions."

Next steps to be taken

Key initiatives for industry players going forward should include enhancing client communication and improving the customer-centric focus of products. The KPMG study found that a renewed focus on educating stakeholders about how complex products work and much greater investor assurance regarding governance issues will be vital to restoring confidence. Reassuringly,

Figure 2 New Product Process – Combined View of Phases and Functions (Matrix)

			Phases				
			Initiation & Analysis	Design	Implement-ation	Testing	Approval & going live
Business Functions	Specialists	Fund management	x	(x)	(x)	(x)	(x)
		Market research	x				
		Legal	x		x		
		Tax	x				
		Internal audit	x	x	x	x	x
		Economic analysis	x	x	x	x	x
	Operations	Trading	x	x	x	x	x
		Compliance	x	x	x	x	x
		Order control	x	x	x	x	x
		Pricing & valuation	x	x	x	x	x
		Risk analysis	x	x	x	x	x
		Performance analysis	x	x	x	x	x
		Fund accounting	x	x	x	x	x
		Reporting	x	x	x	x	x
IT Functions		Data	x	x	x	x	x
		Interfaces	x	x	x	x	x
		IT architecture	x	x	x	x	x

Coordination & communication

Coordination & communication

The X's indicate in which phases issues are identified by the work respective functions within the framework.

Source: Developed by the Global Development Project team, KPMG International, 2008

the survey found that valuation methods and governance arrangements had either already been addressed or were high on the agenda for a significant proportion of respondents.

Gerben Schreurs says, "It has become a fact of life for successful firms to embrace the use of structured products and derivatives in their product portfolio in order to enhance performance with acceptable risk parameters. This requires a cross-sectional approach towards internal processes, customer needs, and product life cycle management, demanding a thorough, ongoing review of existing processes, procedures and policies. This is one of the only ways to try to avoid backlash and restore trust and confidence." Ultimately trust needs to be built on excellence – faster, higher, stronger and safer.

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70%

of investors who answered the KPMG survey say that the credit crisis has reduced their appetite for complex products

60%

of respondents believe trust in fund managers has been eroded due to the effects of the credit crisis

40%

of respondents said they had already formalized their risk frameworks in the past two years

1, 2. 'Beyond the Credit Crisis: the impact and lessons learnt for investment managers', KPMG International, July 2008.

Antonia Blake takes an offbeat look at the world of recruiting top talent into wealth management. Is it really a game of two halves?

We are the

Building the winning team!

Avoiding scoring an 'own goal' in the wealth management war for talent

The worlds of wealth management and football, or soccer as it is known in some parts of the world, might not conjure up immediate comparisons. According to Charlotte Black, a director of London-listed wealth manager Brewin Dolphin, much like a great footballer, a great wealth manager is a raw talent. "The ability to deal with people on a range of levels is fundamental and cannot be acquired," she says.

"However, in both football and wealth management, raw talent needs to be honed through training and experience and, in the case of wealth management, gaining appropriate qualifications."

Nature versus nurture

Famously, football has two distinctly different approaches to hiring new players. Clubs either spot and develop talent over a number of years or go all out to buy the best talent in the market. Each approach has benefits and challenges in terms of sustainability and results.

Arsene Wenger's reputation for nurturing talent as manager of English premiership team Arsenal is notable. The club often takes on players with raw ability and flair, providing them with a mix of training and first team appearances with the aim of making them world class. By contrast, buying the best, experienced, talent with owner Roman Abramovich's £12bn[1] fortune is the basis of London rival Chelsea's success in recent years.

Similar principles apply in wealth management and like Chelsea, by far the most common way for wealth management firms to acquire new recruits is hiring from their rivals.

To buy or not to buy

Wenger said in 2007 that if a rich owner offered him £100m to spend on players, "I'd say to the guy, 'Keep your £100m. You must understand that my team is the work of five years, and now to destroy what we have by buying big names would be crazy'".

Firms like Barclays Wealth agree that the ideal is to build rather than buy to create the shape of the business you want. Its recruitment strategy is akin to an inverted triangle where currently graduates make up the tip, hires from other professions with transferable skills the middle portion, and existing bankers hired from competitors the majority. Barclays Wealth intends to reverse this triangle and says that its 'lateral' hires are already starting to take up key positions in the group.

Poaching talent is undoubtedly a simple and successful way of solving immediate staffing issues and in the current financial environment, it is tempting to hire recruits that can achieve immediate results.

Such a strategy demands deep pockets though. A fully-costed relationship manager will take on average £500,000 a year from the bottom line and the credit crunch is apparently having little impact on compensation levels. Rumors abound of remuneration packages for experienced bankers at levels which will take three or four years to achieve break even as banks attempt to gain market share from their rivals affected by the sub prime crisis.

champions


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A structured approach to remuneration

Arsenal FC's commitment to nurturing its players means that it is often able to attract talent without breaching its reputedly rigid pay structure. This is echoed by those firms that have made wealth management core to their offerings, who report that in order to gain job security and continued development; bankers are willing to join them on their existing salaries and without a golden 'hello'.

Paying top dollar a recipe for success?

Paying top dollar for talent is not always a winning formula. In the same way that Arsenal's young talent does not always have the same success when transferred to a new club, star wealth managers might not hit the ground running as quickly as recruiting banks would like. They need to fully understand the new firm's way of working and will not bring clients over until they are confident that the proposition they can offer to them is strong. There can be instances of culture clashes and expectations not being met on both sides, which means that some high profile hires simply do not work.

While more private bankers are now moving, it is becoming harder to find quality and the challenge for firms is to determine who is really selling a book of business and who has recently inherited it.

There are only a certain number of moves that a wealth manager can make before losing credibility with clients and within the industry. What is more, the client assets that a relationship manager can take over to the new organization are likely to be a very small percentage of their total book. Just as football supporters are loyal to a club the clients of a bank increasingly see themselves as belonging to the organization rather than the relationship manager. The organizations have seen the trend towards "star managers" coming and have taken steps to mitigate against losing clients in these circumstances. The success of recent legal moves against a breakaway from a large international wealth manager have also thrown some doubt on the ease with which clients and colleagues can be recruited to another organization.

Ongoing development and a team approach is key

Continued development is crucial for both novices and established talent. Coutts, the wealth management arm of UK-listed bank RBS, recognizes the necessity of nurturing and rewarding talent at all levels, from its most junior staff and graduate private bankers, all the way up its ranks.

"We give staff a diverse mixture of support and training to guide their career path, from teaching highly technical investment skills and business education on global issues through to softer communication skills," says Nick Pollard, Managing Director, at Coutts.

A team approach is crucial in wealth management where a firm's client experience is only as good as the person covering the phone when the lead banker is not there. According to Coutts, a team-based approach facilitates the emergence of real career stepping stones, which are crucial for developing and retaining talent. Having performance-based reward structures in place are also a key factor in motivation and loyalty, as are providing qualifications that advance careers.

A team approach is crucial in wealth management where a firm's client experience is only as good as the person covering the phone when the lead banker is not there.

It seems that buying talent is no guarantee of ultimate success. After winning the Premiership title in 2005 and 2006, Chelsea have only managed to achieve runners up status in the last two seasons, with Abramovich acknowledging that youth development is a priority for his club.

Thinking laterally

Firms have started to get creative about how and where to recruit staff. Recruitment of new graduates is becoming increasingly common and lateral hiring, taking people who are already established in other disciplines, is another approach.

To help meet the huge increase in demand for talent in Asia, UBS opened its Wealth Management Campus for the Asia Pacific region in Singapore in April 2007, with a view to training 5,000 existing and future wealth managers over the next three years.

Barclays Wealth's Embark program takes individuals who have proven themselves in other disciplines – such as professional services, management consultancy, asset management and investment banking – and overlays industry knowledge, expertise and qualifications, the initial stage of which is a bit like a mini MBA.

While paying for top talent can be expensive, training programs also require considerable capital investment and cash flow.

"Both approaches must be used simultaneously and each will fail if used in isolation. It is necessary to hire experienced talent to provide the depth of mentoring capacity to support the development of less-experienced private bankers," says Mark Kibblewhite, head of the UK operation at Barclays Wealth.

Credit Suisse believes that while hiring experienced staff can help develop a private banking business in the short-term, banks need to develop sustainable talent for the future.

"Teaming junior bankers with more experienced staff is a proven way of developing the next generation of bankers as are structured, in-house education programs. Many successful bankers started their careers in exactly this way – learning the business at grass roots levels," says Matthew Spencer, Head of Intermediaries Business Development at Credit Suisse's Private Bank.

He also makes the point that junior talent is an investment and like any investment, the benefits may not be immediate. "Banks who invest in junior talent are more likely to be rewarded with longstanding and loyal employees."

Aggressive hiring – an own goal for wealth management?

So, which is the right approach? It seems that buying talent is no guarantee of ultimate success. After winning the Premiership title in 2005 and 2006, Chelsea have been runners up in the last two seasons, with Abramovich acknowledging that youth development is a priority for his club.

There is a structural shortage of talent in the wealth management industry and without graduate recruitment and lateral hiring programs; the industry fears that the pool of private bankers could run dry.

James Anderson, Head of Wealth Management at recruitment firm Drayton Finch, believes if this is not addressed as a matter of urgency, "there will soon be gridlock and the promising growth in the private banking industry in recent years will come to a grinding halt".

Developing a core of talent and complementing this with strategic hires from other firms seems to be the key to long term success for both individual firms and the wealth management industry. One approach is just not sustainable without the other. Manchester United FC has followed this strategy in recent years and has overtaken both Arsenal and Chelsea to win the Premiership by adopting both a youth development program and an extravagant hiring in policy.

Continued aggressive hiring without investment in nurturing talent might be something of an 'own goal' for the wealth management industry, which will perpetuate rather than alleviate its talent shortage.

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1. 'The World's Billionaires', www.forbes.com, May 5, 2008.

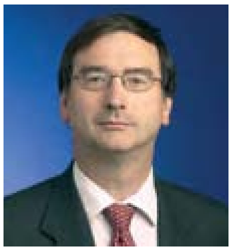
Emerging Markets

Brazil
High yield potential

So far, the Brazilian economy has largely escaped the worst impacts of the sub-prime mortgage crisis in the US. Debt in the housing market is low by international standards, with buyers typically borrowing no more than 70 percent of value. As a result, there is no significant secondary loan market. In fact, there is comparatively little debt in the economy as a whole, since historically credit has been hard to come by.

In recent years, inflation in Brazil has been brought under control, and falling interest rates and rising consumer confidence have helped to make the country's real estate sector ripe for expansion. Ratings agencies are increasingly positive about Brazil's credit-worthiness, and this should trigger an inflow of foreign capital eager to exploit what is an underdeveloped market. With strong domestic industries in oil, banking and agriculture, Brazil is poised to become a Latin American powerhouse.

Residential developers have raised considerable funds over the last few years, which have fuelled significant investment in the build up of land banks; this stock is now ready to support an increased rate of construction. The opportunity for additional capital investment to find a profitable home is clear, and money is already flowing into the market through equity, local banking and international real estate investment funds. But Brazil is an extremely large country – only a little smaller than the US – and realizing its real estate development potential is likely to mean the necessary consolidation of a number of smaller and mid sized players.



The credit crunch is taking its toll on many financial services businesses. Margins are being squeezed; losses are being recorded. Investors in real estate are particularly feeling the squeeze. In this difficult economic climate, can the emerging markets of Brazil, Russia and India offer the prospect of better returns? Jonathan Thompson reviews the outlook.

Russia and the CIS*

Good opportunities, but possible pitfalls

Investment in Russian real estate is subject to many of the same risks affecting investment in other sectors. While the authorities seem to be serious about creating a more business-friendly environment, political, legal and regulatory risks remain. The Russian government has a history of interfering in business which has not yet been fully dispelled. In the real estate sector, there is still a tendency to state expropriation of land whenever it sees a strategic need.

Much of the legislation regarding real estate is new and subject to varying interpretation. For example, leases on land are commonly restricted to a 49-year term in Moscow, a constraint which is often not applied in other regions. There are practical problems facing the construction industry too, most notably a chronic shortage of building materials.

Nevertheless, Russia has experienced strong growth in both GDP and real income in recent years. This healthy domestic market has attracted a surge of foreign investment into real estate, with the value of such capital trebling between 2005 and 2007 to US$9 billion[1]. The Russian banking sector is relatively lightly exposed to the impact of tightening global credit and has comparatively low international debt.

As a result of the strong economy and the benign credit position, demand for commercial property in Moscow is outstripping supply, with rises in office rent of as much as 40 percent a year. The market in St Petersburg is similarly thriving: yields approach those being obtained in Moscow, and a major development project is beginning at the city's airport.

Within the broader CIS confederation, Ukraine and Kazakhstan both offer good prospects. In Ukraine, the political crisis of 2007 appears to have subsided, and stability is returning to the economy. Strong demand for office, logistics and retail space is developing. Unlike some of its neighbors, Kazakhstan's banking sector has had significant international debt, and has suffered quite badly from exposure to the US sub-prime crisis. But its retail development sector is nevertheless experiencing fairly strong growth.

External investors in the real estate sector remain justifiably somewhat wary. But high returns, developments in residential, infrastructure and recreational facilities and favorable tax regimes underline the potential for good returns.

India

The next Asian tiger?

Direct foreign investment in India's real estate sector is currently restricted: only the purchase of shares and convertible instruments is allowed and only where deals are of a particular land size. But this is likely to change in the near future as the country continues its relentless growth, opening up major opportunities.

Strong economic growth, a young, aspiring population of over a billion and a growing, educated middle class are all fuelling a rapid rise in disposable income. Millions of Indians are moving to the cities to take advantage of employment opportunities. There is a severe shortage of houses and apartments, estimated currently at up to twenty million homes. The property market has enjoyed an annual growth rate of 20 percent, and should reach a total value approaching US$100 billion by 2010[2]. And it's not just the residential sector which is growing quickly: urbanization is driving developments in infrastructure such as transport, logistics, health and education.

Despite this, India's real estate market remains relatively immature. However, growing demand for property and the need for funding to hold inventories, means investors are achieving yields on commercial property that are considerably higher than the traditional Asia Pacific hotspots of Hong Kong and Singapore – up to 10–11 percent[3].

India's government is keen to encourage more rapid economic growth, with liberalized economic policies being introduced generally, and the real estate sector opening up in particular. Overseas investors have put up around US$10–12 billion in recent years[4]. Real estate investment trusts (REITs) are likely to be launched into the market shortly, and this will give a further boost to prospects for the development industry.

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*Commonwealth of Independent States.
1, 2, 3, 4. 'Surviving or Thriving? Global Trends in Real Estate 2008', KPMG International, 2008.

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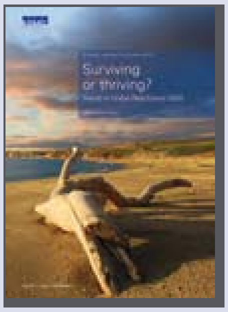


Surviving or Thriving? Trends in Global Real Estate 2008

This white paper looks at some of the pressing issues facing the Global Real Estate sector and evaluates its prospects in the wake of the worldwide credit crisis. It also assesses the opportunities – and challenges – of doing business in some of the emerging markets.

Risk management priorities for Asia Pacific financial institutions: Basel II and beyond

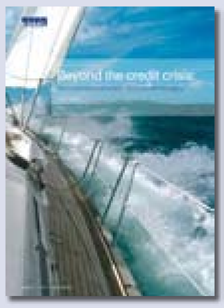
This publication explores the various considerations of developing and implementing a risk management system, under the regulations of Basel II. It also considers how risk management in financial institutions is likely to evolve in the future.

Frontiers in Tax, June 2008

The second edition of *frontiers in tax* is designed to interest, challenge and stimulate tax professionals. This is a sister publication to *frontiers in finance* – as the name implies, it focuses specifically on the tax issues facing the global financial services executive.

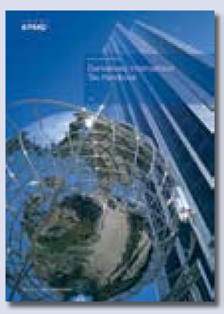
The Global Skills Convergence, September 2008

The Global Skills Convergence argues that there is a demographic fault line running through much of the developed world which will impact negatively on the supply of labor and talent during the next decade. By highlighting the careful planning required, this report looks at how the increased global flow of skills and talent can be capitalized on, particularly for global businesses.



Beyond the credit crisis, July 2008

KPMG International's thought leadership focus paper, produced in cooperation with the Economist Intelligence Unit, examines how the fund flows, returns and reputations of investment managers have been impacted by the credit crisis and the economic conditions of the last 12 months. It is based on a survey of 333 senior executives from across the global fund and investment management community.



Derivatives: International Tax Handbook, July 2008

In 1996, KPMG conducted a survey of the taxation of derivatives in 25 countries. The survey focused on the key features of each regime and highlighted territorial differences and similarities. Now, some 12 years later, the survey has been updated in the form of this more broad ranging *Derivatives: International Tax Handbook*. Covering 46 countries, the 2008 edition of the Derivatives Survey contains commentary covering corporate income tax, VAT, withholding taxes and transfer taxes and clearly illustrates that there is a great variety in the tax treatment of derivatives around the world.

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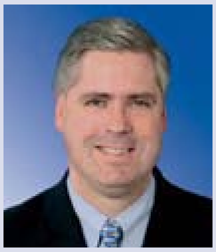

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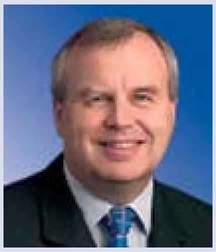

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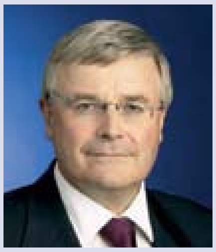

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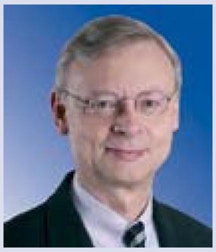

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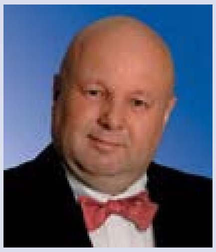

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Produced by KPMG's Global Financial Services Practice in the UK

Designed by Mytton Williams

Publication name: Frontiers in Finance

Publication no: 314 354

Publication date: September 2008

Printed on recycled material