

GIRO conference and exhibition 2010 Jon Sperrin and Simon Sheaf

Being at the sharp end of an ARROW visit

12-15 October 2010

Agenda

- Introduction
- The FSA risk assessment process and framework
- Some current hot topics
- The ARROW experience - some common failings
- Questions

Introduction

- ARROW - Risk-Responsive Operating Framework
- Qualifying firms
- Visit frequency
- Notification
- Flexibility?

The FSA ARROW risk assessment process

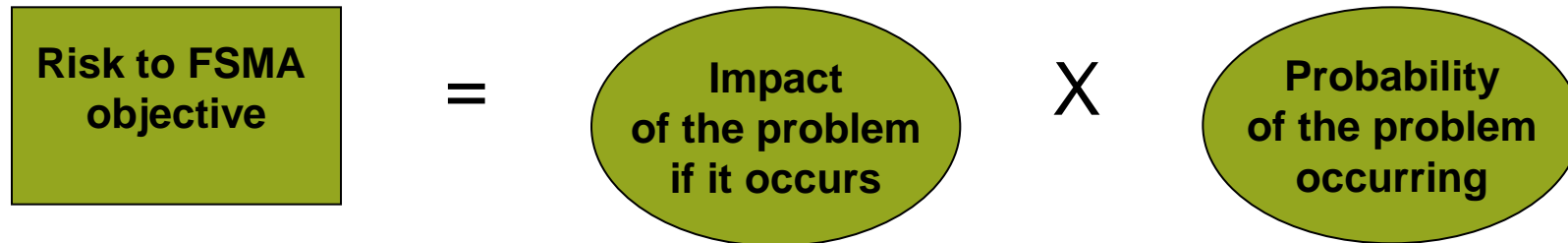
FSA ARROW objectives

- to understand the firm's business and the market in which it operates
- to assess the risks posed by the firm
- to set the supervisory framework for the future

Firm's objectives

- minimise 'Risk Mitigation Programme' (RMP)
- minimise cost and intensity of supervision, and avoid a s166 review
- demonstrate to the FSA that processes and controls comply with their expectations
- to build a strong regulatory relationship

The FSA ARROW risk assessment process



- The simple four point scoring system remains:
- Low
- Medium-low
- Medium-high
- High

All firms will receive a Risk Mitigation Programme – some more extensive than others!

The FSA ARROW risk assessment process

Environmental	Business Model	Controls	Oversight & Governance		Other Mitigants	Net Probability
Environmental Risk	Customers, Products & Markets	Customer, Product & Market Controls	Control Functions	Management, Governance & Culture		Customer Treatment & Market Conduct
	Business Processes	Financial & Operating Controls				Operating
	Prudential	Prudential Risk Controls			Excess Capital & Liquidity	Financial Soundness
Business Risks		Controls	Oversight & Governance			

- Risk scoring:**

- Low: the likelihood of the event occurring is remote
- Medium-low: there is some probability that the event may occur
- Medium-high: there is some significant chance that the event will occur
- High: it is highly likely that the event will occur

The ARROW framework

- Planning - scope, themes, territories, history, etc
- Notification of assessment
- Information request
- 'Discovery'
- Close out meeting
- FSA internal sign-off
- The Risk Mitigation Programme (RMP)
- Follow-up

Actuarial issues

- FSA undertaking far more significant review of actuarial function than previously
- Often involves interviewing Chief Actuary's direct reports
- Vital for the actuarial team to be properly prepared
- Also crucial to ensure that other members of senior management and non-executive directors are appropriately briefed on actuarial matters

Actuarial areas that the FSA is interested in

- Reserving
- Pricing
- Capital management
- Solvency II
- Governance
- Management information
- Catastrophe modelling
- Exposure management
- Team structure and staffing

Some other current hot topics and issues

- Corporate Governance, Systems and Controls
- Approved Persons
- Strategy and Planning
- Risk Management
- Compliance, Risk and Internal Audit
- Adequate Resources (Threshold Condition 4)
- Data Security
- Remuneration

Corporate Governance, Systems and Controls & Approved Persons

- The company and/or group structure should be suitable based on the nature, size and complexity of the business
- The firm's structure and systems should permit effective and timely decision making e.g. committees, management information
- Is the firm's decision making sufficiently challenged i.e. NEDs?
- Senior Management must demonstrate that it takes responsibility for the firm's risks and controls and ability to meet regulatory requirements
- Approved Persons must demonstrate an understanding of regulatory requirements and competence in undertaking controlled functions
- The allocation of responsibilities should be appropriate and avoid conflicts of interest
- Is the firm unduly influenced by other stakeholders e.g. investors, parent?

The competence of Significant Influence Functions (SIF) individuals is a key FSA focus in 2010

Risk Management

- Can the firm demonstrate that it has a formal and robust risk management process?
- Is the Board actively involved in the firm's risk management?
- What is the process for identifying risks? Top down v Bottom Up
- To what extent does risk management drive business decisions and activity?
- Does regulatory risk feature prominently in the firm's risk management process?

Compliance, Risk and Internal Audit

- What assurances does the business have that its policies and procedures are operating accurately, effectively and compliantly?
- An effective combination of compliance, risk and internal audit provides defence for the business.
- Are these functions adequately resourced?
- Is there sufficient independence both between these functions and other operational areas?
- How do these functions report to the Board?

Threshold Condition 4 (TC4)

- Requires firms to maintain adequate resources
- Current FSA focus, driven by failure in capital and business models of the banking sector
- Closer look at business risks of firms and how well capital resources are linked to risk to ensure ongoing solvency
- Some financial aspects of TC4:
 - How risks identified within a risk register link to levels of capital
 - Quality and form of capital (ie debt versus equity)
 - Group risk and inter-company balances
 - Stress and scenario testing performed on business plans and how these affect capital resources / liquidity and solvency.

Threshold Condition 4 (TC4) contd.

- FSA requires non-financial resources to be 'adequate' in relation to the regulated activity being performed
- Non-financial may include:
 - people
 - IT systems
 - premises
 - impact of acquisitions
 - MI
 - 'back office' functions to support the business
- Robust approach needed to resource planning
- Needs to include both 'front' and 'back office'
- Quantity, quality and availability of resources

Data security

- Thematic reviews in 2008 highlighted poor data security measures
- Data Protection Act 1998
- Official jurisdiction rests with Data Commissioner for the UK
- FSA is including DPA within its remit, due to concerns over the potential for customer detriment and financial crime
- Actuarial functions deal with and handle large volumes of data, and therefore should be considered as part of any DPA assessment

The ARROW experience

Common failings during an ARROW visit

- Lack of openness and co-operation with FSA (Principle 11)
- Inadequate preparation for interviews
- Regulatory issues not high on senior management's agenda
- Inconsistent/disjointed messages
- Silo mentality
- Over ambitious business strategy
- Significant issues not reported to FSA
- Spans of control too wide
- Inadequate experience of senior staff for responsibility allocated

The ARROW experience

Common failings during an ARROW visit (cont'd)

- Ineffective monitoring particularly for major projects
- Unable to demonstrate effective and appropriate use of management information
- Ineffective risk management, internal audit, or compliance
- Inadequate training and competence
- Ineffective internal audit & compliance
- Unsubstantiated claims or promises not likely to be delivered
- Out of date procedures, job descriptions, terms of reference and organisation charts

Questions

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