

# ARROW II INSPECTION VISITS

## Arrow II Firm Risk Model

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- **Risk Assessment**
  - **The Risk assessment considers impact and probability**
- **Impact Assessment**
  - **Determined by the size of the firm and its sector**
  - **Determines the approach of the evaluation**
  - **Low impact firm receive no further assessment**

### Probability Assessment

- **Determines the approach to the type of supervision a firm can expect**

# Arrow II Firm Probability Risk Model

Environmental	Business Model	Controls	Oversight and	Governance	Other Mitigants
Environmental Risks	Customers, Products and Markets	Customers, Products and Markets Control	Control Function	Management Governance and Culture	
	Business Process	Financial and Operating Controls			
	Prudential	Prudential Risk Controls			Capital Liquidity

Net Probability
Customer Treatment & Market Conduct
Operating
Financial Soundness

Business Risks	Controls	Oversight and Governance
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ARROW RISK MODEL SCORING	
Category	Description
Low	The likelihood of the event occurring is remote
Medium-low	There is some possibility that the event may occur
Medium-high	There is a significant chance that the event will occur
High	It is highly likely that the event will occur

# Arrow II Firm Probability Risk Model (showing risk elements for each of the nine risk groups)

Environmental	Business Model	Controls	Oversight & Governance		Other Mitigants
<b>Environmental Risks</b> <ul style="list-style-type: none"> <li>▪ Economic environment</li> <li>▪ Legislative/Political Environment</li> <li>▪ Competitive Environment</li> <li>▪ Capital Market Efficiency</li> </ul>	<b>Customers, Products, Markets</b> <ul style="list-style-type: none"> <li>▪ Retail customer characteristics</li> <li>▪ Retail product characteristics</li> <li>▪ Conflicts of interest</li> <li>▪ Distribution Channels</li> <li>▪ Institutional products/market characteristics</li> </ul>	<b>Customers, Products and Markets Controls</b> <ul style="list-style-type: none"> <li>▪ Accepting customers</li> <li>▪ Sales process and product development</li> <li>▪ Post sale handling of customers/counterparties</li> <li>▪ Market conduct controls</li> <li>▪ Membership arrangements</li> <li>▪ Conflicts of interest management</li> </ul>	<b>Control Functions</b> <ul style="list-style-type: none"> <li>▪ Compliance monitoring and guidance</li> <li>▪ Internal audit</li> <li>▪ Enterprise wide risk management</li> </ul>	<b>Management Governance &amp; Culture</b> <ul style="list-style-type: none"> <li>▪ Culture &amp; Management</li> <li>▪ Corporate Governance</li> <li>▪ Relationship with Regulators</li> <li>▪ Strategic Planning</li> <li>▪ Relationship with rest of group</li> <li>▪ Quality of ICAPP</li> </ul>	
	<b>Business Processes</b> <ul style="list-style-type: none"> <li>▪ Structure and ownership</li> <li>▪ Other business process risk</li> <li>▪ Litigation/Legal risk</li> <li>▪ People risk</li> <li>▪ IT Systems</li> </ul>	<b>Financial and Operating Controls</b> <ul style="list-style-type: none"> <li>▪ Policies and procedures and controls</li> <li>▪ Human resources controls</li> <li>▪ Security of client assets or money</li> <li>▪ Financial controls</li> <li>▪ IT security and controls</li> <li>▪ Clearing and settling arrangements</li> <li>▪ Business continuity planning</li> </ul>			
	<b>Prudential</b> <ul style="list-style-type: none"> <li>▪ Element 1 – credit risk</li> <li>▪ Element 1 – market risk</li> <li>▪ Insurance underwriting</li> <li>▪ Element 1 – operational risk</li> <li>▪ Liquidity risk</li> <li>▪ Element 2 risks</li> <li>▪ Element 3 risks</li> <li>▪ Element 4 risks</li> </ul>	<b>Prudential Risk Controls</b> <ul style="list-style-type: none"> <li>▪ Element 1 – credit risk controls</li> <li>▪ Element 1 – market risk controls</li> <li>▪ Insurance risk controls</li> <li>▪ Element 1 – operational risk controls</li> <li>▪ Liquidity risk controls</li> <li>▪ Element 2 controls</li> <li>▪ Element 3 controls</li> <li>▪ Element 4 controls</li> </ul>			
					<b>Excess Capital and Liquidity</b> <ul style="list-style-type: none"> <li>▪ Adequacy of capital</li> <li>▪ Adequacy of PII</li> <li>▪ Adequacy of liquidity</li> </ul>

## Getting the Right Arrow II Assessment – Early Planning

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- **Appoint a Project team**
  - **Don't simply rely on compliance to do it**
- **Think about the FSA's likely focus**
  - **Look for the clues in the pre-visit information request**
  - **Request should be tailored to your business**
- **Make your reply clear – decode any abbreviations**
- **Review your business using the FSA-model**
  - **If you have weaknesses – prepare an action plan**
- **Prepare briefings**
  - **Look at sector briefings**
  - **Financial Risk Outlook**
  - **Dear CEO letters**
- **If you have a relationship manager, use them**

# Preparing for the Arrow II Inspection Visit

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- Review your Action Plan
- Identify interviewees
  - CEO (Corporate Governance)
  - COO (Operational Controls)
  - CIO (Investment Strategy)
  - Head of Human Resources (T&C)
  - Head of Compliance / Risk / Internal Audit (Risk Mitigation Plans)
- Prepare briefings, have mock interviews led by the Compliance Officer
- Agree note-takers in advance

## During the Arrow II Inspection Visit

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- **Have a dedicated 'control room'**
  - **Briefing material to be available**
  - **Key points emerging**
- **Have a close of day de-brief**
  - **with FSA**
  - **With Senior Management team**
- **Give the FSA somewhere to work**
  - **Photocopier**
  - **Power supply**
  - **Phone**

# During the Arrow II Inspection Visit

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- **Interviews**
  - **Bring your key documents**
  - **Know your way around the documents**
  - **Remember business risks and controls**
- **Close-out meetings**
  - **Agree the timing of the close-out meeting**
  - **Be clear on messages given to the firm**
  - **Agree on the on-going communication with the FSA up to the receipt of the draft letter**
- **Arrow Letter**
  - **Review draft letter for factual accuracy**
  - **Ensure that the priorities and issues are clear to the firm**
  - **Draw up risk mitigation programme and produce progress reports**
  - **Keep your relationship manager in the loop**

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