



Key Contact

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“ARROW is one of the key tools that FSA uses in its supervision of firms”

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ARROW II

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Overview

The FSA is a risk based regulator with a risk based approach to its supervision of firms. The Advanced, Risk-Responsive Operating frameWork (ARROW) is one of the key tools that FSA uses in its supervision of firms.

ARROW and ARROW II

ARROW established a common risk language for FSA when it took on the different approaches from a number of different regulators at N2. A review of ARROW was conducted in 2003 and as a result the process of updating to ARROW II began in 2004 and it was implemented during 2006/07. The aims of ARROW II included:

- better communication with firms concerning FSA’s assessment of them;
- greater efficiency and effectiveness of management of risk;
- greater proportionality and consistency in response to risk;
- improved skills and supervisory knowledge of staff;
- overhaul of the risk model to allow better comparison of risks in different areas.

The basic risk model

Risk to FSA’s statutory objectives = Impact of the problem if it occurs X Probability of the problem occurring

Arrow uses this risk model to determine if something is an “issue”. That is, an event or set of circumstances that presents risks to the FSA’s statutory objectives of such a level that action is necessary.

Impact is a reflection of a firm’s size or “regulatory footprint”, essentially the potential harm it could do to FSA’s statutory objectives.

Probability is based on the business risks that are inherent to a firm (including risks relating to lines of business, products, customers, sector and firm) and control risks (an assessment of the adequacy of the controls that reduce or mitigate each business risk).

ARROW II

ARROW II has two components: Arrow Firms and Arrow Themes, with Arrow Firms being split into Full Arrow and Arrow Light.

Arrow Firms is used for relationship managed firms. Whether a firm is subject to a Full Arrow or an Arrow Light assessment depends on the firm’s impact score. Arrow Light is used for Medium Low impact firms and Low impact firms with high probability scores. Full Arrow is used for all Medium High and High impact firms, and there is discretion to use it for Medium Low impact firms with high probability scores.

“Any firm, including small firms, can be subject to an Arrow Themes visit”

Both Arrow Light and Full Arrow have some core areas that are included in the assessment. These are:

- management, governance and culture;
- control functions;
- capital and liquidity;
- customers, products and markets; and
- client money (where applicable).

Full Arrow covers all the core areas and is a full risk assessment of probability of all business risks and control risks at the firm. In addition the supervision team has discretion to review any areas it sees fit, but they are required to be proportionate.

Arrow Light is a reduced scope risk assessment covering the core areas and sectorally important issues, and any other clearly identified significant risks.

Arrow Themes is used for FSA thematic visits. Thematic visits look at particular issues across a sample of firms, normally from the same sector. They can focus on certain parts of a sector or a broad cross section. Results of thematic visits are available to supervisors so that the information can be taken into consideration during Arrow Firms risk assessments where appropriate. Any firm, including small firms, can be subject to an Arrow Themes visit. For small firms nearly all on-site visits will be as a result of thematic work.

Process of an Arrow Firms visit

Arrow Firm assessments incorporate specific stages:

- planning (normally desk based);
- discovery (visit to firm);
- evaluation (assessment of risk and developing the risk mitigation programme (“RMP”));
- communication; and
- follow-up.

There is a validation process by senior and independent staff at FSA after both the planning and evaluation stages. Validation is designed to ensure consistency and quality of the process and in doing so enables better comparison of risks within sectors.

Preliminary feedback is normally given at a close out meeting at the end of the discovery visit. After the evaluation stage and validation a draft letter and RMP is sent; this gives firms the opportunity to confirm there are no factual inaccuracies and discuss the RMP before a final version is issued. If there is a need for substantive changes then the validation process is revisited. The results of the risk assessment will drive the firm’s regulatory cycle and when its next assessment occurs. Follow-up varies and again is dependent on the risks at an individual firm.

Process of an Arrow Themes visit

Arrow Themes visits follow a similar process to that of Arrow Firms, however the planning stage considers the appropriateness of the thematic work as a whole and has a specific validation process for this. The visits are planned as a whole to ensure they are consistent which enables comparison of results between different firms.

The communication from a themes visit will normally include preliminary feedback at a close out meeting followed by firm specific feedback by letter, including, where appropriate, an individual action plan. The overall findings of thematic work are normally made public and the firms that have taken part generally receive a copy of the published report.

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