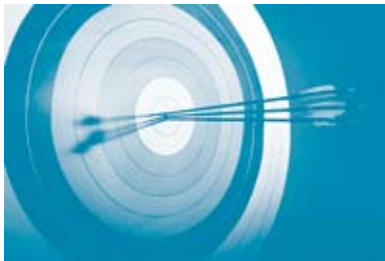


FUNDS-AXIS

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ARROW: Are Your Preparations On Target?

Many firms are daunted by the prospect of an ARROW visit. Here we seek to demystify the process and provide you with the information you need to meet the regulator confidently and fully prepared.



1. What is ARROW?

ARROW is 'Advanced Risk Responsive Operating FrameWork' – using a bit of artistic licence to get the acronym. The FSA uses ARROW to measure the risk a firm poses to its statutory objectives. These objectives are:

- Maintaining confidence in the UK financial system
- Promoting public understanding of the UK financial system
- Securing the appropriate degree of protection for consumers
- Reducing the extent to which it is possible for financial services business to be used for financial crime

The purpose of the ARROW is not to eliminate risk – the FSA do understand that some risk is necessary! – but to **reduce risks to an acceptable level**.

Firms that are subject to ARROW visits will have been impact/probability risk-assessed by the FSA to determine whether they fall within its scope. This means, loosely, that they are judged by the regulator as being of a size, business type or regulatory history which falls under the scope of the ARROW review process. Such firms are relationship managed or 'supervised' by a designated person or team within the FSA.

The regularity of ARROW assessments depends on how the firm fared at its last review, i.e. whether it was rated higher risk or lower risk. The period between reviews is called 'the regulatory period'. This varies from one year (for high risk firms) to four years (for lower risk firms).

Between ARROWs, the firm is subject to 'ongoing monitoring' which refers to day-day processes such as the FSA's review of financial returns, dealing with regulatory queries and working with the firm to rectify any issues uncovered in the ARROW.

ARROWs are either a full ARROW or an 'ARROW light'. ARROW light is for lower risk firms and focuses more on higher level systems and controls than individual operational aspects of the firm. Make sure you know what kind of ARROW your supervisor is undertaking as it will impact on the degree of preparation required.



Hannah Spencer

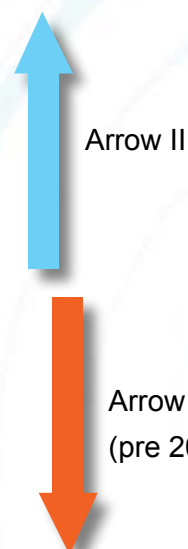
Before joining Funds-Axis, Hannah spent 3 years with the FSA as Relationship Manager in Wholesale Banks & Investment Firms Department. Hannah had supervisory responsibility for a range of asset management firms and led and assisted numerous ARROW risk assessments for a range of large and small firms. Here Hannah provides an overview of what your firm can expect from an ARROW visit and outlines the services that Funds-Axis can provide to support you through an ARROW visit.

2. How does ARROW II differ from the old ARROW?

If you were ARROW'd prior to 2005, you would see the following changes in your next review:

More proportionality	No more tick box regulation. Proportionate use of the FSA's resources so that lower risk firms enjoy a more streamlined approach to supervision.
Better communication with firms	Standardised ARROW letters are sent to firms before and after an ARROW explaining what the FSA requires and why they require it. Firms receive draft copies of ARROW letters outlining findings and may make corrections on ' <i>factual inaccuracies</i> '.
Greater efficiency and better knowledge sharing	The ARROW process now incorporates use of sector analysis. Therefore, current/topical asset management specific risks are incorporated into the risk assessment process.
FSA staff better trained	All supervisors were required to attend a week long residential training course on ARROW and are subject to ongoing training.

3. Capital Adequacy



The ARROW process now also includes the 'SREP' (supervisory review and evaluation process). This is also known as a pillar 2 review designed to assess a company's ICAAP. This is to identify any weaknesses or issues and concludes by the FSA providing the firm with:

- Individual capital guidance (ICG) relating to the firm's risk profile, strategic business model and capital resources.
- Guidance to reaffirm or correct current liquidity ratios, limits or behavioural concessions
- Other prudent measures

4. What form will the ARROW take?

The ARROW will involve visits by your supervisor, a note taker (who is likely to be a fellow-supervisor and member of their team) and possibly their Manager. The number of visits will depend upon the firm's risk profile. They may bring in a specialist if they feel a particular risk needs investigating more thoroughly.

The visit will involve interviews with key members of staff and always includes senior management. **Senior management must be aware that the focus of the visit is on them** and how they control the firm, an ARROW is not just a compliance thing! The FSA may ask for demonstrations of key IT systems or to walk around the building, for example to check how Chinese walls operate. They may also ask for additional data to review on site such as marketing literature, client files/ investment management agreements, compliance or audit reviews, minutes of meetings, etc. Please don't see this list as conclusive, but it will give you some idea of the things you may have to provide. Don't be afraid to suggest you show them a new system or speak to a key person they haven't asked to see. If you've got it, flaunt it!

5. How should I prepare?

- Make sure you are aware of current regulatory developments, particularly where they relate specifically to asset management.
- Read the FSA's Financial Risk Outlook and Business Plan (these are both available on its website). They will give you an indication of what the FSA is currently focusing on.
- Keep abreast of issues, trends or matters raised by the FSA Sector Leaders remembering that under the new ARROW sector-specific risks are considered when risk assessing the firm.
- Ensure all staff are aware that you are being ARROW'd and make sure that Senior Management and key staff receive a thorough briefing on the FSA's aims and objectives and how the ARROW process works. It is very helpful to conduct mock interviews and provide feedback to those likely to be interviewed so that they have a better idea what to expect.
- Make sure you are up to date; i.e. meeting minutes, compliance monitoring, audit reports, key reconciliations, etc. If you have not been able to shift your backlog you will be asked to justify this.

6. How long will it take?



Sadly there is no definitive answer. It depends on the size of the firm, complexity of its business model, risk profile. As a very rough guide it could take anything from a couple of days to a few weeks. Speak to your supervisor for guidance.

7. What communications will I receive?

About a month or two before your visit is due (i.e. when the regulatory period is drawing to a close) you should receive a pre-visit 'information request' letter from your supervisor as they commence planning the visit. This is a list of documents they wish to review as part of the fact finding/knowledge gathering stage. It will give you an idea of what the assessment will cover.

The information you provide will give your supervisor an in-depth idea of your business model and allow them to identify the likely key risk areas within your business.

You should also expect numerous phone calls from your supervisor who will have plenty of questions as they try to get to grips with the structure of your firm and the services you offer. It is a good idea to be as open as possible: if a visit subsequently yields a substantive issue that should have been raised earlier, this will reflect badly on the firm.

During the visit, supervisors may offer an end of day de-brief on any issues they have discovered during the day. Don't be afraid to ask for this if it isn't offered as it is much better to be aware of issues earlier. If an issue is quickly and easily rectifiable it could be remedied before the end of the visit or before the formal ARROW letter outlining findings is sent out. Additionally, if you feel there has been a miscommunication or some facts need clarification you can sort it out sooner rather than later. However, don't worry if the FSA would rather leave such discussions to a 'close out meeting'. There is a lot to take in on a visit and some supervisors will prefer to go home and sleep on it.



A 'close out meeting' occurs at the end of the visit to discuss initial conclusions. This sometimes occurs on the last day of the visit or, more frequently, a week or two later. This would usually be with a member of senior management and compliance. It will go through findings and indicate likely mitigating actions to be included in your risk mitigation programme 'RMP'.

The 'RMP' is a document which outlines the FSA's findings, what mitigating action the firm needs to take and the deadline for completion. This is sent to the firm post visit and will have been subject to review by a panel of internal staff and experienced external reviewers (see paragraph below). It is sent in draft first of all and the firm is invited to correct any 'factual inaccuracies'. There is room to negotiate as long as the eventual outcome is the same as the FSA requests, e.g. you may feel you need more time or would prefer to take a different action to arrive at the same conclusion. Your supervisor will take into account such comments before sending the final ARROW letter and RMP to the Board.

8. What challenge does the FSA receive during the ARROW process?

As mentioned above, your supervisor will receive a robust degree of challenge before and after the ARROW.

Before: Your supervisor prepares a detailed presentation pack outlining the firm's activities, risk profile and ARROW plan. They present this plan to a panel of internal staff (ranging in degree of seniority) and a 'grey panther' (an industry expert). The panel challenge issues like whether the time to be spent at a firm is proportionate, areas covered by the ARROW, risks identified at the firm and whether specialists might be required to assist. This is called a 'pre-validation panel'.

After: Your supervisor's findings are subjected to the scrutiny of the same panel which provided the pre-ARROW challenge. They will question issues like whether the mitigating actions requested in the RMP are proportionate and appropriate, the length of the regulatory period and the firm's risk rating.

9. What if I do not agree with their findings?



It is important to remember that it is very rare indeed that anyone gets a clean sheet, so make sure your expectations are realistic.

The FSA says 'If you want to negotiate on anything in the draft letter or RMP then make sure you base your negotiations on outcomes, if you feel you can achieve the same outcome that the supervisor wants but in a different way, that may be more timely or effective for you, then put that case'. As mentioned above, you are also invited to correct any factual inaccuracies in the letter and RMP. It is important that you check with the business area to which the RMP action relates to ensure there are no factual errors.

10. How does the FSA ensure its ARROWs are consistent?

As mentioned above, the new ARROW methodology incorporates current sector-specific risks. There is an Asset Management Sector team which keeps the FSA informed about fund related issues. Therefore, asset managers will be assessed against the same business risks as each other, which should make the overall outcome more consistent and fairer. Firms may also find it helpful to ask how they scored in comparison with their peer group. In addition, all firms are assessed against certain core risk areas and ARROWs are recorded and risk assessed on the FSA's bespoke IT system which calculates the probability weightings given to different risks on a fair and equal basis.

11. What can Funds-Axis do for you?

The services which Funds-Axis can provide to ensure that you successfully meet the challenges of ARROW include:

- **Senior Management Briefings**
- **Mock Arrow Interviews**
- **Identification of key focus areas**
- **Support visit preparations**
- **Procedure and Policy reviews**
- **Support negotiating outcomes**
- **Funds-Axis GRC™ Solution**

FUNDS AXIS GRC™

FUNDS-AXIS GRC™ (Governance, Risk and Compliance) is innovative technology which provides an automated compliance environment to enable organisations to effectively meet and exceed the FSA's expectations for organisational systems and controls and which can comprehensively support your ARROW preparations!

Key features of FUNDS-AXIS GRC™ include:

- Obligations Library and responsibilities
- An adaptable suite of controls and monitoring activities
- An audit and risk assessment framework
- Customised incident and issue workflow management
- Management and regulatory reporting



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