



ARROW Visits - Governance Issues

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PROGRAMME

5.00 – 5.20 Registration and welcome

Andrew Shiels, Managing Consultant and Head of Edinburgh Practice, **avantage**

5.20 – 5.40 Governance issues seen during a recent ARROW visit

Tony Brian, Head of Operational & Regulatory Risk, **Lloyds Banking Group Insurance Division**

5.40 – 5.55 Roundtable Discussion: Governance Issues in FSA Reviews

5.55 – 6.10 Recent developments at FSA and current hot topics

Iain Wright, Partner, **avantage**

6.10 – 6.25 Roundtable Discussion: Hot topics and impact of restructuring of financial services regulation

6.25 – 6.30 Key Takeaways

Andrew Shiels, Managing Consultant and Head of Edinburgh Practice, **avantage**

6.30 – 7.00 Canapes, drinks and networking

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Welcome and Introduction

Andrew Shiels, Head of the Edinburgh Practice, avantage

FSA ARROW GOVERNANCE REVIEWS | Key Recent Observations

- During 2009, 56 Section 166 reports were issued by the FSA – of which 22% related exclusively to issues associated with corporate governance.
- 25% of critical issues highlighted by the FSA in recent ARROW risk mitigation programmes have related to issues of management, governance and culture, often provoked by strategic uncertainty on the part of senior management.
- Recent ARROW visits have generally become more intrusive – tone of visits is influenced by the personality and approach of individual supervisors.
- Much greater pressure on FSA supervisors to follow the process to the letter – resulting in harsher follow-up actions for firms.
- Despite a Section 166 report being issued for a specific area, governance will be included, as it is seen as the control to prevent risk in many areas of the firm.

FSA ARROW GOVERNANCE REVIEWS | Key Recent Observations

- Recent Section 166 reports have started to focus on individuals performing key roles.
- Skilled Persons increasingly being asked to comment on the competence, experience and skills of individual Board members.
- Strong focus on having appropriately skilled Non Executive Directors in place, with sufficient levels of time commitment to the role.
- Clearly defined risk appetite, linked to a sustainable and well understood strategy.
- Recent governance-related comments made by the FSA, following recent ARROW reviews have centred around :
 - **The need for more competent NEDs;**
 - **Board effectiveness;**
 - **An inability to clearly formulate and articulate strategy.**



Governance issues seen during a recent FSA ARROW visit

Tony Brian, Head of Operational & Regulatory Risk, Lloyds Banking Group Insurance Division¹

¹ The views contained herein are based on the presenter's experience of a number of financial services organisations

Governance aspects in recent Arrows



- Board and particularly the non-executives
- Risk appetite v. strategy
- “Three lines of defence” model
- Clear accountabilities
- Governance structure aligned to business model
- Design of structure
 - TORs
 - Membership
 - Regular reviews
- Effectiveness
 - Are the agendas right?
 - Are the papers right?
 - Do the right people attend?
 - Do they engage?
 - Do they play the right role?
 - Is duplication avoided?
- Evidence
 - How is challenge demonstrated?
 - FSA attendance at some committees



Preparing for Arrow



- Formal Project
- Administrative Support
- Involve the business
- Brainstorm likely issues and hot-spots
- FSA send prior indication of areas of interest?
- Information request
- Introductory briefings (groups)
- Briefing materials
 - corporate governance
 - standard MI
 - storyboards” on issues
 - aide memoires
- (Assume all materials could be left behind!)
- Mock interviews – tailored to individual, immediate follow-up, further sessions where necessary
- Scribes



During and after an Arrow visit

■ During Visit

- Check with interviewees a day ahead
- Immediate de-briefs with interviewees
- Daily catch-ups
- Weekly review on progress
- Expect further info requests

■ After Visit

- Review expected outcome
- Manage internal expectations
- Check record of info sent for completeness
- Check letter and RMP for accuracy
- Start RMP monitoring programme



Roundtable discussion: Governance issues in FSA reviews

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Recent developments at FSA and current hot topics

Iain Wright, Partner, **avantage**

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FSA DEVELOPMENTS | Proposals

A new approach to financial regulation:

- Macro prudential regulation: Bank of England Financial Policy Committee
- Prudential regulation of individual firms: Bank of England subsidiary – Prudential Regulation Authority (all firms, IFAs, fund managers?)
- Consumer protection and market integrity (strange bedfellows?) – Consumer Protection and Markets Regulator
- Financial crime – Economic Crime Agency?

Who will run which?

How will they interact?

More focus on consumer issues (again)?

Generally split is not regarded as a “good thing”

How will FSA function in transition:

- shadow structure
- focus
- oversight of day to day supervisors?

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BUT WHAT DOES THIS MEAN IN PRACTICE? | Supervisory approach

- To deliver “effective on the ground intensive supervision. ... The defining element of our approach is that it is proactive and supported by integrated risk assessment at the individual firm level.”
- To continue “to embed and fully implement the required cultural and organisational change that underpins our intensive supervisory agenda.”
- Outcomes-focussed supervision.
- Move from “old style” retrospective regulation where intervention occurred only when something went wrong to more proactive approach – intervening when FSA believes the results of a firm’s actions will pose a risk to its statutory objectives. (Is this really a fundamental shift?)
- “Inherently more confrontational and risky”, making difficult judgements.
- This requires more detailed information and business modelling capability.
- Are FSA supervisors equipped to be able to do this?
 - More supervisors
 - Sector teams
 - Prudential and conduct specialists
 - Risk team
 - More industry experience
 - Mystery shopping
 - On site visits
- More requests for information...
 - ... with more demanding and harder deadlines...
 - ... and less willingness to negotiate
- More s166 reviews
- But all within the context of uncertainty within FSA

BUT WHAT DOES THIS MEAN IN PRACTICE? | Enforcement (“credible deterrence”)

- *“FSA fines Zurich Insurance £2,275,000 following the loss of 46,000 policy holders’ personal details”*
- *“firms across the financial sector would do well to look at the details of this case and learn from the mistakes ...”*
 - Systems and controls failings lead to loss; no evidence of actual detriment;.
- *“FSA fines Royal Bank of Scotland Group £5.6m for UK sanctions controls failings”*
 - Systems and controls failings leading to “unacceptable risk ”
- *“FSA censures and bans three directors from acting as senior managers for falling short of FSA standards”*
 - action against directors for regulatory failures (found they relied too heavily on external compliance consultant for advice on how to run their business)
- FSA bans and fines former Northern Rock finance director £320,000 for misreporting mortgage arrears figures
- *“This is a message to all FSA approved persons, that they must take their individual responsibilities seriously at all times, or suffer the consequences.”*
- Action against approved persons ...
... but mainly small companies
- More enforcement actions ...
... and higher fines

- Challenge:
 - NEDs
 - Board
 - Executive
 - Risk
- Focus on **people** rather than **systems and controls**
- Focus on evidence:
 - MI, board papers, minutes
 - First hand by FSA attending
- Can't outsource risk (enforcement case)
- Risk culture:
 - What is this?
 - Remuneration
 - Role, impact and visibility of risk functions and senior risk people
- Hector Sants:
 - Focus for regulators is not to define one acceptable culture; rather regulators should focus on what an unacceptable culture looks like and what outcomes that drives.
 - *“There must be a stronger and more explicit obligation to wider society. There must be clear recognition of the need for institutions to contribute to the common good.”*



Roundtable discussion: Hot topics and impact of restructuring of financial services regulation

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Key Takeaways

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