

Terms of Reference of the review

1. The Chief Executive of the FSA, Hector Sants, has requested a ‘lessons learned’ review of the supervision of Northern Rock plc. A review team, led by the FSA’s Director of Internal Audit, Rosemary Hilary, has been commissioned to deliver a report to the Executive by 31 January 2008 and to the FSA’s Board at its meeting dated 28 February 2008.
2. The review will examine the lessons which the FSA should draw from the Northern Rock events and changes these suggest for the FSA’s risk-assessment and risk mitigation practices in general. Where aspects of relevant regulatory practice or policy are currently already being reviewed or revised, the internal audit team will take account of that work in reaching its own conclusions.
3. Internal Audit will review the supervisory approach for Northern Rock plc during the period 1 January 2005 to 9 August 2007. In particular it will review whether the FSA’s prevailing framework for assessing risk was appropriately applied such that the supervisory strategy, including the Supervisory Period and level of resourcing, was in line with Northern Rock’s risk profile. A review of a small sample of other high-impact firms will be included over the same timeframe in order to provide a basis for comparison.
4. Internal Audit will then assess:
 - (i) whether in future the FSA’s framework for assessing risk should place more importance on liquidity, stress-testing, competence of firms’ management and effectiveness of governing arrangements. In assessing this element Internal Audit will take into account the emphasis in the More Principles Based Regulatory approach on outcomes-based regulation;
 - (ii) whether the processes or mechanisms for identifying, sharing and responding to internal and external intelligence/emerging risks (that may have firm-specific or sectoral impacts) can be improved; and
 - (iii) whether improvements can be made in the adequacy of supervisory resource, both in terms of capacity and skills, devoted to high-impact deposit-takers.
5. The review team will exclude other areas of supervisory focus unless deemed appropriate by work emerging from the review. In framing recommendations for the FSA’s Board on 28 February 2008, this internal audit review will not accompany these with a formal cost-benefit analysis.
6. The conclusions of the review will be made public and any changes to the FSA’s approach will be communicated and/or be subject to consultation as appropriate.
7. In undertaking this review, the FSA is seeking to achieve the following outcomes:
 - (i) to understand whether the application of the supervisory approach for high-impact deposit-taking firms was robust;
 - (ii) in light of 7(i), to identify what lessons there are to be learned and to make recommendations that will enhance the supervisory approach going forward;
 - (iii) in completing 7(i) and 7(ii), and in committing to publish its conclusions, to demonstrate to FSA’s stakeholders (including regulated firms, consumers and staff) an on-going commitment, as an organisation, to continuous improvement.