
FINAL NOTICE

To: **Abbey National Asset Managers Limited**

Of: **301 St. Vincent Street
Glasgow
G2 5HN**

Date: **9 December 2003**

TAKE NOTICE: The Financial Services Authority of 25 The North Colonnade, Canary Wharf, London E14 5HS ("the FSA") gives you final notice about a requirement to pay a financial penalty.

1. THE PENALTY

- 1.1. The FSA gave you a Decision Notice dated 9 December 2003 which notified you that, pursuant to section 206 of the Financial Services and Markets Act 2000 ("the Act"), the FSA had decided to impose a financial penalty against you in the amount of £320,000 in respect of breaches of FSA Principle 2 and Rules 3.1.1 and 3.2.6 of the FSA's Senior Management Arrangements, Systems and Controls Sourcebook ("SYSC").
- 1.2. You have confirmed in a letter dated 9 December 2003 that you do not intend to refer the matter to the Financial Services and Markets Tribunal.
- 1.3. Accordingly, for the reasons set out below the FSA imposes a financial penalty on you in the amount of £320,000 ("the Penalty").

2. RELEVANT STATUTORY PROVISIONS AND REGULATORY RULES

- 2.1. Principle 2 of the FSA Principles states:

A firm must conduct its business with due skill, care and diligence.

2.2. SYSC Rule 3.1.1R states:

A firm must take reasonable care to establish and maintain such systems and controls as are appropriate to its business.

2.3. SYSC Rule 3.2.6R states:

A firm must take reasonable care to establish and maintain effective systems and controls for compliance with applicable requirements and standards under the regulatory system and for countering the risk that the firm might be used to further financial crime.

2.4. Section 206(1) of the Act states:

If the Authority considers that an authorised person has contravened a requirement imposed on him by or under this Act, it may impose on him a penalty, in respect of the contravention, of such amount as it considers appropriate.

3. REASONS FOR THE ACTION

Summary

- 3.1. ANAM did not have in place systems and controls appropriate to its business between December 2001 and June 2003.
- 3.2. ANAM did not act with due skill, care and diligence in addressing the concerns raised by its divisional compliance function in connection with the Risk Mitigation Programme ("RMP") project which was initiated in July 2002 to ensure the effectiveness of systems and controls in ANAM and extended to other companies within Abbey National's life assurance and asset management businesses. While recognising the complex nature of the manual processes in place within ANAM, the divisional compliance function was critical of ANAM's failure to meet project deadlines and the poor quality of work undertaken for the RMP project. As a result, it took ANAM three months longer than planned to put its process and controls documentation in place.
- 3.3. ANAM did not act with sufficient urgency in addressing serious concerns about the systems and controls in place on the fund management desks which were raised in two compliance reports in late 2002. It took up to nine months to address these concerns fully.
- 3.4. Compliance monitoring resource available to Abbey National's Life Division (formerly referred to within Abbey National plc as the Life Division of Wealth Management and Long Term Savings division) ("the Life Division"), of which ANAM forms a part, was significantly below budgeted headcount from about March 2002 to June 2003. The resource available was insufficient to maintain adequate

compliance oversight from November 2002 and may have contributed to control failings in ANAM. ANAM allowed a situation where compliance oversight was not being maintained to continue for eight months after concerns were first raised by divisional compliance.

- 3.5. ANAM did not have sufficient management information to allow it to identify, measure, manage and control risks of regulatory concern that affected ANAM between 1 December 2001 and June 2003.
- 3.6. ANAM has demonstrated failings that demand a significant penalty. These failings are viewed by the FSA as particularly serious in the light of the following factors:
 - (1) that they involved a significant failing in senior management arrangements, systems and controls;
 - (2) that ANAM did not assess the status of its systems and controls near or at N2 (December 2001) to satisfy itself that it complied with the FSA SYSC Rules requirements;
 - (3) that ANAM failed to accelerate its RMP project review work once the serious concerns raised by the divisional compliance reports were highlighted and allowed those concerns to continue unremedied for up to nine months;
 - (4) the cost of compensation to clients impacted by the trading activities of a senior fund manager totalled approximately £300,000; and
 - (5) that the Life Division's compliance monitoring resource was insufficient to maintain adequate compliance oversight and may have contributed to control failings in ANAM.
- 3.7. In deciding the level of the financial penalty imposed, the FSA has recognised that ANAM:
 - (1) informed the FSA of the activities of the senior fund manager;
 - (2) implemented detailed and comprehensive systems and controls procedures in June 2003 as a result of the RMP project review;
 - (3) provided compensation to client funds affected by the trading activities of the senior fund manager; and
 - (4) by moving quickly to agree the facts of the case and to settle the matter, has helped the FSA to work expeditiously towards its regulatory objectives, which include protecting consumers.

Facts and Matters Relied On

Background

- 3.8. ANAM is a 100% owned subsidiary of Abbey National plc. Its registered office is at 301 St. Vincent Street, Glasgow, G2 5HN.

- 3.9. ANAM's business consists of managing funds on behalf of other Abbey National Group entities as well as retail investors. It also manages a small number of segregated corporate portfolios. It has funds under management of some £30 billion of which approximately 95% consist of funds managed on behalf of the Abbey National Group.
- 3.10. ANAM has approximately 68 staff involved in the management of funds over nine desks, all based in the Glasgow offices.

ANAM Compliance Arrangements

- 3.11. ANAM is one of nine companies within Abbey National's life assurance and asset management businesses which are authorised and regulated by the FSA.
- 3.12. The compliance arrangements for the Abbey National group of companies adopted a risk based approach and were managed on a divisional rather than a company basis. Life Division Regulation Services ("Life Division Compliance") provided compliance services to these nine companies, including ANAM.
- 3.13. Life Division Compliance consisted of a Head of Regulation, three customer regulation management / relationship management teams and an evaluation team. The role of the evaluation team was to undertake compliance monitoring reviews. It was the responsibility of the regulation management / relationship management teams to ensure that the monitoring review teams' findings were acted upon by business management.
- 3.14. As at 1 December 2002, Life Division Compliance had a total headcount of 22 staff, with six employed in the evaluation team, made up of a manager and five staff. The evaluation team had responsibility for compliance monitoring reviews in the areas of investment management, including ANAM, life and pensions and protection and healthcare.

Discovery of Current Issues

- 3.15. In March 2003, following a preliminary review by Life Division Compliance, ANAM submitted a Form D disclosure to the FSA about the trading activities of one of its senior fund managers.
- 3.16. The disclosure sets out a number of the issues regarding the individual's activities which had been identified by the review. These issues included possible alteration of stock allocations post execution, manipulation of dealing sheets in respect of IPOs favouring certain clients over others and conducting investment trades from outside the controlled dealing environment at ANAM's office.
- 3.17. These issues raised the FSA's concern regarding the adequacy of systems and controls in place at ANAM. On 27 May 2003, the FSA appointed investigators under section 168(5) of the Act.

ANAM's Actions

Ongoing maintenance of appropriate systems and controls

Initiation of the RMP Project

- 3.18. In July 2002, as part of the FSA's risk assessment process, the FSA identified that ANAM had a number of areas where its systems and controls were subject to manual intervention. To mitigate this risk, the FSA recommended that ANAM should identify and evaluate all key aspects of its core businesses and ensure it effectively controlled manual interventions. The FSA set a deadline of the end of December 2002 for ANAM to report back to the FSA.
- 3.19. In response, the Life Division set up the RMP project in August 2002 with the objective of mapping out all processes (including manual interventions) and confirming the effectiveness of controls of not just ANAM but all investment companies within the Life Division. Given the expanded scope beyond that required by the original RMP, an extension from December 2002 to March 2003 was deemed necessary and was agreed between ANAM and the FSA.
- 3.20. In October 2002, ANAM's fund management desks ("Front Office") were identified by the RMP project as an area where the documentation of procedures generally needed to be strengthened.

Compliance investigations into specific areas of ANAM's operations

- 3.21. In late 2002, Life Division Compliance conducted two investigations, one in respect of the Abbey National Smaller Companies Unit Trust and the other in respect of ANAM's Far Eastern desk. These investigations (further detailed below) highlighted that there were deficiencies in Senior Management Arrangements, Systems and Controls resulting in fund dealing and management issues not being identified at an early enough stage.

Abbey National Smaller Companies Unit Trust

- 3.22. During September 2002, ANAM received a letter from the trustees of the Abbey National Smaller Companies Unit Trust noting potential breaches of the trust's investment mandate.
- 3.23. An investigation conducted by Life Division Compliance found that no investment breaches had occurred. However, in a report dated October 2002, Life Division Compliance highlighted significant systems and controls issues. The report emphasised Life Division Compliance's serious concerns about the limited supervisory controls in place over fund managers' trading activities and restated the requirement that senior managers of registered firms must ensure appropriate systems and controls are implemented and adequately documented.
- 3.24. Life Division Compliance has a standard response time of two weeks for the agreement of compliance reports and their findings and recommendations with business areas.

- 3.25. The Abbey National Smaller Companies report was provided to ANAM for comment in October 2002. Life Division Compliance made a number of follow up requests. However, ANAM management did not fully and formally respond until January 2003 despite the two-week response time. ANAM agreed to address the broader control issues raised by the report as part of the RMP project.

Far Eastern Desk

- 3.26. Issues relating to the trading activity on the Far Eastern Desk were identified in October 2002. Following discussions between ANAM Management and Life Division Compliance, a compliance monitoring review, which included the Far Eastern desk, was brought forward to November 2002.
- 3.27. Life Division Compliance reported on 17 December 2002. The findings of this report highlighted the serious nature of the regulatory issues identified and found that:
- (1) dealing procedures reviewed were deficient and out of date;
 - (2) in four out of the 18 trades sampled (23%) the transactions were not input into the computerised dealing system until after the trades were executed;
 - (3) dealing had occurred outside of the controlled environment at the office; and
 - (4) there were a number of areas where the implementation of exception reporting would have an immediately positive impact.
- 3.28. Life Division Compliance undertook a subsequent and more comprehensive review of trading on the Far Eastern Desk which confirmed:
- (1) out of office dealing, the manipulation of dealing sheets favouring certain clients over others and changes to allocations post execution; and
 - (2) a significant failing in senior management arrangements, systems and controls.
- 3.29. ANAM also undertook an exercise, in conjunction with internal and external advisers, to assess the extent of possible client detriment as a result of the above practices across the Front Office desks. The cost of compensation paid to the clients' funds affected totalled around £300,000.
- 3.30. ANAM received the Far Eastern Desk report in December 2002. As ANAM did not fully and formally respond to the findings of this report until February 2003, it did not meet the two-week response time (referred to in 3.24 above). This occurred despite a number of reminders from Life Division Compliance. ANAM Management and Life Division Compliance agreed to address the issues raised by the Far Eastern report as part of the RMP project.

ANAM's response to the RMP project, the Life Division Compliance reports on Abbey National Smaller Companies Unit Trust and Far Eastern issues

- 3.31. The investigations by Life Division Compliance identified controls-related issues arising closely together on two separate desks. This was highlighted to ANAM by

Life Division Compliance. In addition, Life Division Compliance raised issues in relation to the progress with RMP and failure to meet RMP project deadlines.

- 3.32. ANAM did not respond with sufficient urgency to the serious systems and control issues highlighted in the two Life Division Compliance reports. In particular, it did not accelerate its work on the RMP project despite the concerns being raised in respect of two fund management desks within a three month period.
- 3.33. ANAM was required, as the first phase of the RMP project, to map its processes and controls in line with the RMP project deadlines. Whilst recognising the complex nature of the manual processes in place, Life Division Compliance, in October 2002, raised concerns about the lack of progress at ANAM in progressing the first phase of the RMP project. These concerns were brought to the attention of Regulation Services at Abbey National plc.
- 3.34. This meant that the full implications of both the Abbey Smaller Companies Unit Trust and the Far Eastern Life Division Compliance reports were not fully addressed by ANAM for nine and six months respectively after first being brought to ANAM's attention.
- 3.35. During January 2003, Life Division Compliance raised further concerns in respect of the late receipt of ANAM's high level mapping documentation. Life Division Compliance was critical of ANAM and described this documentation as weak, incomplete and insufficiently detailed.
- 3.36. After consultation with ANAM Management, Life Division Compliance agreed with the FSA a further three-month extension to its reporting deadline from March 2003 to June 2003.
- 3.37. During April 2003, Life Division Compliance raised further concerns with ANAM's work on the RMP project as demonstrating a lack of focus and expressed concerns about progress; it noted that other companies within Life Division would complete control matrices by the end of April 2003 with the exception of ANAM's Front Office.
- 3.38. By 30 June 2003, which was the extended deadline agreed with the FSA, ANAM had completed its review and had put in place comprehensive process and control documentation.
- 3.39. However, this meant that it took ANAM three months longer than planned to put its process and controls documentation in place.

Management Information at ANAM

- 3.40. ANAM maintained poor and ineffective monitoring of its fund managers' trading activities from 1 December 2001 until the implementation of its new procedures by the end of June 2003.

- 3.41. The Far Eastern report of December 2002 found that there were a number of areas where the implementation of exception reporting would have an immediately positive impact particularly on the control environment around fund management trading activities.
- 3.42. Despite these findings, as at April 2003 ANAM still did not maintain full control over the risks to the funds under its management because there was inadequate management information in place for the purposes of identifying departures from acceptable fund management practice.

Compliance Resources

- 3.43. The Life Division Compliance monitoring team was significantly under-resourced from about March 2002 to June 2003. For the majority of this period, the monitoring team operated on 60% of its budgeted headcount of five.
- 3.44. The causes of this shortfall were:
- (1) that from the middle of 2002, Abbey National Group companies were subject to a general recruitment freeze;
 - (2) that a detailed request to recruit additional monitoring resource was completed in September 2002 but was not approved at Group level until December 2002; and
 - (3) the difficulty in finding suitably experienced monitoring staff.
- 3.45. From November 2002, the level of available resource was insufficient to maintain adequate compliance oversight and may have contributed to the control failings within ANAM in the period. This meant that ANAM allowed a situation where compliance oversight was not being maintained to continue for eight months between November 2002 and June 2003.
- 3.46. During this time, Life Division Compliance took the decision to cancel or postpone low and medium risk compliance monitoring reviews across the Life Division. As the resource constraint further impacted, in February and March 2003, a decision was made to cancel or postpone four medium-high and high-risk rated compliance monitoring reviews across the division.

4. RELEVANT GUIDANCE

- 4.1. The principal purpose of the imposition of a financial penalty is to promote high standards of regulatory conduct by deterring firms who have breached regulatory requirements from committing further contraventions, helping to deter other firms from committing contraventions and demonstrating generally to firms the benefit of compliant behaviour.
- 4.2. In determining whether a financial penalty is appropriate and its level, the FSA is required to consider all the relevant circumstances of the case. ENF 13.3.3 indicates the factors that may be of particular relevance in determining the level of a financial penalty. These are discussed below.

5. FACTORS RELEVANT TO DETERMINING THE SANCTION

- 5.1. In determining that a financial penalty is appropriate and the amount imposed is proportionate to ANAM's breaches, the FSA considers the following factors to be particularly relevant.

The seriousness of the misconduct or contravention

- 5.2. The level of financial penalty must be proportionate to the nature and seriousness of the contravention. The breaches arose because of a failure to ensure that appropriate systems and controls were in place.
- 5.3. The seriousness is magnified by the fact that ANAM did not act with due skill, care and diligence in addressing the concerns raised by Life Division Compliance with regard to the RMP Project. Nor did ANAM sufficiently recognise the seriousness of Life Division Compliance reports on two separate dealing desks. ANAM failed to address fully the concerns raised in those reports for up to nine months.

The extent to which the contravention is deliberate or misconduct was deliberate or reckless

- 5.4. ANAM's contraventions were not deliberate or reckless.

The amount of profit accrued or loss avoided

- 5.5. ANAM has identified clients adversely impacted by the trading activity on the Far Eastern desk and compensation has been paid. The firm reviewed the circumstances of the Abbey National Smaller Companies Unit Trust and concluded that no compensation was payable.

Conduct following the contravention

- 5.6. ANAM investigated the specific matters of the Abbey National Smaller Companies Unit Trust and Far Eastern desk as soon as the issues came to its attention.
- 5.7. ANAM has acknowledged its control weaknesses and has acted effectively to remedy these weaknesses.

Disciplinary record and compliance history

- 5.8. ANAM has not previously been the subject of disciplinary action.

Action taken by other regulatory authorities and the FSA in relation to similar failings

- 5.9. In setting the level of the penalty, the FSA has taken into account penalties levied by previous regulators and the FSA.

6. CONCLUSION

- 6.1. Taking into account the seriousness of the breaches and the risk they posed to the FSA's statutory objectives, but also having regard to the effective remedial action taken by ANAM and the early settlement of the case, the FSA has decided to impose a financial penalty of £320,000.

7. IMPORTANT NOTICES

- 7.1. This Final Notice is given to you in accordance with section 390 of the Act.

Manner of payment

- 7.2. The Penalty must be paid to the FSA in full.

Time for payment

- 7.3. The Penalty must be paid to the FSA no later than 23 December 2003, being not less than 14 days beginning with the date on which the notice is given to you.

If the penalty is not paid

- 7.4. If all or any of the Penalty is outstanding on 23 December 2003, the FSA may recover the outstanding amount as a debt owed by you and due to the FSA.

Publicity

- 7.5. Sections 391(4), 391(6) and 391(7) of the Act apply to the publication of information about the matter to which this notice relates. Under those provisions, the FSA must publish such information about the matter to which this notice relates as the FSA considers appropriate. The information may be published in such manner as the FSA considers appropriate. However, the FSA may not publish information if such publication would, in the opinion of the FSA, be unfair to you or prejudicial to the interests of consumers.

- 7.6. The FSA intends to publish such information about the matter to which this Final Notice relates as it considers appropriate.

FSA contact

- 7.7. For more information concerning this matter generally, you should contact Martin Weir at the FSA (direct line: 020 7066 1874/fax: 020 7066 1875).

Brian Dilley
Head of Deposit Taking and Financial Stability
FSA Enforcement Division