
FINAL NOTICE

To: The Governor and Company of the Bank of Scotland

Of: Head Office
The Mound
Edinburgh
EH1 1YZ

Date: 5 February 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.

THE PENALTY

The FSA gave you a Decision Notice dated 3 February 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 £750,000.

You have agreed not to refer the matter to the Financial Services and Markets Tribunal under section 208 of the Act.

Accordingly, for the reasons set out below, the FSA imposes a financial penalty on you in the amount of £750,000 (“the Penalty”)

REASONS FOR THE PENALTY

Pursuant to section 206 of the Act, and having agreed with The Governor and Company of the Bank of Scotland (“BoS”) the facts and matters relied on below, the FSA is imposing the Penalty on BoS in respect of breaches of FSA Principles 2 and 9 and IMRO Chapter II Rule 4.5(1), IMRO Chapter VI Rule 2.1(5)(a) and IMRO Chapter VIII Rule 4.3(2)(b).

RELEVANT STATUTORY PROVISIONS AND REGULATORY RULES

Section 206 of the Act provides:

“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.”

The Financial Services and Markets Act 2000 (Transitional Provisions and Savings) (Civil Remedies, Discipline, Criminal Offences etc.) (No. 2) Order 2001 provides, in article 8(2), that the power conferred by Section 206 of FSMA can be exercised by the FSA in respect of the commission of a relevant IMRO contravention as if the Firm had contravened a requirement imposed under FSMA.

The Securities and Investments Board issued Principles (first known as the SIB Principles and then as the FSA Principles) that applied to IMRO members. The FSA Principles were universal statements of the standards expected of practitioners in the financial services industry. IMRO Chapter I Rule 1.1(1)(a) provides that they applied directly to the conduct of Investment Business by all Authorised Persons, including firms regulated by IMRO.

FSA Principle 2 states:

“A Firm should act with due skill, care and diligence.”

FSA Principle 9 states:

“A Firm should organise and control its internal affairs in a responsible manner, keeping proper records, and where the Firm employs staff or is responsible for the conduct of investment business by others, should have adequate arrangements to ensure that they are suitable, adequately trained and properly supervised and that it has well-defined compliance procedures.”

In addition, IMRO Chapter I Rule 2.1(1)(a) provides that each Firm must comply with IMRO’s Rules. IMRO Chapter II Rule 4.5(1) states:

“Subject to Rules 4.5(2) to (8), a Firm which acts as an Investment Manager for a Customer must ensure that he is sent at suitable intervals a report stating the value of the portfolio or account at the beginning and end of the period, its composition at the end, and, in the case of a discretionary portfolio or account, changes in its composition between those dates.”

IMRO Chapter VI Rule 2.1(5)(a) states:

“Without limiting a Firm’s specific obligations to provide information under the Rules, each Firm must keep IMRO promptly and fully informed of any material matter directly affecting the Firm, its Permitted Business or any other activities affecting such business, of which it is aware and which any reasonable person would consider to be relevant to a consideration of the Firm’s position under the Rules, or otherwise as a firm regulated by IMRO.”

IMRO Chapter VIII Rule 4.3(2)(b) states:

“Subject to any direction of the Enforcement Committee, if it appears to the Investigating Team that the Firm or any Related Company of the Firm or any Associate of the Firm or of any such Related Company, has or may have in its possession, custody, power or control, any documents, any other material or any information relating to any matter being investigated or relevant to an Investigation, the team may require the Firm, within such time as may be specified in a notice to the Firm:

(b) to produce to the team any such documents and other material in the Firm's possession, custody, power or control, or to disclose to the team all such information and, if any such documents or material cannot be produced or if such information cannot be disclosed, the team may require the Firm to state, to the best of its knowledge and belief, where and in whose possession, custody, power and control they are;”

FACTS AND MATTERS RELIED ON

Summary

1. The FSA decided to impose a financial penalty on BoS in respect of breaches of the FSA Principles and IMRO's Rules arising from the failure of its PEP/ISA Department to administer customer funds in line with regulatory requirements. These breaches related specifically to BoS's failings in the implementation of its LISA PEP and ISA computer system and the migration to that system of its PEP portfolio and in the management of its PEP/ISA Department. They meant that, throughout the period between November 1999 and August 2001, BoS was unable to reconcile properly the cash that it was holding on behalf of its PEP and ISA customers or, therefore, to state accurately how much money it was holding on behalf of those customers.
2. BoS's breaches are made particularly serious by the following factors:
 - Prior to the cash reconciliation failings BoS experienced with LISA, it had experienced cash reconciliation problems with QUASAR, its previous computer system for managing PEPs and ISAs. Despite this, BoS managed the implementation of LISA in such a way as to permit cash reconciliation problems to develop with LISA.
 - BoS's failings continued notwithstanding that, between December 1999 and November 2000, BoS Group Compliance and Group Internal Audit prepared reports which stated that staff within the PEP/ISA Department lacked knowledge and required training to enable them to perform their roles properly. The fact that the PEP/ISA Department's training needs were not met during this period meant that BoS management failed for a period of time to respond adequately to these reports and ensure that the training needs were met.
 - Until IMRO raised the issue, BoS had not recognised that under its procedures on operational losses compensation might be due to some customers.

- BoS failed to keep IMRO promptly and fully informed of the number of outstanding reconciling items on the cash reconciliation between LISA and BoS's internal accounting records even though the number had reached very substantial levels and despite BoS having been put on notice in June 1999 as to the level of outstanding items that IMRO considered material and of concern.
- BoS failed to provide IMRO with all relevant documents until a year after IMRO requested them.
- The failings with regard to the cash reconciliations and the calculation of customer compensation together with the lack of training and procedures within the PEP/ISA Department constituted systemic weaknesses in BoS's internal controls in relation to its PEP/ISA Department. They arose across many aspects of the implementation of LISA and the PEP Migration and demonstrated a serious lack of management control over the implementation of LISA, the PEP Migration and the PEP/ISA Department.
- The size and nature of BoS's PEP/ISA administration business mean that any material failings in its systems and controls could expose a large number of its PEP and ISA customers to potential loss, which would have to be made good by BoS. BoS's failings in this case affected a large number of customers and extended over the period November 1999 to August 2001.

Background

3. BoS is a major UK clearing bank and is regulated by the FSA. Between 15 March 1988 and 30 November 2001, BoS was an IMRO registered Firm, with permission to perform PEP and ISA administration and was at all material times subject to the FSA Principles and IMRO's Rules.

The LISA system

4. On 6 April 1999, BoS implemented within its PEP/ISA Department a new computer system, known as LISA, to manage ISAs (apart from Mini Cash ISAs). BoS subsequently migrated approximately 38,000 PEPs to LISA that had, until that point, been managed on QUASAR, a predecessor computer system ("PEP Migration"). Having delayed the PEP Migration on ten separate occasions BoS eventually migrated the PEPs between 20 October and 17 November 1999.
5. Shortly after the implementation of LISA, BoS experienced difficulties in reconciling the cash position recorded on LISA with the cash position recorded in BoS's bank accounts, a major control over BoS's PEP/ISA business.
6. At implementation in April 1999 LISA had missing functionality in the following areas: dividends, statements, withdrawals, income distribution and fees. This was, in most cases, planned. In order to counter the missing functionality, BoS instituted a number of manual workarounds whereby the absence of a LISA automated process was compensated for by a manual process undertaken by a member of the PEP/ISA Department. In effect, the PEP/ISA Department staff would, in respect of certain tasks, do the work that was meant to be done by LISA.

7. The manual workarounds put in place following the implementation of LISA and in advance of the migration of the PEPs enabled BoS, during that period, to adequately counter the functionality deficiencies and missing functionality in LISA. However, they were time costly for the PEP/ISA Department staff and the functionality problems with LISA were only fixed over a protracted period of time.

LISA Implementation Failings

Migrating the PEPs administered by its PEP/ISA Department to LISA when it should have appreciated that the PEP/ISA Department would be incapable of dealing with the additional burdens placed upon it by manual workarounds and cash reconciliations

8. BoS migrated the PEPs to LISA:
 - (a) in the knowledge that extensive manual workarounds were required to counter LISA's functionality failings;

Between 6 April 1999 and the date when the PEP Migration occurred, the number of ISAs that were opened with BoS was relatively small. However, the number and extent of manual workarounds were still sufficient to take up a considerable amount of the PEP/ISA Department staff's available time. As the number of ISAs managed by BoS increased, so the burden caused by manual workarounds and outstanding reconciling items increased.

As the increased number of ISAs resulted in an increased number of manual workarounds, BoS knew that migrating the PEPs to LISA with manual workarounds in place would require even more manual workarounds. BoS would have been aware that these additional manual workarounds would have been extensive due to the large number of PEPs, in comparison to the number of ISAs.

- (b) when it should have known, that if it migrated the PEPs to LISA, the number of outstanding reconciling items would increase to levels not amenable to prompt clearance;

BoS experienced problems with its cash reconciliations following implementation which resulted in outstanding cash reconciling items. The problems were in part caused by errors with the accumulators.

The ISA accumulator did not include all of the transactions that it should have done. BoS should have appreciated that this problem would be likely to get worse. In fact, the problem got considerably worse, in relation to both the PEP and ISA accumulators, following the migration of the large number of PEPs to LISA.

In addition, following migration, LISA began mixing transactions between the PEP accumulator and the ISA accumulator. Testing of the accumulators disclosed this problem prior to the migration of its own customers' PEPs. Having discovered the problem, BoS should have known, that if it was not rectified prior to migration, the number of outstanding cash reconciliations would increase to a level that was not amenable to prompt manual clearance.

- (c) failing to appreciate that the PEP/ISA Department would be incapable of dealing with the additional burdens that the manual workarounds and cash reconciliations would place on it.

While the manual workarounds that had been put in place following the implementation of LISA were successful to the extent that they addressed the limitations in LISA's functionality, the manual workarounds that were put in place following migration were not.

Due to the large number of PEPs that were involved in the PEP Migration, the number of manual workarounds had an adverse effect. They put an undue work burden on staff and took up a great deal of time. The reduction in available time meant that the amount of training that PEP/ISA Department staff were able to undertake was reduced and resulted in training deficiencies.

The training deficiencies and functionality problems with LISA together resulted in, or contributed to:

- (a) *the failure by BoS to deal properly with PEP and ISA cash reconciliations between November 1999 and August 2001; and*
- (b) *back value dating for an excessive period in a significant number of cases as described below.*

The clearance of outstanding cash reconciliations not only took up time that could have been spent on other tasks, but was also hampered by the general lack of time available to the PEP/ISA Department, training deficiencies and the interaction between back value dated transactions and cash reconciliations.

Back value dating

9. Post migration LISA system access and functionality problems placed additional demands upon staff. This resulted in the increased use of back value dating, resulting in 111,005 items (out of 2.4 million total items transacted during the relevant period) being posted to customers' accounts more than 14 days after the value date – a time period regarded as excessive. Of these 19,021 involved back value dating of an amount exceeding £5. The total value of such items was £9,077,440 and the average amount of interest paid to the customers affected, based on the average amount per customer back value dated was, for example, 29 pence in the case of 14 days and 87 pence in the case of 6 weeks.

Failing to manage the development and implementation of LISA properly

10. BoS planned the PEP Migration in a piecemeal manner. The original anticipated date of the PEP Migration was 19/20 June 1999. Between then and 17 November 1999 (the date that the last PEPs were migrated to LISA), the date for the PEP Migration was pushed back ten times.
11. Each time the migration date was changed, BoS failed to appreciate how much work was required to ensure a successful migration. As a result, when setting each new migration date, BoS failed to ensure that sufficient time was allowed to identify and

correct the problems with LISA's functionality. BoS should have appreciated that more time was needed to eradicate the faults with LISA's functionality than was, in fact, given.

12. Had it done so, BoS would have been able to plan the migration such that the majority, if not all, of the functionality problems with LISA would have been resolved before the PEP Migration. If that had been done, it is likely that BoS would have avoided many, if not all, of the failings that occurred following migration, such as the failure to deal properly with cash reconciliations.

Failing to deal properly with PEP and ISA cash reconciliations between November 1999 and August 2001

13. Between November 1999 and August 2001, BoS failed to deal properly with PEP and ISA cash reconciliations. The number of outstanding cash reconciling items on LISA increased after implementation, but became substantial in November 1999, following the PEP Migration, and reached a peak of approximately 10,000 outstanding reconciling items in May 2000.
14. Being unable to undertake cash reconciliations adequately meant that BoS could not be sure that it had accounted for all of its cash correctly or had accurately identified how much cash it held for each customer, and therefore did not know in relation to each customer what balances were available to invest. It also made it much harder for BoS to identify a fraud, should one have been perpetrated.
15. There were four main reasons for the problems BoS experienced with cash reconciliations:
 - (a) the PEP and ISA accumulators on LISA failed to include all transactions that they should have included;
 - (b) LISA mixed transactions between the PEP accumulator and the ISA accumulator;
 - (c) human error including mis-postings, mis-matchings and narrative errors; and
 - (d) items related to mini cash ISA balances were included in the accumulators.
16. The clearance of outstanding reconciling items caused by these problems was hampered by a number of factors, including:
 - (a) insufficient focus in relation to training being placed on the clearance of outstanding entries within the PEP/ISA Department; and
 - (b) a build up of outstanding reconciling items in relation to bulked items.
17. BoS unsuccessfully attempted to clear the outstanding reconciling items by itself between June and December 2000. Thereafter consultants appointed by BoS provided assistance to BoS. Eventually, KPMG (as reporting accountants for BoS and IMRO) were able to confirm that, by August 2001, a partially steady state had been reached with regard to the outstanding cash reconciliations and that, as at 10 December 2001, the cash reconciliation was complete and accurate.

18. The difficulties experienced by BoS in undertaking cash reconciliations:
- (a) meant that, between November 1999 and August 2001, BoS's PEP/ISA Department failed to administer customer funds in line with regulatory requirements in that it was unable to reconcile properly the cash that it was holding on behalf of its customers and corporate clients; and
 - (b) were caused, or contributed to, by functionality failings of the LISA system, a failure to ensure that staff within the PEP/ISA Department were adequately trained to operate LISA and undertake reconciliations and initially an insufficient focus for a limited period of time within the PEP/ISA Department on the clearance of outstanding reconciling items.

Failing to ensure that there were adequate procedures in place to govern the operation of LISA and the clearance of outstanding reconciling items

19. BoS failed from November 1999 to August 2001 to ensure that there were adequate procedures in place to govern the operation of LISA and the clearance of outstanding reconciling items. This failure:
- (a) meant that the problems with LISA's functionality were exacerbated and the investigation and resolution of the functionality problems and outstanding cash reconciling items was hampered; and
 - (b) produced tensions amongst staff within the PEP/ISA Department.
20. The failure to have adequate procedures in place extended to the management of the LISA system itself. The LISA servers at BoS were not managed on a day-to-day basis, the database administrator did not maintain the server and access to LISA was available to all staff, which put the integrity of the LISA database at risk.

Failing to ensure staff were provided with adequate training to enable them to operate LISA effectively and failing to respond to staff training needs

21. While management within BoS arranged for relevant staff within BoS generally, and within the PEP/ISA Department specifically, to receive a high level of training on ISAs, those who were to operate LISA were not given sufficient training about the operation of LISA. The insufficiency of training was, in part, the result of a lack of time available for training due to the heavy time demands of the manual workarounds put in place following the implementation of LISA and following the PEP Migration, and the clearance of outstanding items on the cash reconciliations.
22. Consequently, for a considerable period of time, PEP/ISA Department staff were operating LISA and clearing outstanding cash reconciling items without sufficient training in the tasks that they were undertaking. By May 2000, the number of outstanding reconciling items had risen to very high levels. These outstanding reconciling items were caused by, amongst other things, human error in processing the original entries and BoS's failure to clear the outstanding items. Both of these were in part the result of PEP/ISA Department staff receiving insufficient training.
23. During the latter part of 1999 and during 2000 BoS Group Compliance and Group Internal Audit prepared reports which stated that staff within the PEP/ISA Department

lacked knowledge and required training to enable them to perform their roles properly. BoS management failed to respond to these reports and ensure that the PEP/ISA Department staff's training needs were met until March 2001 when BoS Group Internal Audit concluded that the training workstream was broadly complete.

Failure to calculate compensation timeously

24. BoS sought to pay compensation as and when it was found to be due. BoS, however, had not recognised that compensation was due and owing to some customers until IMRO raised the issue with BoS as part of the investigation.
25. The number of customers so affected was 5,549 and the total amount of compensation to be paid is £10,350. BoS has arrangements in hand to compensate all customers.

Failure to produce accurate statements, provide information and produce documents

Failing to send customers full and accurate statements in February 2000

26. In February 2000, BoS encountered problems in producing periodic statements from LISA for both PEPs and ISAs. These problems resulted in errors on the statements. In addition, BoS did not send to some of its customers all of the periodic statements that they should have been sent.
27. The errors that occurred in the February 2000 statements, some of which were manually corrected before they were sent to investors, included:
 - (a) incorrect book costs;
 - (b) incorrect totals (they did not add up);
 - (c) incorrect "brought forward" amounts;
 - (d) no product headings which would have enabled identification of the particular product to which that part of the statement related;
 - (e) statement pages were not clearly numbered; and
 - (f) incorrect cash balances.
28. Before they were sent out, the statements were checked by sample checking across customer types. If errors were found, when comparing the statement details to the customers' transaction histories, all statements were manually reworked for that class of customers. However, despite these checks, some statements for BoS's own customers' ISAs were sent to customers with the wrong "brought forward" and "carry forward" figures.
29. Concerns with regard to the production of statements had been raised within BoS as early as 9 August 1999 when the testing of the PEP Migration highlighted problems with missing statements and wrong dates and amounts. Additionally, in December 1999, a BoS Group Compliance report of a visit to the PEP/ISA Department highlighted that LISA hardware and software issues needed to be resolved before

periodic statements were issued in February 2000. Despite these concerns, the erroneous statements were still sent out.

Failing to provide information

30. On a visit to BoS in June 1999, IMRO Supervision identified a reconciliations backlog of over 400 outstanding items on the QUASAR PEP control account. Consequently, IMRO required BoS to keep it informed as to the nature and number of reconciling items on QUASAR as well as details of any compensation that arose on a monthly basis until further notice. In doing so, IMRO put BoS on notice as to the level at which outstanding reconciling items would be considered by IMRO to be a material matter and of concern.
31. Thereafter, even though the number of outstanding reconciling items relating to BoS's own customers' PEPs and ISAs recorded on LISA increased substantially following the PEP Migration, IMRO was only made aware by BoS of the high level of outstanding reconciling items when it conducted a regular Supervision visit to BoS in May 2000.
32. The recorded levels of outstanding reconciling items relating to BoS's own customers' PEPs and ISAs recorded on LISA between November 1999 and May 2000, and in particular in December 1999 (2,763), February 2000 (6,086) and May 2000 (approximately 10,000) constituted material matters:
 - (a) which directly affected BoS, its Permitted Business or any other activities affecting such business;
 - (b) about which BoS was aware and which any reasonable person would consider to be relevant to a consideration of BoS's position under the IMRO Rules; and
 - (c) about which BoS was required to keep IMRO promptly and fully informed.

Failing to produce documents

33. By letter dated 29 May 2001, IMRO sought production from BoS of various categories of relevant documents and any other documents that BoS considered were relevant to the issues under investigation. BoS was required to produce the documents as they became available, but by no later than 15 June 2001.
34. BoS sent 17 files of information to IMRO on 14 June 2001 covering all of the categories stipulated by IMRO. Following a further search, BoS gave a further file to IMRO on 8 August 2001 during an IMRO visit to BoS.
35. On 23 May 2002 (a year after the original request), BoS informed the FSA that a substantial number of documents had been found on 21 May 2002 which were relevant to the investigation. In total, BoS found 64 additional lever-arch files of documents which were sent to the FSA in tranches between 1 June and 20 June 2002.
36. The FSA regards the discovery of the additional documentation as evidence of an insufficiently thorough search in response to its letter of 29 May 2001.

Contravention of Relevant Requirements

37. The penalty is to be imposed pursuant to Section 206 of FSMA in respect of breaches by BoS of FSA Principles 2 and 9 and IMRO Chapter II Rule 4.5(1), IMRO Chapter VI Rule 2.1(5)(a) and IMRO Chapter VIII Rule 4.3(2)(b).
38. FSA Principle 2 requires firms to use due skill, care and diligence in complying with their regulatory obligations. BoS's failings in respect of the PEP Migration and the management of the implementation of LISA constitute breaches of FSA Principle 2.
39. FSA Principle 9 requires firms to organise and control their internal affairs in a responsible manner and to have well defined compliance procedures. BoS's failings in respect of the management of the PEP/ISA Department, its calculation of customer compensation in all cases and its cash reconciliations constitute breaches of FSA Principle 9.
40. IMRO Chapter II Rule 4.5(1) requires a Firm which acts as an Investment Manager for a Customer to ensure that he is sent at suitable intervals a report stating the value of the portfolio or account at the beginning and end of the period, its composition at the end, and, in the case of a discretionary portfolio or account, changes in its composition between those dates. In respect of the statements due in February 2000, BoS failed to do so.
41. IMRO Chapter VI Rule 2.1(5)(a) requires each Firm to keep IMRO promptly and fully informed of any material matter directly affecting the Firm, its Permitted Business or any other activities affecting such business, of which it is aware and which any reasonable person would consider to be relevant to a consideration of the Firm's position under the Rules, or otherwise as a firm regulated by IMRO. BoS failed to do so in respect of the increasing number of outstanding reconciling items on its PEP and ISA cash reconciliations.
42. IMRO Chapter VIII Rule 4.3(2)(b) provides that subject to any direction of the Enforcement Committee, if it appears to the Investigating Team that the Firm or any Related Company of the Firm or any Associate of the Firm or of any such Related Company, has or may have in its possession, custody, power or control, any documents, any other material or any information relating to any matter being investigated or relevant to an Investigation, the team may require the Firm, within such time as may be specified in a notice to the Firm to produce to the team any such documents and other material in the Firm's possession, custody, power or control, or to disclose to the team all such information and, if any such documents or material cannot be produced or if such information cannot be disclosed, the team may require the Firm to state, to the best of its knowledge and belief, where and in whose possession, custody, power and control they are. BoS failed to comply with such a request.

Relevant Guidance on Sanction

43. IMRO issued a Statement of Disciplinary Policy in May 1994 ("SDP"). The SDP sets out the criteria on which any decision to impose a financial penalty will be based and on which the level will be determined. One of the main purposes 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 benefits of compliant behaviour.

44. In determining whether a financial penalty is appropriate, and its level, the FSA considers all of the relevant circumstances of the case. The FSA considers the following factors to be particularly relevant in this case.

Loss to investors and number of investors who have suffered loss

45. The amount of compensation to be paid to 5,549 customers is £10,350 in total.
46. The small amount of compensation is a result of various factors, one of which is the general fall in the value of shares during the relevant time. It is important to appreciate that, had the value of shares generally risen, it is likely that this small amount of compensation would have risen commensurately.

Deliberate conduct

47. It is accepted that BoS did not deliberately contravene IMRO Rules.

Risk to investors and the degree of such risk

48. All of BoS's PEP and ISA customers (including those of its corporate clients) were exposed to the risk of loss. Due to its failings with regard to the cash reconciliations, BoS was unable to confirm, until the outstanding reconciling items had been reduced to manageable levels, whether or not there had been instances of customer disadvantage.
49. BoS was also unlikely until that time to have been able to identify fraudulent activity, had any such activity taken place, in a timely manner whilst there were outstanding reconciling items.

Systemic failings by the firm with respect to a particular aspect of its business and the size of that aspect

50. It is imperative that firms establish internal procedures that are adequate to ensure compliance with regulatory standards and appropriate levels of consumer protection. Given the size of BoS's PEP and ISA customer base, the systems required had to be of a high quality in order to be appropriate. The failings identified indicate that this was far from the case.
51. The breaches identified in this case are of a serious nature. They result from systemic weaknesses in BoS's internal controls within its PEP/ISA Department, have arisen across many aspects of the implementation of LISA and the PEP Migration and indicate a serious lack of management control over the implementation of LISA, the PEP Migration and the PEP/ISA Department.
52. Matters are made worse by the fact that, while not disciplined, BoS was, in August 1999, required by IMRO Supervision to keep IMRO informed as to the nature and number of reconciling items on QUASAR, as well as details of any compensation that

arose, on a monthly basis due to the number of outstanding reconciling items that had been found on QUASAR during a Supervision visit in June 1999.

Number of breaches and the length of time during which the breaches occurred

53. BoS has committed a number of breaches in respect of both FSA Principle 2 and FSA Principle 9. Additionally, BoS has committed breaches of three separate IMRO Rules.
54. The breaches, particularly the failures with regard to the PEP and ISA cash reconciliations and the failure to ensure staff were provided with adequate training to enable them to operate LISA effectively, occurred over a protracted period of time.
55. In the case of cash reconciliations, BoS began to experience problems with its ISA cash reconciliations immediately after the implementation of LISA in April 1999. It began to experience significant problems with its PEP and ISA cash reconciliations immediately after the PEP Migration in November 1999. These problems were not finally rectified until August 2001 when KPMG confirmed that a partially steady state had been achieved; KPMG finally confirmed that a steady state existed on 10 December 2001.

Whether the firm brought the matter to the attention of IMRO

56. BoS failed to bring the matters to the attention of IMRO before May 2000. IMRO was first made aware of problems associated with LISA and the PEP/ISA Department by BoS during a Supervision visit in May 2000. By that time, the number of outstanding reconciling items on the PEP and ISA cash reconciliations had reached approximately 10,000.
57. The failure by BoS to notify IMRO until May 2000 came despite IMRO Supervision having previously required BoS, following a visit to BoS in June 1999 which disclosed a reconciliations backlog of over 400 outstanding items on the QUASAR PEP control account, to provide details of the nature and number of reconciling items on QUASAR on a monthly basis, and which put BoS on notice as to what IMRO considered to be material with regard to notification to it.

The degree of co-operation shown by the firm or registered individual in the investigation

58. BoS has co-operated with the investigation conducted by IMRO and the FSA.

The firm's attitude towards payment of compensation

59. BoS has paid compensation when it has been found to be due. However, BoS failed to recognise that some compensation to which customers were entitled was due to be paid.
60. The work that was undertaken on compensation by BoS in conjunction with IMRO was fairly extensive, involving work in some 17 different areas that had been identified by BoS and IMRO.

Degree to which the firm has taken steps to remedy the breaches and prevent recurrence

61. Initially, following IMRO's involvement in this matter, BoS were unable to clear the outstanding cash reconciling items. Following attempts by BoS to rectify the problems with the PEP and ISA cash reconciliations on its own, BoS instructed KPMG to assist it to identify the problems with the cash reconciliations and clear the outstanding items. KPMG assisted BoS to do this between December 2000 and December 2001. This shows that BoS took all appropriate steps to remedy the breaches.

The size of the firm and its ability to pay

62. BoS is a large UK clearing bank. It is also part of one of the UK's largest banking groups. There can be no doubt as to BoS's ability to pay the financial penalty proposed.

Disciplinary Record and Compliance History

63. BoS has not previously been the subject of disciplinary action brought by the FSA or its predecessor organisations.

How IMRO has dealt with similar breaches in the past

64. In the past, IMRO took action against a number of member firms for failings in the operation of systems and controls and failings with regard to cash reconciliations. The FSA is not bound to follow fines levied by previous regulators. Nevertheless in making its decision as to the level of financial penalty, the FSA has taken these previous fines into account. In exercising its powers under section 206 of FSMA, the FSA must have regard to any statement made by IMRO which was in force when the conduct in question took place with respect to its policy on the taking of disciplinary action and the imposition of, and amount of, penalties. The FSA has had regard to IMRO's Statement of Disciplinary Policy dated May 1994 in this case.

Conclusion

The FSA is of the view that the facts and matters set out above demonstrate that, at the material times, BoS committed serious breaches of the FSA Principles and IMRO's Rules, relating specifically to the implementation of its LISA PEP and ISA computer system and the migration to that system of its PEP portfolio and to the management of its PEP/ISA Department. In so doing, BoS has demonstrated such failings in complying with the regulatory standards outlined in the FSA Principles, and applicable to all regulated firms, as to demand a substantial financial penalty. In the circumstances, the FSA considers it appropriate to impose a financial penalty of £750,000.

MANNER OF PAYMENT

The Penalty must be paid to the FSA in full.

TIME FOR PAYMENT

The Penalty must be paid to the FSA no later than 7 March 2003, being not less than 14 days beginning with the date on which this notice is given to you.

IF PENALTY NOT PAID

If all or any of the penalty is outstanding on 8 March 2003, the FSA may recover the outstanding amount as a debt owed by you and due to the FSA.

IMPORTANT

This Final Notice is sent to you in accordance with Section 390 of the Act.

Publicity

Sections 391(4), 391(6) and 391(7) of the Act apply to the publication 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.

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

FSA Contacts

For more information concerning this matter generally, you should contact Julia Dunn (direct line: 020 7676 1388 /fax: 020 7676 1389) or James Lake (direct line: 020 7676 5864 /fax 020 7676 5865) of the Enforcement Division of the FSA.

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Julia M. R. Dunn
Head of Retail Selling
FSA Enforcement Division