FINAL NOTICE

To: **Capita Trust Company Limited**

Of: **Phoenix House,**
18 King William Street
London
EC4N 7HE

Date: **20 October 2004**

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 on 15 October 2004 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 of £300,000 on Capita Trust Company Limited ("the firm").

1.2. The firm has confirmed that it will not be referring this matter to the Financial Services and Markets Tribunal.

1.3. Accordingly, for the reasons set out below the FSA imposes a financial penalty of £300,000 (the "Penalty") on the firm.

2. REASONS FOR THE PENALTY

Introduction

2.1. Between June 1997 and September 2002 ("the relevant period") the firm breached relevant IMRO and FSA rules in relation to advisory sales by the firm of SCARPs (Structured Capital at Risk Products - also known as Precipice Bonds).

2.2. In particular, in the period June 1997 to December 2001, the firm breached the following IMRO rules: IMRO II 3.1(1), 3.2(1)(a), 4.1(1) and in the period from December 2001 to September 2002, the firm breached the following FSA rules: COB 5.3.5(1)R, COB 5.4.3R, and COB 2.1.3R, by:

(1) failing to take reasonable steps to ensure that the advice given to customers was suitable in relation to the purchase of SCARPs;

(2) failing to take reasonable steps to enable its customers to understand, or to ensure that customers understood, the nature of the risks involved in SCARPs; and

(3) failing to take reasonable steps to ensure that written communications and information which the firm gave to customers was presented clearly and fairly, and failing to take reasonable steps to communicate with customers in a way which was clear, fair and not misleading.

2.3. In the relevant period approximately 500 customers of the firm invested in SCARPs based on recommendations made by the firm. Some customers invested more than once, resulting in approximately 800 SCARP transactions in total. The total amount invested in SCARPs on the basis of advice given by the firm was approximately £9 million.

2.4. On the basis of a 60 file sample review conducted by the FSA's Enforcement Division it appears likely that most, and possibly all, of the SCARP recommendations made by the firm in the relevant period were non-compliant in terms of significant breaches of one or more of the prevailing IMRO or FSA rules. Of the 60 files sampled by the FSA:

(1) the investigation team identified one or more significant compliance failings in all transactions reviewed (i.e. a 100% failure rate);

(2) in over 90% of cases the firm failed to take reasonable steps to ensure that its advice was suitable before making the recommendation to invest in SCARPs;

(3) in over 90% of cases the firm failed to take reasonable steps to enable its customers to understand, or to ensure that customers understood, the nature of the risks involved in SCARPs; and

(4) in 80% of cases the firm failed to take reasonable steps to ensure that written communications and information which the firm gave to customers was presented clearly and fairly and/or the firm failed to take reasonable steps to

communicate with customers in a way which was clear, fair and not misleading.

2.5. In addition, an independent skilled person appointed pursuant to s.166 of the Act conducted a sample review of 30 files. The skilled person found that of the cases sampled:

(1) less than 10% of the advice given appeared to be suitable;

(2) in more than 55% of cases sampled the advice given appeared to be unsuitable; and

(3) in the remaining 35% of cases there was insufficient information available to the firm to determine whether the advice given had been suitable or not.

2.6. As a result of the widespread and serious nature of the failings identified it appears to the FSA that the firm has acted in breach of SIB Principles 2, 4 and 5 and FSA Principles 2, 6, and 7 by:

(1) failing to act and/or conduct its business with due skill care and diligence;

(2) failing to seek adequate information about the circumstances and investment objectives of its customers and failing to pay due regard to the interests of its customers and failing to treat customers fairly; and

(3) failing to provide adequate information to enable its customer to make informed decisions and failing to communicate information to its customers in a way which was clear fair and not misleading.

2.7. These failings are viewed by the FSA as being particularly serious because:

(1) the firm promoted a complex and higher risk product to investors who were seeking to invest in a lower risk product following retirement or redundancy. The unsuitability of the product for such investors was then compounded in the failure by the firm to explain adequately the product risks to these customers;

(2) the proportion of non-compliant advice appears to be exceptionally high;

(3) the failings continued over a considerable period of time - 5 years;

(4) the firm's marketing of SCARPs to an estimated 3000 customers potentially placed a significant number of customers at risk of loss. Approximately 500 of these customers went on to purchase SCARPs as a result of advice from the firm – resulting in actual loss to investors of approximately £3.5 Million; and

(5) in August 2001, the firm was made aware of serious deficiencies in its advisory sales process in a draft report produced by consultants retained by the firm to report on compliance with the regulatory rules. Despite this knowledge the firm:

(a) failed to report the matter to its Regulator;

(b) failed to review its past SCARP transactions to identify and recompense customers who may have been given unsuitable advice;

(c) rejected all complaints from SCARP customers between March 2002 and November 2003 (there were 20 such complaints) and characterised investor losses as due to poor market performance when the firm was on notice that there was a real risk that the losses could be due to unsuitable advice; and

(d) failed to implement recommendations made by its compliance consultants in August 2001 with the result that the firm continued to make unsuitable recommendations of SCARPs to its customers until September 2002.

2.8. In deciding on the level of penalty to be imposed the FSA has also taken account of the facts that:

(1) the regulated part of the firm's business was a small investment management and financial advice business. The financial advice side of the firm had between 3 and 4 financial advisers in the relevant period;

(2) over the relevant period, the total income generated for the firm as a result of its SCARPs business was less than £300,000; and

(3) the majority (75%) of the SCARP recommendations were made prior to May 2001 when the firm was still Royal & Sun Alliance Trust Company Ltd.

2.9. Whilst the failings demonstrated by the firm merit a significant financial penalty, the FSA considers that these failings have been mitigated by the following factors:

(1) after the discovery of the problem by the FSA and the referral of the firm to Enforcement, the firm has co-operated fully with the Enforcement process;

(2) the firm has co-operated fully with an FSA requirement to appoint a skilled person to report on the sales of SCARPs by the firm; and

(3) following the preliminary findings of the skilled person, the firm has volunteered to cut short the s.166 enquiry and to proceed straight to compensation for all of its SCARP customers who have suffered a loss, without requiring proof of unsuitability in each individual case. As a result, the firm has agreed to pay redress of approximately £3.5 million to all of its SCARP customers affected. This action by the firm will mean that customers who have suffered a loss will receive redress more quickly than would have been possible if the firm had not co-operated with the FSA in this manner.

2.10. The FSA has also had regard to the fact that the firm was acquired by a relatively new entrant to the financial services arena and that since the referral of the firm to Enforcement the firm and its new owners have expressed a willingness to learn from their recent experiences, have expressed their commitment to getting compliance right

in future, and have demonstrated their commitment to their obligation to treat their customers (including existing or 'inherited' customers) fairly by agreeing a redress package quickly and implementing it effectively.

2.11. As a result, the firm has received considerable credit for this, in the extent of the rule breaches reflected in this Notice, in the nature of the penalty itself, and in the amount of the financial penalty the FSA has decided to impose. Without this degree of co-operation the nature of the penalty could have been considerably more serious, and the level of financial penalty would have been considerably higher.

3. Relevant Statutory Provisions and Rules

Section 206 of FSMA 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."

3.1. Prior to 1 December 2001, the relevant statutory provisions were the rules of IMRO and the adopted SIB Principles. The relevant IMRO rules which applied to those of its firms which gave investment advice are set out in Chapter II, Sections 3 & 4 of the IMRO rulebook.

3.2. The Financial Services and Markets Act 2000 (Transitional Provisions and Savings) (Civil Remedies, Discipline, Criminal Offences etc) (No 2) Order 2001 ("the Pre-N2 Misconduct Order) provides, at 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.

3.3. Chapter I, Rule 2.1(1)(a) of the IMRO Rules provided that a member of IMRO must comply with IMRO's Rules.

3.4. The Principles issued by the Securities and Investments Board were universal statements of the standards expected of practitioners in the financial services industry. Chapter I, Rule 1.1(1)(a) of the IMRO Rules confirmed that they applied directly to the conduct of Investment Business by all Authorised Persons, including firms regulated by IMRO. Whilst IMRO I 1.1(c) confirmed that although a breach of a Principle would not in itself give rise to an action for damages, it would be taken into account for the purposes of discipline and intervention.

3.5. From 1 December 2001, the relevant statutory provisions were the FSA rules. The FSA's rules addressing Advising and Selling are set out in Chapter 5 of the FSA Conduct of Business Handbook. The FSA's Principles are set out in the Principles for Businesses section of the FSA Handbook.

Suitability

3.6. IMRO II 3.1(1) provides:

Subject to Rule 3.1(2), a firm must take reasonable steps to ensure that it does not in the course of Regulated Business or Associated Business:

(a) make any personal recommendation to a Private Customer of an Investment or Investment Agreement, or

(b) effect or arrange a discretionary transaction with or for a Private Customer or, subject to Rule 3.1(3), any other Customer;

unless the recommendation or transaction is suitable for him having regard to the facts disclosed by that Customer and other relevant facts about the Customer of which the firm is, or reasonably should be, aware.

3.7. COB 5.3.5(1)R provides:

A firm must take reasonable steps to ensure that it does not in the course of designated investment business:

(a) make any personal recommendation to a private customer to buy or sell a designated investment; or

(b) effect a discretionary transaction for a private customer (except as in (3));

unless the recommendation or transaction is suitable for the private customer having regard to the facts disclosed by him and other relevant facts about the private customer of which the firm is, or reasonably should be, aware.

Understanding of Risk

3.8. IMRO II 3.2 (1)(a) provides:

A firm must not recommend a transaction to a Private Customer, or act as a discretionary manager for him, unless it has taken reasonable steps to enable him to understand the nature of the risks involved.

3.9. COB 5.4.3R provides:

A firm must not:

(1) make a personal recommendation of a transaction; or

(2) act as a discretionary investment manager; or

(3) arrange (bring about) or execute a deal in a warrant or derivative; or

(4) engage in stock lending activity;

with, to or for a private customer unless it has taken reasonable steps to ensure that the private customer understands the nature of the risks involved.

Clear Fair and Not Misleading Information

3.10. IMRO II 4.1(1) provides:

(a) A firm may make a communication with another person which is designed to promote the provision of Investment Services only if it can show that it believes on reasonable grounds that the communication is fair and not misleading.

(b) A firm must take reasonable steps to ensure that any agreement, written communication, notification or information which it gives or sends to a Private Customer to whom it provides Investment Services is presented fairly and clearly.

3.11. COB 2.1.3R provides:

When a firm communicates information to a customer, the firm must take reasonable steps to communicate in a way which is clear, fair and not misleading.

SIB and FSA Principles

3.12. SIB Principle 2 - Skill Care and Diligence provides:

A firm should act with due skill, care and diligence.

3.13. FSA Principle 2 - Skill care and diligence provides:

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

3.14. SIB Principle 4 - Information about Customers provides:

A firm should seek from customers it advises or for whom it exercises discretion any information about their circumstances and investment objectives which might reasonably be expected to be relevant in enabling it to fulfil its responsibilities to them.

3.15. FSA Principle 6 - Customers' interests provides:

A firm must pay due regard to the interests of its customers and treat them fairly.

3.16. SIB Principle 5 - Information for Customers provides:

A firm should take reasonable steps to give a customer it advises, in a comprehensible and timely way, any information needed to enable him to make a balanced and informed decision. A firm should similarly be ready to provide a customer with a full and fair account of the fulfilment of its responsibilities to him.

3.17. FSA Principle 7 - Communications with clients provides:

A firm must pay due regard to the information needs of its clients, and communicate information to them in a way which is clear, fair and not misleading.

Facts and matters relied on

4. Background

4.1. In 1997 the firm was known as Royal & Sun Alliance Trust Company Limited. The principal activity of the firm was the provision of non-regulated services including advising on inheritance tax planning, acting as “on-shore” corporate trustees and the provision of trust and administration services. These non-regulated activities account for approximately 70% of the business carried on by the firm. The remaining 30% of the business consisted of regulated investment business – 15% portfolio management for private clients and 15% independent financial advice. In this latter capacity the firm provided financial advice to a closed client base consisting primarily of ex-employees of the Royal & Sun Alliance group (“RSA”) and their spouses.

4.2. In May 2001, the firm was sold as a going concern to new owners and was renamed Capita Trust Company Ltd. After the sale, the firm continued to provide investment services to the same niche client base of ex-RSA staff.

4.3. Pre-N2 the firm was IMRO regulated, it is now FSA authorised. During the relevant period the firm has had the appropriate IMRO and FSA permissions for its regulated investment business activities.

5. The Firm's Sales Process

5.1. Throughout the 1990's, the firm gave regular presentations and seminars to large groups of RSA employees who were anticipating retirement or (voluntary) redundancy. Attendees were invited to take away a blank questionnaire or fact-find to be completed and submitted at a later date. In the majority of cases potential customers were not offered specific advice or assistance in completing the fact find document but instead were directed to a telephone helpdesk facility if they required assistance in completing the form.

5.2. Based on the information provided in the fact find, the firm would write to the customer recommending that the customer invest in particular financial products. On occasion the adviser contacted the customer by phone or met with the customer prior to issuing this letter.

5.3. In addition to generating new business through seminars and presentations, the firm issued newsletters approximately three times a year which were mass-mailed to the approximately 3000 customers in the firm's customer database. The newsletters provided general financial information and each issue would contain feature items which would focus in more detail on particular topics, for example a feature on PEPs, ISAs, or stakeholder pensions. Several issues of the newsletter contained feature items on SCARPs – described variously as Guaranteed Income Bonds, High Income Bonds or High Income Plans. The newsletters enclosed reply slips containing tick boxes which the customer could complete to indicate which of the featured investments were of interest to them.

5.4. On the basis of these expressions of interest, and using information already available to the firm on the existing customer fact find, the firm would contact the customer and recommend that the customer invest in particular financial products. On occasion the adviser contacted customers by phone or email prior to making the recommendation.

5.5. In summary, during the relevant period the firm's system for giving advice was predominantly correspondence-based, supplemented on occasion by telephone or face-to-face contact with customers. This practice continued throughout the relevant period.

6. SCARP sales

6.1. Using the methods described above, the firm gave advice which resulted in approximately 500 of its customers investing in SCARPs. Some customers invested in more than one SCARP, and some customers split their investments to take account of tax advantages, so that in total the firm's advice resulted in approximately 800 SCARP transactions in the relevant period. The total value of SCARP transactions entered into by customers of the firm was approximately £9 million.

6.2. The majority (75%) of the SCARP transactions were based on advice given to customers between September 1997 and May 2001 when the firm was Royal & Sun Alliance Trust Company Ltd. After May 2001, when the firm became Capita Trust Company Ltd, the sales of SCARPs continued for a further 15 months, gradually winding down to a fairly low volume until September 2002, after which no SCARPs were recommended by the firm. This coincided with a winding-down of SCARP sales in the market generally as existing SCARPs began to mature with significant losses and negative media reporting in relation to SCARPs became widespread.

6.3. The firm sold over 50 varieties of SCARPs in the relevant period. The majority of the bonds have already matured – almost all with a capital loss. The capital loss ranges from 9% to 100% depending on the particular bond. Most of the capital losses exceed 50%.

7. Size of the business

7.1. The total value of investments in SCARPs made as a result of advice given by the firm during the relevant period amounts to approximately £9 million. The total income generated by the firm from SCARP sales in the relevant period is estimated to be less than £300,000, from a total commission income of just under £2 million.

7.2. Throughout the relevant period the firm had between 3 and 4 financial advisers for the IFA part of the business and between 4 and 7 investment managers for the portfolio management side of the business. Since October 2002, the firm has replaced the management of the advisory part of the business and has replaced the majority of the financial advisers. The firm now has 7 investment advisers registered as approved persons (CF21) and 6 investment managers (CF27). The IFA side of the business now has approximately 600 customers.

8. Discovery of the issues by the firm

8.1. In May 2001, the firm was acquired by the Capita Group PLC and became Capita Trust Company Ltd. In July 2001, the firm engaged the services of a firm of external consultants to conduct a compliance review of the IFA side of the firm's business. A report was delivered in draft on 31 August 2001 ("the August 2001 report"). The report warned that:

(1) most of the firm's customers were advised into one of 3 products – SCARPs, unit trusts, or equity ISA's. The firm's advisers had limited knowledge beyond these 3 products whereas the customers believed they were receiving a full independent financial advice service;

(2) the firm was selling potentially high risk products to customers when their attitude to risk did not match that of the product;

(3) the firm carried out no analysis of the investment risk which its customers were willing to run;

(4) customers with limited funds were advised straight into equities when the suitability of that advice could not be demonstrated from the information available to the firm;

(5) the firm often relied on very old fact finds, many were between 8 and 10 years old;

(6) the firm's recommendations were made in letters which did not adequately explain the products;

(7) in general, the firm did not adequately explain the risks involved in particular products. In some cases, no explanation of risk was given. In other cases, when risk warnings were stated, the letter generally went on to down-play the stated risk; and

(8) the firm carried out no real compliance monitoring and the compliance function lacked the resource necessary for effective compliance control.

9. The firm's response to discovery of the issues

9.1. Following the August 2001 report the firm retained external consultants to assist the firm in improving its existing compliance procedures and it began to formulate new compliance procedures with a view to improving the future business carried out by the firm. However, the response of the firm was neither adequate nor timely and as a result the firm continued to give unsuitable advice to its customers to invest in SCARPs until September 2002. By way of example, a basic recommendation in the August 2001 report that customer fact-finds should be completed at least annually was not implemented at all during in the relevant period.

9.2. Whilst the firm did begin to take steps to begin to amend its procedures going forward, the firm did not implement any review to identify which of its existing customers may already have been given unsuitable advice, and whether those customers had suffered or were likely to suffer a loss as a result of that unsuitable advice. In 2003, the firm devised a review of its client database and a review of the current holdings of its customers, but this did not include a review of whether mis-selling had already taken place, and did not include any proposal to notify customers that they may have received unsuitable advice and that they might be entitled to redress as a result.

9.3. The firm received 20 complaints from its SCARP customers in 2002/2003. The firm rejected all of these complaints and characterised investor losses as due to poor market performance, when in fact the firm was on notice of the compliance defects that existed at the time the original advice was given, and therefore on notice that there was a risk that the loss may have been attributable to unsuitable advice rather than market performance.

10. Discovery of the issues by the FSA

10.1. The FSA conducted a visit to the firm in July 2003. An examination of the firm's complaint files revealed that the firm was facing a growing number of complaints about its advice in relation to SCARPs. The FSA requested further details from the firm concerning the scale of the firm's exposure to claims from SCARP customers; however the firm was unable at the time to provide accurate figures for the number of its customers who had been advised to invest in SCARPs, the amounts invested, or the potential losses which its customers faced. In December 2003, the firm was referred to the Enforcement Division of the FSA and a formal investigation into the SCARP business carried out by the firm was commenced. The investigation has focussed on issues arising from the SCARP transactions on which the firm had advised; it has not examined the advice given in relation to products other than SCARPs. The investigation team conducted a sample file review of 60 SCARP recommendations to consider the firm's compliance with the applicable Rules and Principles.

10.2. In summary, the investigation team identified significant compliance failings with the applicable IMRO or FSA requirements in all transactions reviewed (i.e. a 100% failure rate). The review identified the following breaches:

(1) In 57 transactions (95% of all transactions reviewed) the firm had failed to take reasonable steps to ensure that the recommendation made was suitable for the customer, having regard to the facts of which the firm was, or should have been, aware;

(2) In 60 transactions (100% of all transactions reviewed) the firm failed to take reasonable steps to enable its customers to understand, or reasonable steps to ensure that its customers understood, the nature of the risks involved in SCARPs; and

(3) In 48 transactions (80% of all transactions reviewed) the firm failed to take reasonable steps to ensure that written communications and information which the firm gave to customers was presented clearly and fairly and/or the firm failed to take reasonable steps to communicate with customers in a way which was clear, fair and not misleading.

11. Breach of the Suitability rules

11.1. In 57 of the transactions reviewed, in breach of IMRO II 3.1(1) and FSA COB 5.3.5(1)R the firm failed to obtain or update essential customer information, or having obtained it, failed to have regard to it when assessing the suitability of SCARPs for the particular customer. In doing so, the firm failed to take reasonable steps to ensure that it did not give advice unless the advice was suitable. For example:

(1) in 8 of the 57 transactions the firm had recommended a SCARP in circumstances where the risk profile of the product was directly at odds with the client's expressly stated attitude to investment risk;

(2) in 24 of these 57 transactions the firm had obtained no information in relation to the client's attitude to investment risk;

(3) in 21 of these 57 transactions reviewed the firm did not have up to date information in relation to the customers circumstances – some fact-finds were 8 years old at the time the advice was given; and

(4) in 44 of these 57 transactions it was identified that the firm had failed to establish whether the client would need access to the invested funds.

12. Breach of the rules relating to explanation and understanding of Risk

12.1. In all 60 of the transactions, in breach of IMRO II Rule 3.2(1)(a) or FSA COB 5.4.3R, the firm had failed to take reasonable steps to ensure that the client understood the nature of the risks involved with the recommended product.

(1) In 10 of the 60 transactions reviewed, no explanation of the investment risk was provided to the customer;

(2) In the remaining 50 transactions, the firm failed to adequately explain the risks and in many cases gave an inadequate risk warning and then immediately undermined the limited effect of the warning by a further statement minimising the degree of risk involved. For example, in July 1997, in recommending a SCARP to a customer the firm advised that:

"Based upon past performance the risk to your capital is extremely slight……. there is some risk to your capital but in my view this is compensated for by the much better rate of interest which you would receive."

In October 1998, in recommending a SCARP to a customer the firm advised that:

"*You will notice from the brochure that past performance indicates that such a fall in value of these indices over such a period is very unlikely. However you should be aware that past performance is not necessarily a guide to future performance and that there is a risk to your capital although we consider this to be fairly low."* and

(3) in many cases the SCARPs recommended by the firm incorporated a provision for accelerated capital loss once the relevant index had fallen below a particular level, so that customers would lose £2 for every £1 fall in the index. This downside gearing of the risk to capital was in most cases not explained to customers adequately or at all.

13. Information to be Clear Fair and Not Misleading

13.1. In 48 of the 60 transactions, in breach of IMRO II Rule 4.1(1) and FSA COB 2.1.3R the firm failed to take reasonable steps to communicate with its clients in a manner which was clear, fair and not misleading in that:

(1) the firm unfairly described the risk of relevant market falls as 'remote' and 'unlikely' without explaining to investors that if the risk materialised the capital loss would be significant - in some cases resulting in total capital loss;

(2) the firm's reference to historical performance was misleading in that it failed to disclose that the historical period being referred to comprised a period of less than 10 years and that its relevance as an indicator was restricted by this limited period;

(3) in correspondence with customers the firm unfairly drew comparisons between SCARPs and other forms of investment in which investor's capital would not have been at risk; and

(4) in general, the firm's promotions and recommendations emphasised the benefits of SCARPs and downplayed the risk inherent in the product; and taken as a whole, their communications with clients did not present a balanced and fair description of the benefits and disadvantages associated with SCARPs.

13.2. For example, when recommending a SCARP to a customer, the firm advised:

"There is some risk to capital therefore, but I would judge this risk to be slight and more than compensated by the high rate of return over and above a conventional building society account."

13.3. In another example, the firm advised:

"Clearly to achieve such a return there must be an underlying risk to capital and the risk is that the Dow Jones Eurostoxx 50 Index (which measures Europe's 50 largest companies) must not fall by more than 20% during the term of the plan otherwise there is a claw-back of part of your capital as detailed in the brochure. Back testing proves that there has never yet been a 3 year period when this index has fallen let alone by 20% so in my opinion the risk is remote but nevertheless one which must be understood and accepted prior to investment."

14. Contravention of the SIB and FSA Principles

14.1. By reason of the matters set out above, it appears to the FSA that the firm has carried on business in breach of SIB Principles 2, 4 and 5 and FSA Principles 2, 6 and 7 throughout the relevant period.

15. Skilled Person appointment

15.1. In April 2004, the firm appointed a Skilled Person pursuant to s.166 of the Act to review the SCARP transactions on which the firm had advised. In May 2004, the firm received an interim report from the skilled person which provided the results of an initial desk based sample review of 30 SCARP transactions.

15.2. In considering whether of not the recommendation made by the firm was suitable, the interim report found that, from the 30 transactions analysed:

(1) For 2 customers (less than 10%) the firm's recommendation appeared to be suitable;

(2) In 17 cases (more than 55%) the firm's recommendation appeared to be unsuitable; and

(3) In the remaining 11 cases (over 35%) there was insufficient information available to the firm to conclude whether or not the recommendation was suitable for the customer.

15.3. In addition, the interim report concluded that: *"The description by the adviser of the risks inherent within the SCARP product was generally poor"*

15.4. In response to the findings set out in the interim report, the firm agreed to cut short the s.166 review and proceed straight to redress for all of its SCARP customers who have suffered a loss. This will result in the payment of approximately £3.5 million to the firm's SCARP customers who have been affected. The firm has agreed to adopt a methodology similar to that used by the Financial Ombudsman Service (since 1 January 2004) as the basis for their calculation of loss and redress.

16. Relevant Guidance on Penalty

16.1. The principal purpose of the imposition of a financial penalty is to promote high standards of regulatory conduct. It seeks to do this 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.

16.2. The FSA's policy on the imposition of financial penalties is set out in Chapter 13 of the Enforcement manual ("ENF 13") which forms part of the FSA Handbook. Paragraph 13.3 of the Enforcement Manual sets out the factors that may be of particular relevance in determining the appropriate level of financial penalty.

16.3. Article 8(4) of the Pre-N2 Misconduct Order provides that, where the FSA proposes to impose a financial penalty it must have regard to:

"*any statement made by the self-regulating organisation…which was in force when the conduct in question took place with respect to the policy on the taking of disciplinary action and the imposition of, and amount of penalties (whether issued as guidance, contained in the rules of the organisation or otherwise)*".

16.4. Relevant IMRO guidance is contained in its document entitled "No 1 Statement of Disciplinary Policy" issued in May 1994. Section 3 of this document set out the fining policy adopted by IMRO and specified the factors that will be considered when determining the level of penalty – which in all material respects required consideration of the same factors as identified in ENF 13.3. This document has been taken into account by the FSA in determining the appropriate sanction in this case.

16.5. IMRO's statement of policy however, also makes it clear, at paragraph 2 of the document that the criteria for determining the level of sanction are not to be applied rigidly:

"IMRO has also carefully reviewed its experience in assessing disciplinary fines, and has consulted widely with other regulators. Based on this review, it is clear to IMRO that the process of arriving at an appropriate level of fine cannot be a mechanical exercise. To protect the interests of investors, and to ensure that natural justice is observed, it is essential that each case be viewed on its own particular merits. Accordingly, IMRO's disciplinary committees and tribunals have and will consider all relevant circumstances in determining the size of a fine."

16.6. Similarly it is stated in ENF 13.3.4 that the criteria listed in the manual are not exhaustive and all relevant circumstances of the case will be taken into consideration.

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

Seriousness

16.8. The FSA has had regard to the seriousness of the contraventions, including the nature of the requirements breached, the number and duration of the breaches, the identification of the contraventions by the firm's senior management, the number of consumers who were exposed to risk of loss and the number of consumers to whom actual loss was caused, and the extent to which problems were systemic. The level of financial penalty must be proportionate to the nature and seriousness of the contravention. Details of the breaches identified in this case are set out above. For the reasons detailed below the FSA considers that the breaches identified in this case are of a serious nature:

(1) they relate to sales of a complex and higher risk product to investors who predominantly had a lower risk attitude to risk;

(2) they demonstrate a failure by the firm to adequately explain the risks inherent with SCARPs to its customers;

(3) they occurred over a prolonged period of time and resulted in an exceptionally high level of non-compliance with the prevailing rules; and

(4) they potentially exposed a large number of the firm's clients to risk of loss and have led to actual loss of £3.5 million being suffered by approximately 500 investors.

Nature of conduct – ENF 13.3.3(2)

16.9. The FSA does not assert that the firm acted deliberately in breaching the IMRO Rules, SIB Principles and FSA Rules and Principles. However, the firm's failings were aggravated by its failure to respond adequately to deficiencies and weaknesses that were identified in its compliance procedures and sales practices insofar as these related to existing customers and mis-selling which had already taken place. In this respect the FSA has noted that the firm was made aware of such deficiencies in August 2001 following a review of its procedures by external compliance consultants and that subsequent review of its procedures by in-house and external compliance consultants continued to identify problems with its existing compliance procedures and sales practices. The FSA considers that the firm's response to these findings was inadequate in that the firm failed to:

(1) report these findings to its Regulator;

(2) conduct any review of its historic SCARP transactions with a view to identifying and compensating investors who may have been given unsuitable advice; and

(3) implement recommendations made by its external and in-house compliance consultants with the result that the firm continued to make unsuitable recommendations in relation to SCARPs until September 2002.

The size, financial resources and other circumstances of the firm, and the amount of profits accrued or loss avoided

16.10. The firm is, and has been throughout the relevant period, a relatively small regulated business in terms of the number of staff and numbers of customers. During the relevant period the firm employed between 3 to 4 financial advisers and promoted its investment advice service to approximately 3000 people, consisting mainly of ex-employees of its original parent company. The firm now has 7 investment advisers and 6 investment managers and approximately 600 private customers in the financial advice part of the business.

16.11. The firm's business activities primarily relate to the provision of non-regulated services and a relatively small percentage of its business consists of regulated investment business. The firm's total revenue for the relevant period earned from all business activities amounted to £15,715,000. The total amount of commission received by the firm from its regulated investment business activities during this period was approximately £2,000,000 with commission arising from SCARP sales amounting to less than £300,000. The FSA has had regard to the fact that throughout the relevant period the firm had access to considerable financial and other resources which would have enabled it to adequately resource its training, monitoring and compliance function to prevent the problems arising and/or to deal adequately with the problems once they had been identified by their external compliance consultants. Conversely the FSA acknowledges that the firm will now be applying a significant proportion of its resources to resolve the problems in terms of the redress which will be paid and also in terms of the costs incurred as a result of the s.166 exercise undertaken by the firm.

Conduct following the contravention.

16.12. As detailed above the FSA has serious concerns regarding the firm's conduct in the period between the August 2001 Report and the firm's referral to Enforcement in December 2003. The FSA has had regard to the firm's failure to respond adequately and in a timely fashion to deficiencies in its compliance and sales practices which were identified by its own in-house and external compliance consultants. In particular the FSA views as serious the firm's failure to act in a timely manner on recommendations made by its compliance advisers, the firm's failure to report the matters to its regulators, and the failure to consider fairly the interests of its customers who had already received suitable advice.

16.13. Conversely, the firm has demonstrated a very high level of co-operation with the FSA following its referral to Enforcement. The firm has been fully co-operative with the FSA's requirement for it to appoint a skilled person to report on its SCARP advice and in particular the firm has received considerable credit for volunteering to cut short the s.166 enquiry and to proceed straight to compensation for all of its SCARP customers who have suffered a loss, without requiring proof of unsuitability in each individual case.

16.14. The level of financial penalty imposed in this case reflects the co-operative approach adopted by the firm during the enforcement process as well as its agreement to compensate its customers. In the absence of such co-operation a significantly higher financial penalty would have been imposed.

Disciplinary record and compliance history

16.15. The firm has not previously been the subject of any disciplinary action.

Previous action taken by other regulatory authorities and the FSA/IMRO in relation to similar failings

16.16. In deciding on the level of penalty, the FSA has taken into account penalties levied by previous regulators and by the FSA in relation to similar behaviour by other firms.

17. IMPORTANT NOTICES

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

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 3 November 2004, being not less than 14 days from the date on which this notice is given to you.

If Penalty is not paid

If all or any of the penalty is outstanding on 3 November 2004, the FSA may recover the outstanding amount as a debt owed by you and due to the FSA.

Publicity

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 these 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.

Third Party Rights

The FSA gave a copy of the Decision Notice to Royal & Sun Alliance Insurance Group Plc. Accordingly, the FSA must also give a copy of this notice to Royal & Sun Alliance Insurance Group Plc.

FSA Contacts

For more information concerning this matter generally, you should contact Steve Page at the FSA (direct line: 020 7066 1420/fax: 020 7066 1421).

Julia MR Dunn
Head of Retail Selling
FSA Enforcement Division