FINAL NOTICE

To: **Lincoln Assurance Limited**

Of: **Barnett Way**
Barnwood
Gloucester
GL4 3RZ

Date: 16 April 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 on 31 March 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 of £485,000 on Lincoln Assurance Limited ("Lincoln").

1.2. You have agreed not to refer the matter to the Financial Services and Markets Tribunal. Accordingly, the FSA imposes a financial penalty on you in the amount of £485,000 ("the Penalty").

2. REASONS FOR THE PENALTY

2.1. For the reasons set out below, the FSA is imposing a financial penalty of £485,000 on Lincoln in respect of breaches of Rules 4.1, 5.1.1, and 7.2.1 of the Rules of the Personal Investment Authority ("the PIA Rules"), paragraph L8(1) of Schedule L2 and paragraph L3.15 of the Adopted LAUTRO Rules ("the LAUTRO Rules") and Principle 2 of the Statements of Principle of the Securities and Investments Board ("the SIB Principles"), arising out of the actions of its appointed representative City Financial Partners Limited ("CFPL").

3. RELEVANT STATUTORY PROVISIONS AND REGULATORY RULES

3.1. 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."

3.2. The Financial Services and Markets Act 2000 (Transitional Provisions and Savings) (Civil Remedies, Discipline, Criminal Offences etc) (No2) Order 2001 provides, at Article 8(2), that the power conferred by Section 206 of the Act can be exercised by the FSA in respect of failures by a firm to comply with any of the provisions specified in PIA Rule 1.3.1(6) as if the firm had contravened a requirement imposed by the Act.

3.3. PIA Rule 1.3.1(6) provided that a member of the Personal Investment Authority ("PIA") which failed to comply with PIA Rule 1.3.1(2) or any of the SIB Principles was liable to disciplinary action.

3.4. PIA Rule 1.3.1(2) provided that a PIA member must obey the Rules of PIA. These Rules included certain rules initially promulgated by LAUTRO (a former self-regulating organisation) and described as the Adopted LAUTRO Rules.

3.5. The SIB Principles are universal statements of the standards expected of firms that were issued by the Securities and Investments Board ("SIB") and applied to PIA members through provisions of the PIA Rulebook.

3.6. PIA Rule 1.3.9(2) provided:

"A Member must accept responsibility, to the same extent as if the Member had expressly authorised it, for anything said, written, done or omitted ...

(2) by any of its investment staff or other employees in the carrying on of the Member's relevant business"

3.7. Paragraph L8(1) of Schedule L2 of the LAUTRO Rules provided:

"A Company representative shall, in advising an investor as to the suitability for that investor of any investment contract, have regard, in particular, to the investor's financial position generally, to any rights he may have under an occupational pension scheme or the State earnings-related pension scheme (if such rights are relevant in the particular case) and he shall use his best endeavours to ensure

(a) that he recommends only that contract or those contracts which are suited to that investor; and

(b) That there is no other contract available from the Member, or, if the Member belongs to a marketing group, from any member of that group, which would secure the investor's objectives more advantageously."

3.8. PIA Rule 5.1.1 provided:

"(1) A Member must

a) *Keep records which are sufficient to show at any time that it has complied with the requirements of the Rule Book, and*

(b) establish procedures and controls to ensure that those records are made promptly and accurately and, where appropriate, brought up-to-date at regular and frequent intervals.

(2) In particular (but without limiting the generality of (1) above) a Member must keep records of the matters specified in column 1 of Table 5 below and include in them the details specified in column 2 of that Table."

3.9. Table 5 in Chapter 5 of the PIA Rules included the following relevant provisions:

"**II. Customers**

(c) *[For private customers], sufficient details of the information he has been willing to provide about his personal and financial circumstances, investments and other assets, investment objectives and attitude to risk to provide evidence that recommendations made to him or deals on his behalf are suitable…;*

III. Transactions

(c) (where the transaction was arranged or effected for the customer as a result of investment advice given by or on behalf of the Member) sufficient information to show that the transaction was suitable for the investor and, if a transaction in a packaged product, … (if the Member is a product provider or marketing associate) that the product was as advantageous to the customer as any in the product range of the Member or its marketing group."

3.10. LAUTRO Rule L3.15 provided:

"(1) ……. where a company representative recommends an investor–

(a) to buy a life policy …..

the Member shall ensure that the investor is sent or given a written explanation which satisfies the requirements of paragraph (3) below.

(3) A written explanation given to an investor in compliance with this Rule must— …….

(b) *make clear why the recommendation has been made having regard to the investor's financial and other circumstances of which the Member is aware."*

3.11. PIA Rule 4.1 provided:

"A Member must ensure that anything said or written, or any document sent, given or shown, to an investor or potential investor by the Member or on its behalf in the course of its relevant business is clear and fair, and is not misleading, either in design or content."

3.12. PIA Rule 7.2.1 provided:

"(1) A Member must monitor adequately

(a) *the conduct of its investment staff and other employees, and of its appointed representatives and their relevant employees, with a view to ensuring compliance with the procedures which it has established in accordance with Rule 7.1.2 and its own compliance with the Principles and Rules …"*

3.13. SIB Principle 2 provided:

"A firm must act with due care, skill and diligence."

4. REASONS FOR THE ACTION

Conduct in issue

4.1. The case concerns failings by CFPL and Lincoln between 1 September 1998 and 31 August 2000 ("the period in issue") involving unsuitable recommendations made to customers between those dates to purchase 10-year savings plans. CFPL was, until October 2000, the appointed representative of Lincoln, and Lincoln was responsible by virtue of the PIA Rules for CFPL's conduct. Lincoln's monitoring of CFPL over this period was inadequate and, as a result, Lincoln failed to detect inadequately documented or unsuitable sales or other failures by CFPL to meet the standards required by PIA's Rules.

Summary

4.2. During the period in issue, Lincoln acted in a number of respects in breach of the PIA Rules, including the LAUTRO Rules and the SIB Principles.

4.3. Specifically, Lincoln failed to comply with Paragraph L8(1) of Schedule L2 of the LAUTRO Rules in that agents of CFPL failed to use their best endeavours to ensure that they only recommended 10-year savings plans where such policies were suitable for customers' needs and where there was no other Lincoln product available to meet customers' needs more advantageously.

4.4. Further Lincoln failed to comply with:

(1) PIA Rule 5.1.1(1) in that Lincoln failed to keep records which demonstrated that it had complied with the PIA Rulebook;

(2) LAUTRO Rule L3.15 in that Lincoln failed to ensure that the written explanation given by its representative, CFPL, to customers made clear why the recommendation had been made having regard to the customer's financial and other circumstances;

(3) PIA Rule 4.1 in that Lincoln failed to ensure that anything said or written by CFPL, or any document sent, given or shown by CFPL, to a customer or potential investor by the Member or on its behalf in the course of its relevant business was clear and fair, and was not misleading, either in design or content;

(4) PIA Rule 7.2.1(1)(a) in that Lincoln failed to establish procedures to monitor CFPL adequately and to ensure CFPL's compliance with PIA's Rules and Principles;

(5) SIB Principle 2 in that Lincoln failed to exercise due skill, care and diligence to ensure that CFPL only recommended contracts that were suitable for the needs of its customers.

4.5. In so doing, CFPL and Lincoln (who was responsible for the conduct of CFPL) demonstrated failings that demand a significant financial penalty. These failings are viewed by the FSA as particularly serious in the light of the following factors:

- The breaches identified in this case are of a systemic nature, arising from weaknesses in CFPL's documentation and sales process and the monitoring of them by Lincoln with respect to sales of 10-year savings plans during the period in issue. These failures have caused actual or potential financial disadvantage to significant numbers of customers.

- These failings resulted in young single customers being recommended unsuitable inflexible 10-year savings plans with significant early redemption penalties when other more flexible savings products, such as ISAs, that did not have such disadvantages were available and could have met the customers' objectives more advantageously.

- Lincoln had been notified that PIA had concerns regarding the selling practices of CFPL after the Supervision visits in September 1998 and December 1999, and also by the issue of a formal warning in May 1998. This notification of PIA's concerns should have alerted Lincoln to potential problems with CFPL's sales process and focused their attention on ensuring that procedures were put in place and followed by CFPL advisers to ensure that the breaches of PIA's rules central to this case did not occur. Whilst Lincoln did take steps to deal with the failings of CFPL these steps did not eradicate the problems which subsequently came to light.

4.6. While the failings in this case merit a significant financial penalty, the FSA recognises the extent of the co-operation demonstrated by Lincoln once the failings had been drawn to its attention, including:

- Lincoln has acted in a positive and pro-active way to establish whether customers have been mis-sold, and if so, to provide compensation. Following an article in 'Which?' magazine in 2000, Lincoln immediately, and without awaiting the outcome of any investigation by the FSA, initiated a review of 5,000 cases sold to customers under 35 years old between 1 September 1998 and 31 August 2000 to identify whether there was evidence of the sale of an unsuitable savings product. The review showed that the documentation was insufficient always to justify the sale made. In assessing the results of the review Lincoln erred on the side of customers. On the basis of this initial review Lincoln proactively agreed to conduct a review of all sales of the relevant products by CFPL (a total of 28,295 customers) between November 1993 and October 2000 ("the Past Business Review").

- Lincoln worked closely with PIA and subsequently with the FSA to agree an appropriate methodology for identifying and paying redress to potentially disadvantaged customers. All customers were mailed during 2002 and the review is now nearing completion.

- Lincoln has spent considerable sums in conducting the Past Business Review. As at 12 February 2003, 12,731 customers (45.0%) have so far responded. Of these, 7,539 (59.2% of respondents) have declined a review and 5,192 (40.8% of respondents) have requested a review of their case. Of those who have requested a review, 5,090 (98% of respondents requesting a review or 18% of the total population) have received an offer of redress or their case was closed because no redress was required. Reviews of the remaining 102 cases are continuing. 4,027 customers have been paid a total of £7.3 million in redress, after taking into account the cancellation proceeds from their policies. The average redress paid therefore amounts to £1,809 per customer. The total compensation for the customers who have responded, after taking into account the current value of their policies, is calculated as £8.8 million.

4.7 These steps should ensure that customers will receive redress more efficiently and quickly than if Lincoln had not co-operated with PIA and the FSA in this way. In particular, Lincoln deserves credit for having voluntarily extended its review back prior to the period in issue and the FSA does not seek to assert or rely on any failings on the part of either CFPL or Lincoln during that prior period as providing any grounds for taking the action in this Final Notice.

4.8 Accordingly, Lincoln has received credit in the level of financial penalty the FSA has decided to impose for the pro-active and co-operative steps it has taken. Nonetheless, while those steps provide an appropriate justification for mitigating the level of financial penalty, they do not alter the seriousness of Lincoln's failings, which occurred before any of those steps were taken. Given the aggravating factors described in paragraph 3.2, the financial penalty would, but for those steps, have been materially higher.

5. BACKGROUND

5.1. Lincoln Assurance Limited is a limited company and the primary UK company in the Lincoln Financial Group of the USA. Lincoln has been regulated by the FSA since 1 December 2001. Prior to authorisation by the FSA, Lincoln was a member of the PIA having been admitted to membership in November 1994. Prior to membership of PIA Lincoln was regulated by LAUTRO from April 1988.

5.2. On 5 November 1993 Lincoln gave CFPL permission to sell Lincoln products as its appointed representative and CFPL was therefore able to undertake investment business using the authorisation of Lincoln under section 44 Financial Services Act 1986. Lincoln was responsible, pursuant to LAUTRO and PIA Rules, for ensuring CFPL's compliance with the relevant rules. Lincoln subsequently purchased CFPL on 24 December 1999.

5.3. In October 2000, Lincoln disposed of its appointed representative CFPL.

The Products and Suitability

5.4. CFPL, as an appointed representative of Lincoln, in recommending equity based savings product could only recommend Lincoln products. The 3 relevant Lincoln products that could be recommended were (i) 10-year savings plans, (ii) a Lincoln Personal Equity Plan ("PEP") or a Lincoln Individual Savings Account ("ISA") and (iii) a Lincoln Unit Trust. The ISA replaced the PEP on 6 April 1999. The 10-year savings plans in question were Lincoln's Maximum Investment Plan ("MIP") and its Maximum Savings Plan ("MSP"). These products were available during different periods. MIPs were available until April 1999 when Lincoln relaunched its 10-year savings plan with an adjusted charging and bonus structure and renamed it MSP. The MSP therefore replaced the MIP from April 1999.

5.5. Both the MSP and the MIP were "qualifying" 10-year savings plans. The plans were "qualifying" in that the returns to customers could be made free of tax in certain circumstances. Customers contributed a monthly premium to the plan during this 10-year period. These premia were, in part, used to provide life cover. This life cover was required to ensure that the policy remained a qualifying policy. At the end of the 10-year term customers received a lump sum cash payment, the level of which was dependent on investment returns. If policies are held for at least 7.5 years, all policy proceeds are paid tax free to all policyholders, irrespective of their taxable income. A tax liability will however, be incurred by certain policyholders if policies are surrendered within 7.5 years. An additional 5% loyalty bonus was added to the maturity payment in relation to MSPs held for 10 years.

5.6. In considering the appropriate recommendation between a MIP/MSP, a Unit Trust and a PEP/ISA, the CFPL adviser should have specifically borne in mind that MIPs/MSPs were designed to be held for a period of least 10 years. Surrender or encashment prior to that date could lead to substantial penalties. There would also be likely to be low investment returns in the early years due to high charges during the initial period. Over the whole term returns would be reduced by the inclusion in the policy of life cover which may be unnecessary.

5.7. PEPs/ISAs did not have such restrictions on term. Further, due to their preferential tax position, they were potentially more advantageous to customers than MIPs/MSPs. The higher charges applicable to a Lincoln PEP/ISA, however, taken together with the lack of a final bonus after 10 years meant that, for a customer wishing to save for 10 years, it would be likely to produce a lesser return than a MIP/MSP. The same considerations as in relation to a PEP/ISA would apply to a Unit Trust. Unit Trusts were, however, less tax advantageous than either a MIP/MSP or a PEP/ISA.

5.8. In summary, therefore, if a customer purchasing a Lincoln product wished to save for a period of 10 years or above, it is likely that his objectives could be secured more advantageously by purchase of a MIP/MSP than by a PEP/ISA or Unit Trust. If, however, the customer wished to save for a shorter period or for an undefined period, then a MIP/MSP would not be the most advantageous way of achieving this objective because of the penalties on early encashment, the initial low returns and the lack of flexibility inherent in the product.

The Target Market of CFPL and Lincoln

5.9. CFPL's target market was young professionals working in the City who would have been, or had the potential to become, higher rate tax payers. As a result, 74% of MIP/MSP sales were to customers aged 35 or under.

Regulatory History

5.10. PIA issued a "formal warning" to Lincoln on 27 May 1998 on the basis that there was revealed to be a lack of evidence to satisfy "know your client" requirements, poor documentation requiring the issue of revised Reason Why Letters and files which were not adequately documented to demonstrate compliance at point of sale. These breaches indicated a failure by Lincoln to monitor CFPL effectively. Such warnings were part of the range of tools available to PIA in addressing non-compliance. They did not result from any formal disciplinary process. The warning notified Lincoln that PIA had specific regulatory concerns and that, while no disciplinary action was being taken, the details of the apparent breaches would be held on record and could be taken into account in any future disciplinary action.

5.11. Supervision formally visited CFPL in September 1998 and decided not take action at that time.

5.12. A further visit by Supervision took place in December 1999. This visit focused on the selling practices at CFPL, Lincoln's compliance procedures in relation thereto and Training and Competence procedures. Selling practices, in this context, covers CFPL's approach to all stages of the sales process from the adviser's initial contact with the customer through to a sale being concluded.

5.13. During the visit Supervision discovered problems relating to the selling practices of CFPL. In particular, Supervision noted that there were insufficient records on customer files and Reason Why Letters were inadequate. Although one unsuitable sale was identified, no trends of unsuitable sales were identified.

5.14. Following that visit, having provided Supervision with details of the remedial action it proposed to undertake to resolve them, Lincoln sought confirmation from Supervision that disciplinary action would not be forthcoming as a result of the issues identified during the visit.

5.15. Correspondence was then exchanged between Supervision and Lincoln. The effect of this correspondence was that Supervision advised Lincoln that disciplinary action was to be deferred pending improvements in Lincoln's procedures. These required improvements were to be assessed by Supervision in a future visit in 2000.

5.16. Events intervened, in particular the sale of the CFPL sales force and the publication of the 'Which?' magazine article described below, and the scheduled Supervision visit did not take place.

Discovery of Current Issues

5.17. In September 2000 Lincoln and PIA were informed by the Consumers Association that it intended to publish an article in its consumer magazine 'Which?' alleging that CFPL advisers were systematically misselling savings endowments to young single professionals.

5.18. 'Which?' magazine published the article in October 2000. The article alleged that CFPL advisers were using high-pressure sales techniques in order to pressurise young single professionals into purchasing fixed term, 10-year saving endowments rather than more flexible alternatives such as ISA's.

Lincoln's Initial Review

5.19. Supervision agreed with Lincoln's proposal to undertake a review of CFPL's sales of 10-year savings plans to young single professionals to determine whether there was any substance to the allegations in the 'Which?' article.

5.20. Lincoln undertook a mailing exercise with customers to test the allegations made in the 'Which?' article. This exercise commenced in October 2000 when Lincoln issued questionnaires to 5,000 customers under the age of 35 who had taken out a MIP or MSP during the period in issue. 2,042 questionnaires were returned. 909 of these related to MIP sales and 1,133 related to MSP sales. Lincoln also telephoned those customers who had applied for an MSP during the previous month (i.e. September 2000) to test the suitability of CFPL's advice.

5.21. Lincoln initially assessed the suitability of the recommendations by reference to the customer's response to the questionnaire and the information on the customer file.

5.22. Lincoln appointed independent consultants to validate the systems and procedures used in the review and redress processes and to review the quality of the output.

5.23. Lincoln placed cases reviewed into three categories: 'black' cases, where cases had failed the review standard and redress was potentially required; 'grey' cases, where there was insufficient information to enable the suitability of the recommendation to be assessed; and 'white' cases, where Lincoln was satisfied that the recommendation was suitable.

5.24. Lincoln's progress report to the FSA dated 30 July 2001 indicated that:

(1) 53% of MIP sales reviewed had failed the Lincoln review standard and redress was potentially required. In a further 41% of MIP sales there was insufficient information to enable the suitability of the recommendation to be assessed. In the remaining 6% of cases Lincoln was satisfied that the recommendation of a MIP was suitable.

(2) 17% of MSP sales reviewed had failed the Lincoln review standard and redress was potentially required. In a further 55% of MSP sales there was insufficient information to enable the suitability of the recommendation to be assessed. Lincoln advised that it had sought further information in respect of this latter group of cases by writing to the customers concerned and inviting a further response or confirmation that they did not have any complaints. Only two responses were received and they both confirmed that they had no issues about the policy sold. Lincoln wrote a second letter to all grey MSP customers stating that they presumed they were satisfied with the policy and inviting them to write if that was not the case. No further responses were received. In the remaining 28% of cases Lincoln was satisfied that the recommendation of a MSP was suitable.

The Past Business Review

5.25. In light of the results of its initial review Lincoln determined that it would be appropriate for it to extend the review to cover all sales of MIPs and MSPs sold by CFPL between November 1993 and October 2000 when Lincoln disposed of CFPL. Lincoln worked closely with PIA and subsequently with the FSA to agree an appropriate methodology for identifying and paying redress to disadvantaged customers.

5.26. Lincoln has now taken steps to contact all 28,295 customers with in force or out of force policies to offer them a review and, if appropriate, pay redress. It is to Lincoln's credit not only that it has extended its review back to cover some five years prior to the period in issue but also it has erred on the side of the customer in determining whether redress should be paid (liability having been conceded in most cases for reasons of cost effectiveness).

5.27. The potential cost of the Past Business Review is estimated to be in the region of £10 million (including the expenses incurred in conducting the Past Business Review). It is expected that approximately 5,100 customers will receive compensation. Almost all redress has been paid and by April 2003 each respondent should have received either redress or notification that the sale was compliant.

6. ENFORCEMENT'S INVESTIGATION

6.1. The investigation by the FSA's Enforcement Division ("Enforcement") centred on a review of 140 files selected from the 2,042 responders to Lincoln's initial questionnaire ("the Enforcement Review"). Enforcement also considered Lincoln's compliance monitoring procedures.

6.2. The purpose of Lincoln's initial review had been to identify whether or not Lincoln could justify a sale from their own records. It was not necessarily to determine whether each sale was in fact suitable. For example, where there was no Reason Why Letter on Lincoln's files, the case will have been categorised by Lincoln as "black" and therefore potentially requiring redress, even though it was possible that the sale was in fact suitable. Lincoln, in conducting its review, erred in favour of the customer.

6.3. The Enforcement Review was undertaken for a different purpose as it was made in contemplation of potential disciplinary action. In conducting the Enforcement Review, the FSA did not rely on Lincoln's classification; instead it independently reviewed each of the 140 cases to determine whether they complied with PIA's Rules and requirements and, in particular, whether there was evidence that sales were unsuitable.

6.4. The Enforcement Review sought to establish whether there was an identifiable customer need and, if so, whether or not the product sold met that need. Where no specific need was evidenced, or where the product recommended failed to meet the identified customer need, the sale was recorded as unsuitable. Accordingly, some cases classified as "black" by Lincoln were determined by Enforcement to be in breach of PIA's Rules, for instance, with regard to record keeping but not to be unsuitable.

6.5. On the basis of this fresh review, Enforcement concluded that 26% of the recommendations in the cases comprising the Enforcement Review were not suited to the customer's needs. In addition, Enforcement concluded that customer files contained insufficient information in 29% of cases within the Enforcement Review. In 84% of cases Reason Why Letters were found to be inadequate and in 11% of cases such letters were misleading. Lincoln had, until its own initial review, failed to identify these weaknesses.

7. CONTRAVENTIONS OF RELEVANT STATUTORY REQUIREMENTS

7.1. The penalty is to be imposed pursuant to Section 206 of the Act in respect of breaches by Lincoln of the PIA Rules, including the LAUTRO Rules and the SIB Principles. These breaches are set out in detail below.

(1) Failure to make suitable recommendations

7.2. In breach of paragraph L8(1) Schedule L2 of the LAUTRO Rules, Lincoln's appointed representative, CFPL, failed to use its best endeavours to ensure that recommendations made were suited to customers' financial and other relevant circumstances.

Facts and matters relied upon

7.3. In 26% of the cases reviewed by Enforcement CFPL advisers recommended 10-year savings plans to customers when there were more suitable products available from Lincoln. These alternative products, namely a PEP or ISA, would have allowed customers more flexibility and met their circumstances more advantageously than the MIP or MSP that was recommended.

7.4. These sales by CFPL were unsuitable because the advisers did not appropriately assess whether the customers' needs were to save for a 10-year term prior to making a recommendation of a MIP/MSP. Accordingly, such advisers failed to meet the standards required by PIA Rules as they did not use their best endeavours to ensure that the MIP/MSPs were suited to the customers' needs before recommending them. Further they failed to ensure that other products from the Lincoln range, such as a Unit Trust or a PEP/ISA, could not secure the customers' objectives more advantageously.

(2) Failure to keep adequate records

7.5. In breach of PIA Rule 5.1.1 (1), Lincoln failed to keep its records in such a way as to demonstrate it had complied with the PIA Rulebook.

Facts and matters relied upon

7.6. The Enforcement Review demonstrated that customer files often failed to record all relevant customer details. The omissions included details of:

(1) whether the customer had utilised their PEP/ISA allowance;

(2) whether the customer had accessible savings in place;

(3) the customer's disposable income;

(4) over what term the customer needed to save;

(5) the customer's tax status or the level of tax for which the customer was likely to be liable; and

(6) the customer's attitude to risk.

7.7. These elements, either in isolation or in combination, were important considerations when making a recommendation to invest in a 10-year savings product with limited flexibility and accessibility.

7.8. From the total sample of 140 cases in the Enforcement Review, in 41 cases (29%) the CFPL advisers failed to ascertain and record all relevant details relating to a customer's financial and other circumstances.

(3) Failure To issue Reason Why Letters with all required information

7.9. In breach of LAUTRO Rule L3.15, Lincoln failed to ensure that Reason Why Letters issued by its appointed representative, CFPL, gave clear reasons for the recommendations made.

Facts and matters relied upon

7.10. The Enforcement Review of the sample of 140 customer files included a review of the Reason Why Letters provided to customers. From the total sample of 140 cases, in 118 cases (84%) the Reason Why Letters failed to make clear why the recommendations had been made by reference to the customers' financial and other circumstances.

7.11. In particular, Enforcement found that a significant proportion of Reason Why Letters issued to customers:

(1) failed to state why the term of the product was suitable. Expressly, no specific need for a 10-year savings term was identified and then matched to the term of the MIP/MSP;

(2) used identical or similar wording in such a way as to be misleading. In 32 instances the Reason Why Letter:

(a) stated that a MIP/MSP offered a greater fund choice than the PEP/ISA, when customers were often inexperienced customers with no specific need or wish to invest in any particular funds and funds meeting their objective were available in a PEP/ISA;

(b) stated that a MIP/MSP was tax efficient, when a PEP/ISA would have provided greater tax efficiency; and

(c) stated that a customer required a MIP/MSP for disciplined savings, where this need could have been achieved by a PEP/ISA which did not have the early access penalties or tax liabilities associated with the MIP/MSP.

(4) Issuing Reason Why Letters which contain misleading statements

7.12. In breach of PIA Rule 4.1, Lincoln failed to ensure that anything said or written, or any document sent, given or shown, to a customer or potential customer by CFPL or on its behalf in the course of its relevant business was clear and fair, and was not misleading, either in design or content.

7.13. From the sample of 140 customer files reviewed by Enforcement and excluding those that used the standard phraseology described above, 16 files (11%) contained Reason Why Letters that did not satisfy the PIA requirement that any document sent to a customer should be 'clear and fair and not misleading'. Examples of misleading statements found in Reason Why Letters are given below:

(1) "…Unit Trusts and PEPs have been rejected as they are purely equity based therefore they are volatile", when the Lincoln PEP permitted investment into funds ranging from cautious through balanced to aggressive, the last being the only funds likely to be "volatile";

(2) the option of a PEP was incorrectly discounted on the basis that "PEPs are exposed to political vulnerability", when PEPs were to be replaced by ISAs

and existing funds could continue to exist with future contributions being channelled into an ISA which had similar tax benefits;

(3) "ISAs cannot be used since you already have one with Perpetual which is for the next 3-5 years", when a new ISA could be effected each year;

(4) "only a small portion of investment can be placed in the cash element," when the contribution selected by the particular customer could all have been contained within the cash element of an ISA. The letter to this customer also stated that a MSP allowed "unlimited level of contributions to any investment area". As described above, contributions to a MSP are restricted in order to meet qualifying rules attached to endowments;

(5) "they are purely equity based therefore they are volatile", when all the funds selected in the MIP are equity based;

(6) the customer invested in a MSP has the ability to switch funds "…which is not possible for an ISA", when switches between funds were permitted within an ISA, albeit with a 1% charge".

7.14. While a Reason Why Letter cannot make an unsuitable recommendation suitable, the inclusion of misleading statements in Reason Why Letters would have seriously compromised customers' ability to make a considered decision as to whether the product was suitable for their financial and other relevant circumstances.

(5) Failure to monitor appointed representatives adequately

7.15. In breach of PIA Rule 7.2.1 Lincoln failed to monitor adequately the conduct its appointed representative, CFPL, and its relevant employees.

<u>Facts and matters relied upon</u>

7.16. During its review of the 140 cases in the FSA Sample, Enforcement considered the effectiveness of Lincoln's compliance arrangements, in particular the business review procedures.

7.17. Cases that had been assessed as compliant by the Business Review Team were date stamped.

7.18. During its review of the 140 customer files, Enforcement found the following:

(1) of the 37 customer files where concerns regarding suitability were identified,

(a) 35 had been reviewed and approved by the relevant CFPL supervisor;

(b) 20 had been reviewed centrally by Lincoln and stamped "PASSED Business Review Compliance";

(2) of the 41 customer files where the records on the customer files were inadequate to determine whether a suitable recommendation had been made,

(a) 38 had been reviewed and approved by the relevant CFPL supervisor;

(b) 22 had been reviewed centrally by Lincoln and stamped "PASSED Business Review Compliance";

(3) of the 118 customer files where the Reason Why Letter was inadequate and/or misleading,

(a) 68 had been reviewed and approved by the relevant CFPL supervisor;

(b) 40 had been reviewed centrally by Lincoln and stamped "PASSED Business Review Compliance".

7.19. Lincoln's compliance arrangements had failed to identify these weaknesses indicating that Lincoln had failed to monitor adequately the conduct of its appointed representative CFPL.

(6) Breach of SIB Principle

7.20. In breach of SIB Principle 2, Lincoln failed to act with due skill, care and diligence.

<u>Facts and matters relied upon</u>

7.21. As evidenced by the Rule breaches described above, Lincoln failed to act with due skill, care and diligence in its monitoring of CFPL and as a consequence of this failure did not identify unsuitable sales made by CFPL advisers, failed to maintain proper records, failed to issue adequate Reason Why Letters and allowed Reason Why Letters to be issued that contained misleading statements.

8. RELEVANT GUIDANCE ON SANCTION

8.1. Section 206 of the Act empowers the FSA to impose a financial penalty on a firm where the FSA considers that the firm has contravened a requirement imposed on it by or under the Act.

8.2. The imposition of a financial penalty is one of the range of regulatory tools available to the FSA. 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 benefits of compliant behaviour.

8.3. Relevant PIA Guidance is contained in Annex D of "PIA's Approach to Discipline – Statement of Policy" that was issued in December 1995. It has been taken into account by the FSA in determining the appropriate sanction in this case. In all material respects this required consideration of the same factors as are identified in Chapter 13 of the Enforcement Manual.

8.4. PIA's Statement of Policy made it clear, however, that the criteria for determining the level of sanction are not to be applied rigidly, as stated in paragraph 2 of Annex D:

"*Each case is different and needs to be treated on its own merits. It is not possible to apply a mechanistic approach to the determination of the circumstances in which* *disciplinary action should be taken or of the sanctions to be applied. The criteria…should not be treated as exhaustive. Nor should it be assumed that regard would necessarily be had to a particular criterion in any given circumstances."*

8.5. Similarly, it is stated in Chapter 13 of the FSA Enforcement manual at paragraph 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.

8.6. In determining whether a financial penalty is appropriate, and its level, the FSA considers all the relevant circumstances of the case. The FSA considers the following factors (which are expressed both in terms of ENF Chapter 13 Guidance and equivalent PIA Guidance) to be particularly relevant in this case.

ENF 13: The seriousness of the misconduct or contravention.

PIA Guidance: The seriousness of the breaches

8.7. The level of financial penalty must be proportionate to the nature and seriousness of the contravention. The breaches identified in this case are of a systemic nature, arising from weaknesses in CFPL's sales process and the monitoring of them by Lincoln with respect to sales of MIP/MSPs between 1 September 1998 and 31 August 2000. These failures have caused actual or potential disadvantage to customers.

8.8. This misconduct is serious because it resulted in a significant proportion (26% of the cases reviewed by Enforcement) of young single customers being recommended unsuitable inflexible 10-year savings plans with significant early redemption penalties, when other more flexible saving products, such as ISAs, that did not have such disadvantages were available and could have met the customers' objectives more advantageously. The life cover included in these products was not needed by customers and reduced investment returns.

8.9. The seriousness of the misconduct is aggravated by the fact that Lincoln had been notified that PIA had concerns regarding the selling practices of CFPL after Supervision's visits in 1998 and 1999, and also by the issue of a formal warning in May 1998. Although these concerns do not themselves form any part of the grounds for taking the action taken in this Final Notice, PIA's notification of them should have alerted Lincoln to potential problems with CFPL's sales process and focused their attention on ensuring that procedures were put in place and followed by CFPL advisers to ensure that the breaches of PIA's Rules central to this case did not occur. Whilst Lincoln did take steps to deal with the failings of CFPL these steps did not eradicate the problems which subsequently came to light.

ENF 13: The extent to which the contravention is deliberate or inflexible nature and the misconduct was deliberate or reckless

PIA Guidance: Whether the member intentionally or recklessly failed to meet PIA's requirements.

8.10. There is no evidence to suggest that Lincoln deliberately or recklessly contravened PIA Rules. However, notwithstanding the issue of the formal warning in May 1998, Lincoln failed to ensure adequate improvements in CFPL's sales practices.

ENF 13: The amount of profit accrued or loss avoided

PIA Guidance: The extent to which, as a result of the breaches, the Member gained a benefit or avoided suffering a loss.

8.11. Lincoln may have derived a benefit from the recommendation of MIP/MSPs instead of PEP/ISAs or Unit Trusts. The 10 year term and inflexible nature of the MIP/MSPs meant that customers were effectively tied into the product. Lincoln would, therefore be able to levy charges over that period.

8.12. The FSA considers that procedures are now in place, through the Past Business Review, that should ensure that all customers who are due redress will be compensated. Lincoln has now spent significant sums on its remedial work.

ENF 13: Conduct following the contravention

PIA Guidance: The Firm's response once the breaches were identified

8.13. The FSA attaches importance to the co-operation demonstrated by Lincoln. Lincoln should be given credit for the way in which it conducted itself once the issue of misselling had been identified. Since the breaches were identified, Lincoln has acted in a positive and pro-active way to establish whether customers have been mis-sold, and, if so, to provide compensation.

8.14. Steps taken by Lincoln include:

- As agreed with Supervision, Lincoln undertook both telephone contact with customers and a mailing and questionnaire exercise in order to identify whether misselling had occurred.

- Lincoln appointed independent consultants to validate the systems and procedures used in the review and redress processes and to review the quality of the output. The work carried out by Lincoln and validated by the independent consultants revealed a specific problem with the sales process employed by CFPL in the sale of MIPs and MSPs. The independent FSA analysis reached the same conclusion.

- Lincoln has worked closely with PIA and subsequently with the FSA to agree an appropriate methodology for identifying and paying redress to disadvantaged customers.

- Lincoln has contacted all 28,295 customers with in force or out of force policies to offer them a review and, if appropriate, pay redress. This review includes all sales made between November 1993 and October 2000. Lincoln deserves credit for voluntarily going further than the period between September 1998 and August 2000 which was the focus of its initial review (and the subject of the Enforcement Review) and is the period in issue for the purpose of the action taken in this Final Notice.

- Lincoln has erred on the side of the customer in assessing suitability.

8.15. Lincoln has spent considerable sums of money in conducting the Past Business Review. The cost of the Past Business Review is likely to be in the region of £10 million including compensation of approximately £8.8 million to around 5,090 customers.

ENF 13: Previous action by the FSA in relation to similar failings

8.16. The FSA has previously imposed penalties on Firms for compliance failings. The FSA has given consideration to these cases when considering this case.

ENF 13: Action taken by other regulatory authorities in relation to similar findings

PIA Guidance: The way in which PIA has dealt with similar cases in the past

8.17. PIA, Lincoln's previous regulator, took action against firms for compliance and selling practices failings. This action included the imposition of financial penalties. In setting the level of penalty, the FSA has taken into account penalties imposed by PIA.

ENF 13: Disciplinary record and compliance history

PIA Guidance: The Firm's regulatory history

8.18. Lincoln has not previously been the subject of formal disciplinary action.

8.19. PIA however issued a formal warning to Lincoln on 27 May 1998. The formal warning notified Lincoln that PIA had specific regulatory concerns that Lincoln should address. That those concerns were not adequately addressed is demonstrated by the fact that the failings identified in this Final Notice subsequently occurred during the period in issue.

9. MANNER OF PAYMENT

9.1. The Penalty must be paid to the FSA in full.

10. TIME FOR PAYMENT

10.1. The penalty must be paid to the FSA no later than 12 May 2003, being not less than 14 days beginning with the date on which this notice is given to you.

11. IF THE PENALTY IS NOT PAID

11.1. If all or any of the Penalty is outstanding on 13 May 2003, the FSA may recover the outstanding amount as a debt owed by you and due to the FSA

12. IMPORTANT

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

Publicity

12.2 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.

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

12.4 For more information concerning this matter generally you should contact Tom Spender/Graham Turner at the FSA (direct line: 020 7676 1858/1432 / fax 020 7676 1859/1433).

Julia Dunn
Group Leader
FSA Enforcement Division