FINAL NOTICE

To: **Northern Bank Limited**
Of: **PO Box 183**
Donegall Square West
Belfast
BT1 9JS

Date: **4th August 2003**

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

1. THE PENALTY

1.1. The FSA gave you a Decision Notice dated 9th July 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 £1,250,000 in respect of breaches of Rule 3.1.3 of the FSA's Money Laundering Sourcebook ("ML").

1.2. You have confirmed in a letter dated 1st August 2003 that you do not intend to refer the matter to the Financial Services and Markets Tribunal.

1.3. Accordingly, for the reasons set out below the FSA imposes a financial penalty on you in the amount of £1,250,000 ("the Penalty").

2. RELEVANT STATUTORY PROVISIONS AND REGULATORY RULES

2.1. Section 2(2) of the Act includes among the FSA's regulatory objectives the reduction of financial crime.

2.2. Section 146 of the Act states:

The Authority may make rules in relation to the prevention and detection of money laundering in connection with the carrying on of regulated activity by authorised persons.

2.3. Rule 3.1.3(1) of ML states:

A relevant firm must take reasonable steps to find out who its client is by obtaining sufficient evidence of the identity of any client who comes into contact with the relevant firm to be able to show that the client is who he claims to be.

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

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

3. REASONS FOR THE ACTION

Summary

3.1. ML came into effect in December 2001. In January 2002 Northern Bank conducted a review of its compliance with the client identification requirements of ML. The reviews showed high rates of non-compliance with these requirements. Despite this high rate of non-compliance and an earlier 2001 review that showed similarly high rates of non-compliance with its own requirements, Northern Bank failed to take effective action to bring about any significant improvement.

3.2. In September 2002 Northern Bank conducted a further review of its compliance with the client identification requirements of ML which showed that its non-compliance rates were still at unacceptably high levels. As a result, on 6 November 2002 the FSA appointed investigators under section 168 of the Act.

3.3. As a result of the investigation, which included a review of a representative sample of Northern Bank's accounts opened between December 2001 and September 2002, the FSA has concluded that Northern Bank has contravened ML 3.1.3.

3.4. In so doing Northern Bank demonstrated failings which demand a substantial financial penalty. These failings are viewed by the FSA as particularly serious in the light of the following factors:

- notwithstanding the high level of non-compliance identified by its January 2002 review, Northern Bank failed to recognise the seriousness of its breaches and therefore failed to implement prompt and effective remedial action or to inform the FSA; Northern Bank only brought the matter to the FSA's attention after the FSA specifically asked for information on ML compliance rates in April 2002 and then only provided the detailed results of its January 2002 review to the FSA in October 2002;

- the breaches occurred against a background where statutory requirements for firms to have in place anti-money laundering procedures, including procedures to

identify their clients, had been in place for over eight years and where, in anticipation of the FSA's new powers to make Rules relating to the prevention of money laundering with effect from 1 December 2001, there had been a greatly increased emphasis on preventing the use of the financial system for financial crime;

- they also occurred against a background where Northern Bank's own earlier testing in 2001 had revealed similarly high rates of non-compliance with its own requirements;

- the high level of breaches between December 2001 and September 2002;

- the particularly high non-compliance rates with ML found in non-personal accounts where there is an increased risk of actual money laundering taking place;

- the size of Northern Bank in the retail banking market in which it operates means that its failure to have strong and effective procedures for the identification of its clients, as part of its anti-money laundering systems and controls, presented a serious risk to the FSA's statutory objective to reduce financial crime.

3.5. Were it not for the remedial action taken by Northern Bank following the FSA's intervention and for the co-operation demonstrated by Northern Bank in relation to the FSA's investigation, the financial penalty imposed would have been substantially higher.

Facts and Matters Relied On

The Statutory and Regulatory Background

3.6. Anti-money laundering requirements on financial sector firms were first imposed by the Money Laundering Regulations 1993 SI 1993/1933 ("the Regulations"), which took effect on 1 April 1994. The Regulations require financial sector firms to have procedures for, among other things, the identification of their clients.

3.7. Further, from 1990 the Joint Money Laundering Steering Group, of which the British Bankers' Association is a member, provided advice on best practice in anti-money laundering controls by issuing Guidance Notes for the Financial Sector ("the Guidance Notes"). Subsequent editions of the Guidance Notes took account of evolving best practice within the financial services industry. Since 1994 the Guidance Notes have provided advice and guidance on complying with the Regulations such that a court may take them into account in considering whether there has been a breach of the Regulations. Both the editions issued in 2001 reflected the provisions of ML that came into effect on 1 December 2001.

3.8. Prior to ML coming into force and in anticipation of the FSA's statutory objective to reduce financial crime, the FSA repeatedly stressed the importance of high standards of compliance with UK anti-money laundering requirements and that, once its new enforcement powers came into effect, they would be rigorously applied to deal with breaches of ML.

Northern Bank's Actions

3.9. Northern Bank is an authorised deposit taking institution undertaking both retail and corporate banking along with a range of other permitted activities. It is one of four UK and Irish banks owned by National Australia Group Europe, which is itself a subsidiary of National Australia Group. Northern Bank has 95 branches, giving it the largest retail network in Northern Ireland.

3.10. Between March and July 2001 (i.e. before ML came into effect on 1 December 2001) Northern Bank conducted a large-scale review of compliance with its account opening procedures. The review identified high rates of non-compliance with Northern Bank's own client identification requirements.

3.11. In January and February 2002 a further review of anti-money laundering compliance identified continuing high rates of non-compliance with client identification requirements. Despite this, the report of the review concluded that the overall standard of money laundering compliance was "satisfactory" although noting that "weaknesses existed which required attention".

3.12. Following the January 2002 review Northern Bank did not put in place a detailed improvement plan specifically aimed at increasing compliance rates in respect of client identification. There was no specific follow-up testing of branches that had performed particularly poorly.

3.13. In April 2002 the FSA asked Northern Bank about its anti-money laundering compliance rates. Northern Bank provided the FSA with the non-compliance rates identified by its 2001 review but, due to its failure to recognise the seriousness of the non-compliance rates identified by its January 2002 review, did not provide the detailed results of that review to the FSA until October 2002.

3.14. In September 2002 a further internal review of compliance with client identification requirements identified that, while the overall rate of non-compliance had declined somewhat from the rates detected in the January 2002 review, it was still at an unacceptably high level. Following the September review and in light of the FSA's concern regarding its non-compliance rates, Northern Bank drew up and implemented a comprehensive remedial action plan.

3.15. A further internal review in early 2003 indicated that, as a result of the remedial action, non-compliance rates had fallen to low single figures.

The FSA's Investigation

3.16. The FSA reviewed the accounts tested by Northern Bank in its January and September 2002 reviews. Each account file was examined, having regard to the identification criteria set out in the Guidance Notes, to determine whether there was sufficient evidence to show that the client was who he had claimed to be.

3.17. The FSA investigation showed that in 35% of the accounts included in the January 2002 review and 18% of the accounts included in the September 2002 review

Northern Bank had failed adequately to verify that the client was who he had claimed to be. Northern Bank therefore breached ML 3.1.3 in respect of those accounts.

4. RELEVANT GUIDANCE

4.1. The principal purpose of the imposition of a financial penalty is to promote high standards of regulatory conduct by deterring firms which have breached regulatory requirements from committing further contraventions, helping to deter other firms from committing contraventions and demonstrating generally to firms the benefit of compliant behaviour.

4.2. In determining whether a financial penalty is appropriate and its level, the FSA is required to consider all the relevant circumstances of the case. ENF 13.3.3 indicates the factors that may be of particular relevance in determining the level of a financial penalty. These are discussed in Part 5 below in respect of the circumstances of this case.

4.3. As Northern Bank's breaches of ML 3.1.3 also constitute breaches of the Money Laundering Regulations 1993, the FSA has considered whether the case is appropriate for a criminal prosecution. In considering this, the FSA has applied the principles set out in ENF 15.5 and in the Code for Crown Prosecutors, namely the evidential and public interest tests. Having regard to those tests, the FSA has concluded that a prosecution would not be appropriate in this case.

5. FACTORS RELEVANT TO DETERMINING THE SANCTION

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

The seriousness of the breaches

5.2. The high level of breaches identified applied across the whole of Northern Bank's branch network and existed for a considerable period of time.

5.3. The non-compliance rates identified in the January and September 2002 reviews for non-personal accounts were particularly high. The Guidance Notes state that corporate entities are amongst the most likely vehicles for money laundering. The FSA notes, however, that in most cases at least some attempt had been made to identify both personal and non-personal customers.

5.4. The seriousness of the breaches is exacerbated by the fact that they took place against a background of increased regulatory emphasis on the importance of effective anti-money laundering controls and Northern Bank's own earlier testing in 2001 having already revealed high rates of non-compliance with its own client identification requirements.

5.5. The FSA has considered whether the risk arising from organised crime in Northern Ireland should be a factor relevant to determining the penalty. It has decided that it would not be appropriate to penalise Northern Bank on the basis of its location and therefore this has not been a factor in determining the size of the penalty. ML applies with equal force throughout the United Kingdom.

The size, financial resources and other circumstances of the firm

5.6. The size of Northern Bank in the retail banking market in which it operates means that its failure to have strong and effective procedures for the identification of its clients, as part of its anti-money laundering systems and controls, presented a serious risk to the FSA's statutory objective to reduce financial crime.

Conduct following the contravention

5.7. The FSA considers Northern Bank's failure between January and September 2002 to produce an effective strategy to deal with its high rate of non-compliance with the requirements of the Money Laundering Regulations 1993 and the FSA Money Laundering Rules to be a particularly serious matter. Although the non-compliance rate declined in the period between January and September 2002, the absence of a strategy after the January review resulted in the non-compliance rate continuing at unacceptably high levels.

5.8. Due to its failure to recognize the seriousness of the non-compliance rates revealed by its January 2002 review, Northern Bank did not inform the FSA of them until after the FSA made specific enquiries later that year.

5.9. The FSA notes, however, that after September 2002 Northern Bank devoted considerable resources to correct the problem and implemented a comprehensive remedial action plan. The FSA is satisfied that the remedial action plan has appropriately addressed the problem. Furthermore, the FSA notes that during its remedial action Northern Bank re-examined the accounts that had not been properly opened and found no evidence that actual money laundering had taken place.

5.10. Northern Bank has co-operated fully with the FSA's investigation and, by moving quickly to agree the facts of the case and to settle the matter, has helped the FSA to work expeditiously towards its regulatory objectives, which include reducing financial crime.

Previous action taken by the FSA

5.11. In a Final Notice dated 12 December 2002 the FSA imposed a financial penalty of £750,000 on Royal Bank of Scotland plc ("RBS") for breaches of ML 3.1.3 and ML 7.3.2. The FSA noted at the time that, "were it not for the prompt and effective remedial action taken by RBS once it had identified its failings and for the full and pro-active co-operation demonstrated by RBS in relation to the FSA's investigation, the financial penalty imposed would have been very substantially higher". The present case is distinguished particularly by Northern Bank's failure to recognise the seriousness of its breaches and its consequent failure to take prompt and effective remedial action after they were identified in January 2002 and for some nine months after that.

6. CONCLUSION

6.1. Taking into account the seriousness of the breaches and in particular the lack of urgency with which Northern Bank dealt with the matter after January 2002 and the risks that posed to the FSA's regulatory objective of reducing financial crime, the FSA has decided to impose on Northern Bank a financial penalty of £1,250,000.

6.2. Without the effective remedial steps taken by Northern Bank after September 2002, the co-operation afforded to the investigation and the early settlement of the case, the penalty would have been very substantially higher.

7. IMPORTANT NOTICES

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

Manner of payment

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

Time for payment

7.3. The Penalty must be paid to the FSA no later than 18th August 2003, being not less than 14 days beginning with the date on which the notice is given to you.

If the penalty is not paid

7.4. If all or any of the Penalty is outstanding on 18th August 2003, the FSA may recover the outstanding amount as a debt owed by you and due to the FSA.

Publicity

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

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

FSA Contact

7.7. For more information concerning this matter generally, you should contact Andrew Bradley at the FSA (direct line: 020 7066 1450 /fax: 020 7066 1451).

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