Financial Conduct Authority

FINAL NOTICE

To:	**Lloyds TSB Bank plc** **Bank of Scotland plc** **(together referred to as the Firms)**
Firm Reference Numbers:	**119278 & 169628**
Addresses:	**25 Gresham Street, London, EC2V 7HN &** **The Mound, Edinburgh, Midlothian, EH1 1YZ**
Date:	**10 December 2013**

1. ACTION

1.1. For the reasons given in this Final Notice, the Authority hereby imposes on the Firms a financial penalty of £28,038,800, for breaching Principle 3 of the Authority's Principles for Businesses. The breaches occurred between 1 January 2010 and 31 March 2012 (the Relevant Period).

1.2. The Firms agreed to settle at an early stage of the Authority's investigation. They therefore qualified for a 20% (Stage 2) discount under the Authority's executive settlement procedures. Were it not for this discount, the Authority would have imposed a financial penalty of £35,048,500 on the Firms.

2. SUMMARY OF REASONS

2.1. The Authority imposes this penalty on the Firms due to serious failings in the systems and controls governing the financial incentives that they gave to sales staff in LTSB, Halifax and BOS branches. These staff sold protection and investment products to customers on an advised basis (advisers).

2.2. Remuneration schemes play an important role in setting the sales culture of a firm, influencing how and what staff sell to customers. They can create a culture of mis-selling and may undermine a firm's positive efforts to treat customers fairly in other areas. While the Authority recognises that firms may want to incentivise staff to sell particular products, firms must ensure that their systems and controls are sufficiently robust and sophisticated to mitigate effectively the risk of any adverse impact the incentives may have on staff behaviour. This should include appropriately focused risk-based monitoring.

2.3. During the Relevant Period, advisers' incentives at the Firms included a number of higher risk features, such as variable salaries, bonus thresholds which involved disproportionate rewards for marginal sales, and an advanced payment option that could lead to bonus deficits if sales targets were not met. As a result, advisers who met sales targets qualified for substantial salary rises and bonus payments, while advisers who did not faced salary reductions. There was also a significant bias towards sales of protection products, which was a strategic area of focus for the Firms. Advisers were able to access details of their performance against sales targets on a daily basis. There was, therefore, a significant risk that, if not adequately controlled, advisers would sell products to customers that they did not need or want in an attempt to reach salary and bonus incentive thresholds.

2.4. Although the Firms had various systems and controls in place to monitor the quality of sales made by advisers, they failed to take steps to ensure that these controls were appropriately focused on the specific higher risk features of advisers' incentives. In particular, the Firms relied on routine business monitoring that assessed sales deemed higher risk based on customer profiles, product features and/or a random sample of adviser sales. They failed to supplement this with appropriately risk-based monitoring that also focused on the risk profile of advisers.

2.5. Further, while advisers were required to meet certain competency standards to be eligible for salary rises and bonuses, this control was flawed as advisers could meet the required standards even where the Firms had identified issues with their sales. During the Relevant Period, 71% of LTSB advisers, 32% of Halifax advisers and 39% of BOS advisers received a monthly bonus on at least one occasion even though a high proportion of the sales reviewed had been found by the Firms to be unsuitable or potentially unsuitable. As a result of the low minimum numbers of files per adviser which were reviewed, this high proportion could result from only one file being found to be unsuitable or potentially unsuitable.

2.6. In addition, although advisers were supervised by local sales managers, the Firms failed to identify that there was a potential conflict of interest due to the fact that sales managers' bonuses were based on the performance of advisers in their teams.

2.7. Management information was also not sufficient to enable management to identify any patterns in advisers' sales activities that may have warranted closer monitoring.

2.8. The Firms' failure to manage and control adequately the risks to customers that arose from the financial incentives they gave advisers derived from serious deficiencies in their governance over this area. The root cause of these deficiencies was the collective failure of the Firms' senior management to identify sufficiently remuneration and incentives given to advisers as a key area of risk. This led to a failure to recognise that it was an area that required specific and robust oversight.

2.9. The FCA considers the Firms' failings to be particularly serious because:

(1) the Firms are leading providers of protection and investment products to retail customers in the UK. LTSB advisers sold over 630,000 products to over 399,000 customers during the Relevant Period. During the same period Halifax advisers sold over 380,000 products to over 239,000 customers and BOS advisers sold over 84,000 products to over 54,000 customers;

(2) the Firms failed to identify that key changes they made to advisers' incentives and related controls during the Relevant Period served to further increase the risk to customers. In particular, the Firms introduced the right to make automatic demotions (for Halifax and BOS advisers on 1 October 2010 and LTSB advisers on 1 January 2011 respectively) who did not meet their sales targets over a nine month period. LTSB previously had a different version of this incentive feature, which was removed in October 2004 following an internal review to meet Treating Customers Fairly requirements. This was also the subject of discussions with the Authority during 2002-4. While the version of automatic demotion introduced by the Firms during the Relevant Period was not as high risk as the previous version, the Firms failed to consider the reasons for the previous removal in doing this;

(3) the Authority has for many years been warning firms of the need to manage and control risks to customers arising from financial incentives given to sales staff, in particular in publications relating to the Authority's work on Treating Customers Fairly and payment protection insurance; and

(4) many of the Firms' failings were discovered in the course of the Authority's thematic review of risks to customers from financial incentives, final guidance in relation to which was published in January 2013: were it not for the Authority's intervention the breach would have continued for a longer period, exposing more customers to an increased risk of detriment.

2.10. The Firms are in the course of carrying out a review of sales conducted by higher risk advisers during the Relevant Period, and will provide redress to customers where appropriate. The Firms are currently reviewing the sales made by 420 advisers (approximately 12% of all advisers employed during the Relevant Period) who are considered to pose the highest risk. This review is still at an early stage. In the early results 54% of files reviewed have been graded as potentially unsuitable pending further investigation through customer contact, with a further 14% graded as process fails (the remaining 32% were graded as a pass based on the file). Based on the outcomes of attempted customer contact to date the current projection would be for 14% of files reviewed to be found to be unsuitable sales following customer contact.

2.11. Due to increases in the value of the stock market since the start of the Relevant Period, actual customer detriment from any unsuitable sales of investment products may be low. Given the volatility of the stock market this may change in the future. Moreover, this factor will not be relevant to the potential detriment from sales of protection products.

2.12. The Firms have co-operated with the Authority during its investigation. Following feedback from the Authority's thematic review, from October 2011 the Firms made substantial changes to their advisers' financial incentives and related controls to reduce the risk to customers, and now have in place a more robust governance and internal control framework specifically focused on mitigating any adverse impact on adviser behaviour.

3. DEFINITIONS

3.1. The definitions below are used in this Final Notice:

(1) "the Act" means the Financial Services and Markets Act 2000;

(2) "the Authority" means the body corporate previously known as the Financial Services Authority and renamed on 1 April 2013 as the Financial Conduct Authority;

(3) "the Authority's Handbook" means the Authority's Handbook of rules and guidance;

(4) "Advice Fail" means the classification used by the Firms' verification teams for any sales where the advice to the customer was identified as being unsuitable (or potentially unsuitable pending further investigation via customer contact);

(5) "advisers" means front line sales staff in the LTSB, Halifax and BOS branch network, who sold protection and investment products to customers on an advised basis;

(6) "bancassurance" means the selling of insurance and banking products through the same channel, most commonly through bank branches selling insurance;

(7) "BOS" means Bank of Scotland plc's Bank of Scotland brand;

(8) "DEPP" means the Authority's Decision Procedure and Penalties Manual which is part of the Authority's Handbook;

(9) "the Firms" means Lloyds TSB Bank plc and Bank of Scotland plc;

(10) "the FCA" means the Financial Conduct Authority;

(11) "the Group" means Lloyds Banking Group plc;

(12) "GIA" means Group Internal Audit;

(13) "Halifax" means Bank of Scotland plc's Halifax brand;

(14) "the incentive schemes" means the financial incentive schemes in place for LTSB, Halifax and BOS advisers during the Relevant Period;

(15) "ISAs" means Individual Savings Accounts;

(16) "KPIs" means key performance indicators;

(17) "LTSB" means the Lloyds TSB brand used by Lloyds TSB Bank plc;

(18) "MI" means management information;

(19) "OEICs" means Open Ended Investment Companies;

(20) "Process Fail" means the classification used by the Firms' verification team for sales where the advice to the customer was identified as being suitable but the documentation on the sales file did not provide a complete record;

(21) "the Relevant Period" means 1 January 2010 to 31 March 2012;

(22) "risk gateway" means the performance rating system that the Firms used to assess whether advisers met certain competency standards, and that advisers had to pass to be eligible for salary rises and bonuses; and

(23) "Tribunal" means the Upper Tribunal (Tax and Chancery Chamber).

4. FACTS AND MATTERS

Background

The Firms

4.1. The Firms are wholly owned subsidiaries of Lloyds Banking Group plc (the Group), which was formed following the merger of Lloyds TSB Bank plc with HBOS plc in January 2009. The Firms provide a wide range of banking and financial services and have been authorised by the Authority since 1 December 2001.

4.2. Since September 2007, HBOS plc's Halifax and BOS businesses both operated under Bank of Scotland plc's Authority authorisation and banking licence. Following the merger, the Group continued to operate its Halifax and BOS bancassurance businesses under this arrangement. However, its LTSB, Halifax and BOS businesses were governed together within the Group's Retail division.

LTSB, Halifax and BOS bancassurance

4.3. Bancassurance is a term used to refer to the selling of insurance and banking products through the same channel, most commonly through bank branches selling insurance.

4.4. During the Relevant Period, the Firms' LTSB, Halifax and BOS branch networks were leading providers of bancassurance financial products to retail customers in the UK. LTSB had over 1,700 branches, Halifax had over 650 branches and BOS had over 290 branches. On average there were 1,900 advisers working across the branches during the Relevant Period. Advisers were supervised by local sales managers and regional risk consultants.

4.5. Advisers offered long-term savings, protection and investment products to customers. The Firms' protection product range included critical illness, life cover, expenses on death cover and income protection for customers. Their investment product range included Personal Investment Plans, Individual Savings Accounts (ISAs) and Open Ended Investment Companies (OEICs) sold on a single premium basis, and ISAs and OEICs sold on a regular premium basis. During the Relevant Period LTSB customers invested approximately £1.2 billion and paid approximately £71 million in protection premiums. During the same period Halifax customers invested approximately £888 million and paid approximately £38 million in protection premiums and BOS customers invested approximately £170 million and paid approximately £9 million in protection premiums. During the Relevant Period, the Firms earned average commission of £600 for every protection policy sold which was ten times the average £60 in commission earned for every regular premium investment plan sold. It was also twice the average commission earned on sales of lump sum OEICS and ISAs (£260). The only product which earned more commission for the Firms were lump sum investment bonds which earned an average commission of £1,300.

Sales strategy

4.6. From 2010, the Group had a target for its combined retail bancassurance business to approximately double its customer base by 2015. In seeking to meet this growth target the Group's strategy was to focus on sales of protection products over investment products. There were a number of reasons for this strategic focus on protection:

(1) the Group wanted to increase the profitability of its bancassurance business, and protection products were more profitable;

(2) the Group's analysis showed that there was a 'protection gap' in the UK market and wanted to meet the protection needs of customers;

(3) the financial crisis had resulted in a fall in customer demand for investment products; and

(4) the Group had reduced its appetite for sale of investment products, which it saw as higher risk from a regulatory perspective, including anticipated regulatory developments.

4.7. During the Relevant Period, as a result of the various factors described in paragraph 4.6 above, LTSB's sales of protection products increased by 65% while its sales of investment products decreased by 54%. During the same period Halifax's sales of protection products increased by 94% while its sales of investment products decreased by 68% and BOS's sales of protection products increased by 67% while its sales of investment products decreased by 67%.

Financial incentive schemes

4.8. From 2010, the Group sought to harmonise incentives for staff within its LTSB, Halifax and BOS branch networks. This was an ongoing process. However, there remained substantive differences between the incentives provided to advisers in each business (and related controls) throughout the Relevant Period.

4.9. The financial incentive schemes in place for LTSB, Halifax and BOS advisers during the Relevant Period (the incentive schemes) were introduced on 1 January 2010 and included a number of higher risk features that needed to be closely controlled. They were designed to encourage advisers to maximise their sales volumes in line with the Group's strategy. The Firms again made changes to their incentive schemes on 1 October 2010 and 1 January 2011 that further increased the risks involved.

Sales targets and points

4.10. A sales plan for the Group's Retail division, agreed on a quarterly basis, set sales targets for each product sold by the Group's bancassurance businesses. This resulted from a process involving a series of meetings attended by key stakeholders within the Group, in particular from the bancassurance business and the Retail Finance department. Retail Finance had overall responsibility for the process, including reviewing and challenging the sales plan and approving the final sales targets. This was subject to supervision and approval by senior management and relevant committees.

4.11. Once the overall quarterly product sales targets were agreed, separate sales targets were set for each of the Group's LTSB, Halifax and BOS branch networks. For the purposes of setting individual advisers' financial incentives, each business was responsible for converting its sales targets into sales points that its advisers would accrue for each product sold. The sales points were then cascaded into individual monthly sales point targets that advisers were required to meet in order to qualify for salary increases and bonuses.

Key incentives

4.12. The incentive schemes incentivised advisers through:

(1) variable base salaries; and

(2) individual and team bonuses.

4.13. In addition, advisers were sometimes incentivised by way of one-off payments or prizes.

4.14. The Firms' information systems allowed advisers to see on a daily basis the number of sales that they had made and on at least a weekly basis their performance against their sales point targets. Advisers were also provided with information that enabled them to calculate their potential bonuses. As a result, advisers could adjust their approach to sales, including by focusing on certain customers or products, in order to meet their targets.

4.15. There were a number of higher risk features in the incentive schemes, as described below. There was, therefore, a significant risk that advisers would be improperly motivated by their own personal financial circumstances and goals to sell products to customers to achieve a salary increase, avoid a salary decrease, or secure a bonus before the end of the relevant month/quarter. As a result, it was essential that the Firms' systems and controls were sufficiently robust and sophisticated to mitigate this risk effectively.

Higher risk features

Variable basic salaries

<u>LTSB</u>

4.16. LTSB advisers had variable basic salaries which were directly linked to their performance against sales point targets. They were placed in six tiers, with sales point targets and annual basic salaries increasing with each higher tier ranging from £18,200 to £72,600. The majority of advisers were in tiers 3 or 4 with base salaries of £33,706 and £46,671.

4.17. Throughout the Relevant Period, an LTSB adviser who reached the sales point target of a higher tier over three consecutive quarters would automatically qualify for a promotion to that tier and receive a salary rise, subject to passing a risk gateway (see below). For a middle tier LTSB adviser, this meant that they needed to achieve 138% of their existing sales point target to qualify for a promotion and salary rise. From 1 January 2011, where an LTSB adviser consistently failed over a period of nine months to meet 90% of the target for their existing tier, LTSB would have the right to automatically demote them and reduce their salary. During that period the underperforming LTSB adviser would receive personal coaching and support through a performance development plan aimed at improving performance and increasing their sales levels. As with promotions, LTSB advisers could be demoted by more than one tier at a time.

4.18. If LTSB advisers were demoted, they would stay on reduced basic salaries for a minimum of nine months. The drop in salary for a middle tier LTSB adviser caused by a one tier demotion would have been from £33,706 to £25,927 (a 23% base salary reduction), although advisers in lower tiers had lower sales targets to obtain bonuses. If the same LTSB adviser was demoted two tiers their base salary could have fallen to £18,189 (a 46% reduction). LTSB advisers who were close to dropping a salary tier may have felt under pressure to increase their sales volumes. The risks to customers posed by LTSB advisers who were close to dropping a tier were therefore particularly acute.

4.19. In 2011, 139 LTSB advisers (approximately 14%) were demoted by one tier and four advisers were demoted two tiers. In the same time period 94 LTSB advisers (approximately 10%) were promoted by one tier with a further 11 being promoted two or three levels.

Halifax and BOS

4.20. Halifax and BOS advisers had variable basic salaries which were directly linked to their performance against sales point targets. They were in tiers, with sales point targets and basic salaries increasing with each higher tier.

4.21. Throughout the Relevant Period, Halifax and BOS advisers who reached the sales point target of a higher tier could qualify for a promotion to that tier and receive a salary rise, subject to passing a risk gateway (see below). For example, a middle tier Halifax or BOS adviser in the period after 1 October 2010 needed to achieve 133% of their existing sales point target to qualify for a promotion and salary rise. Where Halifax or BOS advisers consistently failed over a period of nine months to meet 90% of the sales point target for their existing tier the Firms would have the right to demote them and reduce their salary. During that period underperforming Halifax and BOS advisers would receive personal coaching and support through a performance development plan aimed at improving performance and increasing their sales levels. Halifax and BOS advisers could (as with promotions) be demoted by more than one tier at a time.

4.22. At the start of the Relevant Period, Halifax and BOS advisers were in five tiers that entitled them to basic annual salaries ranging from £21,600 to £45,500. In order to achieve promotion, as well as consistently meeting sales point targets, Halifax and BOS advisers needed to satisfy certain qualification and experience requirements for the higher tier and have the support of their managers. The demotion of low performing Halifax and BOS advisers was subject to the outcome of a performance assessment. Halifax and BOS advisers could opt to move up a tier twice a year.

4.23. From 1 October 2010, a new tiered salary structure for Halifax and BOS advisers was introduced which aligned the Halifax and BOS structure more closely to the LTSB structure. Under the new structure, Halifax and BOS advisers were placed in six tiers that entitled them to basic annual salaries ranging from £22,000 to £73,000. The new structure made it possible for Halifax and BOS advisers to automatically move up and down salary tiers on meeting sales point targets. They could again be promoted or demoted by more than one tier at a time. This new structure therefore increased the incentive for Halifax and BOS advisers to maximise their sales to influence their salary levels.

4.24. If Halifax and BOS advisers were demoted, they would stay on reduced basic salaries for a minimum of nine months. The drop in salary for a middle tier Halifax or BOS adviser caused by a one tier demotion would have been from £34,000 to £26,000 (a 23% reduction), although advisers in lower tiers had lower sales targets to obtain bonuses. If the same Halifax or BOS adviser was demoted two tiers their base salary could fall to £22,000 (a 35% reduction). As with LTSB advisers, Halifax and BOS advisers who were close to dropping a salary tier may have felt under pressure to increase their sales volumes to maintain their income. The risks to customers posed by Halifax and BOS advisers who were close to dropping a tier were therefore particularly acute.

4.25. In 2011, 112 Halifax advisers (approximately 14%) were demoted by one tier with a further 33 being demoted two or three tiers. In the same time period 12 Halifax advisers (approximately 1%) were promoted one tier and none were promoted more than one tier. In 2011, 20 BOS advisers (approximately 9%) were demoted by one tier with one further adviser being demoted by two tiers. In the same period 14 BOS advisers (approximately 6%) were promoted one tier and 4 were promoted more than one tier.

Bonus thresholds

<u>LTSB</u>

4.26. LTSB advisers were given an individual bonus, an additional bonus and a team bonus if they achieved 100% of their sales point targets over a rolling three month period, subject to passing a risk gateway and meeting any relevant additional criteria (see further below). This was referred to in guidance provided to them about their incentives as a 'champagne bonus'.

4.27. This threshold created a disproportionate reward for, and higher risk around, the marginal sale that took LTSB advisers over the threshold. For example, the sale that took LTSB advisers in the top four salary tiers over the threshold would result in a bonus of 15% of their monthly basic salary from the individual bonus and could result in a further 20% from the additional bonus, which for a middle tier LTSB adviser would be £980 (gross). This sale could, therefore, result in this LTSB adviser receiving a bonus equivalent to a minimum of 35% of their base salary for the month.

4.28. For those LTSB advisers in the lowest two salary tiers, the individual bonus was equivalent to 5% of their basic salary while, as explained above, for those in the highest four salary tiers it was equivalent to 15% of their base salary. The individual bonus was paid on a monthly basis, two months in arrears from the end of the rolling three month period. For example, LTSB advisers would be set sales point targets for each of April, May and June. If they achieved 100% of the total sales point target for the three months by the end of June they would be able to qualify for an individual bonus paid in August.

4.29. For example, for a middle tier LTSB adviser with a gross monthly salary of £2,808, 15% of salary would be earned as a bonus when the LTSB adviser reached their sales point target and then the bonus would be 1% for every 1% sold over this target. The practical effect of this would be:

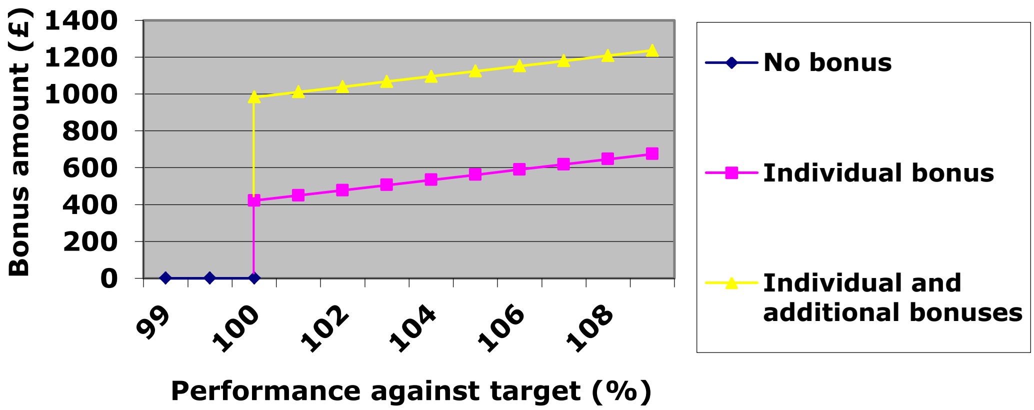
(1) if the LTSB adviser reached 99% of their sales point target they would receive no bonus;

(2) if the LTSB adviser reached 100% of their sales point target they would receive £420 (gross) for the month (being 15% of their monthly salary);

(3) if the LTSB adviser reached 102% of their sales point target they would receive £477 (gross) for the month (being 17% of their monthly salary); and

(4) on achieving 138% of their sales point target, which would also be the level at which the LTSB adviser could move up a tier, the bonus would be £1,488 (gross) for the month (being 53% of their monthly salary).

Figure 1: Bonus progression for an LTSB middle tier adviser



4.30. Much larger bonuses could, however, be earned. The largest individual bonus for a middle tier LTSB adviser during the Relevant Period was 227% of the LTSB adviser's salary or £6,389 (gross) per month. On average over the Relevant Period, around half of the LTSB advisers earned a bonus, and the average bonus, for those who received bonuses, was around £1,150.

4.31. The additional bonus was also based on sales points and was paid on a quarterly basis and was equivalent to 20% of LTSB advisers' basic salaries. To qualify LTSB advisers had to fulfil requirements in addition to reaching the 100% threshold which included achieving product mix minimum targets. The product mix minimum targets set LTSB advisers minimum targets for sales of protection products and sales of investment products (described further below). During the Relevant Period, 12% of LTSB advisers on average received the additional bonus each quarter, which was around £1,810.

4.32. The team bonus was awarded on a quarterly basis. It was based on the performance of an LTSB adviser's whole branch. If the branch qualified for the team bonus, advisers were paid £25 for each full percentage point achieved above the branch's sales targets. This amount could be increased or decreased by up to 25% based on a customer experience assessment, which involved contacting a sample of customers.

Halifax and BOS

4.33. Throughout the Relevant Period, Halifax and BOS advisers had specific monthly bonus point targets that they had to reach to qualify for individual bonuses each quarter. They received one bonus point for every sales point they earned, and could also earn small fractions of bonus points for other reasons, such as referrals leading to customers opening new deposit savings accounts.

4.34. To be able to qualify for individual bonuses, Halifax and BOS advisers had to pass a risk gateway (see below) and exceed a threshold of 95% of a rolling three month bonus point target by the end of the quarter. During 2010, Halifax and BOS advisers' bonuses were calculated by multiplying the number of bonus points they earned by a fixed rate, which increased with each salary tier, and then converting this to £s. The fixed rate was highest for bonus points earned between 95% and 100% of the target. Once an adviser exceeded 100% of the target, a lower fixed rate applied.

4.35. For example, for a middle tier Halifax adviser with a monthly bonus point target of 44,622 and a gross monthly salary of £2,616, the number of bonus points earned by the adviser between 95% and 100% were multiplied by a fixed rate of 30.6%. The number of points that resulted from applying the multiplier then became the bonus in £s. A fixed rate of 13.62% was then applied to bonus points earned by the adviser above 100%. The practical effect of this would be:

(1) if the Halifax adviser reached 95% of their bonus point target they would receive no bonus;

(2) if the Halifax adviser reached 96% of their bonus point target they would receive £137 (gross) for the month. The extra 1% over the 95% target was equivalent to 446 points (1% of the total bonus point target for the month of 44,622). The adviser would earn a £ figure equating to 30.6% of the 446 points (resulting in a bonus of £137 (gross)). This was equivalent to 5% of the adviser's monthly salary;

(3) if the Halifax adviser reached 100% of their bonus point target they would receive £683 (gross) for the month (being 30.6% of the 2,231 points earned over 95% of the monthly bonus point target) which was equivalent to 26% of their monthly salary;

(4) if the Halifax adviser reached 102% of their bonus point target they would receive £804 (gross) for the month (being 30.6% of 2,231, as above, plus 13.62% of the 892 points above 100% of the monthly bonus point target) which was equivalent to 31% of their monthly salary; and

(5) on achieving 109% of their bonus point target, which would also be the level at which the Halifax adviser could move up a tier (if the target was met in each of three consecutive quarters), the bonus would be £1,230 (gross) for the month (being 30.6% of 2,231 points plus 13.62% of 4,016 points) which was equivalent to 47% of their monthly salary.

4.36. Whilst the bonus calculation for BOS advisers was the same as for Halifax advisers, BOS advisers had sales targets which were up to 10% lower than Halifax advisers as the BOS branches typically made less sales. BOS advisers typically had marginally smaller bonuses than Halifax advisers.

4.37. Much larger bonuses could be earned by both Halifax and BOS advisers than those set out in paragraph 4.35 (as illustrated by the following examples). The largest individual bonus for a middle tier BOS adviser during this time was over 280% of the BOS adviser's salary or £7,523 (gross) per month. This middle tier adviser achieved this by earning 269,116 bonus points compared to the target of 116,351 i.e. 231% of target. The largest bonus for any Halifax adviser during this time was £30,485 (gross) over a quarter which was approximately £10,000 per month or 264% of the Halifax adviser's base salary. This adviser, who was in the highest tier, achieved this by earning 332,997 bonus points compared to the target of 168,780 i.e. 197% of target.

4.38. On average, between 1 January 2010 and 1 October 2010, around 37% of Halifax advisers and 47% of BOS advisers earned a bonus. The average bonus for Halifax advisers who received a bonus was around £5,500 (gross) for the quarter, equivalent to around £1,800 (gross) per month, and the average bonus for BOS advisers who received a bonus, was around £5,300 (gross) for the quarter, equivalent to around £1,700 (gross) per month.

4.39. From 1 October 2010, for every additional 1% of their bonus point target that Halifax and BOS advisers achieved between 95% and 100%, the Halifax and BOS advisers could earn a bonus equivalent to a fixed percentage of base salary, which similarly increased with each tier.

4.40. For example, for a middle tier Halifax or BOS adviser in the first quarter of 2011 with a gross monthly salary of £2,833, 6% of base salary would be applied before the Halifax or BOS adviser reached their target and 1% thereafter. The practical effect of this would be:

(1) if the Halifax or BOS adviser reached 95% of their bonus point target they would receive no bonus;

(2) if the Halifax or BOS adviser reached 96% of their bonus point target they would receive £170 (gross) for the month (being 6% of their monthly salary);

(3) if the Halifax or BOS adviser reached 100% of their bonus point target they would receive £850 (gross) for the month (being 30% of their monthly salary);

(4) if the Halifax or BOS adviser reached 102% of their bonus point target they would receive £907 (gross) for the month (being 32% of their monthly salary); and

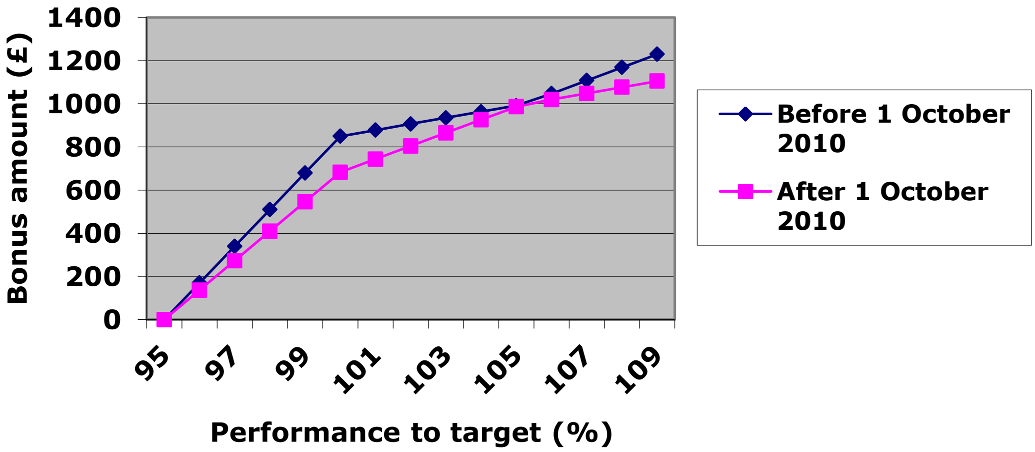
(5) if the Halifax or BOS adviser reached 133% of their bonus point target, which would also be the level at which the Halifax or BOS adviser could move up a tier, the bonus would be £1,785 (gross) for the month (being 63% of their monthly salary).

4.41. Again, much larger bonuses could be earned (as illustrated by the following examples). The largest monthly bonus earned by a middle tier Halifax adviser during 2011 was £3,186 (gross), which was 110% of the Halifax adviser's salary of £2,904 per month. This middle tier adviser achieved this by earning 203,089 bonus points compared to the target of 113,007 i.e. 180% of target. The largest monthly bonus earned by any Halifax adviser during 2011 was £6,986 (gross), which was approximately 140% of the Halifax adviser's salary of £5,000 per month. This adviser, who was in the fifth highest tier, achieved this by earning 220,608 bonus points compared to the target of 118,492 i.e. 186% of target. On average, after 1 October 2010, around 26% of Halifax advisers and 33% of BOS advisers earned a bonus. The average bonus, for those who received bonuses was around £1,500 (gross) per month for Halifax and £2,125 (gross) per month for BOS.

4.42. From 1 September 2011, the Halifax and BOS bonus schemes were aligned with the LTSB scheme as described at paragraphs 4.26-32 above.

4.43. The higher rate bonus period between 95% and 100% of bonus point targets therefore allowed an accelerated amount of bonus to be earned. This was a higher risk feature of Halifax's and BOS's incentive scheme as it encouraged advisers to sell as many products as possible before the end of the month. This was because every sale that Halifax and BOS advisers made in this period would have been worth more than if the sale had been made at the start of the following month.

Figure 2: Bonus accelerator for a Halifax middle tier adviser



4.44. From 1 January 2012 to 31 March 2012 Halifax and BOS had an additional bonus for Halifax advisers and BOS advisers as part of the harmonisation of their incentive schemes to the LTSB incentive scheme. This is as described at paragraph 4.31 above.

4.45. Team bonuses included a similar accelerated bonus element and thresholds for sales between 95% and 100% of the team's target, enabling Halifax and BOS advisers in the team to earn additional fixed cash amounts per percentage point of target achieved within this range.

Uncapped bonuses

<u>LTSB</u>

4.46. As illustrated in paragraph 4.29 above, even after LTSB advisers had reached 100% of their sales point targets, they were incentivised to continue selling as many products as they could by the end of the month. LTSB advisers could earn a further either 1% or 1.25% of their base salary, depending on their tier, for every additional 1% of target that they reached above 100%. The risk associated with the uncapped nature of this bonus applied in particular to the highest selling LTSB advisers.

4.47. On average during the Relevant Period LTSB advisers were earning individual sales bonuses that were 18% of their base salary.

Halifax and BOS

4.48. Similarly, as illustrated in paragraphs 4.35 and 4.40 above, even after Halifax and BOS advisers had reached 100% of their bonus point targets, they were also incentivised to continue selling as many products as they could by the end of the month. The team bonuses that Halifax and BOS advisers could earn for sales once they had exceeded their targets were calculated in a similar way to their accelerated bonuses. While the relevant percentages of bonus points/basic salary involved were lower once Halifax and BOS advisers passed 100%, they were uncapped. The risk associated with the uncapped nature of this bonus applied in particular to the highest selling Halifax and BOS advisers.

4.49. On average during 2010, Halifax and BOS advisers were earning bonuses that were approximately 60% of their basic salary. Following the introduction of the new incentive scheme from October 2010, basic salary was increased, particularly in the higher tiers, and the proportion of bonus to salary across all Halifax and BOS advisers fell on average so that bonus accounted for over 30% of the average adviser's total pay each month.

Halifax's and BOS's monthly bonus payment option

4.50. Another higher risk feature of Halifax's and BOS's incentive schemes was that Halifax and BOS advisers had the option to receive bonus payments in advance as soon as they achieved 100% of their monthly sales point targets. Halifax and BOS advisers who made use of this option could incur bonus deficits at the end of the quarter if they:

(1) failed to achieve their three month rolling bonus point targets;

(2) received monthly payments in advance that were greater than the actual bonuses they were entitled to; or

(3) failed the risk gateway.

4.51. If they incurred a bonus deficit in this way Halifax and BOS advisers would not receive further bonus payments until the deficit was cleared, with all future bonuses being used to this end. In 2010, up to 5% of Halifax advisers had bonus deficits at any one time. On average the bonus deficits were approximately 40% of the Halifax adviser's monthly salary in 2010, for a middle tier Halifax adviser that was equivalent to £1,046. In 2010, up to 1% of BOS advisers had bonus deficits at any one time. On average the bonus deficits were approximately 28% of the BOS adviser's monthly salary in 2010, for a middle tier BOS adviser that was equivalent to £732. There was therefore a risk that Halifax and BOS advisers who used this option would make unsuitable sales to customers to avoid running up bonus deficits or to pay them off.

4.52. The monthly payment option was not available to Halifax and BOS advisers after 31 December 2010. However, deficits could be carried forward into following years until they were cleared. Approximately 2% of Halifax advisers had bonus deficits that remained in place until at least the end of 2011.

Link to amount of premium, type of premium and length of term

<u>LTSB</u>

4.53. LTSB's incentive scheme enabled LTSB advisers to earn more sales points depending on a number of features of the policy sold:

(1) the sales points increased with the amount invested or the premium paid for protection. LTSB advisers who sold larger value policies could therefore increase their bonus;

(2) for investment products sales points were greater for regular premium products compared to lump sum investments;

(3) for protection products the amount of sales points earned increased with the term of the policy sold; and

(4) the sales points earned were different according to the type of life cover sold, with increasing life cover earning the largest number of sales points.

4.54. By way of illustration, the tables below set out the numbers of sales points an LTSB adviser would earn for selling:

(1) an average regular premium protection product where the customer pays £420 per year for a term of 10 years;

Protection product	**Sales points per £1,000**	**Total sales points**
Life cover – decreasing regular premium	140 points per £1,000 of annual premium multiplied by each year of the term	(420 ÷ 1000) x (140 x 10) = **588** points
Life cover – level regular premium	150 points per £1,000 of annual premium multiplied by each year of the term	(420 ÷ 1000) x (150 x 10) = **630** points
Life cover – increasing regular premium	160 points per £1,000 of annual premium multiplied by each year of the term	(420 ÷ 1000) x (160 x 10) = **672** points

(2) an average regular premium investment where the customer pays £5,500 per year; and

(3) an average lump sum investment by the customer of £10,400.

Investment product	**Sales points per £1,000**	**Total sales points**
Investments – regular premium	125 points per £1,000 of annual premium	(5,500 ÷ 1000) x 125 = **688** points
Investments – single premium	34 points per £1,000 invested	(10,400 ÷ 1,000) x 34 = **354** points

4.55. There was therefore a risk that LTSB advisers seeking to maximise their salaries and bonuses would seek to sell products that enabled them to earn the highest number of sales points, for example by persuading customers to take out more protection cover than they needed or select a product term that was longer than required.

Halifax and BOS

4.56. Under Halifax's and BOS's incentive scheme the sales points increased with the amount invested or the premium paid for protection. There was therefore a similar risk that Halifax and BOS advisers seeking to maximise their salaries and bonuses would seek to sell products that enabled them to earn the highest number of sales points, for example by persuading customers to take out more protection cover than they needed.

4.57. As part of the harmonisation of the Halifax and BOS incentives schemes to the LTSB incentive scheme, from September 2011 the sales points awarded to Halifax advisers and BOS advisers were the same as those awarded to LTSB advisers (described in paragraphs 4.53 to 4.55 above).

Product bias

4.58. Where customers did express interest in both protection and investment products, the Firms had in place sales procedures which required advisers to follow a pre-defined hierarchy of needs, which would typically involve addressing protection needs before considering investments.

LTSB

4.59. In line with the Group's strategic focus on sales of protection products and the hierarchy of needs referred to in paragraph 4.58 above, LTSB advisers were required to achieve product mix minimum targets to obtain an additional bonus. These set higher targets for sales of protection products than savings and investment products. During the Relevant Period, the product mix minimum targets required approximately 1.5 to 2 times the number of protection products to be sold compared to sales of savings and investment products. Although the investment and protection products in question were not substitutable, for a proportion of customers who potentially had both investment and protection needs, there was a risk that this minimum target would incentivise LTSB advisers to concentrate inappropriately on selling protection products to these customers in order to achieve their sales point targets and an additional bonus.

Halifax and BOS

4.60. Similarly, in line with the Group's strategic focus on sales of protection products and the hierarchy of needs referred to in paragraph 4.58 above, Halifax and BOS advisers were awarded approximately two times more sales points for the average protection product sale than for the average regular premium investment product sale. Again, although the investment and protection products in question were not substitutable, for a proportion of customers who potentially had both investment and protection needs, there was a risk that this weighting would incentivise Halifax and BOS advisers to concentrate inappropriately on selling protection products to these customers in order to achieve their sales and bonus point targets.

4.61. This weighting in favour of protection products can also be demonstrated on a sales point per £ of premium basis. Halifax and BOS advisers received 0.3 times the annual contribution for each regular premium investment product sale and 7 times the annual premium for each protection product sale. While average sums invested were higher for investment products, Halifax and BOS advisers received 23 times more points for each £ of protection premium sold than for each regular investment product sold.

4.62. The risk gateway used by Halifax and BOS until the end of 2010 (see below) also had a product mix target in respect of its sales competency measure. This targeted 24 investments (lump sums, regular premiums and pensions) and 34 protection policies for Halifax and BOS advisers per quarter.

4.63. As stated in paragraph 4.44, Halifax and BOS introduced an additional bonus. This meant they were required to achieve product mix minimum targets as described at paragraph 4.59 above.

4.64. At various times during the Relevant Period, Halifax and BOS also ran campaigns that encouraged Halifax advisers and BOS advisers to focus on sales of protection products. For example, they ran a nine week campaign from April 2011 to June 2011 that aimed to produce a mix of five protection sales to two investment sales for each adviser per week.

One-off payments or prizes

4.65. In addition, advisers had opportunities to win one-off payments or prizes at various points during the Relevant Period. For example, in September 2010 there was a 'grand in your hand' competition where advisers who met sales and persistency targets and passed the risk gateway (see below) for the month would receive an additional £1,000. In order to meet their persistency targets, a percentage of the regular premium policies that advisers sold had to remain in force for a set period. In the last quarter of 2010, there was a 'Christmas cracker' competition where the top performing advisers over the quarter could win a food hamper or wine selection. In order to qualify an adviser needed to sell a minimum of 50 products of which 20 needed to be protection products and 20 needed to be single premium investment products (regular premium did not qualify).

Systems and controls

4.66. Although the Firms had various systems and controls in place to monitor the quality of sales made by advisers, during the Relevant Period they were not adequately focused on the specific higher risk features of the incentive schemes.

Monitoring & verification

The Firms monitored the quality of sales made by advisers through a sales files checking process. However, the focus of this process was on sales that were deemed higher risk by reference to customer characteristics and product features. They did not focus on adviser characteristics and the specific higher risk features of the incentive schemes.

Selection of sales files for verification

<u>LTSB</u>

4.67. Throughout the Relevant Period, LTSB used data mining tools to select sales files for manual checking by the Firms' verification teams. All sales of investment and protection products made by LTSB advisers were put through the data mining tools which would select their sales files for manual checking based on a number of product and customer characteristics (e.g. age, experience and asset composition). Prior to June 2010, LTSB applied a data mining tool to select files for checking if certain 'triggers' relating to these characteristics were hit. From June 2010 a more sophisticated risk weighting tool was applied to identify 'high risk' cases. It allocated all LTSB advisers' sales files a risk score and if the score for a file was at a certain level it would be selected for manual checking by the verification team. The fact that 100% of LTSB advisers' sales files were subjected to data mining was also taken into account when calculating their verification scores within the risk gateway used by LTSB until July 2011 (see below).

4.68. At the start of the Relevant Period, LTSB relied solely on data mining to identify sales files for verification. LTSB advisers were not subjected to a minimum number of manual checks for their sales files. Therefore some LTSB advisers who did not have any of their sales selected by the data mining tools in a given month did not have any sales files manually checked. This remained the case until 1 June 2011 when LTSB introduced a target of manually checking at least one sales file for each LTSB adviser per month.

<u>Halifax and BOS</u>

4.69. Prior to September 2010, Halifax and BOS used a random selection process for manually checking sales of investment and protection products. At the start of the Relevant Period until March 2010 Halifax advisers and BOS advisers had two randomly selected sales files checked per quarter. From March 2010 they had one additional sales file selected per quarter in respect of 'high risk' business (sales that had received a certain score based on a risk assessment of the customer's characteristics).

4.70. In September 2010, the verification processes for Halifax and BOS were aligned to that used in LTSB with the introduction of the data mining tools.

Sales files verification process and other monitoring

4.71. The Firms' verification teams' sales file checking processes involved verification officers evaluating the documents held on file and the advice given, and providing appropriate feedback from the review to the adviser and the adviser's line manager. Any deficiencies were identified to the regional risk manager. The verification officers would also note any remedial action deemed necessary. Customer contact was also undertaken, where it was necessary to clarify or explore issues identified from the file check and to confirm the customer's understanding of the advice received.

4.72. In addition to verification, the Firms also monitored the quality of sales via customer contact, mystery shopping and analysis of complaints. Furthermore, the Firms' protection product provider monitored unusual patterns and responses in the information given by protection customers at the point of sale.

Failure to supplement routine business quality monitoring

4.73. Despite having in place the monitoring and verification tools and processes described above, the Firms did not focus these on adviser characteristics and the specific higher risk features of the incentive schemes. The Firms should have supplemented their routine business quality monitoring with monitoring of sales by advisers:

(1) who were close to moving up one or more salary tiers;

(2) who were at risk of demotion to a lower salary tier;

(3) who were close to reaching the bonus thresholds;

(4) who had higher risk gateway scores (see below);

(5) who were achieving the highest numbers of sales points; and

(6) at the end of the month/quarter.

4.74. Halifax should have additionally monitored sales by Halifax advisers that entitled them to accelerated bonuses between 95% and 100% of their bonus point targets and by those who had bonus deficits.

4.75. Given the Group's strategic focus on sales of protection products and the greater incentives that advisers were given to sell these products, this additional monitoring should have included a sufficient review of protection sales. This was particularly important as the focus of the Firms' routine monitoring on customer characteristics and product features meant that:

(1) while a higher percentage of protection sales were reviewed in the period January to November 2010, LTSB only reviewed an average of approximately 4% of protection sales between December 2010 and December 2011 (with only 1% of protection sales checked between March and May 2011);

(2) Halifax only reviewed approximately 6% of protection sales during the Relevant Period (with only 3% of protection sales checked between April and July 2011); and

(3) BOS only reviewed approximately 6% of protection sales during the Relevant Period.

4.76. An example of such risk-based monitoring, which was conducted for Halifax advisers after the Authority's thematic visit, involved a review of 31 advisers who had been at risk of dropping a salary tier in May 2011 but due to improved sales performance in June 2011 were able to avoid demotion. The review identified concerns in relation to four advisers (13%) with the types of sales that were made in the last month of the quarter. The concerns identified included advisers making sales to themselves, their family members and branch staff and advisers making a number of sales on the same day in the last week of the quarter.

4.77. In the most serious case, the adviser had not only been at risk of dropping a salary tier but also had a bonus deficit of nearly £5,000 to repay. The adviser processed sales of life cover, critical illness and expenses on death cover to himself and his wife for large premium amounts, with more extensive cover than was previously considered appropriate and which would appear to have been unaffordable given previous policy lapses by the adviser. The adviser also sold a critical illness policy to a staff member in the Halifax branch which was subsequently cancelled. Given the timing of the sales, in the last week of the quarter, it appears that the adviser had made the sales to try and prevent a demotion. Formal disciplinary action was taken against the adviser following the review.

Risk gateway

4.78. In order to be eligible for promotion to a higher salary tier or a bonus, advisers had to satisfy certain competency standards that the Firms oversaw via a performance rating system known as the 'risk gateway'.

4.79. The risk gateway was the primary control that the Firms relied on to oversee adviser behaviour and mitigate the risk of unfair customer outcomes. However, this control was flawed as advisers could pass the risk gateway even if the Firms' verification teams had identified issues with their sales.

<u>LTSB</u>

4.80. LTSB's risk gateway utilised ten key performance indicators (KPIs) to provide a total risk score for each LTSB adviser. The KPIs included the following measures:

(1) 'verification' based on the results of file reviews conducted for the LTSB adviser by the verification team over a three month rolling period. This was divided into two parts, one dealing with files that were judged to be Advice Fails and the other for Process Fails;

(2) 'upheld complaints' based on the number of complaints upheld against the LTSB adviser over a six month rolling period; and

(3) 'sales competence' based on the numbers of protection and investment product sales over a three month rolling period.

4.81. LTSB advisers were assessed in terms of their performance against each KPI and awarded 'risk points' for each. An LTSB adviser had to have a total risk score of less than 75 risk points to pass the risk gateway. The LTSB adviser was then risk-rated as either 'Red', 'Amber' or 'Green', with a Red rating indicating that an LTSB adviser had failed the risk gateway.

4.82. Each KPI had a maximum risk score and it was not possible to fail the risk gateway due to poor performance against any individual KPI. The version of the risk gateway used by LTSB until July 2011 had a maximum score of 25 for Advice Fails and 20 for Process Fails. The score an adviser received was based on the number of fails as a percentage of the total sales made by an LTSB adviser in a quarter rather than only those that had been subject to manual verification checks. This was because the Firms assumed that any sale that had not been selected by the data mining tool for manual checking was a suitable sale. For example, if an LTSB adviser made 100 sales in the three month rolling period and two sales files were selected by the data mining tool for manual checking and both were found to be Advice Fails then the LTSB adviser would receive a pass rate of 98% (resulting in them being placed in the lowest scoring category). A pass rate of less than 90% would result in an LTSB adviser receiving the maximum score of 25.

4.83. This meant that LTSB advisers had to have over 10% of their total sales selected by the data mining tool for manual checking and then for a high percentage of these determined to be Advice Fails to receive the maximum score. Given that LTSB typically checked 10-15% of sales (including some advisers that would be subject to 100% verification for various reasons), it would require an extremely high verification failure rate for most advisers to score the maximum. In many cases it would be impossible. Even then the maximum score of only 25 allowed LTSB advisers to pass the risk gateway if all of their sales were selected for manual checking by the data mining tool and determined to be Advice Fails, provided their other KPIs were sufficiently low.

4.84. In addition, before LTSB introduced the target of checking at least one sales file for each LTSB adviser per month on 1 June 2011, LTSB advisers could pass the risk gateway without having any of their sales files manually checked if none had been selected by the data mining tool.

4.85. From July 2011, the version of the LTSB's risk gateway used a different method for calculating verification with the maximum score being 40 for three or more Advice Fails (the Process Fail score remained unchanged). However, LTSB advisers could again still pass the risk gateway even if all of their reviewed sales were Advice Fails, provided their other KPIs were sufficiently low.

4.86. The maximum scores for upheld complaints was 25. LTSB advisers could still pass the risk gateway even where they had been the subject of a number of upheld complaints, provided their scoring on other KPIs was sufficiently low.

4.87. The sales competence maximum score was 40. This would arise where an adviser had sold two or less protection products and two or less investment products in any three month rolling period. LTSB advisers who were close to reaching a risk score of 75 due to maximum verification and/or complaints scores, could potentially secure bonuses by selling more products to limit their sales competence score. An adviser could reduce their sales competence score to a minimum of 2 risk points by selling over 24 protection and 24 investment products in any three month rolling period. It would not matter if any of the additional sales made to reduce the sales competence score were Advice Fails.

4.88. Sales points awarded for sales which turned out to be unsuitable were "clawed back". However, as LTSB advisers had access to details of their performance against sales targets on a daily basis, including the loss of any points through "claw back", they could respond by seeking to increase their sales to compensate for any such loss to still achieve their sales targets and bonus thresholds.

4.89. LTSB's tolerance for Advice Fails can be illustrated by the fact that, during the Relevant Period, there were:

(1) 1 instance where an LTSB adviser had 7 Advice Fails identified in a month and still received a bonus payment;

(2) 2 instances where an LTSB adviser had 6 Advice Fails identified in a month and still received a bonus payment;

(3) 9 instances where an LTSB adviser had 5 Advice Fails identified in a month and still received a bonus payment;

(4) 32 instances where an LTSB adviser had 4 Advice Fails identified in a month and still received a bonus payment;

(5) 104 instances where an LTSB adviser had 3 Advice Fails identified in a month and still received a bonus payment;

(6) 414 instances where an LTSB adviser had 2 Advice Fails identified in a month and still received a bonus payment; and

(7) 1826 instances where an LTSB adviser had 1 Advice Fail identified in a month and still received a bonus payment.

4.90. During the Relevant Period, 866 out of a total of 1,211 LTSB advisers (71%) received a monthly bonus on at least one occasion even though a high proportion of the sales reviewed had been found to be unsuitable or potentially unsuitable. Furthermore, there were 25 advisers for whom this occurred between three to five times during the Relevant Period. There were 229 LTSB advisers who received a bonus on one occasion when 100% of their verified sales were classified as Advice Fails and of these 30 advisers received a bonus in the same circumstances on more than one occasion. As stated above, at the start of the Relevant Period LTSB advisers were not subjected to a minimum number of checks for their sales files. This remained the case until 1 June 2011 when a target of checking a minimum of one sales file per month was introduced for LTSB advisers. As a result of the low numbers of files per adviser which were reviewed, a high proportion of fails could result from only one file categorised as an Advice Fail.

Halifax and BOS

4.91. Halifax and BOS used two different risk gateways during the Relevant Period, both of which resulted in Halifax advisers and BOS advisers being risk-rated on a points system.

4.92. At the start of the Relevant Period, Halifax and BOS used a risk gateway that measured Halifax advisers' and BOS advisers' performance in five areas including:

(1) 'file quality' based on the results of file reviews conducted for the Halifax adviser or BOS adviser by the verification team in the last quarter;

(2) 'complaints' based on the number of complaints upheld against the Halifax adviser or BOS adviser in the last quarter; and

(3) 'sales competence' based on the numbers of protection and investment product sales in the last quarter.

4.93. Halifax advisers and BOS advisers failed the risk gateway if they scored below 18 points and passed if they scored 18 points or above. If Halifax advisers or BOS advisers had two or more Advice Fails in a particular quarter, they would automatically fail the risk gateway. However, Halifax advisers and BOS advisers could pass the risk gateway if they had only one Advice Fail. At the start of the Relevant Period until March 2010 this meant that the average Halifax adviser or BOS adviser, who had two files reviewed per quarter, could still receive a bonus even if 50% of their verified sales were found to be Advice Fails. From March 2010 until the end of 2010 it meant that the average Halifax or BOS adviser, who then had three files reviewed per quarter, could still receive a bonus even if 33% of their verified sales were found to be Advice Fails.

4.94. From January 2011, a new risk gateway was introduced in Halifax and BOS as part of the harmonisation of its controls with those in LTSB. The risk gateway utilised the same ten KPIs used by the LTSB with a total risk points score of 75. However, this risk gateway had the same flaws described at paragraphs 4.83 and 4.85 above.

4.95. Halifax's tolerance for Advice Fails can be illustrated by how, during the Relevant Period, there were:

(1) 3 instances where a Halifax adviser had 3 Advice Fails identified in a month and still received a bonus payment;

(2) 38 instances where a Halifax adviser had 2 Advice Fails identified in a month and still received a bonus payment; and

(3) 562 instances where a Halifax adviser had 1 Advice Fail identified in a month and still received a bonus payment.

During the Relevant Period, 414 out of a total of 1,288 Halifax advisers (32%) received a monthly bonus on at least one occasion even though a high proportion of the sales reviewed had been found to be Advice Fails. Furthermore, there were 40 advisers for whom this occurred between three to five times during the Relevant Period. As set out above, Halifax had a target of checking a minimum of one sales file for each adviser per month.

4.96. BOS's tolerance for Advice Fails can be illustrated by how, during the Relevant Period, there were:

(1) 9 instances where a BOS adviser had 2 Advice Fails identified in a month and still received a bonus payment; and

(2) 111 instances where a BOS adviser had 1 Advice Fail identified in a month and still received a bonus payment.

4.97. During the Relevant Period, 85 out of a total of 216 BOS advisers (39%) received a monthly bonus on at least one occasion even though a high proportion of the sales reviewed had been found to be Advice Fails. Furthermore, there were 8 advisers for whom this occurred three or four times during the Relevant Period. Again, as set out above, BOS had a target of checking a minimum of one sales file for each adviser per month.

Supervision of advisers

4.98. Local sales managers in the Firms were responsible for day-to-day supervision of advisers. Each sales manager supervised an average of seven advisers. However, during the Relevant Period, sales managers' eligibility for bonuses was directly linked to the sales performance of the advisers they supervised. This created a conflict of interest.

4.99. The supervision of advisers was also not an adequate control over the risks created by the incentive schemes. Sales managers conducted periodic quality assurance checks on advisers' sales but the results were not considered as part of the risk gateway. It was also possible that the Firms' verification teams would review files on which there had been quality issues but which the sales manager had previously considered and addressed. As a result, the risk gateway scores may not have adequately reflected the level of risk posed by the adviser.

4.100. The Firms failed to recognise the weaknesses in their controls over the supervision of advisers and, as a result, did not take steps to manage or reduce the risks posed.

Remuneration governance

4.101. During the Relevant Period there were serious deficiencies in the Firms' governance over the incentive schemes. The root cause of these deficiencies was the collective failure of the Firms' senior management to identify remuneration and incentives for advisers as a key area of risk requiring specific and robust oversight.

Governance framework

4.102. The Group had a Remuneration Governance Policy that set out the governance framework around the Firms' incentives schemes. This included the collective responsibilities of key committees and individuals, the requirement to align the incentives schemes to the Group's risk appetite and the principles to be adhered to in making decisions relating to the design and/or implementation of the incentive schemes.

4.103. In accordance with this policy the Group's Retail Division operated its own Remuneration Committee that was primarily responsible for the design, approval and oversight of the incentive schemes. The Remuneration Committee was formed in December 2009 and became more established in exercising its governance functions in 2010. In addition to this committee, the governance framework included senior management of the Firms' branch networks, the Firms' risk team and the Retail Division's risk team.

4.104. Despite being responsible for overseeing the Firms' incentive schemes the Remuneration Committee:

(1) only considered the schemes at a high level;

(2) did not provide clear direction to the business on the Firms' tolerance for advisers receiving bonuses in circumstances where a number of their sales were found to be potentially unsuitable, including to the teams that were responsible for setting the metrics within the risk gateways;

(3) was predominantly focused on the numbers of advisers that failed the risk gateways and were excluded from receiving bonuses. However, the committee did not have a sufficiently detailed understanding of the tolerances that were built into the risk gateways. Therefore, it was neither aware of the serious deficiencies in the risk gateways described above nor in a position to properly assess the significance of the exclusion rates that were reported to it; and

(4) did not provide clarity to the business on the matters that should have been escalated to it.

4.105. There was also confusion and a lack of clarity as to the role of a prominent business forum in the governance framework in assessing the impact of changes to the incentive schemes, approving those changes and monitoring the controls around them.

Senior management approval of the incentive schemes

4.106. The incentive schemes were introduced on an annual basis at the start of each year. Further changes to the incentives schemes could also be made mid-year. Each annual incentive scheme was subjected to a prior formal approval process involving the stakeholders referred to in paragraph 4.103 above. The Remuneration Committee was responsible for providing ultimate approval for the annual incentive schemes and was required to approve any material mid-year changes.

4.107. The incentive schemes that the Firms introduced from 1 January 2010 were put through this approval process, which also included a pilot phase to test the impact of the schemes on advisers' performance.

4.108. However, while the possibility of an adverse effect on adviser behaviour was generally noted, this process did not identify or test the potential impact of the specific higher risk features of the incentive schemes. Nor did the Firms review whether their existing systems and controls were adequate to manage and control the increased risk to customers that the incentive schemes gave rise to. Rather, the Firms relied on high level MI from the pilot as to the number of advisers who failed the risk gateway, without recognising its limitations.

4.109. It followed that there was a similar lack of oversight of the potential impact of key changes made to the incentive schemes and the control environment during the Relevant Period that further increased the risk to customers, specifically:

(1) the re-introduction of a different form of automatic demotion in LTSB from 1 January 2011;

(2) the introduction of automatic promotion and demotion in Halifax and BOS from 1 October 2010; and

(3) the changes made to Halifax's and BOS's risk gateways from January 2011.

4.110. In relation to the reintroduction of automatic demotion in LTSB from 1 January 2011, LTSB previously had a different version of this incentive feature, which was removed in October 2004 following an internal review to meet Treating Customers Fairly requirements. This was also the subject of discussions with the Authority during 2002-4. While the version of automatic demotion introduced by the Firms during the Relevant Period was not as high risk as the previous version, the Firms failed to consider the reasons for the previous removal in doing this.

Management Information (MI)

4.111. During the Relevant Period, the Firms produced monthly reports from their risk gateways to enable management to oversee on a high level the sales performance of advisers and their risk-ratings. However, given the significant deficiencies in the selection of sales for verification and the risk gateways (described above), such MI may have presented advisers who were responsible for a number of unsuitable or potentially unsuitable sales and/or complaints as rated Green or Amber, rather than Red.

4.112. In addition, the Firms did not produce MI that was sufficient to identify spikes or trends in advisers' sales, which might have indicated areas that warranted more appropriately risk-based monitoring and verification.

GIA's findings

4.113. A Group Internal Audit (GIA) report dated 14 November 2011, produced after the feedback provided by the Authority in August 2011 following the thematic visit but planned in September 2010, was particularly critical of the Firms' governance over the incentive schemes, noting that: '*Management does not have an effective governance framework for its remuneration and incentive schemes. Management has not fully assessed the risks or performed effective oversight of the schemes.'*

4.114. GIA identified that the root cause of its findings included '*the large number of people involved in the processes and the fragmented nature of the controls.*'

4.115. GIA also noted that: '*Management have not identified and sourced the correct information to provide oversight of scheme performance or identified the risks* *within the scheme. There is robust MI covering sales performance and quality but there is insufficient detail at a granular level to understand the split between fixed and variable pay and how this could impact seller behaviour*.'

5. FAILINGS

5.1. The Firms breached Principle 3 during the Relevant Period because they failed to take reasonable care to organise and control their affairs responsibly and effectively, with adequate risk management systems. Annex A sets out extracts from statutory and regulatory provisions and guidance relevant to this Final Notice.

Higher risk incentives

5.2. The Firms' incentive schemes included a number of higher risk features which created a significant risk that, if not adequately controlled, advisers would sell products to customers that they did not need or want, in an attempt to reach salary and bonus incentive thresholds.

Inadequate systems and controls

5.3. The Firms failed to take adequate steps to ensure that their systems and controls were sufficient to control the risks that arose from the incentive schemes. In particular:

(1) the systems and controls were not adequately focused on the specific higher risk features of the incentive schemes. The Firms relied on routine business monitoring that assessed sales deemed higher risk based on customer profiles, product features and/or a random sample of adviser sales, and failed to supplement this with appropriately risk-based monitoring that also focused on higher risk advisers;

(2) while advisers had to pass a risk gateway to be eligible for salary rises and bonuses, this control was flawed as advisers could pass even if a high proportion of the sales reviewed had been identified as unsuitable or potentially unsuitable; and

(3) although advisers were supervised by local sales managers, the Firms failed to identify that there was a potential conflict of interest due to the fact that sales managers' bonuses were based on the performance of advisers in their teams.

Inadequate governance

5.4. The Firms' failure to manage and control adequately the risks to customers that arose from the incentive schemes derived from serious deficiencies in their governance over the incentive schemes. The root cause of these deficiencies was the collective failure of the Firms' senior management to identify remuneration and incentives for advisers as a key area of risk requiring specific and robust oversight. During the Relevant Period there was inadequate committee oversight of the incentive schemes. There was also insufficient consideration given to the risks arising from the incentive schemes when approving them. This served to further increase the risks to customers.

5.5. MI was not sufficient to enable management to identify any patterns in advisers' sales activities that may have warranted closer monitoring.

6. SANCTION

Financial penalty

6.1. The Authority's policy for imposing a financial penalty is set out in Chapter 6 of DEPP. Where the gravamen of the conduct occurred on or after 6 March 2010, the Authority applies a five-step framework to determine the appropriate level of financial penalty to all of the conduct in question. DEPP 6.5A sets out the details of the five-step framework that applies in respect of financial penalties imposed on firms.

Step 1: disgorgement

6.2. Pursuant to DEPP 6.5A.1G, at Step 1 the Authority seeks to deprive a firm of the financial benefit derived directly from the breach where it is practicable to quantify this.

6.3. It is not practicable for the Authority to quantify any financial benefit that the Firms may have derived directly from their breaches at this stage. However, the Firms have agreed to carry out a review of sales conducted by higher risk advisers during the Relevant Period, and to provide redress to customers where appropriate.

6.4. Step 1 is therefore £0.

Step 2: the seriousness of the breach

6.5. Pursuant to DEPP 6.5A.2G, at Step 2 the Authority determines a figure that reflects the seriousness of the breach. Where the amount of revenue generated by a firm from a particular product line or business area is indicative of the harm or potential harm that its breach may cause, that figure will be based on a percentage of the firm's revenue from the relevant products or business area.

6.6. The Authority considers that the revenue generated by the Firms is indicative of the harm or potential harm caused by their breaches. The Authority has therefore determined a figure based on a percentage of the Firms' relevant revenue. The Firms' relevant revenue is the revenue derived by the Firms from the sales of investment and protection products by bancassurance teams in the Firms' branches during the period of the breaches.

6.7. The period of the Firms' breaches was from 1 January 2010 to 31 March 2012.

6.8. The Authority considers the Firms' combined relevant revenue for this period to be £212,415,491. This represents commissions earned by the Firms as distributors on premiums paid by their customers. The total comprises relevant revenue of £124,298,059 in respect of Lloyds TSB Bank plc and relevant revenue of £88,117,432 for Bank of Scotland plc.

6.9. Of the Firms' combined relevant revenue total, the revenue from investment products was £127,542,733 and the revenue from protection products was £84,872,758 i.e. approximately 60% of the Firms' relevant revenue was derived from sales of investment products, and approximately 40% from sales of protection products.

6.10. In deciding on the percentage of the relevant revenue that forms the basis of the step 2 figure, the Authority considers the seriousness of the breach and chooses a percentage between 0% and 20%. This range is divided into five fixed levels which represent, on a sliding scale, the seriousness of the breach; the more serious the breach, the higher the level. For penalties imposed on firms there are the following five levels:

Level 1 – 0%

Level 2 – 5%

Level 3 – 10%

Level 4 – 15%

Level 5 – 20%

6.11. In assessing the seriousness level, the Authority takes into account various factors which reflect the impact and nature of the breach, and whether it was committed deliberately or recklessly. DEPP 6.5A.2G(11) lists factors likely to be considered 'level 4 or 5 factors'. Of these, the Authority considers the following factors to be relevant:

(1) the breaches revealed serious weaknesses in the Firms' management systems and controls over a key strategic area of the Firms' business; and

(2) the breaches caused a significant risk of loss to customers.

6.12. The Authority also considers that the following factors are relevant:

(1) the Firms are leading providers of protection and investment products to retail customers in the UK. LTSB advisers sold over 630,000 products to over 399,000 customers during the Relevant Period. During the same period Halifax advisers sold over 380,000 products to over 239,000 customers and BOS advisers sold over 84,000 products to over 54,000 customers;

(2) the risk to customers was lower in relation to sales of investment products given that:

(a) sales advisers were incentivised to prioritise the sale of protection products over investment products;

(b) save for the period January to June 2010 for Halifax and BOS, the Firms conducted more extensive monitoring over sales of investment products which they generally viewed as higher risk (albeit that the increased risk arising from the incentive schemes was not the focus of this monitoring);

(3) following feedback from the Authority's thematic review, between October 2011 and the end of the Relevant Period, the Firms made substantial improvements to their systems and controls over advisers, which served to reduce the risk to customers. These improvements included:

(a) from October 2011 the introduction of exceptional performance monitoring for Halifax and BOS advisers;

(b) from November 2011 a further increase in the maximum risk gateway score for Advice Fails from 40 to 60;

(c) from November 2011 the removal of the ability for advisers to be promoted or demoted by more than one salary tier at a time;

(d) by the end of February 2012 the removal of automatic demotion completely; and

(4) the Authority's investigation focused on the Firms' systems and controls over the financial incentives that they gave to advisers: the Authority makes no findings in this Final Notice regarding the adequacy of the Firms' wider systems and controls over investment and protection product sales.

6.13. Taking all of these factors into account, the Authority considers the seriousness of the breach to be level 4 and so the Step 2 figure is 15% of £124,298,059 for Lloyds TSB Bank plc, plus 15% of £88,117,432 for Bank of Scotland plc.

6.14. The combined Step 2 figure for the Firms is therefore £18,644,708.85 for Lloyds TSB Bank plc, plus £13,217,614.80 for Bank of Scotland plc i.e. **£31,862,323.65**.

Step 3: mitigating and aggravating factors

6.15. Pursuant to DEPP 6.5A.3G, at Step 3 the Authority may increase or decrease the amount of the financial penalty arrived at after Step 2, but not including any amount to be disgorged as set out in Step 1, to take into account factors which aggravate or mitigate the breach.

6.16. The Authority considers that the following factors aggravate the breach:

(1) the Authority has for many years been warning firms of need to manage and control risks to customers arising from financial incentives given to sales staff, in particular in publications relating to the Authority's work on Treating Customers Fairly and payment protection insurance, including:

(a) 'Treating customers fairly – building on progress' (July 2005);

(b) 'The sale of payment protection insurance – results of thematic work' (November 2005);

(c) 'The sale of critical illness cover: results of thematic work' (May 2006);

(d) 'Treating customers fairly – culture' (July 2007);

(e) Liverpool Victoria Banking Services – Final Notice (July 2008);

(f) Alliance & Leicester – Final Notice (October 2008);

(2) many of the Firms' failings were discovered in the course of an Authority thematic review of risks to customers from financial incentives: were it not for the Authority's intervention the breach would have continued for a longer period, exposing more customers to risk of loss;

(3) in relation to the previous disciplinary record and general compliance history of the Firms:

(a) in September 2003, the Authority fined Lloyds TSB Bank plc £1.9 million for its conduct in selling high income bonds, which also resulted in it paying over £98 million in redress to customers. The Authority found that sales advisers in the firm's branch network were put under general pressure to meet targets, and that its failure to implement sufficiently rigorous controls over this contributed to unsuitable sales;

(b) Bank of Scotland plc has recently been the subject of disciplinary action by the Authority on a number of occasions:

(i) in May 2011, the Authority fined the firm £3.5 million in relation to its handling of complaints relating to retail investments;

(ii) in March 2012, the Authority imposed a public censure on the firm in relation to the management and control of its corporate lending;

(iii) in October 2012, the Authority fined the firm £4.2 million in relation to incorrect mortgage terms and conditions that it gave to standard variable rate customers;

(c) in February 2013, the Authority fined Lloyds TSB Bank plc, Lloyds TSB Scotland plc and Bank of Scotland plc £4.3 million for their failure to pay redress promptly to PPI complainants; and

(d) Lloyds Banking Group plc's provision for compensating customers who were mis-sold PPI was £6.325 billion as at the third quarter of 2013.

6.17. The Authority considers that the following factors mitigate the breaches:

(1) from the end of the Relevant Period the Firms continued to make changes to their advisers' financial incentives and improvements to their systems and controls, beyond those referred to in paragraph 6.12(3) above. The Firms now have in place a more robust governance and internal control framework that is specifically focused on mitigating any adverse impact on adviser behaviour;

(2) the Firms are in the course of carrying out a past business review of sales conducted by higher risk sales advisers during the Relevant Period, and will provide redress to customers where appropriate. This will:

(a) involve a review of sales files of advisers who worked in LTSB, Halifax and BOS branches during the Relevant Period, to identify potential sales quality issues;

(b) initially focus on sales conducted by the highest risk advisers, determined by analysing adviser behaviours by reference to the higher risk features of the incentive schemes described in this Final Notice;

(c) where potential sales quality issues are identified, the Firms will contact customers by telephone and/or letter to discuss the manner in which advisers sold them products and their suitability. Customers do not need to take any action as any customers identified by the review will be contacted by the Firms; and

(3) the Firms have co-operated with the Authority during its investigation.

6.18. Having taken into account these aggravating and mitigating factors, the Authority considers that the Step 2 figure should be increased by 10%.

6.19. Step 3 is therefore £20,509,179.735 for Lloyds TSB Bank plc, plus £14,539,376.28 for Bank of Scotland plc i.e. **£35,048,556.015**.

Step 4: adjustment for deterrence

6.20. The Authority considers that the Step 3 figure represents a sufficient deterrent to the Firm and others, and so has not increased the penalty at Step 4.

6.21. Step 4 is therefore **£35,048,556.015.**

Step 5: settlement discount

6.22. Pursuant to DEPP 6.5A.5G, if the Authority and the firm on whom a penalty is to be imposed agree the amount of the financial penalty and other terms, DEPP 6.7 provides that the amount of the financial penalty which might otherwise have been payable will be reduced to reflect the stage at which the Authority and the firm reached agreement.

6.23. The Authority and the Firms reached agreement at Stage 2 and so a 20% discount applies to the Step 4 figure.

6.24. Step 5 is therefore £16,407,343.788 for Lloyds TSB Bank plc and £11,631,501.024 for Bank of Scotland plc i.e. **£28,038,844.812**.

Conclusion on financial penalty

6.25. The Authority therefore imposes a combined financial penalty of **£28,038,800** on the Firms for breaching Principle 3.

7. PROCEDURAL MATTERS

Decision maker

7.1. The decision which gave rise to the obligation to give this Final Notice was made by the Settlement Decision Makers.

7.2. This Final Notice is given under, and in accordance with, section 390 of the Act.

Manner of and time for Payment

7.3. The financial penalty must be paid in full by the Firms to the Authority by no later than 24 December 2013, 14 days from the date of the Final Notice.

If the financial penalty is not paid

7.4. If all or any of the financial penalty is outstanding on 25 December 2013, the Authority may recover the outstanding amount as a debt owed by the Firms and due to the Authority.

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 Final Notice relates. Under those provisions, the Authority must publish such information about the matter to which this Final Notice relates as the Authority considers appropriate. The information may be published in such manner as the Authority considers appropriate. However, the Authority may not publish information if such publication would, in the opinion of the Authority, be unfair to the Firms or prejudicial to the interests of consumers or detrimental to the stability of the UK financial system.

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

Authority contacts

7.7. For more information concerning this matter generally, contact Andrew Wigston (direct line: 020 7066 6286 /fax: 020 7066 6287) of the Enforcement and Financial Crime Division of the Authority.

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Jamie Symington
Financial Conduct Authority, Enforcement and Financial Crime Division

ANNEX A

1. RELEVANT STATUTORY AND REGULTORY PROVISIONS AND GUIDANCE

Statutory provisions

1.1. Under section 2(2) of the Act, the protection of consumers is one of the Authority's statutory objectives.

1.2. 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 appears appropriate*."

1.3. The Firm is an authorised person for the purposes of section 206 of the Act. The requirements imposed on an authorised person include those set out in the Authority's Principles and rules made under section 138 of the Act.

1.4. The Authority's rule-making powers are set out in Chapter I of Part X of the Act (Rules and Guidance). The Authority has made rules, in particular those contained in SYSC, COB, COBS and DISP in accordance with its powers and provisions under this part of the Act.

The Principles for Businesses

1.5. Principle 3 states:

"A firm must take reasonable care to organise and control its affairs responsibly and effectively, with adequate risk management systems."

Authority's Senior Management Arrangements, Systems and Controls (SYSC)

1.6. SYSC 4.1.1 R (1) states:

"*A firm must have robust governance arrangements, which include a clear organisational structure with well defined, transparent and consistent lines of responsibility, effective processes to identify, manage, monitor and report the risks it is or might be exposed to, and internal control mechanisms, including sound administrative and accounting procedures and effective control and safeguard arrangements for information processing systems*."

1.7. SYSC 4.1.2 R states:

"*For a common platform firm, the arrangements, processes and mechanisms referred to in SYSC 4.1.1 R must be comprehensive and proportionate to the nature, scale and complexity of the common platform firm's activities and must take into account the specific technical criteria described in SYSC 4.1.7 R, SYSC 5.1.7 R and SYSC 7*."

1.8. SYSC 4.1.4 R states:

"*A firm (with the exception of a sole trader who does not employ any person who is required to be approved under section 59 of the Act (Approval for particular arrangements)) must, taking into account the nature, scale and complexity of the* *business of the firm, and the nature and range of the (for a common platform firm) investment services and activities or (for every other firm) financial services and activities undertaken in the course of that business:*

(1) *(if it is a common platform firm) establish, implement and maintain decision-making procedures and an organisational structure which clearly and in a documented manner specifies reporting lines and allocates functions and responsibilities;*

(2) *establish, implement and maintain adequate internal control mechanisms designed to secure compliance with decisions and procedures at all levels of the firm; and*

(3) *(if it is a common platform firm) establish, implement and maintain effective internal reporting and communication of information at all relevant levels of the firm*."

1.9. SYSC 4.1.10 R states:

"*A common platform firm must monitor and, on a regular basis, evaluate the adequacy and effectiveness of its systems, internal control mechanisms and arrangements established in accordance with SYSC 4.1.4 R to SYSC 4.1.9 R and take appropriate measures to address any deficiencies*."

1.10. SYSC 5.1.13 R states:

"*The systems, internal control mechanisms and arrangements established by a firm in accordance with this chapter must take into account the nature, scale and complexity of its business and the nature and range of (for a common platform firm) investment services and activities or (for every other firm) financial services and activities undertaken in the course of that business*."

1.11. SYSC 5.1.14 R states:

"*A common platform firm must monitor and, on a regular basis, evaluate the adequacy and effectiveness of its systems, internal control mechanisms and arrangements established in accordance with this chapter, and take appropriate measures to address any deficiencies*."

1.12. SYSC 6.1.1 R states:

"*A firm must establish, implement and maintain adequate policies and procedures sufficient to ensure compliance of the firm including its managers, employees and appointed representatives (or where applicable, tied agents) with its obligations under the regulatory system and for countering the risk that the firm might be used to further financial crime*."

1.13. SYSC 6.1.2 R states:

"*A common platform firm must, taking into account the nature, scale and complexity of its business, and the nature and range of investment services and activities undertaken in the course of that business, establish, implement and maintain adequate policies and procedures designed to detect any risk of failure by the firm to comply with its obligations under the regulatory system, as well as associated risks, and put in place adequate measures and procedures designed to minimise such risks and to enable the Authority to exercise its powers effectively* *under the regulatory system and to enable any other competent Authority to exercise its powers effectively under MiFID*."

1.14. SYSC 6.1.3 R states:

"*A common platform firm must maintain a permanent and effective compliance function which operates independently and which has the following responsibilities:*

(1) to monitor and, on a regular basis, to assess the adequacy and effectiveness of the measures and procedures put in place in accordance with SYSC 6.1.2 R, and the actions taken to address any deficiencies in the firm's compliance with its obligations;

(2) to advise and assist the relevant persons responsible for carrying out regulated activities to comply with the firm's obligations under the regulatory system."

1.15. SYSC 7.1.2 R states:

"*A common platform firm must establish, implement and maintain adequate risk management policies and procedures, including effective procedures for risk assessment, which identify the risks relating to the firm's activities, processes and systems, and where appropriate, set the level of risk tolerated by the firm*."

1.16. SYSC 7.1.3 R states:

"*A common platform firm must adopt effective arrangements, processes and mechanisms to manage the risk relating to the firm's activities, processes and systems, in light of that level of risk tolerance."*

1.17. SYSC 7.1.4 R states:

"*The senior personnel of a common platform firm must approve and periodically review the strategies and policies for taking up, managing, monitoring and mitigating the risks the firm is or might be exposed to, including those posed by the macroeconomic environment in which it operates in relation to the status of the business cycle."*