FINAL NOTICE

To: **Allied Dunbar Assurance plc**

Of: **UK Life Centre**
Station Road
Swindon
SN1 1EL

Date: 18 March 2004

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

1. THE PENALTY

1.1. The FSA gave Allied Dunbar Assurance Limited ("Allied Dunbar") a decision notice on 11 March 2004 which notified the firm that, pursuant to section 206 of the Financial Services and Markets Act 2000 ("the Act"), the FSA had decided to impose a financial penalty against Allied Dunbar in the amount of £725,000.

1.2. Pursuant to section 206 of the Act, and having agreed with Allied Dunbar the facts and matters relied upon and set out below the FSA imposes a financial penalty of £725,000 on Allied Dunbar in respect of breaches of:

(i) Personal Investment Authority ("PIA") Rules 1.3.1(2), 7.1.2, 7.1.5, 8.2.1, 8.2.4;

(ii) Securities and Investments Board ("SIB") Principles 2 and 9;

(iii) FSA Rules DISP 1.2.1 and DISP 1.2.22 and;

(iv) Principles 2, 3, and 6 of the FSA Principles for Businesses ("FSA Principles").

1.3. Allied Dunbar has confirmed that it does not intend to refer the matter to the Financial Services and Markets Tribunal.

2. REASONS FOR THE PENALTY

2.1 The FSA has imposed a financial penalty on Allied Dunbar in respect of breaches of the PIA Rules, SIB Principles, FSA Rules and FSA Principles identified in paragraphs 3.29 to 3.39 below that occurred between May 2001 and April 2003 and related to its

procedures for the handling of mortgage endowment complaints, the operation of those procedures, including the adequacy and appropriateness of investigations and outcomes, and the systems and controls in place for the monitoring of complaint handling.

2.2. Mortgage endowment policies are savings vehicles into which customers pay regular premiums with the aim of building up a sum to be used to pay off the capital amount owing on a mortgage.

2.3 The FSA considered that certain important aspects of Allied Dunbar's mortgage endowment complaints handling procedures were seriously flawed in that:

(a) complaint handlers were not directed to consider all the evidence about whether the original sales were suitable. A full and fair assessment of whether the original sales were suitable was not therefore made in every case; and

(b) an update to the guidance was issued by Allied Dunbar in June 2002 which specifically directed complaint handlers not to take account of wider suitability issues where customers did not mention risk in their original complaints. As a result, complaint handlers did not always uphold complaints even where it was apparent that the original sales were not suitable. In the event, only a small proportion of cases were affected by this guidance.

2.4 The FSA considered that Allied Dunbar's mortgage endowment complaint handling procedures were also flawed in that:

(a) they gave imprecise directions on the types of evidence to be taken into account by endowment complaint handlers in coming to their decisions about complaints, and insufficient guidance as to the weight to be attached to those different types of evidence. For example, in following the guidance, complaint handlers could and, in several cases examined by the FSA, did give disproportionate weight to sales advisers' versions of events;

(b) the complaint handling systems, including management information systems, produced inadequate information to identify risks of regulatory concern, particularly given the volume of endowment complaints received from 2002 onwards, beyond tracking the time taken to process complaints. Allied Dunbar's senior management focused disproportionately on quantitative issues, rather than on qualitative issues such as those described in paragraphs 2.3 and 2.4(a) above; and

(c) in a number of the complaint cases examined by the FSA, complaint handlers conducted poor quality investigations, failing to gather sufficient evidence or to make a fair assessment of that evidence, and may therefore have made unsound decisions to reject complaints.

2.5 It appeared to the FSA that, by its conduct, Allied Dunbar demonstrated failings that demand a significant financial penalty. These failings are viewed by the FSA as serious in light of the following factors:

(a) they occurred at a time when there was a high level of awareness and concern within the financial services industry of the potential problems surrounding mortgage endowment sales. In October 2000, the FSA announced that the appropriate mechanism for delivering redress in relation to mis-sales of mortgage endowments was through the complaint handling processes of firms. It therefore represents a significant risk to the FSA's consumer protection objective if firms do not handle mortgage endowment complaints fairly and effectively;

(b) they continued after and notwithstanding the letter John Tiner, then a Managing Director of the FSA, wrote to all firms in April 2002 ("the Tiner letter") setting out the FSA's concerns about mortgage endowment complaint handling and asking firms to revise their procedures in light of those concerns. Moreover, the update to the guidance issued by Allied Dunbar in June 2002 contradicted one of the points made in the Tiner letter;

(c) as a consequence of these failings, there was a risk that Allied Dunbar would fail to identify and respond appropriately in all cases where the original sales were not suitable; and

(d) the number and range of issues identified by the FSA on the individual complaints files that it reviewed, coupled with the size and nature of Allied Dunbar, meant that these failings exposed a large number of retail consumers to potential loss. In practice, the risk of actual loss was limited to those customers whose complaints were wrongly rejected. The total number of customer complaints rejected in the period of breach was around 1,000.

2.6 While the failings in this case merit a significant financial penalty, the FSA recognises that these failings have been substantially mitigated by Allied Dunbar, in particular for the reasons below:

(a) Allied Dunbar co-operated fully with the FSA's investigation;

(b) notwithstanding that the period of breach runs until April 2003, Allied Dunbar's Chief Executive signalled proactively in December 2002 the firm's intention to correct any defects in its procedures and to ensure that its customers are treated fairly, reflecting a stronger management culture. To that end, in discussion with the FSA, Allied Dunbar formulated a comprehensive plan to change its complaint handling procedures in a way which addressed the FSA's concerns, which it has now implemented;

(c) Allied Dunbar has undertaken to review by the end of April 2004 all complaints rejected since January 2000 in accordance with its new procedures. This should ensure that all complainants who have suffered loss as a result of the mis-sale of mortgage endowments will receive appropriate redress;

(d) notwithstanding the flaws identified by the FSA in the period of breach, Allied Dunbar made regular improvements to its complaint handling procedures. In particular, in October 2001, it introduced a more detailed approach to the way complaint handlers assessed suitability. Further, in March 2002, on its own

initiative, Allied Dunbar commissioned external consultants to carry out a review of all cases rejected since January 2000;

(e) from 2002/03 onwards, the proportion of cases which the Financial Ombudsman Service ("the FOS") found in Allied Dunbar's favour has met or exceeded the level that the FOS believes that firms should be seeking to achieve; and

(f) the FSA's concerns about Allied Dunbar's management information systems were fully addressed, for example, after Allied Dunbar updated its systems for recording and analysing data on individual complaint handlers.

2.7 Further, Allied Dunbar has changed substantially the senior management which was in place before December 2002.

2.8 It appears to the FSA that, having regard to its statutory objectives which include the protection of consumers, in the circumstances, £725,000 is an appropriate penalty. Were it not for the substantial number of mitigating factors, the penalty would have been significantly higher.

3. BACKGROUND

Introduction

Allied Dunbar

3.1 Allied Dunbar's ultimate parent is Zurich Financial Services ("Zurich").

3.2 Until 30 November 2001, Allied Dunbar was regulated by the PIA. Since then, it has been regulated by the FSA.

3.3 Allied Dunbar started selling mortgage endowment policies in 1983. It has sold 293,522 mortgage endowment policies since A-day, 29 April 1988, when regulation commenced under the Financial Services Act 1986.

Regulatory context

3.4 Allied Dunbar's failings should be placed in the regulatory context of 1999 to 2003.

3.5 In 1999, the FSA and the PIA started a programme of work on mortgage endowments to help ensure that consumers understood the consequences of the changed economic environment and to check that firms' selling practices and complaints-handling procedures were adequate.

3.6 Since the introduction of the PIA Rules in 1994, firms had been subject to an obligation to establish and maintain appropriate and effective written procedures for the proper handling of complaints and were required to ensure that each complaint was promptly and adequately investigated.

3.7 This obligation had particular importance in relation to mortgage endowments. The FSA publicly stated in December 1999 that an industry-wide review of mortgage endowment sales along the lines of the Pensions Review would be disproportionate, and in October 2000 that the appropriate mechanism for delivering redress in relation to mis-sales of mortgage endowments was through the complaints-handling processes of firms.

3.8 The October 2000 statement comprised the FSA's "Progress Report on Mortgage Endowments" which confirmed that the existing complaints-handling process, in conjunction with the issue and promotion of factsheets, was viewed by the FSA as the most effective way of ensuring redress for those consumers who had lost out as a result of mis-selling and that there were no grounds for a blanket industry-wide review.

3.9 The FSA stated in paragraph 3.23 of the Progress Report as follows:

"*It is in consumers' interests that the bulk of complaints arising on endowment mortgages are resolved, and promptly, by firms and these steps will help to ensure this is achieved. Firms are under a regulatory obligation to ensure that all complaints are properly and adequately investigated. The FSA monitors to check that firms are carrying out these obligations promptly and will act where it finds weaknesses that put consumer's interests at risk.*"

3.10 The FSA's factsheet, "Endowment Mortgage Complaints" was also released in October 2000. It explained how an endowment holder should take up any complaints with the firm which sold him the endowment, and how to take his case to the FOS if the firm's response was unsatisfactory. It also included information about how consumers could seek compensation if they felt they were in any way misled at the point of sale and may have lost out financially as a result. This factsheet was updated at regular intervals and was required to be included in the reprojection letters that firms were to send out to all mortgage endowment holders.

3.11 The importance of mortgage endowment complaints-handling processes was again highlighted again in November 2000, via Regulatory Update 80. In May 2001, the FSA announced it had finalised its guidance on how it expected firms responsible for mis-selling mortgage endowment policies to deal with complaints and to calculate redress due. Further information was issued in July 2001, via Regulatory Update 91.

The Tiner Letter

3.12 On 4 April 2002, the Tiner Letter was sent to all Chief Executives in the industry. This letter drew attention to the concerns of the FSA about the way in which mortgage endowment complaints were being dealt with. Most notably, its purpose was to accentuate the importance of fair handling of complaints. Firms were asked to respond to the letter and to review and, if necessary, to revise their complaints-handling procedures in the light of the concerns expressed.

3.13 The Tiner Letter was sent to Chief Executives of product provider firms and large IFA firms who were known to have sold mortgage endowment policies. The letter identified three main issues for the firms' attention:

(a) some firms were not assessing some or all of their consumer complaints fairly, particularly in respect of the assessment of consumers' understanding and acceptance of risk at time of sale;

(b) may firms' complaint handlers placed an over reliance on the decision tree process for complaints published by the FOS in June 2000; and

(c) it was important to consider each complaint separately and avoid the application of precedent (especially previous Ombudsman decisions in respect of other cases) without due regard to the facts of the specific case under review.

3.14 To support the three key issues, and in particular the first, the Tiner Letter included an annex which listed nine specific points. These nine points were provisional messages for firms wanting to avoid unfairness in respect of their complaint handling. Specifically, it was recommended that firms should:

(a) recognise in the assessment of the complaint that the key risk for the consumer is that the endowment may not repay the mortgage loan;

(b) avoid too narrow a view of the scope of the advisory duty in the context of mortgage advice;

(c) recognise that oral evidence can be good and sufficient evidence, avoiding too ready a dismissal of evidence from the consumer which is not supported by documentary proof;

(d) investigate the issue diligently in particular so as to take into account the selling practices at the time, the training, instruction, sales scripts and incentives given to advisers at the time and the track record of the particular adviser;

(e) go the extra mile to clarify ambiguous issues or conflicts of evidence before finding against the consumer;

(f) avoid making a conclusive assumption that a pre-existing endowment held at time of sale, whether for purposes of savings or mortgage repayment, is sufficient evidence of understanding and acceptance of key risk;

(g) avoid making too literal and narrow an interpretation of the issue of the complaint as expressed by the consumer;

(h) avoid rejecting complaints solely on the basis that the consumer signed a proposal form or failed to exercise the cancellation right and so must have presumed to have been satisfied with the advice and the product at time of sale; and

(i) avoid claiming as evidence of risk warning at time of sale (so as to justify rejection of the complaint) either:

- the absence of a statement in product literature that repayment of the mortgage was guaranteed; or

- a statement in product particulars that the firm will monitor the plan and advise the consumer if the level of contribution is insufficient for the target amount to be repaid.

Allied Dunbar's mortgage endowment complaint handling

3.15 Prior to March 2000, Allied Dunbar did not have special arrangements for dealing with mortgage endowment complaints. From March 2000 onwards, it developed separate procedures and principles for dealing with such complaints. These were amended on numerous occasions.

Allied Dunbar's key principles

3.16 Central to Allied Dunbar's principles on mortgage endowment complaint handling was the concept of a "risk profile suitability assessment" ("RPSA"). This test suggested that the key issue when considering the suitability of an endowment mortgage was whether the customer understood and accepted the risks associated with endowment mortgages. Allied Dunbar issued guidance about a variety of different sorts of evidence that could be considered when applying this test.

3.17 Allied Dunbar also issued guidance to its complaint handlers on the effect a customer's attitude to risk ("ATR") had on the suitability of the sale. Where a customer's ATR was recorded at the point of sale, this was considered as part of the RPSA.

Allied Dunbar's practice

3.18 Allied Dunbar used a combination of in-house staff and outsourced contractors organised into teams that dealt solely with mortgage endowment complaints. It operated a quality assurance procedure under which a member of staff would be granted autonomy to make decisions once a number of file checks had been passed. The work of individual complaint handlers was subject to quality control checks.

3.19 In June, November and December 2001, Allied Dunbar's internal audit identified some concerns about the way in which complaints had been dealt with. As a result, a review of all cases rejected in 2000 and 2001 was conducted by third party outsourcers.

3.20 Allied Dunbar produced management information on mortgage endowment complaints, which largely related to the number of cases received and dealt with. It did not include the uphold/reject rates of individual complaint handlers.

Discovery of current issues

3.21 In September 2002, the FSA's Major Financial Groups Division ("MFGD") carried out a focused supervision visit at Allied Dunbar, the purpose of which was to review

its procedures for dealing with mortgage endowment complaints. Following the visit, on 28 October 2002 MFGD wrote to Allied Dunbar outlining a number of concerns.

3.22 These matters were referred to the FSA's Enforcement Division ("Enforcement") and, between January and August 2003, Enforcement conducted an investigation which included a review of 55 endowment mortgage complaint files.

3.23 Separate to the FSA investigation, Allied Dunbar appointed PricewaterhouseCoopers ("PwC") on 1 November 2002 to review its endowment complaint handling systems and procedures. Allied Dunbar provided the FSA with a copy of PwC's report, which also identified weaknesses in Allied Dunbar's handling of mortgage endowment complaints. These weaknesses have since been addressed by Allied Dunbar in discussion with the FSA.

Relevant Statutory Provisions

3.24 Section 206 of the Act provides:

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

3.25 The Financial Services and Markets Act 2000 (Transitional Provisions and Savings) (Civil Remedies, Discipline, Criminal Offences etc) (No 2) Order 2001 ("the Pre-N2 Misconduct Order") provides, at Article 8(2), that the power conferred by Section 206 of the Act can be exercised by the FSA in respect of a failure by a firm to comply with any of the provisions specified in PIA Rule 1.3.1(6) as if the firm had contravened a requirement imposed by the Act.

3.26 PIA Rule 1.3.1(6) provided that a PIA Member which failed to comply with PIA Rule 1.3.1(2) or any of the SIB Principles is liable to disciplinary action.

3.27 The SIB Principles are universal statements of standards expected of regulated firms and applied to PIA members.

3.28 PIA Rule 1.3.1(2) provided that a PIA Member must obey the PIA Rules.

Systems and controls

3.29 PIA Rule 7.1.2 provided that a PIA Member must establish procedures with a view to ensuring that its staff carried out their functions in such a way that the Member complied at all times with the PIA Rules and SIB Principles.

3.30 PIA Rule 7.1.5 provided that a PIA Member must establish and maintain a system of internal control appropriate to the size and type of its business.

Complaint handling

3.31 PIA Rule 8.2.1 provided that a PIA Member must establish and maintain a written procedure for the proper and effective handling of complaints.

3.32 PIA Rule 8.2.4 provided that a PIA Member must ensure that each complaint was promptly and adequately investigated.

3.33 FSA Rule DISP 1.2.1 provides that a firm must have in place and operate effective internal complaint handling procedures.

3.34 FSA Rule DISP 1.2.22 provides that a firm must put in place appropriate management controls and take reasonable steps to ensure that it handles complaints fairly, consistently and promptly and that it identifies and remedies any recurring or systemic problems as well as any specific problem identified by a complaint.

SIB/FSA Principles

3.35 SIB Principle 2 provided that a firm must act with due skill, care and diligence.

3.36 SIB Principle 9 provided that a firm should organise and control its internal affairs in a responsible manner.

3.37 FSA Principle 2 provides that a firm must conduct its business with due skill, care and diligence.

3.38 FSA Principle 3 provides that a firm must take reasonable care to organise and control its affairs responsibly and effectively, with adequate risk management systems.

3.39 FSA Principle 6 provides that a firm must pay due regard to the interests of its customers and treat them fairly.

Relevant Guidance

3.40 The FSA's policy on the imposition of financial penalties is set out in Chapter 13 of the Enforcement Manual that forms part of the FSA Handbook ("ENF"). The principal purpose of a financial penalty is to promote high standards of regulatory conduct by deterring firms who have breached regulatory requirements from committing further contraventions, helping to deter other firms from committing contraventions and demonstrating generally to firms the benefits of compliant behaviour.

3.41 In determining whether a financial penalty is appropriate, and if so its level, the FSA is required to consider all the relevant circumstances of the case. ENF 13.3.3 sets out the factors that may be of particular relevance in determining the level of a financial penalty. The factors set out are not exhaustive (ENF 13.3.4).

3.42 Article 8(4) of the Pre-N2 Misconduct Order provides that, where the FSA is considering the imposition of a financial penalty, it must have regard to:

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

3.43 Relevant PIA guidance was contained in Annex D of "PIA's Approach to Discipline – Statement of Policy" (issued December 1995). In all material respects this guidance required consideration of the same factors as those identified in ENF 13. Further, this guidance made it clear that the criteria for determining the level of sanction are not to be applied rigidly. The FSA has taken this guidance into account in considering the appropriate sanction in this case.

3.44 The FSA considers that the following factors (which are expressed in terms of both the FSA and the equivalent PIA guidance) to be particularly relevant in this case:

ENF 13.3.3(1): The seriousness of the misconduct or contravention
PIA guidance: The seriousness of the breaches

3.45 The level of the financial penalty should be proportionate to the nature and seriousness of the contraventions. The breaches identified in this case were potentially very serious.

3.46 Compliance with regulatory rules relating to complaint handling is particularly important, because the complaint handling process is required to identify cases of mis-selling and provide the consumer with appropriate redress. Compliance with these rules in relation to mortgage endowment complaints is particularly significant because of the well-known problems with mortgage endowment sales, and the FSA's announcement in October 2000 that firms' complaint handling systems are the appropriate mechanism for dealing with those problems.

3.47 From May 2001, important aspects of Allied Dunbar's endowment complaint handling guidance were flawed. Although some subsequent amendments cured certain defects, others created new flaws.

3.48 Allied Dunbar did not respond adequately to the opportunity to review and amend its procedures in light of the Tiner letter. In particular, the guidance it issued by the firm in June 2002 contradicted one of the recommendations in the Tiner letter.

3.49 Although Allied Dunbar had a programme of continual improvement to its procedures, the flaws in this case were discovered by the FSA. Given the firm's volume of sales of endowments (nearly 300,000), and the increasing number of complaints relating to these sales, the risk of loss to consumers whose complaints are wrongly rejected was considerable. However, in setting the level of financial penalty the FSA has taken into account that, in practice, the risk of actual loss was limited to those customers whose complaints were wrongly rejected. The total number of customers complaints rejected in the period of breach was around 1,000.

ENF 13.3.3(2): The extent to which the contravention was deliberate or reckless
PIA guidance: Whether the member deliberately or recklessly failed to meet PIA's requirements

3.50 There is no evidence that Allied Dunbar deliberately breached PIA or FSA Rules or requirements. However, its failure to review adequately its procedures to ensure that they complied with the recommendations in the Tiner letter, coupled with its issuing

of specific guidance which contradicted one of those recommendations, is a serious aggravating factor.

ENF 13.3.3(3): The size, financial resources and other circumstances of the firm
PIA guidance: The extent to which the member's governing body or senior management was culpable. The member's ability to pay

3.51 Allied Dunbar's ultimate parent Zurich is described as one of the largest insurance companies in the world with over 30 million customers and shareholders' equity of US$16.8 billion. Allied Dunbar itself has approximately £19 billion invested on behalf of its 1.5 million customers. There is no doubt as to Allied Dunbar's ability to pay the proposed penalty.

ENF 13.3.3(4): The amount of profit accrued or loss avoided
PIA guidance: The extent to which, as a result of the breaches, the member gained benefit or avoided loss

3.52 There is no evidence that Allied Dunbar deliberately set out to accrue additional profits as a result of its failings.

ENF 13.3.3(5): Conduct following the contravention
PIA guidance: The firm's response once the breaches were identified

3.53 On 22 November 2002, in its substantive response to concerns raised by the FSA (following the FSA's letter of October 2002) Allied Dunbar accepted the need for some minor changes, but gave a robust defence of its existing complaint handling procedures. The FSA considers on balance the position adopted by Allied Dunbar in its response to be an aggravating factor.

3.54 However in mitigation, on 1 November 2002, Allied Dunbar appointed PwC to carry out a review of its complaint handling process. Further in December 2002, Allied Dunbar signalled a commitment to the FSA to put right any defects in its complaint handling procedures. In June 2003, Allied Dunbar notified the FSA of its proposals for a complete overhaul of its procedures, including a further review of complaints previously rejected against its revised procedures. By August 2003, Allied Dunbar had implemented its new procedures. Allied Dunbar anticipates that it will complete its review of cases previously rejected by the end of April 2004.

ENF 13.3.3(6): Disciplinary record and compliance history
PIA guidance: The firm's regulatory history

3.55 Allied Dunbar has no disciplinary record.

ENF 13.3.3(7): Previous action taken by the FSA in relation to similar behaviour by other firms

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

3.56 The FSA has previously taken action against Friends Provident for breaches of rules specifically relating to mortgage endowment complaint handling. The FSA and PIA

have taken action against firms for complaint handling defects, mortgage endowment mis-selling and breaches of rules relating to the pension review, and these cases have been taken into consideration insofar as they present relevant similarities to the instant case.

Facts and Matters Relied On

Suitability

3.57 A key issue to be determined when considering a customer complaint about a mortgage endowment is whether the endowment was suitable for the customer.

3.58 Principles issued by Allied Dunbar in March 2000 referred to this and, in December 2000, its internal guidance suggested that the RPSA was to be applied to all complaint cases as part of the overall suitability assessment. However, no other guidance was issued as to what other material or facts complaint handlers should consider when assessing suitability. In October 2001, more detailed guidance was provided. However, that guidance was materially inadequate. For example, it gave complaints handlers imprecise directions as to the weight to be attached to the different types of evidence obtained from their investigations.

3.59 Guidance issued by Allied Dunbar tended to suggest that, where there was evidence to demonstrate that the customer was aware of the risks attached to mortgage endowments and accepted them, the complaint should be rejected. The guidance should have clearly directed complaint handlers that the customer's understanding and acceptance of risk was just one matter to look at when considering suitability.

Restrictions on complaint handler's role

3.60 An update to the guidance, issued by Allied Dunbar in June 2002, restricted the ability of complaint handlers to uphold a complaint where the sale was plainly unsuitable, in cases where the customer had not referred to risk in their complaint. Notwithstanding the points made in the Tiner letter**,** the update stated that, where the complaint was not risk-based, the complaint handler should conclude that the RPSA was immaterial, unless there was other evidence to suggest that the adviser did not adequately explain the risks. This meant that there was no obligation on a complaint handler to carry out an appropriate assessment of suitability issues relating to risk when the customer did not raise such issues, even where it was apparent that the sales file did not demonstrate suitability.

3.61 This defect was also present in a briefing note provided to the FSA by Allied Dunbar that purported to apply to outsourced staff carrying out the review of rejected cases. It was particularly important that reviewers should have had an unrestricted ability to review all aspects of the sale, but this briefing note limited that ability.

3.62 The deficiency was also identified by PwC, who concluded that there were three areas where a wider suitability assessment was required. These areas were: attitude to

mortgage risk at point of sale, terms extending beyond normal retirement date, and policies sold on a low-start, escalating premium basis.

Evidence of previous products bought by complainants

3.63 Allied Dunbar's guidance on the evidence that could be used when determining whether the customer understood and accepted risk was seriously flawed.

3.64 In March 2000, Allied Dunbar produced a list of the types of information likely to counter a customer's allegation that they believed the endowment was guaranteed to pay off the mortgage. This list made a number of appropriate suggestions as to what could constitute evidence rebutting such an allegation (e.g. point of sale documentation setting out the non-guaranteed nature of product or fact find confirms that discussions took place about that). However, it also stated that any additional evidence that the client was prepared to accept investment risk, such as evidence of previous endowments or significant equity-based investments, could be used to rebut a such a complaint.

3.65 Evidence of previous endowments or equity-based investments should carry little weight in assessing whether a client understood or accepted the risk at the time of sale that an endowment might not pay off their mortgage at the end of its term. It was wrong for Allied Dunbar to include evidence of this sort in a list of the types of evidence that may rebut a client's allegation without giving any warning about its limited evidential value.

3.66 Guidance issued by the firm in June 2001 indicated to staff that existing endowments/equity based investments should not be used as evidence that the risk was understood by the client.

Attitude to risk

3.67 Allied Dunbar failed to adopt a clear and consistent position on the issue of ATR. Also, its complaint handling procedures did not properly take account of the fact that sales advisers often failed to record ATR at the point of sale. Only one of 17 fact finds signed between 8 May 1998 and 19 June 2002 and reviewed by PwC contained a completed numeric ATR scale. ATR scales played a highly significant part in the guidance issued to complaint handlers, yet the firm gave no indication to complaint handlers that ATR scales would often be missing.

Adviser complaint history

3.68 Allied Dunbar failed to instruct complaint handlers to consider the sales adviser's complaint history, even though such information may have assisted the complaint handler in deciding which version of events was correct.

Complaint files

3.69 In the course of its investigation, Enforcement reviewed 55 complaint files. Most of the complaints in that sample had been rejected under Allied Dunbar's complaint handling procedures. The specific issues identified by this review included:

(a) ***Suitability issues***

(i) failure to identify that there was insufficient evidence at the point of sale about the customers' ATR to demonstrate that the sale was suitable and failure to identify that the complaint file contained insufficient evidence of a need for life cover at the point of sale to justify suitability of the sale; and

(ii) rejection of complaints because the customers had not complained about the risk or guarantee issue, even where there was strong evidence that the sale was unsuitable anyway;

(b) ***Identification/categorisation of complaint issues***

failure to address some specific issues raised by the customers;

(c) ***Fairness of communication issues***

failure to give customers the opportunity to respond to material relied upon in making the decision to reject their complaint;

(d) ***Evidential issues***

failure to give an adequate explanation as to why weight was given to the adviser's account over the customer's account, failure to give sufficient weight to the customer's account and failure to give due weight to point of sale evidence supporting the customer's account;

(e) ***Review issues***

recording complaints as non-justified against advisers, notwithstanding evidence pointing to unsuitable sales, including one case where it appeared that the reviewer was actively seeking to defend the case rather than make a balanced assessment.

Management information

3.70 Allied Dunbar was unable to produce management information showing the uphold and reject rates of individual complaint handlers. Taking into account the volume and size of its complaint handling operations and the degree of risk associated with this area of its business, Allied Dunbar should have been able to produce such management information, which would have provided a high-level early warning sign of any unusual complaint handler results.

3.71 Without such information, there was a real risk that Allied Dunbar would fail to identify measure, manage and control risks of regulatory concern, particularly after

volumes of complaints increased sharply in 2002. The absence of such information undermined the effectiveness of Allied Dunbar's endowment complaint handling system, as it led to a risk that complaints would not be dealt with consistently.

3.72 Allied Dunbar has confirmed that these concerns were addressed following an update, effective from the beginning of 2003, to its systems to track data on individual complaint handlers.

4. MANNER OF PAYMENT

4.1 The Penalty must be paid to the FSA

5. TIME FOR PAYMENT

5.1 The Penalty must be paid to the FSA no later than 1 April 2004, being not less than 14 days beginning with the date on which this notice is given to you.

6. IF PENALTY NOT PAID

6.1 If all or any of the Penalty is outstanding on 1 April 2004, the FSA may recover the outstanding amount as a debt owed by you and due to the FSA.

7. IMPORTANT

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

Publicity

7.2 Section 391(4), 391(6) and 391(7) of the Act apply to the publication of information about the matter to which this notice relates. Under those provisions, the FSA must publish such information about the matter to which this notice relates as the FSA considers appropriate. The information may be published in such manner as the FSA

considers appropriate. However, the FSA may not publish information if such publication would, in the opinion of the FSA, be unfair to you or prejudicial to the interests of consumers.

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

FSA Contacts

7.4 For more information concerning this matter generally, you should contact Carlos Conceicao at the FSA (direct line: 0207 066 1174/fax: 020 766 1175).

Julia M R Dunn
Head of Retail Selling
FSA Enforcement Division