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## FINAL NOTICE

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To: **Aviva Pension Trustees UK Limited ("APTUKL")**  
**Aviva Wrap UK Limited ("AWUKL")**

Reference  
Numbers: **APTUKL: 465132**  
**AWUKL: 231530**

Date: **5 October 2016**

### **1. ACTION**

- 1.1. For the reasons given in this notice, the Authority imposes on APTUKL and AWUKL (together, "the Firms") a financial penalty of £8,246,800.00.
- 1.2. The Firms agreed to settle at an early stage of the Authority's investigation. The Firms therefore qualified for a 30% (stage 1) discount under the Authority's executive settlement procedures. Were it not for this discount, the Authority would have imposed a financial penalty of £11,781,262.00 on the Firms.

### **2. SUMMARY OF REASONS**

- 2.1. On the basis of the facts and matters described below the Authority finds that between 1 January 2013 and 2 September 2015 ("the Relevant Period"), the Firms breached Principle 3 (Management and Control) and Principle 10 (Clients' Assets) of the Authority's Principles for Businesses ("the Principles") and associated rules in the Client Assets sourcebook ("the CASS Rules"). The Firms

also breached a number of rules in Chapter 8 (Outsourcing) of Senior Management Arrangements, Systems and Controls sourcebook ("SYSC").

### **Breach of Principle 3**

2.2. During the Relevant Period the Firms breached Principle 3, and a number of CASS and SYSC Rules, by failing to take reasonable care to ensure that they established and implemented adequate controls over the Third Party Administrators ("TPAs") to which they had outsourced the administration of client money and external reconciliations in relation to custody assets. In particular, the Firms:

- (1) failed to put in place adequate organisational arrangements for the safeguarding of client money and safe custody assets or to ensure effective oversight of outsourced CASS functions (CASS 6.2.2R, CASS 7.12.2R (formerly CASS 7.3.2R) and SYSC 8.1.8R);
- (2) failed to dedicate sufficient resource and technical expertise to enable them to implement effective CASS oversight arrangements; and
- (3) failed to prioritise sufficiently CASS compliance, resulting in inadequate oversight of the outsourced CASS functions and their delayed detection and rectification of CASS risks and compliance issues.

### **Breach of Principle 10**

2.3. During the Relevant Period the Firms also breached Principle 10, and a number of CASS and SUP Rules, by failing to arrange adequate protection for client money and safe custody assets for which they were responsible. In particular, the Firms:

- (1) failed to identify and promptly rectify certain issues within their internal client money reconciliation process which were subsequently identified and/or confirmed by the Authority, the Skilled Person and the Firms' external CASS auditors. These issues included the Firms' under-segregation of client money, which during the period from 10 February 2014 to 9 February 2015 peaked at £74.4m;
- (2) mislabelled transactions within the Firms' client money calculations (CASS 7.6.2R and CASS 7.15.3R);
- (3) failed to submit accurate Client Money and Asset Returns ("CMARs") (SUP 16.14.3(R)(1));

- (4) failed to ensure the adequate and accurate segregation of client money;  
and
- (5) held inadequate CASS resolution packs ("CASS RPs") (CASS 10.1.3R).

2.4. Compliance with the CASS Rules is important to ensure client money and custody assets are adequately protected at all times. This is particularly important prior to insolvency to ensure that the wind-down of a firm in the event of insolvency is carried out in as orderly a manner as possible and in a way that reduces the risk of loss of clients' money and safe custody assets. A firm's compliance can have a mitigating effect in an insolvency process and is something over which a firm has ultimate responsibility and control. It is in this context that the Authority views breaches of the CASS Rules, and a firm's failure to comply with those rules, as a particularly serious matter.

2.5. The Authority considers the Firms' failings to be serious for the following reasons:

- (1) given their responsibility for CASS compliance, it was not appropriate for the Firms to outsource functions to TPAs without having sufficient oversight arrangements in place;
- (2) CASS Rules breaches were identified in the Firms' annual external CASS audit reports for consecutive years, indicating that the Firms had failed to implement adequate measures to address these throughout the Relevant Period; and
- (3) some of the Firms' failings were drawn to the Firms' attention by the Firms' external CASS auditors, the Authority and the Skilled Person, rather than through their own compliance monitoring. During the Relevant Period, the Firms' internal audit reviews were infrequent and oversight of the outsourced CASS functions was inadequate.

2.6. The Authority has taken into account that:

- (1) once it was identified that the Firms were not compliant with the CASS oversight requirements, they committed significant internal and external resources to investigating and remediating the issues outlined in this Notice, and in strengthening CASS resource and oversight;

- (2) specifically, the Firms have made significant improvements in the application of dedicated CASS resource, and in strengthening the oversight of the TPAs' work and the associated controls;
  - (3) the Firms showed a significant degree of co-operation during the Skilled Person review and the investigation of the issues by the Authority;
  - (4) it has not found that the Firms acted deliberately or recklessly; and
  - (5) although client money and safe custody assets were at risk of some loss, there was no actual loss of any client money or safe custody assets.
- 2.7. Ensuring the CASS Rules are adhered to supports the Authority's operational objectives of securing an appropriate degree of protection for consumers and protecting and enhancing the integrity of the UK financial system.
- 2.8. The Authority therefore imposes a financial penalty on the Firms in the amount of £8,246,800.00 pursuant to section 206 of the Act.

### **3. DEFINITIONS**

- 3.1. The definitions below are used in this Decision Notice:

"the Act" means the Financial Services and Markets Act 2000;

"APTUKL" means Aviva Pension Trustees UK Limited;

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

"AWUKL" means Aviva Wrap UK Limited;

"the CASS Rules" means the rules and guidance set out in the Client Assets sourcebook chapter of the Authority's Handbook;

"the CASS Visit" means the Authority's CASS Department's supervisory visit to the Firms between 9 and 11 February 2015;

“Client Money Rules” means Chapter 7 of the CASS Rules (as defined above);

“CMAR” means Client Money and Asset Return as defined in the Authority’s Handbook;

“Custody Rules” means Chapter 6 of the CASS Rules (as defined above);

“DEPP” means the Authority’s Decision Procedure and Penalties Manual;

“EG” means the Enforcement Guide;

“the Firms” means AWUKL and APTUKL together;

“IFAs” means Independent Financial Advisors;

“Policy Statement 14/9” means the Review of the client assets regime for investment business published by the Authority on 10 June 2014;

“the PRA” means the Prudential Regulation Authority;

“Principles” means the Authority’s Principles for Businesses;

“the Relevant Period” means the period from 1 January 2013 to 2 September 2015 inclusive;

“the Skilled Person” means the firm appointed in August 2015 under section 166 of the Act to provide a report to the Authority on the Firms’ compliance with the CASS Rules;

“the Skilled Person Report” means the report issued by the Skilled Person on 29 January 2016 consequent to the Authority’s exercise of its power under section 166 of the Act in relation to the Firms;

“SYSC” means the part of the Authority’s Handbook which has the title Senior Management Arrangements, Systems and Controls;

“the TPAs” means the Third Party Administrators to which the Firms outsourced their CASS functions during the Relevant Period; and

“the Tribunal” means the Upper Tribunal (Tax and Chancery Chamber).

#### **4. FACTS AND MATTERS**

##### **Background**

- 4.1. The Firms are UK incorporated entities and are both part of the Aviva group of companies. AWUKL is a wholly owned subsidiary of Aviva Life Holdings UK Limited, which in turn is a subsidiary of Aviva PLC. APTUKL is a wholly owned subsidiary of Aviva Life & Pensions UK Limited whose 100% ultimate beneficial owner is also Aviva PLC.
- 4.2. AWUKL’s principal business activity is operating the Aviva Wrap online platform. Clients can invest via their IFAs in a range of funds, equities and structured products, with the option of holding their investments in a tax efficient wrapper (either an ISA account or, in the case of APTUKL, a self-invested personal pension or ‘SIPP’). APTUKL acts as both operator and trustee of the Aviva Personal Pension Plan in addition to a number of smaller schemes including a number of SIPPs.
- 4.3. The average daily balance of the client money and custody assets accounts during the Relevant Period for AWUKL was £64,410,913.00 and £1,409,841,850.00 respectively. The average daily balance of the client money accounts during the Relevant Period for APTUKL was £189,132,662.00.
- 4.4. A number of CASS issues were identified in the Firms’ annual external CASS audit reports, which should have prompted the Firms to undertake a wider review of their client money and custody asset compliance:
  - (1) the 2013 external CASS audit report for AWUKL identified issues with AWUKL’s internal client money reconciliations and raised concerns regarding the Firms’ maintenance of accurate safe custody asset records (CASS 6.5.2R), particularly given the Firms’ outsourcing to a TPA of external reconciliations in relation to custody assets;
  - (2) AWUKL’s failure to have adequate organisational arrangements in place in relation to its reconciliation processes in breach of CASS 6.2.2R. The auditors noted in the 2012 external CASS audit report for AWUKL that a

distribution value of £111.69 was received for an asset which was not on the Firms' system which prevented the money being applied to the appropriate client's account;

(3) although AWUKL advised the auditors that a revised and strengthened reconciliation format had been implemented in June 2012, four instances of AWUKL's non-compliance with CASS 6.5.10R were identified in the 2013 audit resulting from its failure to promptly identify and correct discrepancies identified by safe custody asset reconciliations, involving assets with an approximate aggregate value of £1,000; and

(4) concerning the Firms' use of a non-standard client money calculation CASS 7.6.8R (currently CASS 7.13.58R), the Authority noted that the Firms' method of internal client money reconciliation did not provide the degree of protection provided by the standard method as set out in CASS 7 Annex 1 G. The Authority notes that the Firms' external auditor confirmed in May 2015 that the Firms' method of internal client money reconciliation did provide that degree of protection.

4.5. The external CASS auditor findings for both AWUKL and APTUKL should have prompted the Firms to reassess and re-categorise CASS compliance as potentially high risk.

4.6. In February 2015, the Authority's CASS Department visited the Firms. During the visit the Authority identified the same and similar CASS compliance issues to those identified by the external auditors. These issues were confirmed to the Firms in a letter of 10 August 2015, which included the following concerns:

(1) serious deficiencies in the Firms' governance and oversight of CASS functions;

(2) the Firms' lack of individuals with combined CASS and financial experience;

(3) a convoluted committee structure which, in particular, lacked any dedicated committee for overseeing the Firms' outsourced CASS functions;

(4) a lack of CASS specific compliance monitoring reports, particularly given the breadth of the rule changes following Policy Statement 14/9 and the

Firms' compliance history based on earlier external CASS audit reports;

- (5) mislabelling of transactions within the client money calculation, prompting wider concerns regarding the Firms' failure to maintain accurate records and accounts and inadequate organisational arrangements; and
- (6) inaccuracies with the Firms' CMAR submissions given that the Firms had made disclosures which were inconsistent with SUP 16.14.3.R.

4.7. Based on the number and gravity of the Firms' failures to comply with the CASS Rules identified during the CASS Visit, the Authority required the Firms to appoint a Skilled Person to conduct an independent review of the Firms under section 166 of the Act.

#### **The Skilled Person Report**

4.8. In August 2015, the Authority required the Firms to provide a Skilled Person's report under section 166 of the Act. On 29 January 2016, the Skilled Person issued its report, which confirmed issues identified during the CASS Visit and expanded on the issues previously identified by the Firms' external CASS audit reports. The findings included:

- (1) inadequacies with the Firms' organisational arrangements for the safeguarding of client money and custody assets resulting in the Firms' inadequate management and oversight of TPAs in respect of outsourced CASS functions. The Skilled Person confirmed the following specific failings with the Firms' oversight and safe custody arrangements:
  - a) deficiencies with the Firms' reconciliation processes resulting in the over-and under-segregation of client money with the Firms' under-segregation having peaked at approximately £74.4m during the period from 10 February 2014 to 9 February 2015;
  - b) inadequate first (business) and second (compliance) lines of defence in relation to the Firms' submission of inaccurate CMARs;
  - c) inaccuracies/failings with the Firms' CASS RPs in breach of CASS 10.1.3R;



- d) the inadequacy of the management information ("MI") provided to senior management in relation to CASS breaches, particularly in relation to the Firms' outsourcing of CASS functions to TPAs; and
  - e) concerning the Firms' use of a non-standard client money calculation, the Skilled Person confirmed that the Firms' method of internal client money reconciliation did not provide the degree of protection provided by the standard method as set out in CASS 7 Annex 1 G. ((CASS 7.15.18R and 7.6.8R) and Annex 1G).
- (2) the Firms' failure to dedicate sufficient resource and technical expertise to enable the Firms to implement effective CASS compliance oversight programs; and
- (3) the Firms' failure to prioritise sufficiently CASS compliance, resulting in the delayed detection and rectification of CASS risks and compliance issues.

**Inadequate organisational arrangements to ensure effective oversight of outsourced CASS functions**

- 4.9. Outsourcing arrangements are common in the asset management industry in relation to purchases and sales of investment fund interests for clients. TPAs typically perform back office activities such as cash and transaction processing, settlement, record keeping, reconciliations and similar CASS compliance functions.
- 4.10. In such circumstances, since a firm is one step removed from CASS operations as a result of its outsourcing arrangements with a TPA, a heightened CASS compliance risk may arise. A firm is therefore required to ensure that it has robust controls and oversight systems in place to monitor and identify any issues arising with the TPA's performance of the CASS functions for which the firm remains fully responsible. This also requires that a firm outsourcing CASS functions ensures that it has adequate CASS skills, expertise and resources to carry out effective oversight of the TPA.
- 4.11. During the Relevant Period, the Firms outsourced to TPAs the administration of their client money and external reconciliations in relation to custody assets. However, during the Relevant Period, the Firms failed to ensure effective

oversight of the TPAs.

- 4.12. In particular, the Firms failed to put in place dedicated CASS committees to ensure the prompt identification and remediation of any issues relating to the TPAs' performance of outsourced CASS functions. Given the recurrence of CASS failings identified by their external CASS auditors, the Firms should have been aware of prevailing issues with their outsourcing of CASS functions and taken steps to ensure that closer monitoring was undertaken of TPAs. The Firms have now set up joint governance committees to oversee the CASS outsourcing arrangements.
- 4.13. The Firms' oversight was also compromised by design limitations detected in the Firms' review processes. For example, the checks which the Firms undertook in relation to their reconciliation processes were informal and lacked consistency. A number of incidences were identified in which weekly reconciliation checks had not been completed. There were also delays in the Firms' identification and rectification of reconciliation inaccuracies and a more general lack of guidance on the reconciliation processes. This also resulted in the Firms' failure to sufficiently challenge the internal controls, competence and resources of the TPAs.
- 4.14. Similar weaknesses were identified in relation to the Firms' escalation process for CASS related issues. The Firms provided no routine CASS updates, with reports only being made when CASS issues occurred. As a result senior management did not receive sufficient assurance on the Firms' CASS compliance in respect of routine CASS activities.
- 4.15. During the Relevant Period, the Firms did not have adequate control frameworks in place to identify, assess and escalate material information about CASS risks and compliance to the Firms' respective Boards. There was insufficient consideration by senior management of the operational effectiveness of the Firms' CASS functions during the Relevant Period. For a substantial part of the Relevant Period, there was insufficient oversight of CASS compliance by the Firms' existing committee structures.
- 4.16. Inadequacies with the quality of the Firms' MI were also identified which further undermined the efficacy of the Firms' oversight of outsourced CASS functions. For example, incomplete MI was provided in relation to the reconciliation of

items which remained outstanding after 30 days. Moreover, the MI provided at senior management level did not include resolution dates for actions and thereby hindered the ability of the Firms' senior management to track the resolution of CASS issues.

- 4.17. In addition, monthly "*spot checks*" lacked key information such as when each check was carried out, by whom and the outcomes of each individual check. This compromised the quality of information being provided to senior management on CASS compliance issues. On occasion, there was inaccurate reporting of the outcomes of spot checks by the Firms' business to the Firms' senior management. The September 2014 spot check carried out in relation to the Firms' internal client money reconciliations confirmed an error within the Firms' calculations but the negative outcome of this spot check was not included in the MI provided to senior management which may have delayed and/or prevented senior management from detecting possible CASS breaches.

#### **Inadequate reconciliation processes**

- 4.18. During the Relevant Period, the Firms operated a non-standard internal client money reconciliation method. However, during the CASS Visit, a number of issues with the Firms' internal reconciliation process were identified which had resulted in the under- and over-segregation of client money.
- 4.19. Client money relating to trade purchases was removed from clients' accounts before trades settled. The Firms also failed to set aside funding for returned cheques in the reconciliation process which meant that purchases could potentially be funded using other clients' money. During the Relevant Period, these failings in the Firms' internal reconciliation processes resulted in under-segregation of client money in amounts ranging from £0.4m to £74.4m during the period from 10 February 2014 to 9 February 2015.
- 4.20. There were also a number of weaknesses in the design of the Firms' oversight of their reconciliation processes. For example, the spread sheets which the Firms used to record data in the daily and weekly reconciliation checks did not provide any guidance or parameters to ensure the consistency of checks conducted. There was also no record of who was scheduled to conduct the daily and weekly checks and whether those checks had been conducted and if so, by whom.

- 4.21. The Skilled Person conducted test sampling on a number of the internal reconciliations produced by the Firms and the internal controls and checks conducted on those reconciliations. This sampling identified that for 12 out of 60 reconciliations reviewed no weekly check had been carried out, thereby indicating that there was insufficient resourcing within the Firms' oversight team since the weekly check was required to ensure that the requisite daily checks had been properly conducted. The test sampling also revealed that even when the daily and weekly checks had been conducted, the checks could be conducted by any member of the Firms' oversight team. This resulted in a lack of consistency in the checking approach.
- 4.22. These findings in relation to the Firms' peer reviews are indicative of the inadequate resourcing in relation to their reconciliation processes. These deficiencies were compounded by the absence of any formal CASS training for staff involved in the Firms' internal reconciliation processes.

#### **Client Money and Assets Return ("CMAR")**

- 4.23. During the Relevant Period, the Firms lacked a formal system or adequate guidance in relation to the CMAR process and controls, including in respect of the requirement for the submission of a monthly CMAR. The Firms' CMAR procedures did not identify who was responsible for the completion and review of the Firms' submissions. The Firms also failed to provide proper guidance on the extent of review required prior to the Firms' submission of their CMARs to the Authority.
- 4.24. In addition, the Firms had inadequate processes in place for dealing with CMAR breaches identified before and after submission to the Authority and the Firms failed to undertake any formal actions to ensure that CMAR breaches did not re-occur.
- 4.25. The Firms relied on summary data provided by the TPAs as input data for the Firms' CMAR submissions. The Firms also had inadequate technical expertise to effectively challenge the accuracy of the external data which resulted in delays in the Firms' detection of CMAR inaccuracies.
- 4.26. A sample of the Firms' CMARs which included the Firms' June 2015 CMARs identified discrepancies between the Firms' internal reconciliations for 30 June

2015 and the Firms' client money resource and requirement reported to the Authority.

- 4.27. Overall, the failings associated with the Firms' CMAR submissions indicated a weak control environment around the preparation, review and submission of the Firms' CMARs.

#### **Inaccuracies with the Firms' CASS RPs**

- 4.28. The Authority identified that for part of the Relevant Period, the Firms did not have a formal control process in place to ensure effective prevention, detection and remediation of breaches in the Firms' CASS RPs.
- 4.29. In addition, during the Relevant Period the Firms lacked formal controls and formal lines of responsibility regarding the prevention, detection and remediation of breaches of rules within Chapter 10 (Resolution Packs) of the CASS Rules.
- 4.30. In particular, the Authority identified the following failings with the Firms' CASS RPs: specific omissions within the Firms' CASS RPs such as a lack of procedures for recording and transferring client money and safe custody assets, delays in the Firms' updating of the CASS RPs for the opening of new bank accounts and a lack of a clear timetable for the production of the CASS RPs.
- 4.31. During 2015 the Firms took steps to improve the CASS RP process by implementing a formal CASS RP checklist but the Firms' review and updating process remained inadequate.

#### **Inadequacy of CASS resources and technical expertise**

- 4.32. The Firms' CASS resources were inadequate which undermined their ability to conduct effective oversight of the TPAs. The Firms' lack of CASS technical expertise brought about the Firms' overreliance on the TPAs which further compromised the Firms' ability to identify, resolve and report CASS breaches and control weaknesses in a timely manner.
- 4.33. During the Relevant Period, there was no formal requirement established within the Firms for CASS training to be undertaken by members of the Firms' CASS team. Nor were there any formal training records maintained of any "ad hoc" CASS training completed by the CASS team members. The Firms have now instituted a formal CASS skills and knowledge matrix for CASS team members.

- 4.34. In addition, during the Relevant Period the Firms combined the CF10 and CF10a functions which further constrained the available resource and technical expertise dedicated to CASS compliance.
- 4.35. This lack of technical knowledge and experience rendered the Firms incapable of effectively challenging the TPAs' performance of the CASS functions.

#### **Failure to prioritise CASS compliance**

- 4.36. The Firms understated the high risks associated with CASS non-compliance which may have prevented and/or delayed the Firms' escalation of CASS issues. The Authority identified inconsistencies in the Firms' risk rating in relation to CASS oversight. In light of the CASS breaches identified in the Firms' external CASS audit reports, the Firms ought to have accorded CASS compliance a higher risk rating. The fact that additional CASS breaches arose in consecutive annual external CASS audits should have prompted the Firms to re-categorise CASS compliance as high risk. The Firms did not appear to have had adequate systems and controls in place to challenge the basis upon which CASS risks had been assessed.

### **5. FAILINGS**

- 5.1. The regulatory provisions relevant to this Final Notice are referred to in Annex A.
- 5.2. Based on the facts and matters described above, the Authority finds that the Firms have breached Principle 3 and Principle 10 and associated CASS and SYSC Rules.
- 5.3. Principle 3 requires a firm to take reasonable care to organise and control its affairs responsibly and effectively, with adequate risk management systems. The Authority has concluded that the Firms failed to take reasonable care to organise and control their outsourced CASS functions in a responsible and effective way.
- 5.4. In breach of Principle 3, the Firms:
- (1) failed to implement and maintain adequate policies and procedures to detect and manage the high level of client money and custody assets risks which arose from the Firms' outsourcing their CASS functions. In particular, the Firms failed to carry out adequate and formal compliance oversight and review exercises of both the performance of the TPAs, and

the quality of the MI provided by the TPAs, in relation to outsourced CASS functions;

- (2) failed to dedicate sufficient resource and technical expertise to enable them to implement effective CASS oversight arrangements; and
- (3) failed to prioritise sufficiently CASS compliance, resulting in inadequate oversight of the outsourced CASS functions and the delayed detection and rectification of CASS risks and compliance issues.

5.5. Principle 10 requires a firm to arrange adequate protection for clients' assets for which it is responsible. The CASS Rules set out detailed requirements placed on firms to ensure adequate protection of client money and custody assets. The Authority has concluded that the Firms failed to arrange such adequate protection of client money and custody assets for which they were responsible.

5.6. In breach of Principle 10 the Firms:

- (1) failed to identify and promptly rectify issues within their internal client money reconciliation process resulting in the Firms' under-segregation of client money;
- (2) mislabelled transactions within the Firms' client money calculations (CASS 7.6.2R and CASS 7.15.3R);
- (3) failed to submit accurate CMARs;
- (4) failed to ensure the adequate and accurate segregation of client money; and
- (5) held inadequate CASS RPs.

5.7. In addition, by outsourcing these critical CASS functions the Firms remained fully responsible for discharging all of their obligations under the CASS Rules and all other regulatory requirements. Despite this, the Firms failed to retain the necessary expertise to supervise the outsourced functions effectively and to manage the risks associated with the outsourcing (SYSC 8.1.6R and SYSC 8.1.8(5)R).

- 5.8. Having regard to the issues above, the Authority considers it is appropriate and proportionate in all the circumstances to take disciplinary action against the Firms for their breaches of Principles 3 and 10 and associated CASS and SYSC Rules during the Relevant Period.

## **6. SANCTION**

### **Financial penalty**

- 6.1. The Authority's policy on the imposition of financial penalties is set out in Chapter 6 of DEPP. In determining the financial penalty, the Authority has had regard to this guidance.
- 6.2. In respect of conduct occurring on or after 6 March 2010, the Authority applies a five-step framework to determine the appropriate level of financial penalty. 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

- 6.3. 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.
- 6.4. The Authority has not identified any financial benefit that APTUKL and/or AWUKL may have derived directly from their breaches.
- 6.5. The Step 1 figure is therefore £0.

#### Step 2: the seriousness of the breach

- 6.6. DEPP 6.5A.2G provides that at Step 2 the Authority determines a figure that reflects the seriousness of the breach. Although DEPP 6.5A.2G(1) indicates that in many cases 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, it also recognises that revenue may not be an appropriate indicator of the harm the breach may cause. In those cases the Authority will use an appropriate alternative.
- 6.7. Here, the Authority considers that the revenue generated by the Firms is not an appropriate indicator of the harm or potential harm caused by their breach in this case.



- 6.8. The Authority considers that the appropriate indicator in this case is the average value of client money and safe custody assets held over the Relevant Period. The Authority has therefore used the Firms' average client money and safe custody assets balance over the Relevant Period to determine the figure at Step 2.
- 6.9. The average daily balance of the client money and safe custody assets accounts during the Relevant Period for AWUKL was £64,410,913.00 and £1,409,841,850.00 respectively and the average daily balance of the client money accounts during the Relevant Period for APTUKL was £189,132,662.00.
- 6.10. In deciding on the percentage of the client money and safe custody assets value that forms the basis of the step 2 figure, the Authority considers the seriousness of the breach and chooses a percentage that is appropriate to the relevant fixed level which represents, on a sliding scale of 1 to 5, the seriousness of the breach; the more serious the breach, the higher the level. The percentage levels that the Authority applies to cases involving client money and safe custody assets are as follows:

<b>Level</b>	<b>Client Money</b>	<b>Custody Assets</b>
<b>Level 1</b>	0%	0%
<b>Level 2</b>	1%	0.2%
<b>Level 3</b>	2%	0.4%
<b>Level 4</b>	3%	0.6%
<b>Level 5</b>	4%	0.8%

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

- (1) risk of loss of client money and safe custody assets to clients: the Firms' breaches meant that had AWUKL and/or APTUKL become insolvent at any point during the Relevant Period, it is likely that an insolvency practitioner would have had to seek the resolution of a court before client money and/or safe custody assets could be distributed to clients. This would have exposed the Firms' clients to a potential risk of loss of their money and safe

custody assets over and above that which may otherwise have been expected in an insolvency situation; and

- (2) serious or systemic weaknesses in the Firms' systems and controls: the Firms' breaches resulted from serious weaknesses in the Firms' systems and controls relating to oversight of outsourced CASS functions which continued for a prolonged period, notwithstanding CASS issues having been raised by the Firms' external CASS auditors during the Relevant Period.

6.12. DEPP 6.5A.2G (12) lists factors likely to be considered 'level 1, 2 or 3 factors'. Of these, the Authority considers the following factors to be relevant in this case:

- (1) no profits were made or losses avoided as a result of the breach, either directly or indirectly;
- (2) there was no actual or potential effect on the orderliness of, or confidence in, markets as a result of the breach; and
- (3) that the breaches were committed negligently or inadvertently, i.e. not deliberately.

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

- (1) detrimental impact on CASS RP: had the Firms complied with the requirement to maintain and be able to retrieve adequate CASS RPs, they would have been able to provide a more comprehensive record against which the insolvency practitioner could compare other information sources held by the Firms, thereby mitigating any delay in the return of client money and safe custody assets; and
- (2) the Firms failed to identify and/or remediate breaches of the CASS Rules (notwithstanding the Firms' receipt of external audit reports identifying a number of CASS breaches) until June 2015.

6.14. The Authority has taken these factors into account and considers the overall seriousness of the breach to be level 3.

6.15. The Step 2 figure is 2% of the Firms' average client money balances (£64,410,913.00 for AWUKL and £189,132,662.00 for APTUKL) and 0.4% of the

average client safe custody asset balance for AWUKL (£1,409,841,850.00) during the Relevant Period which based on a breakdown of the client money and safe custody asset figures provided by the Firms amounts to £10,710,238.90.

Step 3: mitigating and aggravating factors

6.16. 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.

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

(1) the importance of arranging adequate protection for client money and safe custody assets was well publicised by the Authority during the Relevant Period, including through previous enforcement actions for breaches of the CASS Rules, which have drawn firms' attention to the need for increased focus on this area (and specifically the importance of protecting client money and safe custody assets); and

(2) some of the Firms' failings were drawn to the Firms' attention by the Authority and by the Firms' external CASS auditors, rather than through their own CASS compliance monitoring.

6.18. The Authority considers that the following factors mitigate the breach:

(1) once it was identified that the Firms were not compliant with the CASS oversight requirements, they committed significant internal and external resources to investigating and remediating the issues outlined in this Notice, and in strengthening CASS resource and oversight; and

(2) specifically, the Firms have made significant improvements in the application of dedicated CASS resource, and in strengthening the oversight of the TPAs' work and the associated controls.

6.19. The Authority has considered the various aggravating and mitigating factors and having done so considers that the Step 2 figure should be subject to a 10% uplift at Step 3.

6.20. The Step 3 figure is therefore £11,781,262.80.

#### Step 4: adjustment for deterrence

- 6.21. DEPP 6.5A.4G provides that if the Authority considers the figure arrived at after Step 3 is insufficient to deter the firm who committed the breach, or others, from committing further or similar breaches, then the Authority may increase the penalty.
- 6.22. The Authority considers that the Step 3 figure of £11,781,262.80 represents a sufficient deterrent to the Firms and others, and so has not increased the penalty at Step 4.
- 6.23. The figure at Step 4 therefore remains £11,781,262.80.

#### Step 5: settlement discount

- 6.24. 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. The settlement discount does not apply to the disgorgement of any benefit calculated at Step 1.
- 6.25. The Authority and APTUKL and AWUKL reached agreement at stage 1 and so a 30% discount applies to the Step 4 figure.
- 6.26. The figure at Step 5, rounded down to the nearest £100, is therefore £8,246,800.00.

#### Conclusion on financial penalty

- 6.27. The Authority therefore imposes on the Firms a total financial penalty of £8,246,800.00 (£11,781,262.80 before stage 1 discount).

## **7. PROCEDURAL MATTERS**

### **Decision maker**

- 7.1. The decision which gave rise to the obligation to give this 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 19 October 2016, 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 20 October 2016, 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 notice relates. Under those provisions, the Authority must publish such information about the matter to which this 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 Karie Twinem (direct line: 020 7066 3098/email: [karie.twinem@fca.org.uk](mailto:karie.twinem@fca.org.uk)) of the Enforcement and Market Oversight Division of the Authority.

Anthony Monaghan

Head of Department  
Financial Conduct Authority, Enforcement & Market Oversight

## **1 January 2013 ANNEX A**

### **RELEVANT STATUTORY AND REGULATORY PROVISIONS**

#### **1. Relevant Statutory Provisions**

1.1. The Authority's operational objectives are set out in section 1B (3) of the Act and include the objective of securing an appropriate degree of protection for consumers.

1.2. Section 206(1) 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."*

#### **2. Relevant Regulatory Provisions**

##### **Principles for Businesses ("Principles")**

2.1. The Principles are a general statement of the fundamental obligations of firms under the regulatory system and are set out in the Authority's Handbook. They derive their authority from the Authority's rule-making powers set out in the Act. The relevant Principles are as follows.

2.2. Principle 3 (management and control) states that:

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

2.3. Principle 10 (client assets) states that:

*'A firm must arrange adequate protection for clients' assets when it is responsible for them.'*

##### **Client Assets sourcebook ("CASS")**

2.4. CASS is the part of the Authority's Handbook which sets out the Authority's requirements in relation to holding client money and safe custody assets.

**2.5. CASS 6.2.1R states that:**

*'A firm must, when holding safe custody assets belonging to clients, make adequate arrangements so as to safeguard clients' ownership rights, especially in the event of the firm's insolvency, and to prevent the use of safe custody assets belonging to a client on the firm's own account except with the client's express consent.'*

**2.6. CASS 6.5.2R states that:**

*'A firm must maintain its records and accounts in a way that ensures their accuracy, and in particular their correspondence to the safe custody assets held for clients.'*

**2.7. CASS 6.5.10R states that:**

*'A firm must promptly correct any discrepancies which are revealed in the reconciliations envisaged by this section, and make good, or provide the equivalent of, any unreconciled shortfall for which there are reasonable grounds for concluding that the firm is responsible.'*

**2.8. CASS 6.6.2R states that:**

*'A firm must keep such records and accounts as necessary to enable it at any time and without delay to distinguish safe custody assets held for one client from safe custody assets held for any other client, and from the firm's own applicable assets.'*

**2.9. CASS 7.12.2R (formerly CASS 7.3.2R) states that:**

*'A firm must introduce adequate organisational arrangements to minimise the risk of the loss or diminution of client money, or of rights in connection with client money, as a result of misuse of client money, fraud, poor administration, inadequate record-keeping or negligence.'*

**2.10. CASS 7.15.3R (formerly CASS 7.6.2R) states that:**

*'A firm must maintain its records and accounts in a way that ensures their accuracy, and in particular their correspondence to the client money held for clients.'*

**2.11. CASS 7.6.8R states that:**

*'A firm that does not use the standard method of internal client money reconciliation must first send a written confirmation to the FCA from the firm's auditor that the firm has in place systems and controls which are adequate to enable it to use another method effectively.'*

**2.12. CASS 7.15.18R (effective from 1 June 2015) states that:**

*'(1) Before using a non-standard method of internal client money reconciliation, a firm must:*

- (a) establish and document in writing its reasons for concluding that the method of internal client money reconciliation it proposes to use will:
  - (i) (for the normal approach to segregating client money) check whether the amount of client money recorded in the firm's records as being segregated in client bank accounts meets the firm's obligation to its clients under the client money rules on a daily basis; or*
  - (ii) (for the alternative approach to segregating client money) calculate the amount of client money to be segregated in client bank accounts which meets the firm's obligations to its clients under the client money rules on a daily basis;**
- (b) notify the FCA of its intentions to use a non-standard method of internal client money reconciliation; and*
- (c) send a written report to the FCA prepared by an independent auditor of the firm in line with a reasonable assurance engagement and stating the matters set out in (2).*

*(2) The written report in (1)(c) must state whether in the auditor's opinion:*

- (a) the method of internal client money reconciliation which the firm will use is suitably designed to enable it to (as applicable):
  - (i) (for the normal approach to segregating client money) check whether the amount of client money recorded in the firm's records as being segregated in client bank accounts meets the firm's obligation to its clients under the client money rules on a daily basis; or**



*(ii) (for the alternative approach to segregating client money) calculate the amount.'*

**2.13. CASS 7.6.6G (effective until 1 June 2015) states that:**

*'(1) Carrying out internal reconciliations of records and accounts of the entitlement of each client for whom the firm holds client money with the records and accounts of the client money the firm holds in client bank accounts and client transaction accounts should be one of the steps a firm takes to satisfy its obligations under CASS 7.6.2 R, and where relevant SYSC 4.1.1 R and SYSC 6.1.1 R.*

*(2) A firm should perform such internal reconciliations:*

*(a) as often as is necessary; and*

*(b) as soon as reasonably practicable after the date to which the reconciliation relates;*

*to ensure the accuracy of the firm's records and accounts.*

*(3) The standard method of internal client money reconciliation sets out a method of reconciliation of client money balances that the FSA believes should be one of the steps that a firm takes when carrying out internal reconciliations of client money.'*

**2.14. CASS 7.12.2R (formerly 7.3.2R) states that:**

*'A firm must introduce adequate organisational arrangements to minimise the risk of the loss or diminution of client money, or of rights in connection with client money, as a result of misuse of client money, fraud, poor administration, inadequate record-keeping or negligence.'*

**2.15. CASS 7.13.58R (formerly CASS 7.6.8R) states that:**

*'(1) In addition to the requirement under CASS 7.13.57R, before adopting the alternative approach, a firm must send a written report to the FCA prepared by an independent auditor of the firm in line with a reasonable assurance engagement, stating the matters set out in (2).*

*(2) The written report in (1) must state whether, in the auditor's opinion:*

*(a) the firm's systems and controls are suitably designed to enable it to comply with CASS 7.13.62R to CASS 7.13.65R; and*

*(b) the firm's calculation of its alternative approach mandatory prudent segregation amount under CASS 7.13.65R is suitably designed to enable the firm to comply with CASS 7.13.65R.'*

**2.16. CASS 7.15.14G (effective 1 June 2015) states that:**

*An internal client money reconciliation should:*

*(1) be one of the steps a firm takes to arrange adequate protection for clients' assets when the firm is responsible for them (see Principle 10 (Clients' assets), as it relates to client money);*

*(2) be one of the steps a firm takes to satisfy its obligations under CASS 7.12.2R and CASS 7.15.3R and, where relevant, SYSC 4.1.1R (1) and SYSC 6.1.1R, to ensure the accuracy of the firm's records and accounts;*

*(3) for the normal approach to segregating client money (CASS 7.13.6R), check whether the amount of client money recorded in the firm's records as being segregated in client bank accounts meets the firm's obligations to its clients under the client money rules on a daily basis; and*

*(4) for the alternative approach to segregating client money (CASS 7.13.62R), calculate the amount of client money to be segregated in client bank accounts which meets the firm's obligations to its clients under the client money rules on a daily basis.*

**2.17. CASS 6.2.2R states that:**

*'A firm must introduce adequate organisational arrangements to minimise the risk of the loss or diminution of clients' safe custody assets, or the rights in connection with those safe custody assets, as a result of the misuse of the safe custody assets, fraud, poor administration, inadequate record-keeping or negligence.'*

**2.18. CASS 10.1.3R states that:**

*"A firm falling within CASS 10.1.1 R must maintain and be able to retrieve, in the manner described in this chapter, a CASS resolution pack."*

**2.19. SUP 16.14.3R states that:**

- (4) *'Subject to (3), a firm must submit a completed CMAR to the FCA within 15 business days of the end of each month.*
- (5) *In this rule month means a calendar month and SUP 16.3.13 R (4) does not apply.*
- (6) *A firm which changes its 'CASS firm type' and notifies the FCA that it is a CASS medium firm or a CASS large firm in accordance with CASS 1A.2.9 R is not required to submit a CMAR in respect of the month in which the change to its 'CASS firm type' takes effect in accordance with CASS 1A.2.12 R, unless it was a firm to which the requirement in (1) applied immediately prior to that change taking effect.'*

**2.20. SYSC 8.1.6R states that:**

*'If a firm outsources critical or important operational functions or any relevant services and activities, it remains fully responsible for discharging all of its obligations under the regulatory system and must comply, in particular, with the following conditions:*

- (1) the outsourcing must not result in the delegation by senior personnel of their responsibility;*
- (2) the relationship and obligations of the firm towards its clients under the regulatory system must not be altered;*
- (3) the conditions with which the firm must comply in order to be authorised, and to remain so, must not be undermined; and*
- (4) none of the other conditions subject to which the firm's authorisation was granted must be removed or modified.'*

**2.21. SYSC 8.1.8R states that:**

*'A common platform firm must in particular take the necessary steps to ensure that the following conditions are satisfied:*

- (1) the service provider must have the ability, capacity, and any authorisation required by law to perform the outsourced functions, services or activities reliably and professionally;*
- (2) the service provider must carry out the outsourced services effectively, and to this end the firm must establish methods for assessing the standard of performance of the service provider;*
- (3) the service provider must properly supervise the carrying out of the outsourced functions, and adequately manage the risks associated with the outsourcing;*
- (4) appropriate action must be taken if it appears that the service provider may not be carrying out the functions effectively and in compliance with applicable laws and regulatory requirements; and*
- (5) the firm must retain the necessary expertise to supervise the outsourced functions effectively and to manage the risks associated with the outsourcing, and must supervise those functions and manage those risks’.*

### **Decision Procedure and Penalties Manual (“DEPP”)**

2.22. Chapter 6 of DEPP, which forms part of the Authority’s Handbook, sets out the Authority’s statement of policy with respect to the imposition and amount of financial penalties under the Act.

### **The Enforcement Guide**

2.23. The Enforcement Guide sets out the Authority’s approach to exercising its main enforcement powers under the Act.

2.24. Chapter 7 of the Enforcement Guide sets out the Authority’s approach to exercising its power to impose a financial penalty.