
FINAL NOTICE

To: **Berkeley Independent Advisers Limited**

Of: **Eaton House
Eaton Road
Coventry
West Midlands
CV1 2FT**

Date **1 December 2005**

TAKE NOTICE: The Financial Services Authority of 25 The North Colonnade, Canary Wharf, London E14 5HS ("the FSA") gives you final notice about the issuing of a statement of public censure:

1. ACTION

- 1.1. The FSA gave you a Decision Notice on 29 September 2005 which notified you that, pursuant to section 205 of the Financial Services and Markets Act 2000 ("the Act"), the FSA had decided to impose a statement of public censure on Berkeley Independent Advisers Limited ("BIA").
- 1.2. BIA has confirmed that it will not be referring this matter to the Financial Services and Markets Tribunal.
- 1.3. Accordingly, for the reasons listed below and pursuant to section 205 of the Financial Services and Markets Act 2000 (the "Act"), the FSA publishes a statement in the form of this Final Notice censuring Berkeley Independent Advisers Limited ("BIA") in respect of breaches of: Rules 3.1.1 and 3.2.6 in the part of the FSA's Handbook entitled Senior Management Arrangements, Systems and Controls ("SYSC Rules"); Rules 2.1.3, 5.2.5, 5.2.9, 5.3.14 and 5.3.16 in the part of the FSA's Handbook entitled Conduct of Business ("COB Rules"); and Principles 3, 6, 7 and 9 of the FSA's Principles for Businesses ("FSA Principles").

- 1.4. The serious nature of the breaches identified in this Final Notice would have led the FSA to propose the imposition of a financial penalty of £425,000 on BIA, were it not for the limited nature of BIA's financial resources and the desire of the FSA to ensure that BIA's customers receive appropriate redress in accordance with the past business review detailed at paragraphs 2.3 and 13.10 of this Final Notice.

2. REASONS FOR THE ACTION

- 2.1. The FSA is publicly censuring BIA in respect of breaches of the FSA's Rules and Principles referred to in paragraph 1.3 in relation to the following matters:

- (1) BIA failed to take reasonable care between 1 December 2001 and 27 September 2004 (the "relevant period") to establish and maintain effective systems and controls in relation to sales by its appointed representatives of Whole of Life policies or Regular Savings Plans. In particular:
 - (a) there was inadequate oversight by senior management and by the compliance department of the creation and development of a sales strategy which, in respect of certain types of customers who wished to build up a fund for use in retirement recommended Whole of Life policies or Regular Savings Plans as a more suitable alternative to other pension and savings products;
 - (b) BIA's compliance department was unable to monitor effectively and adequately sales of Whole of Life policies or Regular Savings Plans and where failures were identified, failed to take appropriate action; and
 - (c) BIA failed to respond appropriately and effectively, with due regard to the interests of its customers and their fair treatment, to several reports from its compliance department and three independent professional firms, all of which identified significant concerns with BIA's sales strategy.
- (2) BIA failed in the relevant period to take reasonable care to ensure that the advice of its appointed representatives in relation to Whole of Life policies and Regular Savings Plans was suitable for its customers, having regard to its customers' personal and financial circumstances. In particular:
 - (a) BIA failed to ensure that recommendations were only made by its appointed representatives after they had obtained and were in possession of sufficient personal and financial information in relation to their customers;
 - (b) BIA failed to ensure that its appointed representatives made and retained a record of their customers' personal and financial circumstances;
 - (c) BIA failed to ensure that its appointed representatives issued suitability letters that explained why the recommendation was suitable for the

customer and contained a summary of the main consequences and possible disadvantages of the recommendation; and

- (d) BIA otherwise failed to ensure that its appointed representatives communicated with its customers in a way that was clear, fair and not misleading.

2.2. BIA's breaches are viewed as being particularly serious because:

- (1) Appointed representatives exposed customers to a potentially inappropriate strategy which had not been formally approved by BIA. BIA also failed to undertake any assessment of whether its appointed representatives had the skills to successfully implement the strategy. Further, when the strategy was recommended to customers, BIA failed to monitor whether or not it had been recommended appropriately;
- (2) the failures exposed 3,800 of BIA's customers to the risk of financial loss;
- (3) BIA has yet to fully identify which of those 3,800 customers were sold Whole of Life Policies or Regular Savings Plans in accordance with the sales strategy or those who were missold and has failed to provide any customers who may have been disadvantaged with any compensation;
- (4) the failures continued for a substantial period of time and continued even after the FSA put BIA on notice in August 2002 that there was a risk that its recommendations for Whole of Life policies and Regular Savings Plans may be unsuitable;
- (5) the failures continued even after BIA had, between May and December 2003, received information (including information which suggested that the sales may have been commission driven) which should have caused BIA to take steps to mitigate the risk of unsuitable sales;
- (6) the failings exposed systemic weaknesses in BIA's internal controls. In particular, the approach adopted by the File Review team was fundamentally flawed in that it did not include an adequate assessment of whether the advice provided by its appointed representatives was suitable or not; and
- (7) whilst BIA's compliance department identified the risk that appointed representatives may have missold policies and put forward a number of recommendations for rectifying the situation, BIA discounted all but one of the compliance department's recommendations even after the compliance department suggested that the sales appeared to be commission driven.

2.3. BIA's failures therefore merit disciplinary action. As detailed at paragraph 1.4 above, were it not for BIA's limited financial resources, the FSA would have proposed the imposition of a financial penalty of £425,000 on BIA. In determining what would have been the appropriate level of financial penalty, the FSA recognises the following measures taken by BIA which have served to mitigate the seriousness of its failings:

- (1) shortly after the commencement of the FSA's investigation BIA voluntarily suspended sales of Whole of Life policies and Regular Savings Plans;
- (2) given the risk of unsuitable sales, BIA is now committed to undertaking a past business review ("PBR") to review advised sales of Whole of Life policies and Regular Savings Plans in the relevant period with a view to:
 - (a) Identifying unsuitable recommendations made by BIA's appointed representatives;
 - (b) assessing any consumer loss; and
 - (c) paying appropriate redress where unsuitable advice has led to loss.
- (3) since April 2005 BIA has worked very closely with the FSA to bring the investigation to a timely conclusion;
- (4) a new senior management team is now in place at BIA.

The PBR should ensure that customers who purchased Whole of Life and Regular Savings Plan products will receive appropriate redress where other, alternative saving and pension vehicles would have been more suitable.

3. RELEVANT STATUTORY AND REGULATORY PROVISIONS

Public Censure

- 3.1. Section 205 of the Act provides:

"If the Authority considers that an authorised person has contravened a requirement imposed on him by or under this Act, the Authority may publish a statement to that effect".

- 3.2. Section 39(3) of the Act provides:

"The principal of an Appointed Representative is responsible, to the same extent as if he had expressly permitted it, for anything done or omitted by the representative in carrying on the business for which he has accepted responsibility."

FSA Principles for Business

- 3.3. The Principles are a general statement of the fundamental obligations of firms under the regulatory system. They derive their authority from the FSA's rule-making powers as set out in the Act and reflect the FSA's regulatory objectives.
- 3.4. Principle 3 (Management and control) provides that:

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

3.5. Principle 6 (Customers' interests) provides that:

A firm must pay due regard to the interests of its customers and treat them fairly.

3.6. Principle 7 (Communications with clients) provides that:

A firm must pay due regard to the information needs of its clients, and communicate information to them in a way which is clear, fair and not misleading.

3.7. Principle 9 (Customers: relationships of trust) provides that:

A firm must take reasonable care to ensure the suitability of its advice and discretionary decisions for any customer who is entitled to rely upon its judgment.

Senior Management Arrangements, Systems and Controls Rules

3.8. SYSC 3.1.1 R provides that:

A firm must take reasonable care to establish and maintain such systems and controls as are appropriate to its business.

3.9. SYSC 3.2.6 R (Compliance) provides that:

A firm must take reasonable care to establish and maintain effective systems and controls for compliance with applicable requirements and standards under the regulatory system and for countering the risk that the firm might be used to further financial crime.

Conduct of Business Rules

3.10. COB 2.1.3 R (Clear, fair and not misleading communication) provides that

When a firm communicates information to a customer, the firm must take reasonable steps to communicate in a way that is clear, fair and not misleading.

3.11. COB 5.2.5 R (Requirement to know your customer) provides that:

Before a firm gives a personal recommendation concerning a designated investment to a private customer, or acts as an investment manager for a private customer, it must take reasonable steps to ensure that it is in possession of sufficient personal and financial information about that customer relevant to the services that the firm has agreed to provide.

3.12. COB 5.2.9 R (Record keeping: personal and financial circumstances) provides that:

... a firm must make and retain a record of a private customer's personal and financial circumstances that it has obtained in satisfying COB 5.2.5 R.

- 3.13. COB 5.2.11G (1)(a) (Guidance on the collection of information about a private customer) provides that:

Information collected from a private customer should, at a minimum provide an analysis of a customer's personal and financial circumstances leading to a clear identification of his needs and priorities so that, combined with attitude to risk, a suitable investment can be recommended.

- 3.14. COB 5.3.14 R (1) provides that:

A firm that gives a personal recommendation, in relation to a life policy, to a person who is a policyholder or a prospective policyholder of a life policy, must provide the person with a suitability letter prior to the conclusion of the contract

- 3.15. COB 5.3.16 R provides that:

The suitability letter in COB 5.3.14 R must:

(1) explain why the firm has concluded that the transaction is suitable for the customer, having regard to his personal and financial circumstances;

(2) contain a summary of the main consequences and any possible disadvantages of the transaction; ...

FACTS AND MATTERS RELIED ON

4. The firm

- 4.1. The firm was incorporated as a limited liability company on 20 February 1990. On 4 January 2002 it became a wholly owned subsidiary of Berkeley Berry Birch Plc ("BBB"), a holding company whose shares are listed on the London Stock Exchange.¹
- 4.2. BIA operates a network of appointed representative members ("members") by providing regulatory and administrative services to them. There are approximately 249 members of the network, with a total of 450 advisers between them.
- 4.3. BIA has been authorised by the FSA since 1 December 2001, with permission granted by the FSA pursuant to the Act to conduct certain regulated activities (including advising and arranging deals in investments). Prior to that, BIA was a member of the Personal Investment Authority ("PIA") from 5 December 1994 to 30 November 2001. Prior to that, BIA was a member of the Financial Intermediaries, Managers and Brokers Regulatory Association.

¹ BBB was formed in January 2002, when Berry Birch Noble plc, a national independent financial advisor and insurance broker engaged in a reverse take over of the Berkeley Financial Services Group Limited, a privately owned holding company. This takeover resulted in the formation of BBB.

BIA's compliance arrangements

- 4.4. BBB owns a number of subsidiaries (the "BBB Group") which, other than BIA, includes three other subsidiaries which operate in the insurance and financial advisory industry and which are authorised by the FSA. Each of the BBB Group subsidiaries operates as a separate business. The chief executive officer ("CEO") of each BBB Group subsidiary reports to the BBB board on a monthly basis.
- 4.5. Berkeley Berry Birch Group Support Services Limited ("GSS"), another company in the BBB Group, was established in July 2002. GSS provides support services to the other BBB Group companies such as administration, human resource, IT, financial recording and compliance services.
- 4.6. Following the formation of the BBB Group, GSS was BIA's compliance department ("Compliance"). BIA, therefore, relied on staff within GSS to provide compliance support and to make sure that BIA's obligation to ensure that its members complied with the FSA's Rules and Principles was fulfilled. In addition, GSS was responsible for issuing compliance procedures and guidance, reviewing business, undertaking periodic visits to members to review their work and records and carrying out investigations.
- 4.7. GSS's Compliance staff were organised into five teams: Pension Transfer, Compliance Review, Pension Review, Compliance Services, and Field Operations. The Compliance Review Team (sometimes called the File Review team) was responsible for checking cases for compliance with BIA procedures and FSA Rules, throughout the relevant period.
- 4.8. Each team within Compliance was led by a Head of Department who reported to the Compliance Operations Manager who in turn reported to GSS's Compliance Director. The Compliance Director reported to GSS's CEO, but also reported on a monthly basis to the Boards of both BBB and BIA.

5. Savings products

- 5.1. During the relevant period, BIA's members made recommendations to a number of customers who had a general need to save, or a specific need to save (eg: to provide an income in retirement), to purchase a life policy, being either:
 - (1) a Whole of Life ("WoL") policy; or
 - (2) a Regular Savings Plan ("RSP") policy.

WoL

- 5.2. A WoL assurance policy provides permanent protection against death to the policyholder, in that it pays a sum assured whenever death occurs. In addition, WoL policies will, typically, after 1 to 2 years gradually acquire a surrender value which over time may prove substantial and which can be encashed at any time. Further, the policy would normally provide tax free cash.

RSP

- 5.3. An RSP is potentially a qualifying savings plan. The plan is qualifying in that the return to customers can be free of tax if certain qualifying conditions are met. One qualifying condition is that the plan must include an element of life cover. A proportion of premiums paid to the RSP therefore must be used to provide for that life cover.
- 5.4. RSPs are typically written with a term of between 10 and 25 years. At the end of the term the customer receives a lump sum the size of which is dependent on the performance of the underlying fund. If the policies are held for more than seven and a half years, all proceeds from the policy are paid tax free to all policyholders. A tax liability will however be incurred by some customers if the policy is surrendered in the initial seven and a half years of the term.

Other products

- 5.5. There are a range of other products available to meet customers' needs for general savings or to provide an income in retirement. For example, an Individual Savings Account ("ISA") enables customers to save into a fund which is tax efficient and enables customers unrestricted access to the fund.
- 5.6. Customers who want to provide for an income in retirement can use a Personal Pension Plan ("PPP"). Contributions to a PPP benefit from receiving tax relief at the contributor's marginal rate of Income Tax. Further, the underlying funds receive preferential tax treatment. The fund built up in a PPP must be used to purchase an annuity between the ages of 50 and 75. Payments of an annuity are treated as taxable income at the time the payments are made.

6. Discovery of the issues by FSA

- 6.1. In August 2002, the FSA asked BIA's Senior Management, as part of BIA's Risk Mitigation Program, to review the training that had been offered to its members on WoL policies to ensure the training had been targeted at appropriate individuals (advisors with appropriate skills sets) and to ensure that sales of WoL contracts were only made to appropriate customers. In addition, senior management were asked to review the business written by members who had attended this training.
- 6.2. BIA responded in a letter of 28 August 2002:
 - (1) BIA noted that Compliance had reviewed the course and concluded that both the content of the course and the message given to members on the course were compliant; and
 - (2) BIA asserted that they had undertaken a review of sales and concluded that customers did not appear to have been disadvantaged. Consequently, BIA did not consider that a retrospective review of business was necessary. However, BIA agreed to keep the issue under constant review and promised the FSA that, should concerns be raised at any time, appropriate action would be taken.
- 6.3. The FSA undertook a supervision visit to BIA in October 2003 which focussed on the sale of WoL policies of one member and compliance monitoring at BIA. This visit

resulted in some minor corrective action which was undertaken to the satisfaction of the FSA.

Supervision visit May 2004

- 6.4. In May 2004 the FSA conducted supervision visits to the head office of BIA and 12 of its members. The visits focussed on sales made by BIA's members of WoL policies from a particular provider and RSPs, from another provider. During the visits the Supervision team reviewed 130 files (36 WoL policies and 94 RSPs) at 12 members. The visits also examined the compliance and monitoring procedures in respect of these sales.
- 6.5. Following the visits the FSA issued a report on 7 October 2004 (the "Supervision Report") which highlighted concerns in relation to 62 of the 130 cases reviewed at 10 of the 12 members. The issues identified included concerns regarding the quality of documentation and concerns regarding the suitability of the advice provided by the members. The Supervision Report also identified concerns in relation to BIA's systems and controls (the findings of the Supervision Report are set out in greater detail in paragraphs 13.2 to 13.4 below).

7. BIA's sales strategy

The training sessions

- 7.1. In 2000, BIA began to actively explore ways to increase business derived from directors of privately owned small and medium sized enterprises ("SMEs").
- 7.2. In May 2000 a training consultant ("the consultant") ran a series of training courses for its members. The consultant's experience in the corporate market was seen by BIA as essential to increasing BIA's productivity in this area. BIA's intention was to increase the productivity of members who attended his course by developing their marketing skills and equipping them with the skills to enter the corporate market.
- 7.3. The consultant established a monthly training session and acted as the leader and facilitator of the training sessions. Attendees received training on sales techniques and, as the sessions progressed, they began to discuss and develop sales concepts and strategies designed to increase the amount of business secured from the corporate market.
- 7.4. The majority of the attendees were retail practitioners and any member of BIA willing to pay for the cost of the training was able to attend. BIA did not assess whether attendees had sufficient expertise following the training to implement the strategy.

Development of the sales strategy

- 7.5. During the training sessions, the consultant and the attendees discussed what they perceived to be a growing dissatisfaction among customers with traditional means of saving for retirement such as PPPs or Executive Pension Plans ("EPPs"). The consultant believed that pensions were a 'sterile' product whose perceived advantages had been eroded over time by legislative changes and the prevailing economic situation. In particular, the perceived disadvantages of PPPs and EPPs included:
- (1) The obligation to use the fund to purchase an annuity;
 - (2) Uncertainty over future tax relief for pensions; and
 - (3) Inability to access funds held within a pension scheme until age 50.
- 7.6. The consultant and attendees began to develop an alternative strategy for providing income in retirement based on a concept previously developed by the consultant ("the strategy"). The strategy was designed to meet the requirements of SME company directors who had either made no pension provision, lost faith in pensions or who were relying on their business to provide income in retirement.
- 7.7. The consultant and attendees considered what alternatives to traditional pension schemes were available and determined that a WoL policy was a more suitable alternative for certain directors for long term saving and as a vehicle within which to build funds for retirement. In particular, they considered that in certain cases the WoL products would provide those customers with some of the benefits of pensions (such as disciplined savings, tax efficiencies and income in retirement) but also provide some benefits that pensions were unable to offer (such as flexibility in choice of fund, access to the fund before retirement, and life and critical illness cover).
- 7.8. Accordingly, the strategy envisaged that, where customers had a need for life cover along with a need to make long term savings or to build up a fund for use in retirement, the WoL policy would provide a more suitable alternative to other pension and savings products.
- 7.9. Senior management at BIA (in contrast to Compliance) were briefed and agreed with the merits of the strategy within the corporate market.

Shift in sales strategy from WoL to RSP

- 7.10. At the beginning of 2003, the strategy was amended by effectively ceasing to use the WoL policy of one product provider and using a RSP from another product provider. Whilst the RSP had a number of different features the change in strategy also coincided with a change in the terms of commission offered by the WoL provider which ceased paying indemnity commission on policies over £1,000 per month².

² Indemnity commission is commission paid in a lump sum to an adviser on completion of a contract.

- 7.11. The immediate reaction to this was that members sold multiple contracts of £999 per month. Despite there being both advantages and disadvantages of selling multiple contracts in such a way, Compliance attributed the decision as being a commission motivated decision in order to obtain indemnity commission from the sale.
- 7.12. As no alternative suitable WoL policy providers were found, a particular provider's RSP with a term which extended into retirement was recommended, effectively providing the same benefits created through the use of a WoL policy.

8. BIA's controls surrounding the sales strategy.

- 8.1. BIA employed two primary means of controlling the application of the strategy by its members. Firstly, BIA issued guidance to its members for use when recommending WoL or RSP policies. Secondly, Compliance had a File Review team which sought to review sales to ensure that they complied with the guidance. Collectively these controls were flawed and thus, ineffective.

The Guidance

- 8.2. Initially, the strategy advocated the use of WoL policies. As explained in paragraph 7.10 above, the strategy was amended in early 2003 to advocate the use of RSP policies.
- 8.3. Notwithstanding this change, in September 2003 BIA issued guidance for use by members when recommending WoL policies. The guidance was limited in nature it that it primarily concentrated on the need to ensure that members complied with the "know your customer" and suitability letter requirements. The guidance also emphasised the need to explain to customers within the suitability letter the advantages and disadvantages of the recommended WoL product.
- 8.4. In response to the change in the strategy BIA issued guidance to its members to provide them with assistance when making recommendations to customers for RSPs.
- 8.5. The guidance prescribed the type of customer who might benefit from the strategy. This target group was narrowly defined as controlling directors of limited companies, who may be restricted by the earnings cap for pension contributions, may be higher rate taxpayers in retirement, and may want to be remunerated in dividends rather than salary.
- 8.6. The original guidance for RSP sales was issued in January 2003 with a subsequent version issued on 1 May 2004 following advice from external consultants (see paragraph 11 below). It was issued to members who were attendees at the consultant's training course and placed on BIA's website. However members who had not attended the consultant's course were not alerted to its existence or to the importance of following the guidance when recommending RSPs for use as long term savings or retirement vehicles.
- 8.7. The guidance was ignored in a substantial number of cases. In December 2003 Compliance's review of 180 RSP sales led them to conclude that only 84 were made to directors of which all but approximately 5 or 6 were directors of small or self

owned businesses. The remaining 96, however, fell outside of the target group prescribed in the guidance. As set out in more detail in paragraph 11.18 a firm of solicitors who acted as BIA's compliance auditors also identified, in December 2003, that sales were being made to customers outside of the target group and that guidance was therefore not being followed by members.

- 8.8. Despite sales having been identified by Compliance as not having been made in accordance with issued guidance, BIA took no further steps to determine whether the recommendations in the 96 cases were suitable.

File Review team

- 8.9. Compliance's File Review team was responsible for the review of a percentage of the sales submitted by BIA's members.
- 8.10. In order to determine whether a recommendation made to a customer is suitable, a review of a file must consider whether or not the recommendation made is suitable taking account of a customer's personal and financial circumstances. Whilst BIA's File Review team did review the file in an attempt to ensure that relevant details had been recorded and the customer had been provided with appropriate information regarding the recommendation it did not attempt any detailed assessment of suitability.
- 8.11. If the File Review team determined that the adviser should provide further advice to the customer this did not typically result in a comprehensive review of the underlying suitability of the transaction.
- 8.12. However, even given the limited nature of the review conducted by the File Review team, the vast majority of cases were queried. For example, on 20 November 2003 the team reported that, from 245 cases reviewed to date, only six (i.e 2.4%) had been accepted as compliant on first submission.
- 8.13. Even where the File Review team had identified that a customer had not received all of the disadvantages of WoL and RSPs, they failed to carry out any assessment of the underlying suitability of the transaction. Instead, the File Review team asked the member to write to the customer enclosing the additional disadvantages of the WoL and RSPs. The further communication to the customer contained no indication as to whether or not BIA considered the advice to be unsuitable for them.
- 8.14. In addition, the File Review team was ineffective in that it only reviewed cases after they had been put on risk and did not, as a matter of routine, carry out pre-sale vetting of transactions. This meant that, where the remedial action was undertaken, customers would receive a letter from the member some time after the completion of the sale setting out further information but with no indication as to whether or not that information would have impacted on their decision to accept the recommendation from the member.
- 8.15. In no case did the remedial action, following a file review, result in a customer rejecting the original recommendation from the adviser.

9. Compliance's oversight of the sales strategy

- 9.1. It was incumbent on BIA to provide effective compliance oversight of the training courses run by the consultant in order to ensure that the strategy promoted during these training courses would lead to compliant and suitable sales.

Monitoring of the training course

- 9.2. Between December 2001 and November 2002, Compliance made various attempts to review the content of the training courses. These attempts were hampered by problems that Compliance experienced in obtaining material regarding the training courses and, whilst BIA had said in a letter to the FSA in August 2002 that the training had been reviewed by Compliance, it was not until November 2002 that a review of the course appears to have been completed by a senior manager within Compliance. Therefore, whilst the consultant's courses were intended by BIA's senior management to increase the productivity of its members and to develop new sales concepts from June 2000, a review of the strategy by Compliance appears to have only taken place in November 2002. Furthermore whilst the senior manager within Compliance responsible for the review of the strategy concluded in August and November 2002 that it was satisfactory, it is not clear what steps (if any) were taken to review the strategy and on what basis the review concluded that the strategy was satisfactory.
- 9.3. Regardless of the nature of the reviews conducted in August and November 2002, by May 2003 it is clear that another senior manager within Compliance, rather than being satisfied, was sufficiently concerned to recommend that sales made in accordance with the strategy be suspended (see paragraph 10 below). These concerns were set out in a Compliance report completed in May 2003.
- 9.4. BIA's senior management did not formally require Compliance to attend the training courses until January 2004. There was therefore no monitoring of the delivery of the training courses by Compliance prior to this date.

10. The May 2003 Compliance report

- 10.1. BIA's File Review team began to identify concerns in relation to sales made in accordance with the strategy from early 2002 onwards. However, it was not until May 2003 that Compliance produced a substantive report ("the Compliance Report") which set out in detail the nature of the concerns identified.
- 10.2. The Compliance Report noted that the consultant had been advising BIA's members that traditional pension arrangements no longer represented value for money and that WoL and RSPs should be used instead. The report detailed some of the common problems identified by the File Review team such as:
- (1) a lack of illustrative comparisons to other savings and investment products;
 - (2) insufficient evidence that other options had been discussed and discounted;
 - (3) no evidence that premiums were affordable to and beyond retirement;

- (4) no rationale for term of contract; and
 - (5) no evidence of customer objectives.
- 10.3. The Compliance Report noted that, whilst Compliance had issued guidance in the past to assist members when recommending WoL policies, following the guidance would not necessarily ensure the suitability of the sale but would only ensure that the member had set out all the options open to a customer. The Compliance Report noted that the sales represented a significant risk to BIA both in terms of the potential financial impact of the sales being classified as unsuitable and in terms of the risk of these issues being identified by the FSA.
- 10.4. In addition, the Compliance Report was concerned that the motivating factor behind the strategy was a desire to increase members' commission income. To support this assertion the Compliance Report noted that the change in the strategy from recommending WoL policies to RSPs had coincided with a reduction in the level of premium on which indemnity commission would be paid by the WoL policy provider.
- 10.5. The Compliance Report included a recommendation that a ban be imposed on all of these sales until further work was undertaken to clarify whether the recommendations arising from the consultant's workshop were suitable.

11. The four external reports

- 11.1. In light of the concerns raised by Compliance, BIA commissioned four independent reports from three external firms ("the external reports") during the period April to December 2003. The first two reports received on 3 April and 4 July 2003 respectively were provided by a firm of actuaries. The third report received on 8 September 2003 was provided by a technical services company with expertise in compliance issues. The fourth report received on 18 December 2003 was provided by a firm of solicitors who performed a compliance audit role for BIA.
- 11.2. All of the external reports highlighted significant issues of concern regarding the strategy and its implementation by BIA members.
- 11.3. Key concerns arising from the external reports included the following:
- (1) WoL policies and RSPs provided lower fund values and retirement income in comparison with the projected returns from pensions and should not therefore be used as the primary investment vehicle for building up a fund for retirement for the majority of customers;
 - (2) WoL and RSPs should not be promoted as the only alternative to pensions and should only be considered after other alternative products had been determined to be inappropriate;
 - (3) that guidance issued by BIA in relation to the sale of WoL and RSPs as an alternative to pensions was not being followed by BIA's members resulting in a significant number of sales being made to customers outside of the target group of controlling directors;

- (4) Compliance was experiencing significant backlogs in its file review work; and
- (5) that the failure to follow guidance was leading to the identification of significant corrective action by Compliance in the majority of reviewed RSP cases.

First Actuarial Report

- 11.4. In order to determine the validity of Compliance's concerns, BIA's senior management asked a firm of actuaries to determine whether the strategy of using a particular provider's RSP products as a means of saving for retirement would result in larger fund values at retirement compared to traditional pension and savings products.
- 11.5. The 3 April 2003 report compared the anticipated benefits arising from investment in a particular product provider's RSP with those available from other traditional pension and savings products such as an ISA and a Stakeholder Pension.
- 11.6. The report concluded that the particular product provider's RSP produced the lowest level of income of all the products considered. Further, the report concluded that the RSP produced the lowest total payment on death and, in comparison with other products such as PPPs and ISAs, was not a tax efficient vehicle for the purposes of providing income in retirement. The report supported the Compliance Report's findings that recommendations to use the specified RSP as a vehicle for pension provision in retirement should be suspended.
- 11.7. The report was considered within Compliance and then circulated to the consultant and a member who had attended the training courses and was a supporter of the strategy. Both the consultant and the member raised concerns regarding the accuracy of the report's findings.
- 11.8. BIA did not accept the report's recommendation that sales of RSPs be suspended.

Second Actuarial Report

- 11.9. A second actuarial report was commissioned from the same firm of actuaries in order to enable them to take into account the views of the consultant and the member (who had read and commented on the first report) and to test the robustness of their original findings by testing the performance of the RSP against a wider range of alternative products and scenarios. In particular, the second report's comparative analysis drew a distinction between shareholding directors and salaried directors/employees in order to take into account the greater range of remuneration methods available to shareholding directors.
- 11.10. The report concluded that the RSP did not provide the highest level of total lifetime benefits whenever death occurs. The report also recommended that, in view of the lower level of income provided by a RSP on retirement compared to a traditional pension arrangement, the RSP should not be used as the main investment vehicle for the majority of customers saving for retirement.
- 11.11. This second report was provided to BIA's senior management on 4 July 2003 and circulated to three members who had attended the training courses and were

supporters of the strategy. The three members criticised the technical accuracy of the reports. It was also forwarded to BBB's senior management on 29 July 2003.

- 11.12. BIA did not make its membership aware of the report's findings or consider whether the report raised sufficient doubt regarding the appropriateness of the strategy to warrant reconsidering the need for a PBR.

Technical Services Company Report

- 11.13. Whilst Compliance did not criticise the technical accuracy of the actuarial reports, BIA's senior management authorised a review of the findings of these reports by a technical services company (the "TSC") in order to attempt to satisfy the concerns of the three members.

- 11.14. TSC considered:

- (1) the validity of using WoL policies as an alternative to pensions;
- (2) the relevance and appropriateness of other "non-pension" alternatives to pensions; and
- (3) in respect of the second actuarial report, whether it had covered all relevant issues and whether it alone should be the sole basis of advice to BIA's members regarding this area of BIA's business.

- 11.15. The report, in conclusion, supported the finding of the actuaries that a WoL policy should not automatically be considered as the main alternative investment vehicle for retirement. Further, the report concluded that whilst considering alternatives to pensions was valid, it was wrong to promote the WoL policies as the sole option for funding retirement. The report indicated that a WoL policy should, for most customers, only be considered after pensions or ISAs have been identified as being inappropriate.

- 11.16. In response to the TSC recommendation the guidance was amended so that consideration of WoL and RSPs should only take place after pensions and ISAs have been discounted. However, as a consequence of lengthy consultation involving the consultant and certain members who had attended the training courses, the revised guidance did not come into effect until 1 May 2004 some 6 months after the receipt of the TSC report.

- 11.17. Whilst the TSC report made clear that WoL and RSPs should only be recommended once ISAs and pensions had been discounted, BIA took no action to check whether past business which had followed the strategy had discounted ISAs and pensions.

Solicitors' Report

- 11.18. BIA engaged solicitors to conduct periodic audits in respect of its systems and controls. During the December 2003 audit, the solicitors considered issues relating to the sale of RSPs, including reviewing three individual files and assessing the effectiveness of BIA's File Review team. A report detailing the findings from this

visit was provided to members of BIA's and BBB's senior management on 18 December 2003.

- 11.19. The report's conclusions included the finding that members were not following the guidance on RSP sales in the majority of cases. In particular, the solicitors found that sales were being made outside of the target customer group of controlling directors.
- 11.20. In order to meet the attendant risk that this failing could result in unsuitable sales, the report included a recommendation for the 100% pre-sale monitoring of policies until it could be established that guidance was being followed and only suitable sales were being made. Further, the solicitors cautioned BIA that if significant corrective action was required in the majority of cases, as Compliance confirmed was the case, then BIA should take pro-active steps to address the problem.
- 11.21. The report also identified concerns regarding the capacity and resources of BIA's compliance File Review team. In particular the solicitors noted that the File Review team were currently experiencing a 3 ½ month backlog with their file review work and that the random sampling of files from members, as provided for in BIA's compliance plan, had not been undertaken for approximately a year.
- 11.22. The report also stated that the decision to recommend a particular provider's RSP instead of a particular provider's WoL appeared to be directly related to the cessation of the payment of indemnity commission on the WoL. The solicitors considered that this indicated that the sale of the RSPs may be commission driven.

BIA's response to the external reports

- 11.23. BIA's response to the concerns identified in these four reports was inadequate for the reasons set out below:
 - (1) BIA failed to circulate the reports' findings to all of its members and therefore the membership of BIA were unable to take into account the reports' findings when making RSP recommendations;
 - (2) BIA failed to consider whether the findings detailed in the four reports justified a review of past business. In its letter to the FSA dated 28 August 2002, BIA had undertaken to reconsider the need for a PBR should doubts regarding the appropriateness of its review of the strategy arise. However, despite the concerns identified in the four reports regarding the strategy no such consideration took place;
 - (3) revised guidance in relation to the sale of RSPs was not issued by BIA until 1 May 2004, some 13 months after receipt of the original actuarial report and some 4 months after BIA had received a fourth external report identifying concerns regarding its use of WoL policies and RSPs as an alternative to pensions. Further, BIA took no steps to review policies that had been sold in the period prior to the revised guidance being issued on 1 May 2004; and
 - (4) apart from the revised RSP guidance, BIA did not take any further action in respect of the reports' findings.

12. Compliance Reporting to the BBB Board

- 12.1. From September 2002 to November 2003 the BBB Board received regular formal reports and informal communications regarding issues relating to the strategy.
- 12.2. In November 2003 a member of Compliance provided a report on the strategy to a BBB Board member. This report included a summary of the findings of the first three external reports. The BBB Board member's involvement increased in December 2003 and January 2004 following receipt of the solicitors' report. The BBB Board member dealt directly with the Compliance department to address the concerns raised.
- 12.3. The BBB Board member was sufficiently concerned by the reports' findings to write and ask BIA to consider the following six options to address what he perceived to be the risks arising from the strategy:
 - (1) 100% pre-sale vetting;
 - (2) revising the guidance;
 - (3) licensing the sale of the products;
 - (4) withholding commission;
 - (5) stop the sale outside the target market; and
 - (6) increased training
- 12.4. Of the six proposed options, only option (2) was adopted by BIA, with revised guidance eventually being issued to members on 1 May 2004. Options (1) and (4) were rejected to avoid additional costs and further member complaints. Options (3) and (6) were not implemented on the basis that BIA's File Review team provided an effective check on sales (this decision was taken despite BIA being aware that the file review team were experiencing delays in checking files that were impacting on its effectiveness). The suspension of sales envisaged in option 5 only took place in December 2004, after the commencement of the FSA enforcement investigation, with BIA suspending the sale of RSP and WoL contracts made in accordance with the strategy.
- 12.5. By reason of the matters set out in paragraphs 8 to 12, it appears to the FSA that BIA has breached the following FSA Rules: SYSC 3.1.1R and 3 .2.6R and FSA Principles 3 and 6.

13. Suitability of sales of WoL and RSP policies

- 13.1. BIA is required by FSA Principle 9 to take reasonable care to ensure the suitability of its advice for any customer who is entitled to rely upon its judgment. BIA's customers would have relied upon BIA to provide them with advice that was suitable for them given their personal and financial circumstances.

FSA Supervision Visit Report

- 13.2. In May 2004 the FSA conducted a supervision visit to the head office of BIA and 12 of its members. The FSA reviewed sales of WoL policies from a particular provider and RSPs, also from another particular provider. During the course of the visits the Supervision team reviewed 36 WoL policies and 94 RSPs at 12 members. Of the customer files that were reviewed, 62 cases were queried as follows:
- (1) in 35 cases, BIA failed to demonstrate that the recommendation was suitable for the customers;
 - (2) in 22 cases, the recommendations were effected without a need for life cover being identified;
 - (3) in 18 cases, BIA had provided misleading product comparisons;
 - (4) in 5 cases, the products sold were effected over a term which would run into retirement without adequate explanation of how the plan would be funded in retirement.
- 13.3. Further, the Supervision Report noted that:
- (1) BIA appeared to consistently fail to identify potentially unsuitable recommendations when checking business written by its members, calling into question the effectiveness of its compliance arrangements; and
 - (2) Business was only checked after transactions had been put on risk and, whilst a significant number of cases required further disclosure to the customer in order to pass the internal check, none were rejected. There was a risk that cases and suitability letters were amended after point of sale to be compliant, but that the overall suitability of the recommendation was not assessed.
- 13.4. BIA responded to the findings of the Supervision Report on 30 November 2004. Of the 62 cases queried by the FSA, BIA admitted that there were concerns in 31 of these cases across 5 of the members, but contended that these concerns were limited to concerns regarding the standard of documentation and not, necessarily, the quality of the underlying advice.

Further review by Enforcement

- 13.5. BIA provided the FSA with a sample of customer files of sales of WoL and RSP policies made during the relevant period. The FSA reviewed these files to determine what the typical profile of the customers was and whether this was in line with the strategy and target market.
- 13.6. Of the 85 files (54 RSPs and 31 WoL) where this level of information was available, the review found that 31 sales were made to directors/owners of SMEs, 43 were sales made to employed individuals, and 11 sales were made to customers with other

employment statuses such as self employed individuals and housewives. Therefore 64% of the sales were made to customers outside of the target market.

BIA's further review

- 13.7. However, BIA has since continued to review its findings and have acknowledged that:
- (1) a number of sales were effected which contained life cover that was paid for by the customers' premium when that customer had no need for life cover;
 - (2) suitability letters sent to some customers which recommended that they effect a WoL or RSP did not demonstrate why that recommendation was suitable, given the availability of other, potentially more suitable products such as PPPs or ISAs; and
 - (3) customers were provided with analysis and comparisons between the WoL or RSP and alternative products which may have misled the customers with regards to the merits of the products.
- 13.8. Whilst Compliance did take steps to review files, BIA has acknowledged that it is very likely that the above failures will have resulted in unsuitable sales having been made to customers.
- 13.9. By reason of the matters set out in paragraph 13 above, it appears to the FSA that BIA has breached the following FSA Rules: COB 2.1.3R, 5.2.5R, 5.2.9R, 5.3.14R, 5.3.16R and FSA Principles 6, 7 and 9.

Past Business Review

- 13.10. BIA is proposing to perform a PBR, in order to determine the extent of any misselling. BIA has indicated that it is committed to providing redress to those customers who have suffered financial loss as a result of any unsuitable advice and has estimated that the cost of such redress could be between £500,000 and £1 million in total.

14. RELEVANT GUIDANCE ON FINANCIAL PENALTY

- 14.1. The FSA's policy on the imposition of financial penalties is set out in Chapter 13 of the Enforcement Manual which forms part of the FSA Handbook. The principle purpose of the imposition of a financial penalty is to promote high standards of regulatory conduct. It seeks to do this 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.
- 14.2. Paragraph 13.3 of the Enforcement Manual sets out the factors that may be of particular relevance in determining the appropriate level of financial penalty. Paragraph 13.3.4 states that the criteria listed in the Manual are not exhaustive and all relevant circumstances of the case will be taken into consideration.

- 14.3. The FSA considers that BIA's failings would have merited the imposition of a financial penalty of £425,000 were it not for the limited nature of BIA's financial resources as set out in paragraph 15.4 of this Final Notice. In determining what would have been the appropriate level of financial penalty the FSA considers that the factors set out between paragraphs 14.4 and 14.15 are particularly relevant in this case.

The seriousness of the misconduct or contravention

- 14.4. The level of financial penalty must be proportionate to the nature and seriousness of the contravention. In determining the appropriate sanction, the FSA has had regard to the seriousness of the contraventions, including the nature of the requirements breached, the number and duration of the breaches, the number of customers who were exposed to risk of loss and to whether the misconduct or contravention revealed serious or systemic weaknesses of the management systems or internal controls. For the reasons detailed below the FSA considers that the breaches identified in this case are of a serious nature:

- (1) BIA is a national IFA network with 249 members. As a network, BIA was responsible for the compliance of its members. Instead of discharging its responsibilities, BIA allowed its members to expose customers to a potentially inappropriate strategy when that strategy had not been formally approved by BIA or Compliance, and without undertaking any assessment of whether its members had the skills to successfully implement the strategy;
- (2) When the strategy was recommended to customers, BIA failed to monitor whether or not it had been recommended appropriately. The failings exposed systemic weaknesses in BIA's management and internal controls. In particular, the approach adopted by the File Review team was systemically flawed in that they did not make any assessment of whether the advice provided by the members was suitable or not;
- (3) the failings occurred over a significant period of time (December 2001 to September 2004);
- (4) the failures have exposed approximately 3,800 of BIA's customers to the risk of financial loss. BIA estimates that the total loss could be between £500,000 to £1 million; and
- (5) customers have been exposed to the risk of financial loss despite BIA, between May 2003 and December 2003, having been in receipt of information (i.e the May 2003 Compliance Report and the four external reports) which should reasonably have caused BIA to investigate whether or not customers had suffered financial loss as a consequence of unsuitable sales.

The extent to which the contravention or misconduct was deliberate or reckless.

- 14.5. The FSA has not determined that BIA deliberately breached the relevant rules and principles. However, during the relevant period, BIA was presented with a number of options by Compliance and by external firms which, had they been adopted, would have mitigated the risk that BIA's members may have missold WoL and RSPs. Other

than amending existing guidance, BIA chose not to adopt the majority of the options. These options included suspending sales of WoL and RSPs until further information about the strategy was obtained or checking all WoL policies and RSPs before they were put on risk.

- 14.6. BIA failed to consider the extent to which the Compliance report and the external reports merited the carrying out of a PBR in order to determine the suitability of RSP and WoL sales. This showed a reckless disregard by BIA for the interests of their customers.

The amount of profits accrued or loss avoided

- 14.7. The FSA has not determined that BIA deliberately set out to accrue additional profits or avoid a loss through the sales of WoL and RSPs. However, the effect of implementing a strategy which favoured the recommendation of WoL and RSPs over other products such as PPPs and/or ISAs resulted in BIA's members receiving larger commission payments than they would otherwise have received had they recommended other such products. BIA's contractual arrangements with their members meant that BIA, in turn, benefited from the increased commission income earned by its members. The FSA has taken particular note of the fact that when the commission terms offered by one provider of the WoL were amended to reduce the amount of commission paid at the inception of the contract; the strategy was amended to favour a RSP from an alternative product provider.
- 14.8. Following commencement of the FSA's investigation BIA now proposes to conduct a PBR of WoL and RSP policies in order to determine the extent of any misselling. This, together with the cost to BIA of conducting the PBR, will mean that there is likely to be no net gain to BIA as a result of unsuitable sales of WoL and RSPs.

Conduct following the contravention

- 14.9. The FSA has had regard to the fact that BIA took no action to determine the extent of any misselling, despite receiving reports between May 2003 and December 2003 that indicated misselling was a significant risk, until the FSA's discovery of the issues in September 2004. This failure occurred despite assuring the FSA in August 2002 that the need for a PBR would be reviewed should BIA have concerns regarding the implementation of the strategy.
- 14.10. The FSA has given BIA due credit for its decision to voluntarily suspend sales of WoL and RSP policies by its members following commencement of the Enforcement investigation in September 2004. However, despite accepting that a PBR was necessary in October 2004, and taking a number of preparatory steps, the PBR is yet to commence. This delay has served to aggravate BIA's failings.
- 14.11. It is acknowledged that, prior to April 2005, except for the delay in the commencement of the PBR detailed above, BIA has co-operated with the investigation. Since April 2005, BIA have co-operated very closely with the FSA in order to reach a timely resolution of the investigation. In particular, BIA has acknowledged that the failures identified by the FSA are very likely to have contributed to unsuitable sales. The level of financial penalty that would have been

imposed, but for BIA's limited financial resources, reflects the co-operative approach adopted by BIA during the settlement discussions which has enabled this investigation to be resolved in an appropriate and timely manner.

Disciplinary record and compliance history

- 14.12. BIA has been disciplined on two previous occasions by the PIA for failing to take reasonable care to monitor its members.
- 14.13. In 1997 BIA was ordered by the PIA Membership and Disciplinary Tribunal to pay a fine of £70,000 and the PIA's costs after it admitted that it had failed to take all reasonable steps to ensure that its members conduct pensions reviews in accordance with the standards established by PIA.
- 14.14. In 2000 BIA was fined £125,000 and ordered to pay PIA's costs for failures relating to Systems and Controls. In particular, BIA had failed to adequately monitor the conduct of its members and had failed to follow their own internal procedures for reviewing customer files.

Previous action taken in relation to similar failings

- 14.15. In deciding what would have been an appropriate level of financial penalty, the FSA has taken into account financial penalties levied by previous regulators and by the FSA.

15. RELEVANT GUIDANCE ON PUBLIC CENSURE

- 15.1. The FSA's policy on public censures is set out in Chapter 12 of the Enforcement Manual which forms part of the FSA Handbook. The Guidance makes it clear that the issuing of a public censure is a serious sanction. Furthermore the Guidance confirms that where it is not appropriate to impose a financial penalty, a public censure may have particular value in enabling the FSA to pursue its regulatory objectives by highlighting the requirements and standards of conduct expected of firms and approved persons and demonstrating that those standards are being effectively enforced, so helping to maintain confidence in the financial system. In addition, public censures promote public awareness of the standards expected of firms and approved persons which also contributes towards greater consumer protection.

The size, financial resources and other circumstances of the firm

- 15.2. Section 12.3 of the Enforcement Manual details those factors that are relevant to determining whether to issue a public censure rather than impose a financial penalty. Paragraph 12.3.3 confirms that the criteria to be applied are similar to those for determining the level of financial penalty listed in ENF 13 (as considered in Section 14 above). In addition to considering these criteria and all the relevant circumstances of the case, the FSA will consider whether a firm has the means to pay a financial penalty. In this respect ENF 12.3.3(6) provides the following detailed Guidance:

"if the firm or approved person has inadequate means (excluding any manipulation or attempted manipulation of their assets) to pay the level of financial penalty which their breach or misconduct would otherwise attract, this may be a factor in favour of a lower level of penalty or a public statement. However, it would only be in an exceptional case that the FSA would be prepared to agree to impose a public statement rather than a financial penalty, if a financial penalty would otherwise be the appropriate sanction. Examples of such exceptional cases could include:

- (a) verifiable evidence that an approved person would suffer serious financial hardship if the FSA imposed a financial penalty; and*
- (b) verifiable evidence that the firm would be unable to meet other regulatory requirements, particularly financial resource requirements, if the FSA imposed a financial penalty at an appropriate level."*

- 15.3. ENF 12.3.3(6) therefore requires the FSA to take into account whether there is verifiable evidence that the firm would be unable to meet other regulatory requirements, including its financial resource requirements if the FSA imposed an appropriate financial penalty.
- 15.4. BIA has provided the FSA with financial information which shows that it had a capital adequacy deficit of £(8,649,322) as at 31 July 2005.
- 15.5. In accordance with the Guidance set out in ENF 12.3.3(6), the FSA has had regard to whether or not BIA has sufficient resources to pay an appropriate financial penalty in addition to the substantial sums which will potentially be paid to customers as a result of the redress exercise which BIA proposes to undertake. The FSA has also taken account of the fact that BIA will incur substantial costs as a result of carrying out the PBR.
- 15.6. The FSA has determined that, in all the circumstances of this case, the appropriate disciplinary sanction is for BIA to be issued with a public censure. In reaching this decision the FSA has concluded that there is verifiable evidence that BIA is not able to meet its financial resource requirements and does not have adequate means to pay the level of financial penalty which would otherwise be merited by the breaches detailed in this Final Notice.

16. IMPORTANT NOTICES

- 16.1. This Final Notice is given to you under section 390 of the Act.

16.2. Publicity

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 these 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 BIA or prejudicial to the interests of consumers.

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

16.3. Third party rights

No third party rights have been identified in this case.

FSA contacts

- 16.4. For more information concerning this matter generally, you should contact Jennifer Brennan at the FSA (direct line: 020 7066 2808 /fax: 020 7066 2809) or Philip Cooper at the FSA (direct line: 020 7066 1496/Fax: 020 7066 1497).

Julia Dunn
Enforcement Division
The Financial Services Authority