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## FINAL NOTICE

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To: **Bradford & Bingley plc("BBG")**

Of: **PO Box 88  
Crossflatts  
Bingley  
West Yorkshire  
BD16 2UA**

Date 22 December 2004

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

### **1. PROPOSED ACTION**

1.1. The FSA gave you a decision notice on 20 December which notified you that pursuant to section 206 of the Financial Services and Markets Act 2000 ("the Act"), the FSA had decided to impose a financial penalty of £650,000 on Bradford & Bingley plc ("BBG") in respect of breaches of the following Rules and Principles:

- until 1 December 2001 ("N2"), the Securities and Investments Board ("SIB") Principles 2 and 9 and the connected Rules of the Personal Investment Authority ("PIA"), including Adopted SIB Rules, listed in the Appendix to this Notice ("the Appendix"); and
- after N2, the FSA's Principles for Businesses ("FSA Principles") 2, 3 and 9 and the connected Rules in the parts of the FSA's Handbook entitled *Conduct of Business* ("COB Rules") and *Senior Management arrangements, Systems and controls* ("SYSC Rules") also listed in the Appendix.

### **2. THE SIB PRINCIPLES AND FSA PRINCIPLES, RELEVANT STATUTORY PROVISIONS AND OTHER REGULATORY RULES**

2.1. The SIB Principles are universal statements of standards expected of firms. They were issued by the SIB and applied to PIA members.

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

2.3. SIB Principle 9 provided that a firm should organise and control its internal affairs in a responsible manner, keeping proper records, and where the firm employs staff or is

responsible for the conduct of investment business by others, should have adequate arrangements to ensure that they are suitable, adequately trained and properly supervised and that it has well-defined compliance procedures.

- 2.4. The FSA's Principles are set out in the part of the FSA's Handbook entitled Principles for Businesses. They are a general statement of the fundamental obligations of authorised persons 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.
- 2.5. FSA Principle 2 provides that a firm must conduct its business with due skill, care and diligence.
- 2.6. FSA Principle 3 provides that a firm must take reasonable care to organise and control its affairs responsibly and effectively, with adequate risk management systems.
- 2.7. FSA Principle 9 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.
- 2.8. The FSA's regulatory objectives established in section 2(2) of the Act include the protection of consumers and maintaining confidence in the financial system.
- 2.9. Section 206 of the Act provides:

*“If the Authority considers that an authorised person has contravened a requirement imposed on him by or under this Act, it may impose on him a penalty, in respect of the contravention, of such amount as it considers appropriate.”*
- 2.10. The Financial Services and Markets Act 2000 (Transitional Provisions and Savings) (Civil Remedies, Discipline, Criminal Offences etc) (No2) Order 2001 provides, at Article 8(2), that the power conferred by Section 206 of the Act can be exercised by the FSA in respect of failures by a firm to comply with any of the provisions specified in Rules 1.3.1(6) of the PIA Rules as if the firm had contravened a requirement imposed by the Act.
- 2.11. PIA Rule 1.3.1(2) provided that a PIA member must obey the PIA Rules, which included the Adopted SIB Rules.
- 2.12. PIA Rule 1.3.1(6) provided that a PIA member which failed to comply with, inter alia, the PIA Rules or any of the SIB Principles was liable to disciplinary action.

### **3. REASONS FOR THE PROPOSED ACTION**

- 3.1. The FSA has decided to impose a financial penalty on BBG in respect of breaches of the SIB Principles, connected PIA Rules, including the Adopted SIB Rules and of the FSA's Principles and Rules referred to in paragraph 1.1. The breaches, which occurred between January 2001 and December 2002 ("the period in issue") arose from failures on the part of BBG in relation to the mis-selling of Structured Capital at Risk Products ("SCARPs") and With-Profit Bonds ("WPBs"), as follows:

- Failure to make suitable recommendations;

- Failure to maintain adequate records of customers and sales;
- Failure to maintain systems and controls that were sufficiently robust to prevent the failures referred to above and, when failings with regard to documentation (which should have been investigated in order to assess whether there was any underlying mis-selling) were identified, failure to resolve them in a timely manner.

3.2. BBG's failings were made all the more serious because of the following factors:

- 1). BBG had been put on notice that there were significant issues with the quality of the documentation created during meetings with customers on a number of occasions from 1998 onwards. Despite having been in receipt of reports from external parties which indicated that the only major issue concerned documentation, the warnings in the independent review should have been sufficient to cause BBG to question certain aspects of its sales process. However, BBG failed to pay sufficient attention, or to give proper consideration to the potential implications of these warnings;
- 2). BBG's systems and controls were not sufficiently robust to prevent these failings or, when they were identified, to resolve them in a timely manner;
- 3). BBG failed to appreciate the significance of the documentary failings and failed to report them to senior management;
- 4). The failings in BBG's sales process and systems and controls in respect of SCARPs and WPBs were systemic and continued for a significant period of time; and
- 5). These failings were such that they exposed approximately 6,800 of the 29,000 of BBG's customers who purchased these products to a higher risk of financial loss than was appropriate for the attitude to risk of those individual customers. BBG are compensating approximately 6,800 customers with compensation estimated at approximately £6 million.

3.3. BBG's failings therefore merit a substantial financial penalty. In fixing the amount of the proposed penalty, however, the FSA recognises the following measures taken by BBG which serve to mitigate the seriousness of its failings:

- 1). BBG has co-operated fully with the FSA since its senior management became aware of the issues in August 2002;
- 2). BBG has conducted a thorough investigation into the circumstances surrounding the issues concerned;
- 3). BBG has undertaken a full review of its selling practices (the "ROSP review"), retrained all of its advisors and implemented new systems and controls in relation to its sales and checking processes;
- 4). BBG has reviewed the business it advised upon and has satisfied itself and the FSA that the only aspect of the business requiring a proactive past business review were WPBs and SCARPs;

5). BBG has, following agreement with the FSA, undertaken a proactive past business review in order to identify any potential mis-sales of:

- WPBs in the period 1 January to 31 December 2002; and
- SCARPs in the period 1 January 2001 to 31 December 2002;

and has made appropriate arrangements for compensation where a customer's attitude to risk was inappropriate for a SCARP or WPB.

#### **4. BACKGROUND**

##### **BBG's Regulatory History**

4.1. BBG has been regulated by the FSA since 1 December 2001. Prior to that it was regulated by the Personal Investment Authority ("PIA"). BBG's Head Office is at Crossflatts, Bingley, West Yorkshire.

4.2. BBG is the largest Independent Financial Adviser ("IFA") in the UK (although it has recently announced a deal to serve as a tied agent of Legal & General). It sells a range of financial products (including WPBs and SCARPs) through its network of branch offices throughout the UK. BBG offered a personal wealth independent financial adviser service ("WIFA"). The WIFA business was undertaken under the trading-style of "MarketPlace".

##### *Compliance arrangements*

4.3. BBG's Compliance arrangements were divided into two distinct elements:

- 1). A Compliance Policy and Process area which had responsibilities including monitoring regulatory developments; and
- 2). A Compliance monitoring department responsible for all of the financial services business conducted by BBG. This department had two key areas of activity:
  - A Field Monitoring Unit, which concentrated on making visits to Sales Managers and BBG branches to assess the management of its advisers and to conduct reviews of the suitability of advisers' recommendations; and
  - The Business Monitoring Unit ("BMU"), the primary purpose of which was to monitor the quality of advice given by BBG's advisers.

4.4. The BMU was responsible for performing a central check on the quality of business written by BBG. It reviewed sales-related documentation submitted by BBG's advisers and measured the quality of the documentation against a pre-determined set of guidelines governed by regulatory requirements and BBG's own internal procedures. It adopted a risk-based approach that reviewed some, but not all, of the sales of advisers and also certain types of higher-risk transactions such as pension transfers.

## *Compliance reporting to Senior Management and the Board*

### Audit Risk and Compliance Committee ("AR&CC")

- 4.5. The role of the Audit Risk and Compliance Committee ("AR&CC") was to monitor the effectiveness of BBG's Risk Management processes and financial and other internal control systems. The AR&CC consisted of four non-executive directors, although executive directors were also invited to attend AR&CC meetings. In order to assist it in meeting its objectives the AR&CC received regular reports from Compliance and in particular, on the results of reviews conducted by Compliance (as described in 4.3(2) above) and external agencies where thought appropriate .

### Group Risk Committee ("GRC")

- 4.6. The Group Risk Committee ("GRC") was established to support the Group Chief Executive in ensuring that the Group's overall risk management was effective and that key risks were managed cost-effectively and in keeping with the firm's overall risk appetite. Further, the GRC was responsible for considering matters relating to governance, control and regulatory and compliance issues.
- 4.7. On 28 May 2002 an external professional services firm reported on BBG's high level systems and controls, internal audit and risk management within BBG. They concluded, without any material exceptions, that the high-level procedures relating to compliance reporting and escalation were satisfactory.

## **5. PRODUCTS AND RISKS**

### ***SCARPs***

- 5.1. SCARPs are stock-market based products that offer either growth or income that is generally more favourable than that of a deposit-based account offered by a bank or building society.
- 5.2. The risks of SCARPS are significant because of the inflexible nature of the underlying investment vehicles. This inflexibility means that the risks inherent were significantly greater than those of traditional "pooled" equity investments, such as unit trusts. The principal risks of SCARPs are:
- (1) The contracts are for a fixed term. SCARPs are designed to give maximum benefits only after a fixed period. If they are cashed in early, customers may get a poor return as the underlying investments may have to be sold.
  - (2) The return of capital is pre-determined because it is linked to a specified index. There is no facility to "manage" the investment either to enhance returns or reduce exposure to falling markets.
  - (3) Some SCARPS have a product feature where capital reduces on an accelerated basis relative to the performance of a relevant index by a pre-determined ratio, for example at a rate of 2:1. This is known as "enhanced gearing". For example, a 2:1 gearing can reduce capital by 2% for each 1% fall in the relevant index.

- (4) The charges are higher than for traditional "pooled" equity investments such as unit trusts.
- 5.3. In order to mitigate some of the risks, SCARPS contained features which meant that as long as the performance of the index remained within set parameters capital invested within a SCARP was protected. This is known as the "soft protection barrier".
- 5.4. During the period in issue BBG sold approximately 11,000 SCARPs. BBG only offered SCARPs that were stock-market based and linked to specific indices. None of the SCARPs that it offered were linked to baskets of shares where the inherent risks were greater.
- 5.5. Of the SCARPs sold by BBG, approximately 2,300 (21% of the total sold) had enhanced gearings. The large majority of these had downside gearing of 2 for 1, once the soft protection barriers had been breached.

#### **WPBs**

- 5.6. WPBs, in general, have a lower risk profile than funds that invest in equities as they typically invest in a mix of shares, bonds, property and cash deposits. The return on investments is smoothed by retaining some of the return in good years and releasing it in years when performance is poor. They also offer the prospects of a better rate of return than a deposit-based savings account because of the mix of assets within the fund.
- 5.7. The risks of WPBs are generally considered to be lower than the risks associated with equity-based investments because the addition of annual bonuses ameliorates the effects of any fluctuations in the underlying investments and the asset mix.
- 5.8. However, WPBs still contain some investments that fluctuate in value. Further, providers can reduce their risk by the inclusion of a Market Value Adjuster ("MVA") within the product that can reduce the value on early encashment. Generally, MVAs are applied to the value of encashments when there are significant falls in the value of the underlying investments. The application of MVAs protects the value of funds for investors that choose to remain invested in WPBs during periods of significant market or economic downturn.
- 5.9. Since 2000, WPBs have seen reduced bonus declarations and the application of MVAs which have resulted in significantly reduced capital returns for customers.
- 5.10. During the period in issue BBG sold 18,703 WPBs.

#### **Discovery of the issues**

- 5.11. As a result of a PIA Monitoring Visit in October 1998 BBG was aware of failings in relation to the documentation of sales made by its advisers but BBG considered that there was no suitability issue. Following the amalgamation of the BMU and FMU, BBG commissioned on-going work to monitor sales documentation which continued to identify that the documentary records of dealings with customers were still not of a sufficiently acceptable standard.

5.12. In February 2001, BBG arranged for an independent third party to review the quality of work conducted by the BMU, FMU and other parts of the BBG group ("the independent review"). A series of reports were issued as a result of this review and the further work that was commissioned by BBG as a result of the issues identified. These reports were as follows:

- An interim report that commented on the initial findings of a desk-based review of 30 cases, which included a high proportion of bonds including WPBs, and was issued in February 2001 ("the interim report"). The report observed that advisers did not appear to be conducting full financial analysis of customers' circumstances.
- A final report (following on from the interim report) that presented the findings of the desk-based review of 115 sales and was issued in February 2002 ("the first report"). The report stated that there had been great improvements in 2001 but identified that reviewers were not taking an holistic approach to checking and that in the checking process there were inconsistent standards and inadequate or unused procedures.
- In May 2002 the FSA asked for details of the methods used by BBG to measure the effectiveness of the BMU. In response to this query, BBG's Compliance department drew the FSA's attention to the independent review. Subsequently, the FSA requested copies of the interim and first reports of the independent review and, at a meeting on 9 August 2002 the FSA raised with BBG the potential risk that the failings might indicate mis-selling.

5.13. In September 2002 BBG decided to undertake the ROSP review. The ROSP review included a comprehensive programme of adviser, supervisor and checking training and reassessment, together with the introduction of an improved sales process, enhanced documentary requirements and increased controls in relation to adherence to policies and standards. As part of the ROSP, BBG commissioned two further independent reviews:

- A report dated November 2002 that commented on a review of 165 WPB sales ("the second report"). The findings of the report identified an inconsistent approach to the validation of customers' attitude to risk and stock market linked investment products including SCARPs.
- A further report dated February 2003 ("the third report") that commented on a review of 299 sales of different products that highlighted significant and specific problems with the sales of SCARPs such that it cast into serious doubt the suitability of those sales.

5.14. Both the first and second reports highlighted deficiencies in:

- 1). the quality of the files submitted by BBG's advisers;
- 2). the approach of BBG's advisers towards gathering relevant client information in relation to sales of WPBs; and
- 3). the ability of the FMU and BMU to identify such deficiencies.

## **Remedial action**

- 5.15. BBG acknowledged that, given the overall conclusions from the second and third reports, it would need to take proactive steps to address any suitability issues in respect of relevant sales of WPBs and SCARPs. A past business review was accordingly commissioned to identify unsuitable sales and to provide appropriate redress where necessary. As a result of the past business review, BBG has agreed to pay compensation in respect of any losses it is currently estimated by BBG that this may total approximately £6million. However, when considering the value of compensation it is important to note that where there is a lack of documentation to support the sale BBG has accepted without challenge a customer's recollection of their attitude to risk in order to ensure that those affected are compensated in a timely manner.

## **6. CONTRAVENTION OF RELEVANT STATUTORY REQUIREMENTS**

- 6.1. The penalty is to be imposed pursuant to Section 206 of the Act in respect of breaches of the PIA Rules, including Adopted SIB Rules and Principles, and of the FSA Rules and Principles, details of which are set out below:

### **(1) Failure to make suitable recommendations**

- 6.2. Since N2 BBG has been required by FSA Principle 9 to take reasonable care to ensure the suitability of its advice and discretionary decisions for any customer who is entitled to rely upon its judgment. BBG was also required to take reasonable care to ensure that it made only recommendations that were suitable in light of customers' personal and financial circumstances by virtue of PIA Adopted SIB Rule 5.01 until N2 and FSA COB Rule 5.3.5 after N2. BBG failed to do so.

#### Facts and matters relied on

- 6.3. As a result of the issues initially identified with regard to WPBs, BBG commenced a detailed review of the findings in September 2002. This was followed by a customer contact programme that commenced in January 2003. The programme initially considered WPBs but was later extended to include SCARPs as a result of the third report.
- 6.4. As part of its customer contact programme BBG re-contacted customers to gather further information that had not been recorded or had not been adequately recorded when the original sale was made. A reassessment of the original advice was made once the additional information had been gathered:
- 1). 87 SCARP sales were reassessed and it was concluded that in 18 cases (21%) the original advice was unsuitable; and
  - 2). 111 WPB sales were reassessed and it was determined that unsuitable advice had been given in 24 cases (22%).
- 6.5. BBG identified that the primary reason for the lack of suitability was a mismatch between the investment risk inherent within WPBs and SCARPs on the one hand and customers' attitude to risk on the other.



- 6.6. In addition, the risk pyramid, a sales aid used by BBG's advisers to classify the risk profile of products into three broad categories (cautious, balanced and adventurous), was seriously flawed. Specifically, the risk pyramid did not specify a category for customers who did not want to take any risk with their capital. Consequently, these customers were categorised as "cautious" in common with customers who were prepared to take some risk with their capital. This was important as it would have helped to identify those BBG customers for whom a WPB was inappropriate.

**(2) Failure to maintain adequate records of customers and sales**

- 6.7. BBG was required to record sufficient relevant personal and financial information about its customer in order to be able to make suitable recommendations, by virtue of PIA Rule 5.1.1(2) until N2 and FSA COB Rule 5.2.9 after N2. BBG failed to do so.

Facts and matters relied on

- 6.8. BBG's used a document entitled a "Client Needs Analysis" ("the CNA") to record personal and financial information about its customers. The CNA contained questions and sections designed to ensure that advisers recorded particular aspects of a customer's personal and financial circumstances such as income and expenditure. The third report identified deficiencies in 222 cases out of the 299 cases reviewed (74%).

**(3) Failure to maintain adequate systems and controls**

- 6.9. Before N2 BBG was required by SIB Principle 9 to organise and control its affairs in a responsible manner. Since N2, BBG has been required by FSA Principle 3 to take reasonable care to organise and control its affairs responsibly and effectively.
- 6.10. During the period in issue BBG was also required by SIB Principle 2 and FSA Principle 2 to conduct its business with due skill, care and diligence.
- 6.11. Until N2, BBG was required by PIA Rules 7.1.2 to establish procedures with a view to ensuring that it complied at all times with the relevant regulatory Rules and Principles and by PIA Rule 7.1.5 to establish and maintain a system of internal control appropriate to the size and type of its business. BBG was also required to monitor adequately the activities of staff to ensure compliance. Since N2, BBG has been required by SYSC Rule 3.1.1 to take reasonable care to establish and maintain such systems and controls as are appropriate for its business. BBG failed to do so.

Facts and Matters Relied On

- 6.12. BBG's failures to conduct its business to the requisite standard are evidenced by:
- The breaches described in paragraph 6 of this Notice; and
  - The failure of BBG to take earlier action with regard to the results of the independent review as described below.

**The independent review**

- 6.13. The interim report provided an analysis of the quality of the FMU's ability to review the advice given by BBG's advisers. A sample of 30 cases, which had previously been reviewed by the FMU found that further work was required and highlighted

concerns with the recommendations made. Whilst the report contained a number of caveats which meant that BBG could not reasonably have been expected to have formed conclusions based on the report alone, the comments were sufficiently serious that they should have served to put BBG on notice that there was a risk that sales of WPBs may not have been suitable for customers.

- 6.14. In addition to concerns regarding suitability, the interim report listed a number of general concerns about the quality of the work conducted by the BMU including:
- 1). Inconsistent standards of fact-find checking;
  - 2). Some reviewers were not taking all aspects of customers' circumstances into consideration and failing to take a holistic approach to checking; and
  - 3). The fact that number of incidents where a "fail" grade was subsequently overturned on appeal by Sales Management without further investigatory work being conducted.

#### **Reporting on the results of the independent review**

- 6.15. Despite the fact that the interim report highlighted documentary failings which meant that BBG could not be satisfied with the suitability of its WPB sales, BBG did not commence a detailed review of the findings until September 2002. This was followed by a customer contact programme that commenced in January 2003..
- 6.16. BBG's own internal guidelines meant that the results of the interim report should have been escalated. BBG had escalation guidelines according to whether a particular issue was defined as important, significant or critical. Critical issues were defined as those issues potentially affecting 5% or more of BBG's customers or staff or carrying a likelihood of causing censure by the FSA. According to BBG's own criteria, such issues should have been escalated to the Group Chief Executive, Group Management Board and Group Risk. There was a lack of adequate review and consideration of the interim and first reports and, despite the potentially damaging findings, neither the existence of nor the results of the reports were escalated to senior management.
- 6.17. The first report was delivered in February 2002 and, whilst noting that there had been improvements during 2001, it did not resile from any of the comments made in the interim report.
- 6.18. A BBG draft internal audit report ("the audit report"), produced in September 2002, indicated that there had been a number of separate control failures which had contributed to a failure to consider and review adequately the issues identified by the interim and first reports.

#### **Reporting to the AR&CC and GRC**

- 6.19. During the period in issue the AR&CC and GRC received regular reports on the state of Compliance within BBG. Whilst the AR&CC and GRC were regularly receiving such reports, which suggested that there was a poor standard of documentation on customer files they also received reports which suggested that the quality of the underlying advice was suitable.

- 6.20. Whilst the AR&CC and GRC were entitled to place some reliance on the reports which stated that the standard of advice was suitable, neither committee sufficiently challenged whether the reports of poor documentation were, in fact, indicators of potential suitability issues.

## 7. RELEVANT GUIDANCE ON SANCTIONS

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

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

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

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

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

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

*ENF13.3.3(1): The seriousness of the misconduct or contravention*  
*PIA Guidance: The seriousness of the breaches. The scale of any investor losses and the extent to which investors were exposed to risk of such losses.*

- 7.6. The level of financial penalty must be proportionate to the nature and seriousness of the contravention. The nature of the breaches was such that BBG's sales process put approximately 6,800 SCARPs and WPB customers at a higher risk of financial loss than was appropriate given their attitude to risk. The seriousness of the breaches is summarised at paragraphs 3.1 and 3.2 above.

- 7.7. In particular BBG's failings occurred over a significant period of time and resulted in a significant proportion of BBG's customers who purchased WPBs and SCARPs

receiving advice that was unsuitable. The customer contact programme commissioned in late 2002 as part of the overall ROSP commencing in January 2003 after discovery of the issues found that 21% of customers purchasing SCARPs and 22% of customers purchasing WPBs from BBG received unsuitable advice.

- 7.8. Whilst a definitive final figure for the amount of redress and/or the value of compensation that BBG will have to provide is not yet finalised, BBG's own current estimate is approximately £6 million.
- 7.9. The seriousness with which the FSA views the breaches is aggravated by the fact that they resulted from systemic weaknesses in BBG's sales and monitoring of WPBs and SCARPs and a failure to follow BBG's own internal escalation procedures.
- 7.10. BBG was put on notice that there were concerns regarding the quality of documentation in relation to its sales processes generally from October 1998 and, more specifically, from April 2001 that there were concerns regarding the sale of WPBs.
- 7.11. Following receipt of the interim and first report BBG failed to investigate whether the concerns about the suitability of WPBs had put customers at risk of financial loss, for a period of almost two years until September 2002. This is also a serious aggravating factor. Whilst BBG's senior management were receiving and placing reliance on reports which led them to believe that the advice BBG provided was suitable, the failure to consider adequately the potential consequences of the interim and first reports was such that BBG's behaviour is regarded as unacceptable.

ENF13.3.3(2): The extent to which the contravention is deliberate or misconduct was deliberate or reckless.

PIA Guidance: Whether the member intentionally or recklessly failed to meet PIA's requirements.

- 7.12. The FSA does not assert that BBG deliberately breached the PIA and the FSA's Rules and requirements or that BBG's failures have been deliberate or reckless.

ENF13.3.3(3): The size, financial resources and other circumstances of the firm.

PIA Guidance: The extent to which the member's governing body or senior management was culpable. The member's ability to pay.

- 7.13. During the period in issue, BBG was the largest IFA in the UK. Its brand had widespread public recognition, and it had significant financial resources. BBG's prominent national standing raised amongst its customers the expectation that the service it provided to them would be of a high standard. Customers therefore went to BBG in the expectation that it would provide a competent and professional financial advisory service. BBG's senior management failed to ensure that the resources and expertise that it did have available to it were deployed appropriately and effectively to ensure that BBG did not breach its regulatory requirements.
- 7.14. BBG would be able to pay a financial penalty in the amount proposed.

ENF13.3.3(4): The amount of profit accrued or loss avoided.

PIA Guidance: The extent to which, as a result of the breaches, the Member gained a benefit or avoided suffering a loss.

- 7.15. BBG received about £22 million commission from the sales of WPBs and SCARPs during the period in issue. Given the level of failings identified by the customer contact programme that 21% of SCARP sales and 22% of WPBs were unsuitable, this would equate to about £4.7 million of commission in respect of the mis-sales in terms of commission received by BBG.
- 7.16. BBG's annual report and accounts for 2003 shows that it made a pre-tax profit of £263 million for the year ending 31 December 2003.

ENF13.3.3(5): Conduct following the contravention

PIA Guidance: The firm's response once the breaches were identified.

- 7.17. It is important that firms, when they receive indications that call into question the suitability of advice they have given customers, take immediate and effective steps to investigate. For a period of almost two years, BBG failed to take such steps.
- 7.18. BBG was first alerted to potential failures in their sales process by the PIA in October 1998. Subsequently, BBG received periodic warnings that there had been compliance failures and that the FMU and BMU were not identifying these failures. The recipients of these warnings failed to take appropriate action, and the ability of others within BBG to take effective action was hampered by the failure to escalate the contents of the interim and first reports.
- 7.19. Whilst BBG failed to react in an adequate and timely manner to the contents of the interim and first reports, the approach that BBG has taken to its failures since the end of 2002 has ensured that the extent of the failures and all customers who had suffered loss as a result could be quickly identified.
- 7.20. In particular, BBG initiated the ROSP review which sought to determine the extent of any failures. Further, BBG has adopted a positive approach towards the payment of compensation to its customers. In particular, where there is a lack of documentation to support the sale BBG has accepted without challenge its customers' recollection of their attitude to risk.

ENF13.3.3(7): Previous action taken by the FSA in relation to similar behaviour by other firms

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

- 7.21. The FSA has previously fined firms in respect of a combination of the breaches committed by BBG. The FSA has also taken into account penalties levied by previous regulators and the FSA in relation to the breaches.

ENF 13.3.3(8) Action taken by other regulatory authorities

- 7.22. There has been no action taken by other regulatory authorities.

## **8. DECISION MAKER**

- 8.1. The decision which gave rise to the obligation to give this notice was made by the Regulatory Decisions Committee.

## **9. IMPORTANT NOTICES**

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

### **Manner of payment**

The Penalty must be paid to the FSA in full.

### **Time for payment**

The Penalty must be paid to the FSA no later than 5 January 2005, being not less than 14 days beginning with the date on which the Notice is given to BBG.

### **If the Penalty is not paid**

If all or any of the Penalty is outstanding on 5 January 2005, the FSA may recover the outstanding amount as a debt owed by BBG and due to the FSA.

### **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 a 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 BBG 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.

### **FSA contacts**

For more information concerning this matter generally, you should contact David Bates at the FSA (direct line: 020 7066 1446 /fax: 020 7066 1447).

Julia MR Dunn

**Head of Retail Selling**

**FSA Enforcement Division**

## **APPENDIX**

### **Rules referred to in the Notice**

1. PIA Rule 5.1.1 provided that a firm must keep sufficient records to establish compliance with relevant regulatory rules.
2. PIA Rule 7.1.2 provided that a firm must establish procedures to ensure that it and its employees comply with regulatory rules and principles, and to keep these procedures under review.
3. PIA Rule 7.1.5 provided that a firm must establish and maintain a system of internal control appropriate to the size and type of its business,
4. Adopted SIB Rule 5.01 provided that a firm must not make recommendations to a customer of an investment unless satisfied that the recommendation or transaction is suitable given the information which the customer has given or of which the firm is or ought to have been aware.
5. SYSC Rule 3.1.1 provides that a firm must take reasonable care to establish and maintain such systems and controls as are appropriate to its business.
6. COB Rule 5.2.9 provides that a firm must make and retain records of customers' personal and financial circumstances obtained in the course of its enquiries.
7. COB Rule 5.3.5 provides that a firm must not make any personal recommendation to a private customer to buy or sell a designated investment unless this recommendation is suitable for that customer having regard to information given by him or of which the firm is or ought to have been aware.