

## FINAL NOTICE

To: Liberata Financial Services Limited  
Of: No. 1 London Bridge  
London  
SE1 9AJ  
Date 8 April 2008

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

### 1. THE PENALTY

- 1.1. The FSA gave Liberata Financial Services Limited (LFS or the firm) a Decision Notice on 4 April 2008 which notified LFS that for the reasons listed below and pursuant to section 206 of the Financial Services and Markets Act 2000 (the Act), the FSA had decided to impose a financial penalty of £525,000 on LFS. This penalty is in respect of breaches of Principles 3 and 2 of the FSA's Principles for Businesses (the Principles) between 6 January 2005 and 25 April 2007 (the Relevant Period) in relation to failures in its systems and controls for producing and issuing documents to policyholders.
- 1.2. LFS confirmed on 18 March 2008 that it will not be referring the matter to the Financial Services and Markets Tribunal.
- 1.3. Accordingly, for the reasons set out below and having agreed with LFS the facts and matters relied on, the FSA imposes a financial penalty on LFS in the amount of £525,000.

- 1.4. LFS agreed to settle at an early stage of the FSA's investigation. It therefore qualified for a 30% reduction in penalty, pursuant to the FSA's executive settlement procedures. Were it not for this discount, the FSA would have sought to impose a financial penalty of £750,000 on LFS.

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

### **Summary of conduct in issue**

- 2.1. The FSA has imposed a financial penalty on LFS for breaches of the FSA's Principles. These breaches, which are described in more detail in section 5 below, relate to LFS's:
  - (1) failure to take reasonable care to organise and control its affairs responsibly and effectively, with adequate risk management systems (Principle 3); and
  - (2) failure to conduct its business with due skill, care and diligence (Principle 2).
- 2.2. LFS's failures relate to its systems and controls for producing and issuing documents to policyholders relating to investment, savings and retirement products. These failings include ineffective procedures, inadequate monitoring of document production and a failure to act appropriately in response to warnings that documents were not being produced. The failings resulted in customers not being treated fairly. As a consequence of the failings, approximately 30,000 policyholders did not receive documents containing important information about their savings, investment and pension products (some of these documents were due to be sent prior to LFS becoming regulated). Of these policyholders, 161 suffered financial loss, as a result of documents not being issued, amounting to £17,584.
- 2.3. The extent of the failings resulted in an unacceptable risk that any of the policyholders whose policies LFS administered using its automated document production system (approximately 1.3 million policyholders) would not receive important financial information on which to base their investment decisions and, consequently, suffer financial loss.
- 2.4. The FSA considers these failings to be particularly serious because:
  - (1) the production and timely dispatch of documents to policyholders was a core part of LFS's business. Despite this, LFS's systems and controls were wholly inadequate to investigate and resolve errors in its document production process;
  - (2) between December 2005 and January 2007 LFS acted recklessly in failing to consider warnings in its management information that documents subject to its automated production process were not being produced;
  - (3) despite being aware in April 2006 that a number of policyholders had not received documents and that a third of these were at risk of financial loss, LFS failed to consider whether other policyholders had been similarly affected; and
  - (4) the failings persisted over a significant period of time.

2.5. LFS's failures therefore merit the imposition of a financial penalty. In deciding upon the level of disciplinary sanction, the FSA recognised the following measures taken by LFS which serve to mitigate the seriousness of its failings:

- (1) LFS appointed external consultants in February 2007 to assist it to review its document production system, identify the documentation which had not been produced, analyse the potential impact on policyholders and ensure that all appropriate documents were provided to policyholders;
- (2) By April 2007, new management implemented a comprehensive review of LFS's systems and controls. This led to the restructuring of its management and oversight arrangements, improvements in management information and the installation of a dedicated team to oversee its document production system;
- (3) LFS implemented a remedial action plan, in April 2007, which ensured that all policyholders who suffered financial loss were promptly compensated; and
- (4) LFS co-operated fully with the FSA in the course of its investigation, including proactively identifying relevant information and bringing it to the FSA's attention. LFS has agreed the facts quickly ensuring an efficient resolution of the matter.

### **3. BACKGROUND**

#### *The firm*

- 3.1. LFS is a third party administrator which provides services to authorised firms in the life and pensions sectors. LFS offers a range of services including policy and customer services administration, investment fund administration and unit pricing, finance and statutory reporting and valuations. In total, LFS administers over 1.8 million life and pensions policies comprising over 3,000 different types of savings, investment and retirement products.
- 3.2. LFS has been authorised by the FSA since 6 January 2005 with permission for arranging deals in investments and making arrangements with a view to transactions in investments. In addition, from 14 January 2005, LFS has had permission for assisting in the administration and performance of contracts of insurance.

#### *Migration and administration of policies*

- 3.3. In order to administer policies, LFS transfers data about policyholders and their policies from its clients' systems onto its own systems (a process known as 'data migration'). LFS undertook a number of data migrations between 1997 and 2006. This significantly increased the number of policies it administered. The number of policies LFS administered during the Relevant Period ranged from 1.4 million to 1.5 million.
- 3.4. A significant part of LFS's administration of policies involves the regular dispatch of large numbers of documents to policyholders. The majority of documents dispatched are annual policy statements detailing the performance of the policy and its value. This information is important to allow policyholders to make informed decisions about their investments. Some of the documents dispatched require policyholders to

consider the information contained in the document and take action. For example, letters are sent to policyholders prior to retirement detailing the level and type of annuity which could be purchased using an accumulated pension fund.

#### *The Computer Initiated Correspondence Module*

- 3.5. LFS uses a number of automated systems to administer policies. Its principal system, 'Amarta', is a bespoke system developed and maintained by LFS. One of the components of Amarta is the Computer Initiated Correspondence module (CIC). CIC is designed to produce documents to be sent to policyholders automatically in accordance with a series of rules relating to particular events or dates. For example, a policy reaching maturity will prompt CIC to produce a maturity statement which sets out the value of the policy and the options available. Similarly, the anniversary of a policy will prompt CIC to produce an annual statement. During the course of a year, LFS sends over 6.5 million documents produced in this way.
- 3.6. CIC relies on internal automated controls to check if the underlying data used to populate any given document is accurate and complete. Errors may arise if there are gaps in the data (for example, where the address is incomplete) or in the event of a processing issue (for example, where the policy value needs to be reviewed).
- 3.7. Where an error arises, the document is suppressed by CIC pending resolution of the error and a message is generated. A document may be suppressed for legitimate reasons (for example, if a policyholder has died) or due to a system problem. LFS staff must determine the cause of the error message (which is in system code) so that they can take remedial action and release the document if appropriate. The remedial action may include manually overriding CIC.

## **4. RELEVANT STATUTORY AND REGULATORY PROVISIONS**

- 4.1. 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 contraventions, of such an amount as it considers appropriate."*

- 4.2. Under section 2(2) of the Act, market confidence and the protection of consumers are regulatory objectives for the FSA.
- 4.3. The FSA's Principles for Businesses constitute requirements imposed on authorised persons under the Act.

## **5. BREACHES OF THE FSA'S PRINCIPLES FOR BUSINESSES**

### **Principle 3**

- 5.1. Principle 3 (Management & Control) provides that:

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

### **Facts and matters relied on**

- 5.2. By reason of the facts and matters detailed in paragraphs 5.3 to 5.16, the FSA considers that LFS has breached Principle 3 of the FSA's Principles for Businesses.
- 5.3. Throughout the Relevant Period, LFS was obliged to take reasonable care to implement systems and controls which were appropriate for its business. This required it to review its systems and controls regularly to ensure they remained adequate and to ensure that staff were able to understand them and resolve any foreseeable difficulties.

#### *Failure to take reasonable care to establish effective procedures for dealing with error messages*

- 5.4. As set out at paragraph 3.7 above, CIC produces error messages in the event that the production of a document is suppressed. During the Relevant Period, LFS relied on its staff being able to interpret error messages, identify their cause and implement remedial action as appropriate. It did not provide them with adequate procedures for how they should deal with error messages. The firm's procedure was limited to a simplistic written instruction that staff should report error messages to the 'CIC administrator' or 'Amarta Developer Team' for further action. There were no instructions in place to inform staff (including the CIC administrator or the Amarta Developer Team) how they should resolve the errors and training for staff was inadequate.
- 5.5. Nor did LFS put in place any system, such as a list of error messages with an explanation of their root cause, to ensure that staff could interpret the messages and resolve them appropriately. This was despite the fact that the messages were in system code, rather than 'plain English', making their interpretation difficult.
- 5.6. The need for a robust system to deal with error messages was heightened by the fact such messages were routinely produced. Between 2005 and 2006, additional policies were migrated on to CIC. This increased the complexity of the tasks which staff had to undertake and the number of error messages. Nevertheless, LFS continued to assume (incorrectly) that its staff would be able to resolve error messages without substantive procedures and failed to take any steps to review or amend its procedures.
- 5.7. Throughout the Relevant Period, LFS failed to take reasonable care to establish effective procedures to investigate and resolve error messages. This failure resulted in a significant number of error messages not being dealt with and documents not being dispatched. It, in turn, also resulted in an unacceptable risk that any of the policyholders would not receive important information about their policies and/or suffer financial loss.

#### *Failure to take reasonable care to monitor the production of documents*

- 5.8. Throughout the Relevant Period, LFS failed to establish effective risk management systems to monitor the production of documents.

- 5.9. Between January 2005 and December 2005, LFS failed to put in place any controls to monitor the dispatch of documents. As a consequence, LFS was unable to assess at all during that period whether documents were being issued to policyholders correctly.
- 5.10. From December 2005, LFS produced a monthly management information pack designed to inform it of the adequacy of its document production process. The management information included a breakdown of outstanding 'Contacts' for each book of business and the number of days that the Contact had been outstanding. (CIC automatically groups documents into Contacts: a Contact is a number of documents relating to a particular type of policy due to be issued to any number of policyholders. For example, any personal pension annual statements to be sent out on a given day.) A Contact would be recorded as outstanding if it contained any documents which had not been sent.
- 5.11. In providing numbers of outstanding Contacts, the management information consistently informed LFS that there were documents which had not been produced and that a significant proportion of those documents had been outstanding for long periods of time (in many instances over a year).
- 5.12. Whilst the management information was effective to indicate, at a high level, the non-production of documents, it was limited as a control as it did not identify:
- (1) whether Contacts were outstanding for legitimate reasons;
  - (2) the number of documents which had not been produced (a Contact can contain any number of documents from a single document to several thousand);
  - (3) the number of policyholders who had not received documents; or
  - (4) the potential impact on policyholders of documents not being produced (for example, the management information failed to distinguish between a document detailing the ongoing performance of a fund and a document, such as a maturity statement, which required action to be taken).
- 5.13. LFS's reliance on the management information as the only tool to monitor the performance of CIC was not acceptable.
- 5.14. During the Relevant Period, LFS conducted only sporadic and limited reviews of CIC to ensure that it was operating effectively. In fact, between January 2005 and March 2006, LFS did not conduct any review of CIC. In March 2006, the firm conducted an audit (the March 2006 audit) which focussed (in part) on CIC. This audit considered only a discrete number of policies administered by LFS. In January 2007, a further audit of CIC was conducted this time by a third party which, again, focused on a discrete, different, book of business. It was unreasonable for LFS to limit its review of its document production system to irregular audits each with a limited scope.
- 5.15. It was not until January 2007 that LFS took steps to determine the extent of its failure to send documents to policyholders and review its systems and controls in relation to document production.

- 5.16. As a result of LFS's failure to implement controls which were appropriate for its business, throughout the Relevant Period, it was unable to monitor adequately whether documents were being dispatched to policyholders as required.

## **Principle 2**

- 5.17. Principle 2 (Skill, Care & Diligence) provides that:

*A firm must conduct its business with due skill, care and diligence.*

### **Facts and matters relied on**

- 5.18. By reason of the facts and matters detailed in paragraphs 5.19 to 5.24 the FSA considers that LFS has breached Principle 2 of the FSA's Principles for Businesses.

- 5.19. The FSA requires firms to respond to information that their systems and controls are not operating effectively, in particular where there is a risk that customers have not been or may not have been treated fairly. On at least 17 occasions between December 2005 and January 2007, LFS had reason to suspect that documents had not been issued to policyholders but it failed to respond in an appropriate manner to the risks which had been highlighted.

*Failure to act on warnings identified by its management information and the March 2006 audit*

- 5.20. From December 2005, LFS's management information identified that 8,405 Contacts were outstanding across all of the firm's books of business, a significant proportion of which had been outstanding for longer than a year. In March 2006, there were 8,410 Contacts outstanding, of which 4,773 had been outstanding for over a year.

- 5.21. LFS did not carry out any investigation of the outstanding Contacts indicated in its management information. It assumed that the outstanding Contacts represented documents which had been legitimately suppressed. Given that LFS knew that the management information did not identify individual suppressed documents, it was reckless for the firm to assume that all of the documents within the outstanding Contacts were legitimately suppressed without undertaking any proper investigation.

- 5.22. LFS also received more detailed warnings from the March 2006 audit referred to at paragraph 5.14 above. This identified that for the single book of business considered by the audit there were 3,295 outstanding Contacts.

- 5.23. Following the March 2006 audit, LFS produced a plan in April 2006 to clear the outstanding Contacts. This plan noted that a third of the outstanding Contacts contained documents which had the potential to cause policyholders financial loss. Despite being aware from its management information of outstanding Contacts in all of its books of business, it failed to consider whether similar remedial action was necessary in respect of other policies. In addition, despite the audit recommending an investigation of the underlying reasons why documents had not been produced, no investigation was carried out. The FSA views these failings as particularly serious as at this time LFS had already identified that there was a risk of financial loss to policyholders from the outstanding Contacts.

- 5.24. LFS therefore failed to act with due skill, care and diligence by not considering adequately, and acting on, warning signals identified in its management information and not acting properly on clear indications in the March 2006 audit, that policyholders were at risk of not receiving documents. Further, when LFS did identify that there was a risk of financial loss to policyholders relevant to one book of business, it failed to implement remedial action across the whole of its business or to give consideration to whether other policyholders may also be exposed to the risk of financial loss.

## **6. RELEVANT GUIDANCE ON PENALTY**

### **Determining the level of financial penalty**

- 6.1. The FSA's policy in relation to the imposition of financial penalties is set out in Chapter 6 of the Decision Procedure and Penalties Manual (DEPP) which forms part of the FSA Handbook. It was previously set out in Chapter 13 of the Enforcement Manual (ENF). These Manuals set out the factors that may be of particular relevance in determining the appropriate level of financial penalty for a firm or approved person. The criteria are not exhaustive and all relevant circumstances of the case will be taken into consideration.

### **Deterrence**

- 6.2. The principal purpose of imposing a financial penalty is to promote high standards of regulatory conduct by deterring persons who have committed breaches from committing further breaches, deterring others from committing similar breaches and demonstrating generally the benefits of compliant behaviour.

### **The seriousness of the breaches**

- 6.3. The FSA has had regard to the seriousness of LFS's contraventions, including that LFS's failings exposed any of approximately 1.3 million consumers to the risk that they would not receive timely financial information about their policies and/or suffer financial loss. For the reasons set out at paragraph 2.4 the FSA considers that the breaches are of a serious nature.

### **The extent to which the breach was deliberate or reckless**

- 6.4. As set out in paragraph 5.21 above, the FSA considers that LFS's assumption throughout 2006 that all of the documents within outstanding Contacts were legitimately suppressed was reckless. The FSA does not consider that LFS acted in a deliberate manner.

### **The size, financial resources and other circumstances of the firm**

- 6.5. The FSA has taken into account LFS's financial resources. There is no evidence to suggest that LFS is unable to pay the financial penalty.



### **The amount of profits accrued or the loss avoided**

- 6.6. The FSA has not determined that LFS deliberately set out to accrue additional profits or avoid a loss through the way in which it operated its systems and controls.

### **Conduct following the breach**

- 6.7. LFS notified the FSA of its failings and at the same time implemented a comprehensive review of its systems and controls. This review has led to changes in its monitoring and oversight of document production.
- 6.8. LFS engaged external consultants to assist it to identify the documents which had not been sent and analyse the potential impact on policyholders. Following this review, LFS implemented remedial action to ensure that all appropriate information was provided to policyholders and all policyholders who have suffered financial loss, as a result of LFS's failings, have received compensation as appropriate.
- 6.9. LFS has co-operated fully with the Enforcement action, including proactively identifying relevant information and bringing it to the FSA's attention. Without this level of co-operation the financial penalty would have been higher.

### **Disciplinary history and compliance record**

- 6.10. LFS has not been the subject of previous disciplinary action.

## **7. CONCLUSION**

- 7.1. Having regard to the seriousness of the breaches and the risk they posed to the FSA's statutory objectives of market confidence and the protection of consumers, the FSA has imposed a financial penalty of £525,000 on LFS.

## **8. DECISION MAKER**

- 8.1. The decision which gave rise to the obligation to give this Final Notice was made by Settlement Decision Makers on behalf of the FSA.

## **9. IMPORTANT**

- 9.1. This Final Notice is given to LFS in accordance with section 390 of the Act.

### **Manner of and time for payment**

- 9.2. The financial penalty must be paid in full by LFS to the FSA by no later than 22 April 2008, 14 days from the date of this Final Notice.

### **If the financial penalty is not paid**

- 9.3. If all or any of the financial penalty is outstanding on 23 April 2008, the FSA may recover the outstanding amount as a debt owed by LFS and due to the FSA.

### **Publicity**

- 9.4. Sections 391(4), 391(6) and 391(7) of the Act apply to the publication of information about the matter to which this notice relates. Under those provisions, the 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 LFS or prejudicial to the interests of consumers.
- 9.5. The FSA intends to publish such information about the matter to which this Final Notice relates as it considers appropriate.

### **FSA contacts**

- 9.6. For more information concerning this matter generally, you should contact Mario Theodosiou at the FSA (direct line: 020 7066 5914/fax: 020 7066 5915) of the Enforcement Division of the FSA.

**William Amos**  
**Head of Retail 1**  
**FSA Enforcement Division**