FINAL NOTICE

To: **Royal Bank of Scotland plc**

Of: **42 St Andrew Square**
Edinburgh
EH2 2YE

Date **12 December 2002**

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 you a decision notice on 19th November 2002 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 against you in the amount of £750,000.

1.2 You have informed us that you do not intend to refer the matter to the Financial Services and Markets Tribunal.

1.3 Accordingly, for the reasons set out below the FSA imposes a financial penalty on you in the amount of £750,000 ("the Penalty").

2. RELEVANT STATUTORY PROVISIONS AND REGULATORY RULES

2.1 Section 2(2) of the Act includes among the FSA's regulatory objectives the reduction of financial crime.

2.2 Section 146 of the Act states:

The Authority may make rules in relation to the prevention and detection of money laundering in connection with the carrying on of regulated activity by authorised persons.

2.3 Rule 3.1.3(1) of the FSA's Money Laundering Rules ("the ML Rules") provides:

A relevant firm must take reasonable steps to find out who its client is by obtaining sufficient evidence of the identity of any client who comes into contact with the relevant firm to be able to show that the client is who he claims to be.

2.4 Rule 7.3.2(1) of the ML Rules provides:

A relevant firm must make and retain…the following records…in relation to evidence of identity:

(i) a copy of the evidence of identity obtained under ML3; or

(ii) a record of where a copy of the evidence of identity can be obtained; or

(iii) when it is not reasonably practicable to comply with (i) or (ii), a record of how the details of the evidence of identity can be obtained; and

when it has concluded it should treat a client as financially excluded (ML 3.1.5G to ML 3.1.7G Financial exclusion), a record of the reasons for doing so;…

2.5 Section 206(1) of the Act states:

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

3. REASONS FOR THE PROPOSED ACTION

Summary

3.1 Following information provided by RBS which suggested to the FSA that RBS may

have contravened the ML Rules, being requirements imposed upon RBS under the Act, the FSA on 30 May 2002 appointed investigators under section 168 of the Act.

3.2 As a result of that investigation, which was based on a sample of accounts opened between January 2002 and May 2002, the FSA has concluded that RBS has contravened both Rule 3.1.3 and Rule 7.3.2 of the ML Rules.

3.3 In so doing RBS demonstrated failings which demand a significant financial penalty. These failings are viewed by the FSA as particularly serious in the light of the following factors:

- they occurred against a background where statutory requirements for firms to have in place anti-money laundering procedures, including procedures to identify their clients, had been in place for over eight years and where, in anticipation of the FSA's new powers to make Rules relating to the prevention of money laundering with effect from 1 December 2001, there had been a greatly increased emphasis on preventing the use of the financial system for financial crime;

- the high level of breaches between January and March 2002;

- notwithstanding the systems which RBS had in place, there was a failure adequately to monitor compliance with regulatory requirements;

- the FSA believes that the size of RBS and the retail banking market in which it operates presents a serious risk to the FSA's statutory objective to reduce financial crime.

3.4 Were it not for the prompt and effective remedial action taken by RBS once it had identified its failings and for the full and pro-active co-operation demonstrated by RBS in relation to the FSA's investigation, the financial penalty proposed would have been very substantially higher.

Facts and Matters Relied On

The Statutory and Regulatory Background

3.5 Statutory anti-money laundering requirements on financial sector firms were first imposed by The Money Laundering Regulations 1993 ("the Regulations"), which took effect on 1 April 1994. The Regulations require financial sector firms to have procedures for, among other things, the identification of their clients and the maintenance of records.

3.6 Further, from 1990 the Joint Money Laundering Steering Group, of which the British Bankers' Association is a member, provided advice on best practice in anti-money laundering controls by issuing Guidance Notes for the Financial Sector ("the

Guidance Notes"). Subsequent editions of the Guidance Notes took account of evolving best practice within the financial services industry. Since 1994 the Guidance Notes have provided advice and guidance on complying with the Regulations such that a court may take them into account in considering whether there has been a breach of the Regulations. Both the editions issued in 2001 reflected the provisions of the ML Rules that came into effect on 1 December 2001.

3.7 Prior to the ML Rules coming into force and in anticipation of the FSA's statutory objective to reduce financial crime, the FSA repeatedly stressed the importance of high standards of compliance with UK anti-money laundering requirements and that, once its new enforcement powers came into effect, they would be rigorously applied to deal with breaches of the ML Rules.

RBS Actions

3.8 RBS is an authorised deposit taking institution undertaking retail banking along with a wide range of other permitted activities. It forms part of the Royal Bank of Scotland Group ("RBS Group").

3.9 RBS Retail Banking ("RBS Retail") uses a process called the "New Account Sanctioner" ("NAS") when opening new accounts. NAS is intended to ensure that the 'Know Your Customer' ("KYC") information necessary for verifying identity is in place prior to an account being opened. NAS has been in place for five years. The effectiveness of NAS is monitored by RBS Retail's compliance function. The procedure used by RBS Retail has been independently audited by RBS Group Internal Audit ("GIA") a number of times.

3.10 In late 2001 RBS Group instigated a program of actions to reduce the level of KYC control failures across the RBS Group to satisfactory levels by 31 March 2002. This objective was in line with requirements set down by the FSA with regard to the NatWest Retail Banking. One stream of the required work was a series of independent audits carried out by GIA.

3.11 GIA conducted testing of the NAS procedures in RBS Retail in December 2001. The tests were conducted on 241 accounts opened in November 2001. These tests identified a KYC failure rate of 11.2% i.e. either the customer's name or address (or both) had not been verified to the standards laid down in the NAS process within RBS Retail or the required records of identity had not been retained.

3.12 The results of the GIA tests were made available to RBS Group management, including the Group Compliance Department, in January 2002. In line with the Group-wide program of work to reduce KYC control failures to satisfactory levels, a remedial action plan aimed at ensuring adherence to the NAS process was immediately drawn up and implemented during the period January 2002 to March 2002.

3.13 The next round of testing, in March 2002, was conducted by Retail Compliance on accounts opened in January 2002, following the implementation of the action

plan. These tests indicated that the KYC failure rates had increased further.

3.14 On 10 April 2002 RBS Group informed the FSA of the failings identified by the GIA tests in December 2001 and gave a copy of the GIA report to the FSA.

3.15 The results of the March tests were orally reported to the FSA at a meeting on 23 April 2002.

3.16 The remedial action plan initiated in January 2002 has resulted in KYC failure rates being significantly reduced from April 2002.

The FSA Investigation

3.17 At the request of the FSA, RBS supplied account opening documentation in relation to 181 accounts opened between January and May 2002. The accounts were those which were classified by GIA and Retail Compliance as failing against internal procedures from the sample of 2170 accounts which they had examined.

3.18 Each account file was examined, having regard to the identification criteria set out in the Guidance Notes to determine whether there was sufficient evidence to show that the client was who he had claimed to be.

3.19 Paragraph 4.72 of the Guidance Notes states that the true full name (and/or names used) and current permanent address should be established and independently validated for all private individuals whose identity needed to be verified. Paragraph 4.73 states that the information obtained should provide satisfaction that a person of that name exists at the address given and that the applicant is that person.

3.20 The FSA considers that a firm's failure adequately to establish and validate an applicant's name and permanent residential address constitutes a failure to take reasonable steps to find out who its client is and therefore constitutes a breach of ML 3.1.3.

3.21 Of the 181 account files examined, 89 were found to have insufficient evidence to show that the client was who he had claimed to be and therefore breached ML 3.1.3.

3.22 In respect of 7 account files, RBS was unable to supply copies or details of the documents it had used to verify identity. These files therefore constituted breaches of ML 7.3.2.

3.23 Two of the seven files referred to in paragraph 3.22 were found to constitute breaches of both ML 3.1.3 and 7.3.2, making a total of 94 accounts with one or more failings.

4. RELEVANT GUIDANCE

4.1 The principal purpose of the imposition 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 benefit of compliant behaviour.

4.2 In determining whether a financial penalty is appropriate and its level, the FSA is required to consider all the relevant circumstances of the case. ENF 13.3.3 indicates the factors that may be of particular relevance in determining the level of a financial penalty. These are discussed in Part 5 below in respect of the circumstances of this case.

4.3 As the breaches of ML 3.1.3 and 7.3.2 also constitute breaches of the Money Laundering Regulations 1993, the FSA has considered whether the case is appropriate for a criminal prosecution. In considering this, the FSA has applied the principles set out in ENF 15.5 and in the Code for Crown Prosecutors, namely the evidential and public interest tests. Having regard to those tests, the FSA has concluded that a prosecution would not be appropriate in this case.

5. FACTORS RELEVANT TO DETERMINING THE SANCTION

5.1 In determining that a financial penalty is appropriate and that the amount proposed is proportionate to RBS's contraventions the FSA considers the following factors to be particularly relevant in this case.

The seriousness of the breaches

5.2 The high level of breaches identified applied across the whole of the RBS Retail network and existed from at least December 2001 (as identified by the GIA report) until March 2002, with particularly high failure rates in January 2002 and March 2002. RBS has stated that the rise in failure rates in March 2002 was partly due to the implementation of the remedial plan; the effect of the remedial plan in terms of reduced failure rates not being apparent until the following month.

5.3 The breaches revealed weaknesses in the RBS anti-money laundering control system. The FSA considers the failure effectively to monitor the compliance of the RBS Retail network with the requirements of the Money Laundering Regulations 1993 and the FSA Money Laundering Rules to be a serious matter. The seriousness of the breaches is exacerbated by the fact that they took place against a background of increased regulatory emphasis on the importance of effective anti-money laundering controls.

5.4 The FSA notes, however, that RBS itself discovered the breaches through its own GIA/Compliance testing in December 2001. Additionally, in most cases some attempt had been made to identify the customers.

The size, financial resources and other circumstances of the firm

5.5 The FSA expects that a bank such as RBS should ensure that its anti-money laundering controls operate effectively across the whole of its network. The FSA believes that a failure in anti-money laundering systems and controls in a large retail bank such as RBS is particularly serious in that it poses a greater risk that financial crime may be facilitated and therefore constitutes a greater risk to the FSA's statutory objective to reduce financial crime.

Conduct following the contravention

5.6 RBS informed the FSA of its contraventions and has co-operated fully and pro-actively with the FSA's investigation.

5.7 Once it had identified the problem, RBS took it seriously. It devoted considerable resources at an early stage to correct the problem and instituted a remedial action plan of its own accord. The FSA is satisfied that the remedial action plan has appropriately addressed the KYC non-compliance issue.

6. CONCLUSION

6.1 Taking into account the seriousness of the contraventions and the risks they posed but also the prompt and effective remedial steps taken and the co-operation shown, the FSA has decided that a financial penalty of £750,000 be imposed. Without RBS's remedial actions and co-operation, the penalty would have been very substantially greater.

7. IMPORTANT NOTICES

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

Manner of payment

7.2 The Penalty must be paid to the FSA in full.

Time for payment

7.3 The Penalty must be paid to the FSA no later than 31st December 2002, being not less than 14 days beginning with the date on which this notice is given to you.

If penalty not paid

7.4 If all or any of the Penalty is outstanding on 1st January 2003, the FSA may recover the outstanding amount as a debt owed by you and due to the FSA.

Publicity

7.5 Sections 391(4), 391(6) and 391(7) of the Act apply to the publication of information about the matter to which this notice relates. Under those provisions, the FSA must publish such information about the matter to which this notice relates as the FSA considers appropriate. The information may be published in such manner as the FSA considers appropriate. However, the FSA may not publish information if such publication would, in the opinion of the FSA, be unfair to you or prejudicial to the interests of consumers.

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

FSA Contacts

7.7 For more information concerning this matter generally, you should contact Carlos Conceicao at the FSA (direct line: 020 7676 1174 /fax: 020 7676 9723).

Brian Dilley
Head of Deposit Taking & Financial Stability
FSA Enforcement Division