

FSA DISCIPLINARY NOTICE

FSA has given a Final Notice to Royal & Sun Alliance Life & Pensions Limited, Royal & Sun Alliance Linked Insurances Limited and Sun Alliance and London Assurance Company Limited (collectively referred to below as “RSA”) imposing a financial penalty on RSA of £1.35 million. The reasons for the decision are set out below.

REASONS FOR THE PENALTY

For the reasons set out below the FSA is imposing, pursuant to section 206 of the Financial Services and Markets Act 2000 (“the Act”) the Penalty on RSA in respect of breaches of PIA Rules 7.2.2, 5.1.1 and 5.1.3 and SIB Principles 2 and 9.

RELEVANT STATUTORY PROVISIONS AND REGULATORY RULES

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”.

The Financial Services and Markets Act 2000 (Transitional Provisions and Savings) (Civil Remedies, Discipline, Criminal Offences etc) (No 2) Order 2001 provides, at Article 8(2), that the power conferred by Section 206 FSMA can be exercised by the FSA in respect of a failure by a firm to comply with any of the provisions specified in Rule 1.3.1(6) of the PIA Rules as if the firm had contravened a requirement imposed by the Act.

PIA Rule 1.3.1(6) provides that a PIA Member which fails to comply with PIA Rule 1.3.1(2) or any of the Principles is liable to disciplinary action.

The Principles are universal statements of standards expected by regulated firms. These were issued by the Securities and Investment Board (“SIB”) and applied to PIA members.

PIA Rule 1.3.1(2) provides that a PIA Member must obey the Rules of PIA.

PIA Rule 7.2.2 provides that:

“Where it appears to PIA that it is necessary or desirable in the interests of investors, PIA may require a Member (or a class of Members) to carry out a review of any aspect of its investment business with a view to determining whether redress should be offered to any investor who has suffered loss and damage as a result of a failure by the Member to comply with its relevant duties.

PIA may prescribe the standards and a specification for the conduct of any such review.

A Member to whom any such requirement applies shall take all reasonable steps to carry out a review of its investment business in accordance with such standards and specification as PIA may prescribe”.

The Pensions Review is such a review of investment business. It covers pension opt-out, pension non-joiner and pension transfer business transacted between 29 April 1988 and 30 June 1994.

PIA Rule 5.1.1 provides that:

“A Member must (a) keep records which are sufficient to show at any time that it has complied with the requirements of the Rule Book ...”

PIA Rule 5.1.3(3) provides that:

“The Member must keep its records in such a way that (a) any particular record is promptly accessible...”

SIB Principle 2 provides:

“A firm should act with due skill, care and diligence”.

SIB Principle 9 provides 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 they are suitable, adequately trained and properly supervised and that it has well-defined compliance procedures”.

FACTS AND MATTERS RELIED ON

Summary

1. Following corporate restructuring which took place after the merger of the Royal Insurance and Sun Alliance groups, there are now three companies whose policies form part of the Pensions Review, namely those referred to in this Notice as RSA. All reporting to the FSA on the Pensions Review since the merger has been conducted by Royal & Sun Alliance Life and Pensions Limited.
2. RSA has committed breaches of the PIA Rules referred to above in the conduct of its Pension Review and, in so doing, has demonstrated such failings in complying with the regulatory standards outlined in the above referred to SIB Principles, and applicable to all regulated firms, as to demand a significant penalty. These breaches and failings are viewed by the FSA as particularly serious due to the following aggravating factors:
 - they occurred after and notwithstanding that a substantial fine had already been imposed on RSA by PIA for serious failings in respect of the conduct of its Pensions Review in the period up to September 1997;
 - certain breaches were identified by PIA’s Pensions Review Monitoring Division (“PRMD”) in July and August 2000 and not by RSA, whose management until that time had believed its Pensions Review to be proceeding satisfactorily;

- in the FSA's view, if those certain breaches had not been identified by PIA, RSA may not have identified up to 13,500 reviewable cases and, as a result, may not have identified investors entitled to redress exceeding £32 million. The FSA, however, accepts that RSA did not deliberately set out to avoid paying proper redress to investors;
- they were identified more than 2 years after RSA's deadline for completion of all Phase 1 cases and, as a result, RSA will not complete Phase 1 until 4 years after that deadline;
- they have, by virtue of the nature and size of RSA's customer base, exposed numerous customers to the risk of loss as well as revealing weaknesses in its management systems and internal controls.

The Pensions Review

3. PIA Rule 7.2.2 permitted PIA to require members to undertake a review of past business if this was necessary or desirable in the interests of investors. In response to widespread concerns about mis-selling of personal pensions by regulated firms, it was decided that such a review should be carried out of all pension transfer, opt-out and non-joiner business conducted between 29 April 1988 and 30 June 1994 by all regulated firms. This has become known as the Pensions Review.
4. The initial guidance on the Pensions Review was issued by SIB in 1994 and further detailed guidance setting out which cases should be reviewed, general principles as to how this should be undertaken and when the Pensions Review must be completed was subsequently issued by PIA. Collectively this is known as the Guidance.
5. The first phase of the Pensions Review (known as Phase 1) concerned priority cases where investors were more likely to have suffered a loss. These included older investors who were closer to retirement and who, if entitled to redress, were closer to experiencing actual loss as the pension payments they received on retirement would be more likely to be less than those they would have received had they remained in an occupational scheme. The industry deadline for completion of Phase 1 was December 1998. Phase 2, which commenced in August 1998, concerned all other investors.
6. As RSA had one of the largest Pensions Review populations it was set a specific deadline for completion of Phase 1 of its review of June 1998. Its deadline for completion of Phase 2 was, in common with the rest of the industry, June 2002.

Previous Disciplinary Action

7. Royal Life Insurance Limited (now Royal & Sun Alliance Life and Pensions Limited) and Sun Alliance Life Limited were jointly fined £225,000 in October 1998 and ordered to pay costs of £100,000 by the Membership and Disciplinary Tribunal of PIA in respect of a failure adequately to progress certain aspects of the Pensions Review in accordance with PIA Rule 7.2.2. Those aspects were not the same as those now identified.
8. That disciplinary action arose from a visit made by PIA's Pensions Review Monitoring Division ("PRMD") in 1997. Following that visit corrective action was prescribed by PRMD including, for instance, a requirement that RSA confirmed the accuracy of its

Phase 1 starting population. RSA reported to PRMD on the completion of this remedial action and in March 1998 provided PIA with a report from a specialist auditor addressing the starting population issue.

Pensions Review Weaknesses

9. PRMD made a visit (“the 2000 PRMD Visit”) to RSA in July and August 2000 to review RSA’s progress with its Pensions Review. Significant weaknesses were identified.
10. In particular, RSA had not:
 - Issued mailings to investors in accordance with the Guidance;
 - Taken adequate steps to identify its starting population accurately;
 - Taken adequate steps to identify all reviewable cases;
 - Reviewed certain cases within a reasonable timescale;
 - Reviewed certain cases within deadlines prescribed by PIA;
 - Adequately monitored its Pensions Review exercise; and
 - Demonstrated adequate control of its Pensions Review exercise.
11. Prompted by the very serious concerns raised by the 2000 PRMD Visit, RSA immediately and voluntarily undertook its own effective and extensive review and remedial programme including the appointment of independent third party consultants to report on their processes, procedures and controls and any improvements required. The independent third party consultants stated that “The objectives of [their] review were to assess RSA’s procedures and processes against the PIA’s requirements and industry best practice and to design an ongoing compliance monitoring programme”. RSA’s management also significantly increased its involvement in the Review.

Identification of Reviewable Cases

12. The review and remedial programme undertaken by RSA demonstrated, among other things, different inaccuracies within its starting population to those referred to in paragraph 8. The identification of a firm’s starting population is fundamental to the whole Pensions Review. It involves the firm identifying the total universe of pensions sold at the relevant time so that all these cases can be assessed and it can be determined whether investors require a review and, if so, whether they have suffered a loss. Accordingly, it is of crucial importance that this process is completed accurately and without delay. If all relevant cases are not captured, not all investors who should will have their cases reviewed and, if a review would in fact show that they have suffered loss, they will not be compensated. In the event, after the significant and widespread problems had been identified by the 2000 PRMD Visit and after its own review and remedial programme had started, RSA determined in November 2000 that the most appropriate way forward to identify accurately all reviewable cases was for them to rebuild their starting population.

13. RSA's review and remedial programme also highlighted deficiencies in RSA's conduct of the next stage of the Review. That was the process of excluding sales where the investor could not have been disadvantaged, where, for example, an investor was self employed and, therefore, had no occupational scheme available to him. The unreliability of RSA's original processes and procedures, taken together with RSA's wish to ensure all problems were identified, resulted in RSA re-examining some 130,000 cases in order to determine whether they were properly excluded.
14. RSA has advised the FSA that as at 30 June 2002, 12,444 cases have been added to the Review from all areas of remedial work and that it estimates that a further 150 cases may be added. 5,068 of these cases are Phase 1 cases.

Delays in Concluding Phase 1 of the Review

15. As RSA had one of the largest Pensions Review populations it was set a specific deadline of June 1998 for completion of Phase 1 of the Review. It did not meet this deadline and, in fact, was still, as at 8 February 2002, identifying new Phase 1 cases. At that date RSA had 1,908 outstanding Phase 1 cases, more than 50% of the total number of outstanding Phase 1 cases among product provider firms.
16. RSA's most recent advice to the FSA was that on 30 June 2002 RSA had 294 outstanding Phase 1 cases, meaning that it had completed 98.6% of Phase 1 of the Review.

Procedural and Management Weaknesses

17. There were serious weaknesses in RSA's procedures for the Pensions Review. These arose in many significant areas of RSA's Pensions Review and indicate weaknesses in the management control of the Review.
18. The independent third party consultants reported in February 2001 on a compliance review conducted in January 2001 by the independent third party consultants on Phase 2 of the RSA Pensions Review. The report stated that there was little evidence of thorough procedures for the conduct of the Review, that RSA had inadequate management information systems and inadequate training for Review staff. They also noted significant weaknesses in the progression of cases.
19. RSA's management also failed adequately to monitor its Pension Review in that prior to the further PRMD Visit RSA's compliance department had sampled less than 1% of excluded cases and action recommended by internal audits often took many months to implement.
20. The problems identified by PRMD and the advice of the third party independent consultants led to RSA voluntarily revisiting its procedures for reviewing individual cases, taking steps to improve its management information systems, and increasing resources significantly and increasing senior management involvement in the Review.
21. Up to the time of the further PRMD Visit there was limited evidence of effective senior management control of the Review. Since the 2000 PRMD Visit, RSA has increased senior management involvement in the Review and has expressed its commitment, at the highest level to resolving all outstanding problems with the Review.

Record Keeping

22. In carrying out the review and remedial programme required to address the problems with its Pensions Review RSA identified and drew to the attention of FSA a fundamental problem with its archiving facilities. RSA has been unable, apparently as a result of mis-filing or poor records maintenance, to locate significant numbers of investor files relating to the Pensions Review. Retrieval rates for some projects have been as low as 50%.

Contravention of Relevant Statutory Requirements

23. The penalty is to be imposed pursuant to Section 206 of the Act in respect of breaches by RSA of PIA Rules 7.2.2, 5.1.1 and 5.1.3 and SIB Principles 2 and 9.
24. PIA Rule 7.2.2 requires firms to take all reasonable steps to carry out the Pensions Review in accordance with the Guidance. RSA has failed to do so.
25. PIA Rules 5.1.1 and 5.1.3 require regulated firms to maintain accurate records which can easily be retrieved in respect of transactions undertaken by investors. RSA has, again, failed to do so.
26. SIB Principle 2 requires firms to use due skill, care and diligence in complying with their regulatory obligations. RSA's serious failings in the conduct of the Pensions Review constitute a breach of Principle 2.
27. SIB Principle 9 requires firms to organise and control their internal affairs in a responsible manner and to have well defined compliance procedures. RSA's serious failings both in respect of conduct of its Pensions Review and in respect of its archiving facilities also constitute breaches of Principle 9.

Relevant Guidance on Sanction

28. 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 ("ENF"). 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 benefits of compliant behaviour.
29. In determining whether a financial penalty is appropriate and its level the FSA considers all the relevant circumstances of the case. The FSA considers the following factors to be particularly relevant in this case.

The seriousness of the misconduct or contravention

30. The breaches identified in this case are of a significant nature. They result from systemic weaknesses in RSA's internal controls, arising across significant areas of the Review and indicate a lack of adequate management and compliance control over the Review.
31. The breaches have taken place over a lengthy period (throughout the Pensions Review). They have caused actual disadvantage to significant numbers of consumers in that the review of their pension arrangements has been delayed unreasonably.

32. RSA is part of one of the UK's largest insurance groups. The size of RSA's Pensions Review population adds to the seriousness of the breaches in terms of their potential impact on significant numbers of investors.
33. The cases of 1,908 Phase 1 investors (whose cases should have been concluded by June 1998) were outstanding as at 8 February 2002 and RSA were still identifying new Phase 1 cases. By definition, these investors are priority investors who are more likely to have suffered loss as a result of the misselling of personal pensions.
34. In addition, RSA failed to deal within 6 months of the company being notified of the death or retirement of the cases of at least 591 investors as required by the Guidance. Regulated firms are required to prioritise these cases as these investors or their heirs may be experiencing actual loss each day that their case is not reviewed. This may be because pension payments actually being received are lower than those which would otherwise have been received.
35. In FSA's view if certain breaches had not been identified by PRMD then, as RSA had not themselves been aware of these problems, they may not have identified up to 13,500 investors (representing 23% of RSA's current estimate of the total number of reviewable cases). In such circumstances, those investors may not have been paid redress exceeding £32 million.
36. RSA's inability to locate customer records has served to increase the delays experienced by consumers by increasing the time taken for remedial action to be completed and presents the potential for problems in respect of the Firm's ability to deal with future queries by any such consumers about their files or to action any requirements imposed by its regulator in respect of such clients or transactions.

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

37. RSA did not deliberately or recklessly contravene PIA Rules. RSA's procedures for the Pensions Review were, however, inadequate.
38. Royal Life Insurance Limited (now Royal & Sun Alliance Life and Pensions Limited) together with Sun Alliance Life Limited were previously disciplined by PIA in 1998 and jointly fined a total of £225,000 in relation to certain aspects of its Pensions Review. Despite this, RSA did not ensure that appropriate procedures were implemented (including adequate compliance monitoring and adequate management information and therefore appropriate involvement to ensure satisfactory progress of the Review to the appropriate standards). The remedial action undertaken by RSA and the procedures implemented as a result did not identify all the issues raised during the 2000 PRMD Visit.
39. The management information which existed was of poor quality reflecting a very high level approach to the number of cases completed on a daily basis. As a result senior management believed the Review was progressing adequately. This indicates that there was a lack of appropriate senior management involvement. This reflects a breakdown in RSA's systems and controls in relation to the Review.
40. It is imperative that firms establish internal procedures that are adequate to ensure compliance with regulatory standards and appropriate levels of consumer protection. Given the size of the Pensions Review at RSA, the systems required had to be of a high

quality in order to be appropriate. The weaknesses identified indicate that, despite RSA's efforts, this was not the case.

The amount of profits accrued or loss avoided

41. RSA has not directly accrued additional profits or avoided loss as a result of these breaches. The FSA accepts that RSA did not deliberately set out to avoid paying compensation to consumers. Nevertheless the impact of the weaknesses in RSA's Review procedures, without the FSA's intervention, could, if RSA had not identified the issues, have led to investors not receiving redress exceeding £32 million. The FSA recognises that, as a result of the extensive remedial work undertaken by RSA since the 2000 PRMD Visit, all investors entitled to compensation should ultimately receive payment and that RSA has incurred very significant costs in remedying the problems.

Conduct following the contravention

42. While RSA's internal monitoring processes had identified and implemented a number of remedial projects, RSA did not identify the main contraventions. In March 2001 it advised that until the 2000 PRMD Visit it had believed that the Review was being concluded satisfactorily.
43. Following the 2000 PRMD Visit RSA voluntarily appointed an independent third party to review its processes and procedures and has pro-actively sought to identify all problems with its Review.
44. RSA has throughout been open and co-operative with the FSA and has kept PIA/FSA informed of the work which is being undertaken and the matters which are being identified as a result of the remedial work. RSA itself identified its problems in respect of records retrieval and notified PIA of these.
45. RSA has improved the quality of management information across the Review and has significantly improved its procedures. RSA has advised the FSA that it has set itself the benchmark of best practice in the industry.
46. RSA has increased the internal profile of the Review and the resources dedicated to it, including at senior management level. Internal staff have been re-deployed, additional staff have been recruited and extensive use has been made of external consultants.

Disciplinary Record and Compliance History

47. As mentioned above Royal Life Insurance Limited and Sun Alliance Life Limited were jointly fined £225,000 in October 1998 by the Membership and Disciplinary Tribunal of PIA in respect of a failure adequately to progress certain aspects of the Pensions Review in accordance with PIA Rule 7.2.2.
48. That disciplinary action arose from a visit made by PRMD in 1997. Following that visit corrective action was prescribed by PRMD including a requirement that RSA confirmed the accuracy of its Phase 1 starting population. The findings of the 2000 PRMD Visit indicate that the corrective action taken was insufficient to remedy all issues relating to RSA's Pensions Review.

49. Whilst the underlying issues relating to the previous disciplinary action were not identical to those now identified they did indicate certain weaknesses in RSA's Pensions Review procedures. The FSA regards this failure to respond effectively to previous disciplinary action to be a particularly serious factor in this case.

Action taken by other Regulatory Authorities in Relation to Similar Failings

50. The FSA has not previously imposed financial penalties on firms for Pensions Review or systems failings. PIA (RSA's previous regulator) has, in the past, taken action against a number of member firms for Pensions Review failings and for failings in the operation of systems and controls. The FSA is not bound to follow fines levied by previous regulators. Nevertheless in determining and agreeing the level of penalty to be imposed in this case and in connection with the final settlement of the conduct of the Pensions Review being undertaken by RSA, the FSA has taken these previous fines into account together with all the circumstances of the case including the extensive mitigating factors set out at paragraph 42 to 46 above and the fact that RSA neither deliberately nor recklessly contravened PIA Rules or SIB Principles or sought to avoid paying compensation to consumers.

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