FINAL NOTICE

To: **Scottish Amicable Life plc**

Of: **PO Box 25**
Craigforth
Stirling
Scotland
FK9 4UE

Date: **4 March 2003**

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 31 January 2003 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 £750,000 on Scottish Amicable Life plc ("Scottish Amicable").

1.2. You have agreed not to refer the matter to the Financial Services and Markets Tribunal. Accordingly, for the reasons set out below, the FSA imposes a financial penalty on you in the amount of £750,000 ("the Penalty").

2. REASONS FOR THE PENALTY

2.1. For the reasons set out below the FSA is imposing, pursuant to Section 206 of the Act, the Penalty, on Scottish Amicable in respect of breaches of Rule 7.1.2 of the Rules of the Personal Investment Authority ("the PIA Rules"), paragraph L8(1) of Schedule L2 of the Adopted LAUTRO Rules ("the LAUTRO Rules") and Principle 2 of the

Statements of Principle of the Securities and Investments Board ("the SIB Principles").

3. RELEVANT STATUTORY PROVISIONS AND REGULATORY RULES

3.1. Section 206 FSMA 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."

3.2. 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.

3.3. PIA Rule 1.3.1(6) provided that a PIA Member which failed to comply with PIA Rule 1.3.1(2) or any of the Principles was liable to disciplinary action.

3.4. PIA Rule 1.3.1(2) provided that a PIA member had to obey the PIA Rules, which included the LAUTRO Rules and the SIB Principles.

3.5. The SIB Principles were universal statements of the standards expected of all regulated firms that were issued by the Securities and Investments Board and applied to members of the Personal Investment Authority ("the PIA").

3.6. PIA Rule 1.3.9 provided:

"A Member must accept responsibility, to the same extent as if the Member had expressly authorised it, for anything said, written, done or omitted ... by any of its appointed representatives or their investment staff or other employees in carrying on the investment business for which the Member has accepted responsibility in writing, or by any person held out by the Member as being its appointed representative."

3.7. PIA Rule 7.1.2(1) provided:

"A Member must establish procedures ... with a view to ensuring that its investment staff and other employees and its appointed representatives and their employees carry out their functions in such a way that the Member complies at all times with the Rules and Principles."

3.8. Paragraph L8(1) of Schedule L2 of the Code of the LAUTRO Rules provided:

"A Company representative shall, in advising an investor as to the suitability for that investor of any investment contract, have regard, in particular, to the investor's financial position generally, to any rights he may have under an occupational pension scheme or the State earnings-related pension scheme, (if such rights are relevant in the particular case) and he shall use his best endeavours to ensure

(a) that he recommends only that contract or those contracts which are suited to that investor; and

(b) that there is no other contract available from the Member, or, if the Member belongs to a marketing group, from any member of that group, which would secure the investor's objectives more advantageously."

3.9. Principle 2 of the SIB Principles ("SIB Principle 2") provided:

"A firm must act with due care, skill and diligence."

3.10. Scottish Amicable would therefore have been liable to disciplinary action under PIA Rule 1.3.1(6). Accordingly, the FSA may impose a financial penalty on Scottish Amicable pursuant to Section 206 of the Act.

4. REASONS FOR THE PROPOSED ACTION

Summary

4.1. In the period January to December 2000, Scottish Amicable acted in breach of the PIA Rules, including the LAUTRO Rules and the SIB Principles, arising out of its sale of mortgage endowment contracts in that:

(a) Scottish Amicable's Appointed Representatives ("ARs") failed to use their best endeavours to make only suitable recommendations to mortgage endowment clients, in breach of paragraph L8(1) of Schedule 2 of the LAUTRO Rules;

(b) Scottish Amicable's procedures failed to ensure that its ARs' best endeavours would result in them only recommending Home Purchaser policies where such policies were suitable for clients, in breach of PIA Rule 7.1.2(1); and

(c) Scottish Amicable breached SIB Principle 2 in that: (i) it failed to exercise due care, skill and diligence in respect of both its sales systems and its control functions; and (ii) although it did make some changes to its systems during the course of 2000 in response to PIA Regulatory Update 72 published in December 1999 ("RU72"), it did not in all proper respects take appropriate and timely action in response to RU72.

4.2. In so doing, Scottish Amicable 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 related to the sale of endowment policies used as vehicles to repay mortgages - a mortgage is for most people the most significant financial transaction of their lives, and where it is missold, it can have the most serious consequences;

- there were systemic failures running through the sales processes used in that period, in that advisers did not, in many cases, place appropriate emphasis on

identifying whether a customer was prepared to take the risk that his mortgage might not be repaid at the end of the term, even if he made all the premium and mortgage interest payments. The FSA places very great emphasis on the importance of adequate sales and monitoring systems to ensure compliance with regulatory rules and standards;

- the size and nature of the firm meant that these failures exposed a large number of consumers to potential loss;

- they occurred notwithstanding the fact that detailed regulatory guidance had only very recently been issued to the industry in RU72. The FSA regards this as very serious, particularly as RU72 itself had not been issued in a vacuum – issues regarding the sale of mortgage endowment contracts were well known in the industry towards the end of 1999, with the publication of the Institute of Actuaries Report, the ABI Ten Point Plan and then RU72. Consequently, by then, firms and their senior management should have been in position to deal effectively with such issues;

- they were identified by the PIA in January 2001, after firms had been specifically warned by RU72, in December 1999, that the PIA would be visiting firms to assess whether that guidance had been followed;

- Scottish Amicable and its senior management failed to respond in a timely and effective manner to guidance in RU72 relating to the customer's attitude to risk in circumstances where it had a reasonable opportunity to do so. The FSA is of the view that it is imperative that**,** when detailed regulatory guidance is issued, firms and their senior management react to it in a timely and effective manner.

4.3. While the failings in this case merit a significant financial penalty, the FSA considers that these failings have been mitigated to a considerable extent by the particularly proactive co-operation demonstrated by Scottish Amicable once the failings had been drawn to its attention by the PIA, including:

- the speed with which it acted to address the issues raised by the PIA, including:

  - the immediate integration of Scottish Amicable's compliance arrangements into those of the Prudential Group to ensure consistent standards were applied and a comprehensive review of compliance arrangements in place was undertaken;

  - the withdrawal of the Mortgage Endowment Product on 30 April 2001 and the subsequent closure of the Appointed Representative sales channel in August 2001;

  - immediately appointing reporting accountants to conduct an independent sample review of its sales of mortgage endowment policies for the period January to December 2000 to establish whether

such policies had been missold and, as a result, consumers had been financially disadvantaged; and

- the fact that, at the same time and of its own volition, it appointed reporting accountants to assess more widely its compliance function, including its management reporting systems;

- the responsible attitude of senior management in doing so;

- the diligence and speed with which it conducted the sample review;

- the fact that it promptly accepted the findings of the review, compensated customers and extended the review to a population of 33,781 policyholders covering a period from 1 January 1999 to February 2001. Scottish Amicable has also agreed to take additional steps to further ensure that current mortgage endowment policyholders who were sold policies between 29 April 1988 and 31 December 1998 will receive redress where appropriate; and

- the fact that, where there was any confusion or doubt as to whether misselling had taken place, it erred on the side of the consumer.

4.4. These steps have meant that Scottish Amicable has in place processes that should ensure consumers have been and will be offered redress more efficiently and quickly than if it had not co-operated with the PIA and the FSA in this way.

4.5. The FSA considers that Scottish Amicable's conduct following the identification of the contravention by the FSA is a model of the type of co-operation and acceptance of responsibility by senior management which is desired by the FSA, and which consumers deserve.

4.6. Accordingly, Scottish Amicable has received considerable credit for this in the amount of the financial penalty the FSA has decided to impose. Without this level of co-operation, the financial penalty would, given the aggravating factors described in paragraph 3.2, have been substantially higher.

5. BACKGROUND

The Regulated Firm

5.1. Scottish Amicable is a limited company with its head office and registered address at PO Box 25, Craigforth, Stirling, Scotland, FK9 4UE.

5.2. Scottish Amicable was formed as part of the arrangements by the Prudential Group to acquire the business and operations of Scottish Amicable Life Assurance Society ("SALAS"). Scottish Amicable was admitted to the PIA on 1 October 1997. SALAS was first authorised by LAUTRO from 24 April 1988. Scottish Amicable is a wholly owned subsidiary of the Prudential Assurance Company Ltd, which is itself a wholly owned subsidiary of Prudential plc. Scottish Amicable was regulated by the PIA until 30 November 2001, and after 1 December 2001, it has been regulated by the FSA.

Discovery of Current Issues

5.3. The current issues should be placed in the regulatory context of 1999/2000, as they occurred at a time when there was a high level of awareness within the industry of the issues surrounding mortgage endowment sales.

5.4. On 28 October 1999, the Institute of Actuaries Working Party ("IAWP") published a report in which it concluded, that in light of the change in economic conditions, (i) mortgage endowments should only be recommended where they were "demonstrably better" than a repayment mortgage; and (ii) the charging structure of certain endowment policies may not have rendered them good value (particularly in the case of short term contracts).

5.5. In December 1999 the ABI issued a ten point action plan, which adopted the principles for good advice on new sales proposed by the IAWP.

5.6. Against this background, further PIA Regulatory Guidance was issued, namely RU72 in December 1999 and RU80 in November 2000.

RU72

5.7. RU72 was published by the PIA as a consolidated statement of the standards to be met by firms in their sales of mortgage endowments. The PIA's Supervision Department ("PIA Supervision") had conducted themed/targeted supervision visits on mortgage related endowments in the summer and autumn of 1999. These themed supervision visits had raised concerns about the quality of advice and information given to customers, and of record keeping by which firms evidence that advice and information. The main areas that gave the PIA particular regulatory concern were:

(1) suitability (failure to demonstrate that an endowment was a suitable mortgage repayment method for the particular customer having regard to his or her circumstances);

(2) affordability (lack of evidence that the customer had, and would continue to have, the ability to make premium payments into the endowments policy, recognising that premium payments might have to be increased in the future to cover the amount of the loan at maturity);

(3) attitude to risk (lack of evidence that the risks of mortgage related endowment policies were clearly and fully explained or that the firms had a sufficient understanding of customers' attitude to taking market–linked risk in the financing arrangements for their homes); and

(4) life assurance (whether it was needed).

5.8. By RU72 the PIA and the FSA issued a public warning to PIA regulated firms that the general standards of selling practices and record keeping revealed by the themed supervision visits were inadequate, that such practices were unacceptable and that consideration was being given as to whether firms should be referred for further investigation and possible discipline. Firms were also warned that the regulators

would undertake a further detailed examination of selling practices based on business done in the 4th quarter of 2000, by which time they would expect to see "*clear evidence of a marked improvement in sales practices and associated record keeping*". Firms were warned that the regulators would not hesitate to take disciplinary action where appropriate to enforce the relevant standards.

5.9. By December 1999, therefore, firms were clearly on notice that it was imperative that they review and, where necessary, revise their procedures in relation to advice that they gave on mortgage related endowments to ensure that the advice was suitable, that the advice was clearly and properly recorded and that the business was undertaken in accordance with the highest professional standards.

RU80

5.10. In November 2000, the PIA issued RU80, repeating the PIA's concerns about the assessment of attitude to risk, and the assessment of the extent to which a customer is prepared to be exposed to market risk in the repayment of their mortgage. RU80 reminded firms of the warnings in RU72.

Themed Supervision visit – January 2001

5.11. As anticipated in RU72, PIA Supervision conducted a number of "themed visits" in relation to the sale of mortgage related endowment products in late 2000 and early 2001. One of the main purposes of these visits was ascertain the adequacy of a firm's response to the issues raised in RU72 and to identify whether there had been sufficient improvements in sales practices and associated record keeping. Scottish Amicable was visited in January 2001.

5.12. The findings of PIA Supervision from this visit, as recorded in its report dated 16 March 2001 ("the PIA Supervision Report"), were that there were major weaknesses at Scottish Amicable which needed urgent attention, in particular in relation the areas of Compliance and Selling Practices. The weaknesses identified in the PIA Supervision Report included that:

(1) in relation to selling practices, from a review of 100 mortgage endowment client files, in 98 files Scottish Amicable had not recorded sufficient personal and financial information to demonstrate clearly that recommendations made were suitable for clients. PIA Supervision concluded that this was because Scottish Amicable's procedures for ascertaining and recording "Know Your Client" information for investment backed mortgages was fundamentally flawed. In particular, the focused fact find "Personal Mortgage Review for Mortgage Clients Only" did not require advisers to ascertain and record sufficient information about customers' financial and other circumstances;

(2) in the 98 cases, the information recorded within the client files failed to demonstrate adequately why the product selected was the most suitable for clients from all the products within Scottish Amicable's range. In particular there was insufficient information on the customer files to demonstrate that customers had been provided with sufficient information in order to make an informed decision;

(3) Scottish Amicable's Reason Why letters were inadequate;

(4) in relation to training and competence, Scottish Amicable failed to implement amendments to its programme of training and competence in a timely fashion following on from the issue of RU72 in December 1999;

(5) Scottish Amicable's compliance function and compliance procedures were not sufficiently robust, and there was evidence that Scottish Amicable's systems had not been adequately revised following RU72: in particular, Scottish Amicable's failure to adequately monitor its investment staff and other employees. These failures were evidenced by the staff's failure to detect the systemic problems found in Scottish Amicable's selling practices and in the client files identified by the PIA in its report; and

(6) the overall competence of compliance staff reviewing customer files within the AR contact centre was inadequate.

5.13. The PIA Supervision Report was sent to Scottish Amicable on 16 March 2001. By 30 March 2001, the Chief Executive of Prudential Intermediary Business (of which Scottish Amicable formed a part) wrote to PIA Supervision stating that the Prudential Group intended to instruct an independent firm of accountants to examine independently the sales of all mortgage related endowment products by Scottish Amicable's ARs since the issue of RU72 (in December 1999) with a view to ensuring that none of its customers had been disadvantaged.

The Prototype Review

5.14. The independent firm of accountants conducted a prototype review of mortgage endowment cases effected in the period after 19 December 1999 to assess whether and if so, how, the rest of the mortgage endowment population should be reviewed ("the Prototype Review").

5.15. As part of the first stage of the Prototype Review, a sample of client files was reviewed to identify whether there were any weaknesses in Scottish Amicable's system for giving advice, including obtaining and recording personal and financial information. The main area of concern identified was in relation to attitude to risk – i.e. whether the client was willing to take the risk that the endowment may not produce sufficient funds to repay the original loan at the end of the term.

5.16. As the second stage of the review, a questionnaire was sent to a sample of 268 customers. The questionnaire addressed all the concerns raised in RU72 and consisted of six sections, which related to the suitability of the endowment method, the suitability of the type of endowment policy, the general affordability of the policy, the affordability of policies extending beyond an investors' intended retirement age, and lapsed policies. With regard to the suitability of the endowment method, one of the issues assessed was whether clients had in fact been prepared to take the risk that the endowment might not produce sufficient funds to repay the original loan at the end of the term.

5.17. Considerable efforts were made to encourage clients to respond to the questionnaire. If the client had not responded within three weeks a written reminder was sent, including a copy of the questionnaire. If the client had still not responded after a further two weeks, a telephone chase call was made in all cases where a valid telephone number could be found (either from the client's records or directory enquiries). If the client could not be reached or there was still no response then a close out letter was sent stating non-response as a reason for closing the case, and giving the client four weeks to have the case re-opened. Checks were also carried out to validate addresses, or to contact clients through their bank where necessary. The aim of the mailing and chasing process was to elicit as high a response rate as possible to provide substantial data on which to base analysis of the results. In the event, a response rate of 82.1% was achieved, which was higher than expected.

5.18. The independent firm of accountants reported that 21% of clients who responded (17% of clients mailed) had been offered redress. This included 11% of responders (9% of clients mailed) whose cases "*reflected a weakness in the sales process*", being sales of mortgage endowment policies made to customers who did not have the appropriate attitude to risk. A further 7% of responders were offered redress as a result of the review erring on the side of the customer where there was some doubt or confusion as to whether a mortgage endowment policy had been appropriate. Of the remaining 3% of responders offered redress (consisting of six cases), two clients were offered redress on the basis that the policies sold extended beyond their intended retirement ages, and they indicated that they would not be able to maintain the premium payments into retirement; three were redressed because the particular type of policy (the Step Up) did not appear to be appropriate and in one case there was evidence of churning. No redress was found to be due to the remaining 79% of customers who responded.

6. CONTRAVENTIONS OF RELEVANT STATUTORY REQUIREMENTS

6.1. The penalty is to be imposed pursuant to Section 206 of the Act in respect of breaches by Scottish Amicable of the PIA Rules, including the LAUTRO Rules, and the SIB Principles. These breaches are set out in detail below.

(1) Failure to Make Suitable Recommendations

6.2. Pursuant to Paragraph L8(1) of Schedule L2 of the adopted Lautro Rules, Scottish Amicable's ARs were obliged to use their best endeavours to recommend to clients only those contracts that were suited to that client. Identifying a client's attitude to risk is an essential element of assessing whether a mortgage endowment is suitable for a customer – it is critical that a client understands and is prepared to take the risk that the policy will not provide sufficient funds to repay the mortgage on maturity, and that he may have to increase his premiums during the life of the policy, introduce funds from other sources, extend the term of his mortgage or even sell his property in order to make up the shortfall. If the customer is not prepared to accept this risk, then the product is unsuitable.

6.3. Therefore, the failure to assess a client's attitude to risk carefully constitutes a failure by the AR to use his best endeavours to recommend a product that was suitable for a customer's needs, in accordance with the relevant rules.

6.4. During the period covered by the Prototype Review Scottish Amicable was in breach of Paragraph L8(1) of Schedule L2 of the LAUTRO Rules because its ARs failed to use their best endeavours to recommend Scottish Amicable's Home Purchaser Policies only where such policies were suitable for such clients.

6.5. By virtue of PIA Rule 1.3.9 Scottish Amicable is responsible for the conduct of its ARs. It follows that failure by its ARs to make suitable recommendations is a failure by Scottish Amicable.

Facts and Matters relied on

6.6. As described above, Scottish Amicable conducted a Prototype Review of all its mortgage related endowment business since the issuance of RU72 in December 1999.

6.7. The results of the Prototype Review are summarised at paragraph 4.18. The review found that the mortgage endowment policies sold to 11% of respondents (9% of the investors mailed) were unsuitable on the basis that the customers did not have the appropriate attitude to risk. This percentage of unsuitable sales is, in the view of the FSA, unacceptably high.

(2) Lack of Procedures for Ensuring Suitable Recommendations

6.8. Pursuant to PIA Rule 7.1.2(1) Scottish Amicable was required to establish procedures to ensure that its ARs carried out their functions in such a way that Scottish Amicable complied at all times with the Rules and Principles.

6.9. Pursuant to Paragraph L8(1) of Schedule L2 of the LAUTRO Rules, Scottish Amicable's ARs were obliged to use their best endeavours to recommend to clients only those contracts suited to that client.

6.10. At all times, Scottish Amicable's ARs were required to follow Scottish Amicable's procedures. The best endeavours of an individual representative were therefore determined among other things by the procedures established by Scottish Amicable.

6.11. During the relevant period, Scottish Amicable was in breach of Rule 7.1.2(1) of the Rules in that it failed to establish procedures to ensure that its representatives' best endeavours would result in them only recommending Scottish Amicable's Home Purchaser Policies where such policies were suitable for clients.

Fact and Matters relied on

6.12. Scottish Amicable failed to establish and maintain procedures to ensure that its ARs' best endeavours would result in them only recommending Scottish Amicable's endowment products when they were suitable taking into account the individual client's attitude to risk.

6.13. Deficiencies in Scottish Amicable's selling practices and procedures were identified by PIA Supervision in their January 2001 visit, as summarised in paragraph 4.12.

6.14. The sales process, including the fact find, that was in place for the period January to December 2000 failed to require that the ARs specifically ascertain and record the client's attitude to the risk that his mortgage might not be repaid at the end of the term ("mortgage risk"). The fact find only required the AR to ascertain and record the client's attitude to investment risk, which determined the degree of investment risk that the client was willing to take with respect to the funds in which the endowment mortgage premiums would be invested. There was no separate category that identified those clients that were mortgage risk averse and therefore should not have been recommended a mortgage endowment at all. Further, the lowest category of risk included both certain investments that were suited to clients who were prepared to take a risk and certain investments for clients who were not. There were also major deficiencies in the monitoring procedures at Scottish Amicable as identified in the PIA Supervision Report which were further evidenced by the fact that a significant number of unsuitable recommendations were made to clients as detailed in the Prototype Review. Scottish Amicable changed its fact find documentation in February 2001, requiring ARs to ascertain and record clients' attitude to both mortgage risk and investment risk. This ensured that clients averse to mortgage risk would be identified.

(3) Breach of SIB Principle 2

6.15. SIB Principle 2 required firms to use due skill, care and diligence in complying with their regulatory obligations.

Facts and Matters relied on

6.16. By reference to the Rule breaches described in paragraphs 5.2 to 5.14, Scottish Amicable was in breach of SIB Principle 2 in that it failed to use due skill, care and diligence to ensure that the only contracts recommended to clients were those which were suited to their needs and it failed to take all appropriate action in response to PIA Regulatory Update 72 published in December 1999.

6.17. As referred to above, RU72 reminded firms of their obligations when recommending a mortgage related endowment product. RU72 indicated that the main areas of concern included suitability and the assessment of attitude to risk. RU72 also reminded firms of the need to ensure that sufficient information was recorded to demonstrate that recommendations made were suitable.

6.18. While Scottish Amicable did make some changes to its sales systems during the course of 2000 in response to RU72, it is evident from the PIA Supervision Report and the Prototype Review that these were not adequate.

6.19. The steps taken by Scottish Amicable in response to RU72 included:

(1) in March 2000, it issued an update to its ARs, directing them to explain to clients the risks associated with an endowment mortgage, to ensure the client understood those risks, and to record these facts;

(2) in May 2000 the "Reason Why Letters" ("RWL") were amended to include more information on the difference between the capital and interest-only repayment methods;

(3) in June 2000, it provided its ARs with specific training on endowments concentrating on the amendments to the RWL; and

(4) in August 2000, it instructed its National Sales Support Centre (which provided a quality check on the advice provided by the ARs) to return mortgage endowment policy applications where the Fact Find showed a "cautious" attitude to risk unless mortgage risk had been fully explained and a low growth rate assumed.

6.20. However, it was not until February 2001 that Scottish Amicable amended its Fact Find to require its ARs to assess and record at the point of sale specific information relating to clients' attitude to mortgage risk, as well as investment risk. RU72 had directed firms to ensure that a sufficient understanding of customers' attitudes to taking market-linked risk in the financing arrangements for their homes was obtained before a recommendation was made. This represented a failure to act with due skill, care and diligence in response to RU72.

6.21. As a result of the failures in Scottish Amicable's sales and monitoring procedures unsuitable sales were made. The independent firm of accountants concluded in the Prototype Review that 11% of respondent customers (9% of customers mailed) were missold mortgage endowments on the basis that they did not have the appropriate attitude to risk. The view of the FSA is that these missales occurred as a result of Scottish Amicable's failure to take appropriate and timely action to respond to the issues identified in RU72 and to implement its own internal compliance updates. Accordingly Scottish Amicable has failed to act with due skill, care and diligence.

7. RELEVANT GUIDANCE ON SANCTION

7.1. 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 and Annex D of "PIA's Approach to Discipline – Statement of Policy" that was issued in December 1995 indicate the factors that may be of particular relevance in determining the level of a financial penalty. These are discussed below in respect of the circumstances of this case.

7.2. Article 8 (4) of the Pre-N2 Misconduct Order provides that, where the FSA proposes to impose a financial penalty it must have regard to:

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

7.3. 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.

7.4. Relevant PIA Guidance is contained in Annex D of "PIA's Approach to Discipline – Statement of Policy" that was issued in December 1995. In all material respects this required consideration of the same factors as identified in Chapter 13 of the Enforcement Manual. It has been taken into account by the FSA in determining the appropriate sanction in this case.

7.5. The PIA's Statement of Policy makes it clear however that the criteria for determining the level of sanction are not to be applied rigidly, as stated in paragraph 2 of Annex D:

"*Each case is different and needs to be treated on its own merits. It is not possible to apply a mechanistic approach to the determination of the circumstances in which disciplinary action should be taken or of the sanctions to be applied. The criteria…should not be treated as exhaustive. Nor should it be assumed that regard would necessarily be had to a particular criterion in any given circumstances."*

7.6. Similarly, it is stated in Chapter 13 of the FSA Enforcement Manual at clause 13.3.4 that the criteria listed in the manual are not exhaustive and all relevant circumstances of the case will be taken into consideration.

7.7. 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 (which are expressed both in terms of FSA and equivalent PIA Guidance) to be particularly relevant in this case.

ENF 13: The seriousness of the misconduct or contravention.

PIA Guidance: The seriousness of the breaches

7.8. The level of financial penalty must be proportionate to the nature and seriousness of the contravention. The breaches identified in this case are of a systemic nature, arising from weaknesses in Scottish Amicable's sales process for Home Purchaser policies. The failure in Scottish Amicable's process for assessing its clients' attitude to mortgage risk has caused actual or potential disadvantage to significant numbers of consumers. These are, in the view of the FSA, serious failures which require the imposition of a significant penalty.

7.9. The misselling of mortgage endowments is a significant industry wide issue, which has major implications for consumer confidence and trust in the financial system.

7.10. The PIA has publicly warned firms on several occasions – RU72 (December 1999), RU80 (November 2000), RU91 (July 2001) - that it would not hesitate to take disciplinary action with regard to deficiencies in firms' sales procedures in the selling of mortgage endowments.

7.11. Scottish Amicable's breaches are considered to be particularly serious as it failed to respond adequately to the PIA's concerns identified in RU72, and despite being

warned that the PIA would consider regulatory action against firms who failed to comply with the regulatory requirements. Furthermore, such issues had already been well publicised to the industry by the end of 1999, as a result of the Institute of Actuaries Report and the ABI Ten Point Plan.

7.12. Scottish Amicable sold 11,816 mortgage endowment policies during the period from 1 January 2000 to 31 December 2000. Scottish Amicable is currently reviewing 33,781 policies from January 1999 to February 2001 on the basis that the results of the Prototype Review indicate that up to 21% of respondent clients were redressable (11% clearly on the basis of attitude to risk).

7.13. Scottish Amicable has also agreed to take additional steps to further ensure that current mortgage endowment policyholders who were sold policies between 29 April 1988 and 31 December 1998 will receive redress where appropriate.

7.14. Scottish Amicable has informed the FSA that it is setting aside £11 million for redress payments for the whole period from January 1999 to February 2001.

ENF 13: 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.

7.15. There is no indication that Scottish Amicable deliberately or recklessly contravened PIA Rules.

ENF 13: 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.

7.16. Notwithstanding Scottish Amicable's failings, the FSA considers that procedures are in place, through the Past Business Review, that should ensure that all customers who are due redress will be compensated. As a result, there is nothing to suggest that Scottish Amicable will have benefited financially from the policies which were missold to customers.

ENF 13: Conduct following the contravention

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

7.17. The FSA attaches great importance to the co-operation demonstrated by Scottish Amicable. Scottish Amicable has been given considerable credit for the way in which it has conducted itself once it had received the PIA Supervision Report highlighting concerns with its sales of mortgage endowments. In the FSA's view, Scottish Amicable's approach following the contravention is a model of the type of co-operation and acceptance of responsibility by senior management which is desired by the FSA and which clients deserve. Accordingly, this is a major factor that has been taken into consideration in setting the financial penalty.

7.18. The breaches were identified as a result of a visit from PIA Supervision in January 2001 rather than by Scottish Amicable. However, since the breaches were identified, Scottish Amicable has reacted in an extremely helpful, positive and proactive way to amend its procedures and establish whether clients have been mis-sold, and if so, whether they have been financially disadvantaged:

(1) Scottish Amicable responded promptly – within 2 weeks - by informing the FSA that it had (a) instructed a review of its PIA Compliance functions and (b) instructed an independent firm of accountants to look independently at the sales of all endowment related mortgage business sold by its Appointed Representatives since RU72, with a view to ensuring that none of their customers had been financially disadvantaged. Scottish Amicable thus acknowledged at the earliest opportunity, once its failings had been identified by the PIA, that there were concerns about the sales process and took decisive action to address those concerns.

(2) Of its own accord Scottish Amicable then instructed an independent firm of accountants to conduct the Prototype Review in April 2001 into 250 sample cases. Scottish Amicable acted very diligently on this – for example, the response rate was 82.1%, which from the experience of other such reviews, is a high response rate. This was due to the ongoing efforts made by their reviewing staff to make contact with clients (both by letter and telephone) and encourage them to return the questionnaire. The Prototype Review identified that 21% of customers were due redress. Scottish Amicable took a pragmatic view, erring on the side of the customer to offer compensation, even where there was some doubt.

(3) On the basis of the results of the Prototype Review, Scottish Amicable has now extended its Past Business Review to 33,781 policies sold between January 1999 and February 2001. The Past Business Review began in June 2002 and is due to be completed by 31 March 2004. Scottish Amicable has also agreed to take additional steps to further ensure that current mortgage endowment policyholders who were sold policies between 29 April 1988 and 31 December 1998 will receive redress where appropriate.

(4) From February 2001 Scottish Amicable had also changed its procedures to ensure that client's attitude to mortgage risk was ascertained and recorded. This involved the fact find being amended to require the AR to ascertain and record the client's risk profile, including the customers' attitude to mortgage risk. In addition explanatory pamphlets were provided to clients that explained the definitions of the categories of risk ("Cautious"; "Moderate"; "Balanced"; "Focused" and "Speculative") in respect of mortgage and investment risk.

(5) Scottish Amicable withdrew from the mortgage related endowments market from April 2001.

7.19. Scottish Amicable has committed substantial sums of money and considerable management time to conducting its Past Business Review including the Prototype Review.

7.20. Scottish Amicable has co-operated fully with the FSA in its investigation. There is no evidence that Scottish Amicable has at any time misled the PIA or the FSA. Scottish Amicable was proactive in taking steps to redress any clients who may have been missold and has, as a matter of principle, erred on the side of the customer where there was any doubt (such as where the customer could not fully recollect events). It has so far paid £37,670 in redress to customers as a result of the Prototype Review, the average payment being £1,000 per customer.

ENF 13: Previous action by the FSA in relation to similar failings

7.21. The FSA has previously imposed penalties on firms for mortgage endowment misselling. The FSA has also made clear publicly the approach that will be adopted to concerns about the sale of mortgage endowments in RU72. This has been taken into account in setting the level of penalty.

ENF 13: Action taken by other regulatory authorities in relation to similar findings

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

7.22. Scottish Amicable's predecessor regulator, the PIA, has taken action against firms for systems and control failings, including compliance and selling practices failings. This action has included the imposition of financial penalties. The FSA is not bound by such decisions. Nevertheless, in determining the level of penalty imposed in this case, the FSA has taken them into account together with all the particular circumstances described in this Final Notice.

ENF 13: Disciplinary record and compliance history

PIA Guidance: The Firm's regulatory history

7.23. Scottish Amicable has not previously been the subject of formal disciplinary action.

8. MANNER OF PAYMENT

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

9. TIME FOR PAYMENT

9.1. The penalty must be paid to the FSA no later than 19 March 2003, being not less than 14 days beginning with the date on which this notice is given to you.

10. IF THE PENALTY IS NOT PAID

10.1. If all or any of the Penalty is outstanding on 20 March 2003, the FSA may recover the outstanding amount as a debt owed by you and due to the FSA

11. IMPORTANT

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

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 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.

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 Felicity Rowan / Tom Spender at the FSA (direct line: 020 7676 1424 / fax 020 7676 1425).

Julia Dunn
Group Leader
FSA Enforcement Division