
FINAL NOTICE

To: Standard Life Assurance Limited
Of: Standard Life House
30, Lothian Road
Edinburgh
Midlothian
EH1 2DH
Date: 20 January 2010

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. ACTION

- 1.1. The FSA gave Standard Life Assurance Limited (SLAL or the firm) a Decision Notice on 13 January 2010 which notified the Firm 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 £2,450,000 on SLAL. This penalty is in respect of breaches of Principle 3 (management and control) and Principle 7 (communications with clients) of the FSA's Principles for Businesses (the Principles) between 10 July 2006 and 28 February 2009 (the Relevant Period).
- 1.2. SLAL confirmed on 13 January 2010 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 SLAL the facts and matters relied on, the FSA imposes a financial penalty on SLAL in the amount of £2,450,000.

1.4. SLAL agreed to settle at an early stage of the FSA's investigation. It therefore qualifies 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 £3,500,000 on SLAL.

2. REASONS FOR THE ACTION

2.1. The FSA has imposed a financial penalty on SLAL for breaches of the FSA's Principles in relation to SLAL's failure to:

- (a) ensure that there were proper systems and controls in relation to the Pension Sterling Fund (the Fund), specifically the systems and controls concerning the marketing material produced and in relation to the prompt and full investigation of the concerns arising regarding marketing material (Principle 3); and
- (b) ensure that the marketing material issued in relation to the Fund was clear, fair and not misleading (Principle 7).

2.2. SLAL became responsible for the Fund on 10 July 2006, following the demutualisation of the Standard Life Group. The Fund was managed by Standard Life Investments Limited (SLI) for and on behalf of SLAL. The Fund initially primarily invested in bank deposits and other very short dated instruments. The balance of the underlying investments changed over time, and by July 2007 the majority of the Fund was invested in floating rate notes (FRNs).

2.3. Marketing material issued in relation to the Fund was not clear, fair and not misleading. In particular, despite the majority of the Fund being invested in FRNs:

- (a) the fact sheet produced by a third party data producer (the data producer) from April 2007 until 16 April 2008 (except for the period 2 to 20 January 2008) contained a pie chart showing that 100% of the Fund was invested in cash; and
- (b) marketing literature issued by SLAL referred to the Fund being wholly invested in cash.

2.4. These failures arose because there was no adequate systems or controls in place to ensure that marketing material issued accurately reflected the investment strategy for the Fund.

2.5. SLAL also failed to ensure that there were adequate systems and controls properly to investigate concerns regarding the marketing material. This resulted in a failure promptly to remedy failings after concerns were raised. In particular, from September 2007 onwards various complaints were made by consumers about the nature of the Fund and the underlying assets, given the description of the Fund in marketing material, and concerns were also raised by employees of SLI and SLAL. Although internal reviews of marketing material were carried out, the reviews were too narrow and failed to identify properly the failings. The failings were only fully identified in February 2009.

2.6. The failures to have adequate systems to ensure that the marketing material was accurate led to consumers being misled as to the true nature of the investments held

by the Fund and, as a result, being given misleading information on the risk of capital losses. This was inconsistent with Treating Customers Fairly.

2.7. SLAL's breaches are serious for the following reasons:

- (a) there was a risk of unexpected consumer losses being incurred, as demonstrated by the reduction in the value of the Fund by 4.8% (approximately £100 million) on one day in January 2009;
- (b) there were a large number of consumers in the Fund, and the value of the Fund was significant (96,752 retail consumers with investments of £1.92 billion as at November 2008);
- (c) the Fund was intended primarily for the investment of pensions. It was considered appropriate for individuals approaching retirement, and individuals looking for a stable investment when the outlook for bonds and equities was uncertain. The capital security of such an investment was therefore of great importance; and
- (d) there was a failure to promptly identify and remedy the failings after concerns regarding marketing material were raised from September 2007 onwards.

2.8. SLAL's failures therefore merit the imposition of a significant financial penalty. In deciding upon the level of disciplinary sanction, the FSA has taken account of a number of factors, including the following proactive steps taken by SLAL to address the situation:

- (a) following a 4.8% drop in the unit price of the Fund on 14 January 2009, resulting from a re-valuation of certain assets held by the Fund¹, SLAL paid a total of £102.7 million into the Fund to restore the value of the investors' holdings to the position they would have been in prior to the fall in the unit price. In this way, SLAL compensated consumers for the loss suffered as a result of fall in the unit price;
- (b) SLAL have reviewed both the current and historic marketing material in relation to the Fund and have contacted existing consumers who were identified as having received poorer quality marketing material to determine whether any further compensation may be required in their cases;
- (c) SLAL commissioned a report by an independent third party into (i) the issues that had arisen in relation to the Fund, and (ii) improving the systems and controls in relation to the marketing of the Fund; and

¹ The temporary reduction in the liquidity of certain assets held by the Fund, which led to their re-valuation, was a result of the difficult market conditions in 2008.

- (d) SLAL brought the issues to the attention of the FSA, and has fully cooperated with the FSA investigation.

3. RELEVANT STATUTORY AND REGULATORY PROVISIONS

Statutory provisions

- 3.1. Under Section 2(2) of the Act the protection of consumers is a regulatory objective for the FSA.
- 3.2. 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."

FSA Principles

- 3.3. The FSA's Principles are a general statement of the fundamental obligations of firms under the regulatory system. They derive their authority from the FSA's rule-making powers as set out in the Act and reflect the FSA's regulatory objectives.
- 3.4. Principle 3 states that:

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

- 3.5. Principle 7 states that:

"A firm must pay due regard to the information needs of its clients, and communicate information to them in a way which is clear, fair and not misleading."

4. FACTS AND MATTERS RELIED ON

Background

- 4.1 SLAL is a wholly owned subsidiary of Standard Life Plc. SLAL has been authorised by the FSA to perform a number of regulated activities since 17 February 2006. SLAL provides pensions and life assurance products to retail consumers. It took over this authorised business from The Standard Life Assurance Company when it was demutualised on 10 July 2006.
- 4.2 The unit linked funds underlying SLAL's pension and life assurance products are owned by SLAL but are managed by SLI under an Investment Management Agreement.
- 4.3 SLAL produced marketing material for retail and institutional customers in respect of its pension products and underlying funds. Some marketing material for retail

customers was distributed directly to customers, whilst some was available from financial advisers and the SLAL website.

The Pensions Sterling Fund

- 4.4 The Pension Sterling Fund (the Fund) is a unit linked fund. It was launched on 19 August 1996 as an alternative to Standard Life's Pensions Cash Fund. It was designed to provide enhanced returns whilst maintaining low volatility. The total value of the Fund as at 23 December 2008 was £2.2 billion, comprising 98,000 retail customers.
- 4.5 The Fund initially invested in a mix of cash and very short dated instruments. During the Relevant Period, the Fund also invested in FRNs. The proportion of FRNs increased significantly from 2005 following a change in investment mix. By July 2007, the percentage of FRNs had increased to 80.7%. The proportion then decreased due to a decision not to continue to invest in certain types of FRNs. By January 2009, approximately 50% of the Fund was invested in FRNs.

Discovery of issues

- 4.6 Throughout 2008, the decreasing liquidity in the market for FRNs resulted in a lack of transparency in the prices of certain types of FRNs in the Fund. Consequently, SLAL re-valued certain assets held by the Fund and on 14 January 2009 announced a reduction in the unit price of the Fund of 4.8%.
- 4.7 Standard Life conducted some consumer research following the unit price fall. The findings indicated that a significant proportion of Fund investors (a) were not aware of the mix of investments in the Fund and (b) considered the 4.8% price drop to be higher than they expected. On 11 February 2009 Standard Life plc announced a £102.7 million injection into the Fund to restore the value of investors' holdings to the position they would have been in were it not for the unit price fall.
- 4.8 Following the injection of cash into the Fund, the Board of Standard Life plc initiated a post event review and engaged an independent third party to investigate the matter.

Marketing of the Fund

- 4.9 Throughout the Relevant Period, marketing material for the Fund failed adequately to set out the nature of the investments in the Fund. SLAL therefore failed to ensure that marketing material for the Fund was clear, fair and not misleading. Customers were misled as to the assets held in the Fund and as a result, customers did not have the necessary information with which to make an informed decision about whether the Fund was suitable for their investment strategy.
- 4.10 The Fund was intended primarily for the investment of pensions. It was marketed as a stable investment suitable for investors who were looking for a temporary home for their money when the outlook for bonds and equities was uncertain. It was also targeted at customers approaching retirement who were looking to protect a tax-free lump sum.

- 4.11 SLAL failed to ensure that the risks inherent in the underlying assets of the Fund were adequately described in the marketing material. As a result many customers did not expect there to be any risk of capital loss and did not expect the unit price to fall by as much as 4.8% in one day.

Outsourced factsheets

- 4.12 During the Relevant Period, there were inadequate systems and controls in place surrounding the production of factsheets by the data producer. The data producer produced Standard Life branded factsheets for SLAL owned funds from 2007. These factsheets were publicly available through Standard Life's website and its Adviserzone website. There were inadequate controls around the arrangements with the data producer, both in terms of the information that was supplied to them and the information that was subsequently produced by them. These control weaknesses extended beyond the Fund and related to all factsheets produced by the data producer.
- 4.13 In relation to the Fund, from April 2007 until 16 April 2008 (except for the period 2 to 20 January 2008) SLAL published misleading information on its website, a factsheet produced by the data producer stating that the Fund comprised 100% cash. Customers who based their investment decision on this factsheet were likely to have been unaware of the nature of the assets in the Fund and the potential volatility of its unit price.
- 4.14 The standard template that formed the basis of the factsheets was signed off by Marketing Compliance. However, SLAL failed to perform any quality assurance to ensure the accuracy of the data that the data producer used.
- 4.15 Similarly, SLAL failed to have in place any adequate process to check the quality and accuracy of the factsheets. The Marketing team did carry out informal ad-hoc checks on the data producer factsheets but these focussed on the completeness of data rather than accuracy. There were no cross-checks with source information and no adequate process for checking the information extracted from the factsheets for use in other marketing material. In addition, once inaccurate information was identified, there was no system to correct this.

SLAL marketing material

- 4.16 In addition to the outsourced factsheets, SLAL produced its own marketing material for its pension and life products. A process was in place within SLAL for creating and updating marketing material. The marketing material was drafted by a Communications Consultant in consultation with a group responsible for approving the marketing material. Marketing Compliance also reviewed the draft and authorised the final proof once any changes had been made. Marketing Compliance was responsible for ensuring that marketing material was clear, fair and not misleading.
- 4.17 However, Marketing Compliance did not review descriptions of the Fund in SLAL marketing material to ensure those descriptions were accurate. In addition, Marketing

Compliance failed to undertake any quality assurance checks to ensure that printed material agreed to the authorised final proof.

- 4.18 During the Relevant Period, descriptions of the Fund in SLAL marketing material were misleading. For example, at times the Fund was described as “investing wholly in cash”:

“The Fund is invested wholly in cash – the most stable investment. This fund helps investors who are looking for a temporary home for their investment just before they retire and it is particularly suited to funds set aside for a tax-free lump sum”.

- 4.19 These failures occurred despite an internal audit report published in January 2007 having concluded that the controls around approving marketing material were not robust and required improvement. Although SLAL initiated plans to address these weaknesses, the introduction of these plans was postponed and adequate systems were not introduced.
- 4.20 As part of Standard Life Plc’s review of the issues arising in relation to the pricing of the Fund, a review of point-of-sale literature for the Fund was performed. This review identified that 54.6% of customers had received either B or C category material (where A represents “Better Quality”, B represents “Arguable Cases” and C represents “Poorer Quality”).

Awareness of issues

- 4.21 During the Relevant Period, SLAL failed to take adequate corrective action when the issues came to light with the data producer factsheets and SLAL marketing material for the Fund. In particular, there were a number of instances where SLI and SLAL staff and customers asked questions about the promotion of the Fund. SLAL failed to properly follow through and escalate the issues and, therefore, they remained unresolved.
- 4.22 In September 2007, concerns were raised by SLI to SLAL Marketing over the display of 100% cash in the factsheets produced by the data producer for the Fund. Although SLAL Marketing raised these concerns with the data producer, the data producer could not immediately change the factsheets because of a system issue that would affect their entire client base. SLAL Marketing failed to escalate this issue within SLAL and failed to monitor the progress of its resolution by the data producer. As a result, the data producer continued to issue incorrect and misleading factsheets for the Fund until April 2008, when the issue with the data producer was rectified.
- 4.23 Following a customer complaint, in September 2007 SLAL Marketing also reviewed specific Fund marketing literature. This resulted in a change to the wording of the Fund description to highlight that the value of the Fund may fall. However, SLAL failed to escalate this to senior management and to notify existing customers.
- 4.24 SLAL Compliance also at this time undertook a review of marketing material including the factsheet produced by the data producer and a version of the marketing

material for the Fund. Although the review concluded that customers had not deliberately been misled, it failed to consider whether customers had been misled, regardless of whether it was deliberate or not.

- 4.25 In February 2008, concerns were again raised by SLI to SLAL Marketing over the continued display of 100% cash in the factsheets produced by the data producer for the Fund. SLAL Marketing again raised this with the data producer but failed to ensure appropriate and timely action was taken. SLAL also again failed to escalate the issue to senior management.
- 4.26 During May to September 2008, SLAL Marketing undertook a review of fund objectives contained in the fact sheets produced by the data producer for all unit linked funds (including the Fund). However, the review did not extend to other marketing material, in which the Fund was described as being wholly invested in cash, and did not as a result identify these inaccuracies.
- 4.27 In October 2008, another review of Fund marketing material was performed. The conclusions of the review focussed on tightening current literature. SLAL failed to give consideration to the impact on existing customers who may have received previous literature, and in particular failed to ensure that existing customers were contacted and advised as to the correct nature of the investments held by the Fund.

Lack of adequate communication between business areas and committees

- 4.28 During the Relevant Period, SLAL failed to ensure that there were adequate processes in place to enable effective communication between business areas and committees. This resulted in a lack of awareness of any divergence between the description of the Fund in marketing material and investments held by the Fund.
- 4.29 There was no adequate control process for ensuring that marketing material in respect of the Fund accurately reflected the investment strategy of the Fund. The business operated in distinct silos, with the result that marketing material issues relating to the Fund were passed from area to area without any one business area or committee having overall responsibility for ensuring that the marketing material correctly reflected the investments held by the Fund.

5. BREACHES OF THE FSA'S PRINCIPLES FOR BUSINESSES

- 5.1. On the basis of the facts and matters set out above, the FSA considers that SLAL has breached Principles 3 and 7 of the FSA's Principles for Businesses.

Principle 3 – Management and control

- 5.2. By reason of the matters set out above, SLAL has breached Principle 3 of the FSA's Principles for Business by:
 - (a) failing to ensure that there was effective communication between business areas and committees, including failing to ensure that the overall responsibility for the

marketing material issued in relation to the Fund was clearly apportioned between areas;

- (b) failing to ensure that there was any adequate system in place to ensure that the marketing material in relation to the Fund accurately reflected the investment strategy for the Fund, and was clear, fair and not misleading; and
- (c) failing to ensure that there were proper systems and controls to investigate promptly and fully any concerns regarding the marketing material by ensuring that a full review of the relevant marketing material took place and that the results were escalated to senior management, and failing to ensure that any existing customers who were not aware of the true nature of the investments held by the Fund were advised of the nature of the investments.

Principle 7 – Communications with clients

5.3. By reason of the matters set out above, SLAL has breached Principle 7 of the FSA's Principles for Business by:

- (a) issuing marketing material in relation to the Fund that was not clear, fair and not misleading; and
- (b) displaying on its website marketing material, produced by the data producer, that was not clear, fair and not misleading.

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 FSA has had regard to the relevant provisions of ENF and DEPP in reaching its conclusions as to the appropriate sanction for this case. The criteria set out in ENF and DEPP are not exhaustive and all relevant circumstances of the case will be taken into consideration.

The seriousness of the breaches

- 6.2. The FSA has had regard to the seriousness of the breaches, including the nature of the requirements breached, the number and duration of the breaches, the extent to which the breaches revealed serious or systemic weaknesses of the management systems or internal controls, the number of customers who were exposed to loss or the risk of loss and the number of customers likely actually to suffer financial detriment.
- 6.3. The FSA considers that the failure to implement adequate and effective systems and controls in relation to the Fund is of a serious nature (see paragraph 2.7 above). There was a failure to identify and remedy failings promptly. For a period of more than two years the firm did not have adequate systems and controls in relation to the marketing

of the Fund, which resulted in consumers being misled as to the nature of the investments held by the Fund, and thereby exposed to a risk of unexpected losses. These failures continued despite concerns being raised by both consumers and employees. The potential level of loss to consumers is shown by the reduction in value of the Fund on 14 January 2009 of approximately £100 million as a result of the re-valuation of certain of its assets. This risk of loss is also particularly significant in light of the investment by consumers of their pensions in the Fund.

The extent to which the breach was deliberate or reckless

- 6.4. The FSA does not consider that the misconduct on the part of SLAL was deliberate or reckless.

The size, financial resources and other circumstances of the firm

- 6.5. There is no evidence to suggest that SLAL is unable to pay the financial penalty.

The amount of profits accrued or the loss avoided

- 6.6. There is no evidence that SLAL or Standard Life plc either profited, or avoided any loss, as a result of the breaches.

Conduct following the breach

- 6.7. SLAL's conduct following the breach has been taken into account, including in particular the conduct set out at paragraph 2.8 above. As set out above, following a drop in the unit price of the Fund resulting from the re-valuation of certain assets, SLAL paid £102.7 million into the Fund to compensate customers. SLAL took proactive steps to address the situation, commissioning a report by an independent third party into the systems and controls relating to the marketing material issued in respect of the Fund, and improving those systems and controls in relation to the Fund and other unit linked funds, including bringing the production of fact sheets in-house.
- 6.8. Since the discovery of the failings in 2009, SLAL and its senior management have fully cooperated with the FSA's investigations.

Previous action taken in relation to similar failings

- 6.9. In determining the level of financial penalty, the FSA has taken into account penalties imposed by the FSA on other authorised persons for similar behaviour. However, the FSA has also had regard to the principal purpose for which it imposes sanctions, namely to promote high standards of regulatory conduct by deterring persons from committing breaches as well as demonstrating generally the benefits of compliant business.

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 £2,450,000 on SLAL.

8. DECISION MAKER

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

9. IMPORTANT

- 9.1. This Final Notice is given to you 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 SLAL to the FSA by no later than 3 February 2010, 14 days from the date of the Final Notice.

If the financial penalty is not paid

- 9.3. If all or any of the financial penalty is outstanding on 3 February 2010, the FSA may recover the outstanding amount as a debt owed by SLAL 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 you 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 Samantha Carruthers (direct line: 020 7066 0174/fax: 020 7066 0175) of the Enforcement and Financial Crime Division of the FSA.

William Amos

Head of Retail 1

FSA Enforcement & Financial Crime Division