FINANCIAL CONDUCT AUTHORITY

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FINAL NOTICE

To: **Standard Life Assurance Limited**

Reference Number: **439567**

Address: **Standard Life House, 30 Lothian Road, Edinburgh, Midlothian, EH1 2DH**

Date: **23 July 2019**

1. ACTION

1.1. For the reasons given in this Final Notice, the Authority hereby imposes on Standard Life Assurance Limited (Standard Life) a financial penalty of £30,792,500 pursuant to section 206 of the Act.

1.2 Standard Life agreed to resolve this matter and qualified for a 30% (stage 1) discount under the Authority's executive settlement procedures. Were it not for this discount, the Authority would have imposed a financial penalty of £43,989,300 on Standard Life.

2. SUMMARY OF REASONS

2.1. The Authority takes this action against Standard Life for breaches of Principle 3 (Management and Control) and Principle 6 (Customers' Interests) of the Authority's Principles for Businesses (the Principles) that occurred between 1 July 2008 and 31 May 2016 (the Relevant Period) in relation to non-advised sales of annuities to existing customers who were approaching retirement and who may have been eligible for an enhanced annuity.

2.2. By failing to take reasonable care to organise and control its affairs responsibly and effectively, with adequate risk management systems, Standard Life failed to pay due regard to the interests of its customers and to treat them fairly.

2.3. Standard Life's approach to selling non-advised annuities to existing customers during the Relevant Period included higher risk incentives that placed pressure to sell on front line staff. When combined with poor systems and controls and the complex nature of a product that was sold to potentially vulnerable consumers, this led to some customers being treated unfairly and created a significant risk of consumer detriment.

2.4. The Authority has taken into account, and given credit for, the following:

(1) On 31 January 2017, Standard Life voluntarily agreed to conduct a past business review of non-advised annuity sales in order to provide proper redress in a timely manner to customers who are likely to have suffered loss as a result of Standard Life's non-compliance with a requirement. Standard Life is currently reviewing approximately 81,000 sales of non-advised annuities, where customers may have been entitled to an enhanced annuity. As at 31 May 2019 Standard Life had paid approximately £25.3 million to 15,302 customers. Based on the redress payments made to customers as a result of Standard Life's redress exercise to date, the estimated total redress payable for the entire customer population will amount to approximately £61.2 million. This total redress figure covers back-payments and interest paid to affected customers to put them in the position they would have been in had they bought an enhanced annuity (with a higher rate than the annuity they in fact purchased) on the open market at the point of retirement. SLAL will continue to make payments to affected customers at the enhanced rate for the remainder of their lives in accordance with the terms of their annuity

policies, and has set aside additional reserves to cover these future payments.

(2) Standard Life has been working very cooperatively with the Authority in respect of its past business review, and continues to do so.

(3) Standard Life closed its enhanced annuity product to new business in the second quarter of 2016.

2.5. Standard Life has acknowledged its past failings and proactively sought to put them right by compensating customers who were treated poorly. As a result, the Authority has taken this into account as a mitigating factor when determining the financial penalty.

2.6. An annuity is an insurance contract that provides a customer with a guaranteed income for life in return for a lump sum premium, usually paid from a pension policy. It is a complex financial product for which the ordinary customer's need for accurate information is high. This is particularly so in the context of a non-advised sale, where the customer chooses their annuity product based on factual information and does not receive financial advice about which specific product would be most suitable for their individual needs.

2.7. As part of the sales process, firms are required to explain to the customer that they may get a better annuity rate if they shop around on the open market, which is known as the "Open Market Option", so they can make an informed decision.

2.8. Where customers have a shortened life expectancy because of specified health or lifestyle conditions, such as a heart condition or smoking, they may be eligible for an enhanced annuity which would pay a higher income. This is on the basis that the annuity would likely be paid for a shorter period. Therefore, it is important that the firm obtains adequate information from the customer to determine whether they may be eligible for an enhanced annuity, and provides clear, fair and not misleading information about enhanced annuities. The nature and extent of enhanced annuities available in the market changed during the Relevant Period with a wider range of conditions being covered and enhanced annuities becoming more widely available over time.

2.9. During the Relevant Period Standard Life failed to:

(1) Implement sufficiently detailed call guidelines to ensure that relevant and important information in relation to enhanced annuities (including customers' entitlement to shop around), was provided to the customer in a consistently clear, fair and not misleading way during customer calls;

(2) Implement adequate systems and controls to mitigate the risk that Standard Life's financial interests, and those of its call handlers, were prioritised above fair customer outcomes;

(3) Implement systems and controls which effectively mitigated the risks created by high risk incentive schemes;

(4) Implement adequate systems and controls to monitor calls between call handlers and customers; and

(5) Produce sufficient Management Information (MI) to enable Standard Life's senior management to identify any failings in relation to the quality and volume of call monitoring.

2.10. Standard Life failed to take reasonable care to organise and control its affairs responsibly and effectively, with adequate risk management systems, by using high level call guidelines, and giving call handlers significant discretion as to how they communicated with customers. These failings created a significant risk that during telephone calls with its non-advised customers Standard Life would fail to provide them with appropriate and timely information about:

(1) The possible financial benefits of an enhanced annuity;

(2) Their potential eligibility for an enhanced annuity;

(3) The option to shop around for an enhanced annuity on the open market;

(4) The possibility that different firms may apply different eligibility criteria for enhanced annuities; and

(5) The possibility that different firms may pay more (or less) income under an enhanced annuity.

2.11. During the Relevant Period call handlers' incentives included higher risk features such as bonus thresholds that had disproportionate rewards for marginal sales. As a result, subject to meeting some call quality control thresholds, call handlers who met or exceeded sales targets qualified for a substantial "monthly production bonus", with 21.9% of call handlers throughout the Relevant Period achieving more than 100% of basic salary by way of bonus. There was therefore a significant risk that customers who may have been eligible for an enhanced annuity would be sold an annuity which was inappropriate for their needs or which they did not want, because call handlers wanted to reach bonus incentive thresholds.

2.12. Between 2011 and 2013, at the peak of its misconduct, Standard Life had an active sales strategy known as the "Annuities Challenge." One aim of this strategy was to increase profits on annuity sales by offering an incentive to existing customers choosing to consolidate their Standard Life pension pot with external funds into a Standard Life annuity. In 2011 annuity sales made up 50% of Standard Life's UK business profit.

2.13. Although Standard Life undertook call monitoring, it was not adequate or robust. Standard Life did not respond to evident risks by adjusting or enhancing its approach to monitoring. Call monitoring was insufficient to identify potential poor customer outcomes and did not take account of additional risks posed by the higher risk features of the incentive schemes.

2.14. The combined effect of these failings created a significant risk of poor outcomes for customers who may have been eligible for an enhanced annuity. Standard Life utilised high level call guidelines, which afforded call handlers significant discretion as to how they communicated important information to customers. This meant that enhanced monitoring of customer calls was required to ensure that clear, fair and not misleading information was consistently provided to customers and that they were treated fairly.

2.15. Certain higher risk features of Standard Life's incentive structures in turn created the risk that call handlers would place their own financial interests ahead of appropriate customer outcomes. These higher risk incentives placed pressure on call handlers to sell a non-advised annuity to customers who may have been entitled to a better enhanced annuity elsewhere.

2.16. Standard Life's failings led to an environment in which higher risk incentive schemes created pressure to sell and therefore required robust checks and balances to mitigate the risks caused by this pressure. Its systems and controls failings created a significant risk that profit would be prioritised above fair and favourable customer outcomes. This is particularly serious for the following reasons:

(1) The weaknesses in Standard Life's sales and monitoring procedures were systemic, including its management systems and internal controls relating to the sale of annuities;

(2) Annuities are a complex financial product for which the ordinary customer's need for accurate information is high;

(3) The choice of a particular annuity can affect customers, and sometimes their dependents, for the rest of their lives;

(4) Some of the customers purchasing annuities were potentially vulnerable. These customers would have depended on Standard Life to provide them with appropriate and timely information;

(5) Standard Life's conduct created a significant risk that customers who were eligible for enhanced annuities would not be provided with appropriate and timely information in a clear, fair and not misleading way, or treated fairly;

(6) Customers who were eligible for an enhanced annuity may have lost, and in some cases did lose, money as a result; and

(7) The Authority and other industry bodies had published material relevant to the sale of enhanced annuities.

2.17. The Authority hereby imposes on Standard Life a financial penalty of £30,792,500 pursuant to section 206 of the Act.

2.18. Any facts or findings in this Notice relating to any function, committee or group of persons should not be read as relating to all the members of that function, committee or group, or even necessarily any particular individual.

3. DEFINITIONS

3.1. The definitions below are used in this Notice:

"ABI" means the Association of British Insurers.

"the Act" means the Financial Services and Markets Act 2000.

"the Authority" means the body corporate previously known as the Financial Services Authority and renamed on 1 April 2013 as the Financial Conduct Authority.

"COBS" means the Authority's Conduct of Business Sourcebook.

"Contribution Bonus" means one of the four variable elements of pay for Standard Life Direct call handlers that could be affected by sales volumes.

"Customer Relationship Development" means the business area which transacted non-advised sales of annuities from the third quarter of 2012 to the end of the Relevant Period.

"Customer Services Division" means the business area which transacted non-advised sales of annuities from the beginning of the Relevant Period to the third quarter of 2012 (when the Customer Relationship Development area was formed).

"Customer Hub" means the business area formed in the third quarter of 2012 bringing together Standard Life Direct and the Pensions Claims Retirements team of the Customer Services Division (renamed Customer Relationship Development).

"ILA" means Impaired Life Annuity.

"KPI" means Key Performance Indicators.

"Monthly Production Bonus" means a bonus awarded to call handlers based on individual sales volumes and quality.

"Open Market Option" means the option to use the proceeds of a pension to buy an annuity on the open market.

"Private Client Management" means a business area which transacted non-advised annuity sales until late 2012, of which the core business was providing retirement planning advice to Standard Life's higher net worth advised clients.

"Product and Proposition Team" means the function responsible for retail customer product development and management.

"Relevant Period" means the period from 1 July 2008 to 31 May 2016.

"Risk Assurance" means the function delivering second line oversight of Standard Life's key business processes and risks.

"Standard Life" means Standard Life Assurance Limited.

"Standard Life Direct" means the business area responsible for dealing with complex non-advised annuity sales throughout the Relevant Period.

"SLCML" means Standard Life Client Management Limited (the parent entity of Standard Life Direct and Private Client Management).

"SYSC" means the Authority's Systems and Controls Sourcebook.

"UK Risk and Compliance" means Standard Life's UK compliance function including all lines of risk function within the UK business.

4. FACTS AND MATTERS

Background

Overview of the corporate structure of Standard Life during the Relevant Period

4.1. During the Relevant Period Standard Life was a subsidiary of Standard Life Plc and offered pensions, savings products and retirement solutions to its customers.

4.2. Between 1 July 2008 and 31 May 2016 Standard Life's business activities included the non-advised sale of annuities to its existing pension holders.

4.3. Non-advised sales of annuities were conducted by different business areas within Standard Life: the Customer Services Division, the Customer Relationship Development area and Standard Life Direct and Private Client Management. These areas also sold other protection and investment products.

4.4. From July 2008 to the third quarter of 2012, both Standard Life Direct and the Customer Services Division were responsible for the annuities sales process. The Customer Services Division dealt with simple cases including Standard Life standard annuities. They would refer customers with more complex cases to Standard Life Direct. Such referrals included customers who may have been eligible for an enhanced annuity.

4.5. In the third quarter of 2012 the Customer Hub was formed, merging Private Client Management, Standard Life Direct and part of the Customer Services Division, (that part was renamed Customer Relationship Development). This created a single channel for Standard Life's pension customers to access service, guidance, and advice on annuities. Given the evolution of the Customer Services Division and Customer Relationship Development business areas, these areas of the business are referred to throughout this Notice according to their name at the relevant time.

4.6. Standard Life launched its own enhanced annuity product in November 2013 to allow existing customers with adverse lifestyle conditions as well as ill health to purchase an enhanced annuity from Standard Life, rather than having to purchase from another provider.

4.7. In July 2015, Standard Life launched a panel of external annuity providers which included a range of enhanced annuity (covering both ill health and lifestyle factors) and standard annuity providers.

4.8. During the Relevant Period Standard Life had a referral arrangement for impaired life (underwritten) enhanced annuities with an external provider which were suitable for customers with a reduced life expectancy. From the beginning of the Relevant Period to April 2016 this referral arrangement was primarily available to customers who engaged directly with Standard Life on a non-advised basis.

4.9. Where a customer was identified as having a health condition and met the relevant referral criteria, they would be eligible for referral to the external provider for an individually underwritten enhanced annuity. The external provider did not offer "lifestyle annuities", which took into account lifestyle factors such as smoking.

4.10. In 2015 the Government introduced Pensions Freedoms which increased the range of retirement options open to consumers. This led to a decrease in the volume of sales across the annuities market generally and so Standard Life closed some of its annuity products (including enhanced annuities) to new business in the second quarter of 2016.

Overview of Standard Life's Annuity Sales Process

4.11. Standard Life offered private pensions to retail customers, who would make regular pension contributions. When they reached retirement, in order to convert their pension into a regular income, customers generally had to purchase an annuity.

4.12. Existing Standard Life pension customers did not have to purchase a Standard Life annuity and could shop around for a more competitive rate offered by other annuity providers. During the Relevant Period, Standard Life was required to make their pension customers (including those who may have been eligible to purchase an enhanced annuity) aware of their option to shop around, which is known as the "Open Market Option."

4.13. An existing Standard Life pension customer would receive a "wake up pack" six months before their retirement date. The customer would then receive a "follow up pack" six to ten weeks before their retirement date, which would include a quotation showing the lump sum amount available in the customer's pension plan. If the customer wanted to purchase a Standard Life annuity, the sale could be completed during a telephone call with a call handler. The customer would then receive a "follow up pack" based on the quoted annuity rate and a "settlement pack" which confirmed the annuity rate.

4.14. These Standard Life packs provided written information to customers on enhanced annuities and the right to shop around in line with the regulatory requirements at the time.

4.15. Guidance as to the nature and scope of statements to be made to customer about enhanced annuities (including the right to shop around) evolved during the Relevant Period. In the early part of the Relevant Period explicit guidance on disclosures related largely to written documentation provided to customers. It was therefore for firms to determine the appropriate approach in customer calls in light of their general regulatory obligations.

Overview of call handler documentation

4.16. During the Relevant Period, the documentation generally used by call handlers in Standard Life Direct as part of the non-advised annuity sales process, included:

(1) Call guidelines, otherwise known as "call flows" or "call standards" which provided guidance on the relevant points for call handlers to cover during calls with customers;

(2) "Process flows" which set out the steps that call handlers were required to complete during the call;

(3) Individual "call flows" (otherwise known internally as "crib sheets"), which were personalised documents prepared by individual call handlers as prompts for points to cover during a call;

(4) Structured call scripts (introduced in March 2016), which categorised and set out the points to cover on a call in a standardised order for call handlers;

(5) Guidance notes in the form of targeted pieces of guidance or email bulletins, which covered a specific topic relevant to the sales process; and

(6) "System guides" for call handlers that explained how a system worked and how customer information was to be entered into the system.

4.17. Standard Life Direct call guidelines were divided into guidelines of general applicability, called Best Business Practice guidelines, TCF guidelines and product specific call guidelines. Although Treating Customers Fairly ("TCF") practices were incorporated into product specific call guidelines, specific TCF call guidelines were not introduced into the Customer Relationship Development area until 2015.

4.18. The TCF call guidelines used in Standard Life Direct (which were revised periodically) were not product specific and applied to all telephone calls from the beginning of the Relevant Period until the introduction of the structured "call flow" document in 2016. The TCF guidance covered the key areas of providing accurate and factual information, presenting balanced and unbiased information and checking that the information provided had been properly understood by the customer.

4.19. Each call handler's own call flows were based on the call guidelines which they expanded upon by writing their own notes. Generally, call handlers created separate notes for different products and these would typically consist of a series of bullet points around which the call handler would build the conversation with the customer. There was no formal sign off or monitoring process for each call handler's own call flow document to ensure that it met the regulatory requirements and included all the necessary points. This created the risk that customer experiences would vary and that important information would not be provided clearly, or at all, depending on the individual call handler and the quality of their notes.

4.20. The high-level nature of the call guidelines combined with the significant degree of discretion which call handlers were afforded, created the risk that important information, particularly in relation to eligibility for enhanced annuities (including the right to shop around) might not be provided to the customer in a clear, fair and not misleading way. Consequently, this created the risk that some customers who may have been eligible for an enhanced annuity would make decisions based on unclear or incomplete information that could have a detrimental impact on the income they were entitled to receive during retirement.

4.21. It is particularly important that consumers have access to helpful information that enables them to make well-informed decisions about their retirement options.

Design and sign-off process of call handler documentation

4.22. There was no formal governance framework which mandated the processes for the design, sign off and monitoring of the documentation used by call handlers in Standard Life Direct, the Customer Services Division or Customer Relationship Development area.

4.23. Throughout the Relevant Period the drafting and design of call guidelines, process flows and system guides was undertaken by Sales Quality Managers. These managers later became the People, Process and Development Management Team alongside first line management within Standard Life Direct, with input from other functions as required (including UK Risk and Compliance and the Product and Proposition Team). Major changes or reformulations of call guidelines were signed off by, or received final review from, UK Risk and Compliance.

Standard Life Direct: Material developments in the call handler documentation regarding the Open Market Option, Health & Lifestyle Conditions and TCF Factors

2008 - 2009

4.24. From 1 July 2008 to 31 January 2009, the TCF call guidelines in Standard Life Direct included a generic warning against the risk of providing inaccurate or misleading information to the customer.

4.25. Similarly, although the call guidelines addressed the customer's potential eligibility for an enhanced annuity, the guidance in 2008 was generic and very high level, simply stating:

"Inform the customer that we can provide information on products from the Standard Life Group and some external providers".

4.26. Call handlers could therefore exercise significant discretion as to how they communicated a customer's potential options for purchasing an enhanced annuity. The guidance did not cover how to discuss, explain and assess a customer's potential eligibility for an enhanced annuity. This created a significant risk that the call handler would not explain adequately, or at all, what an enhanced annuity was, who might be eligible and how it might impact on the customer's retirement income. This information could be critical for customers who were making a decision to purchase an annuity without receiving financial advice, particularly because once set up, an annuity cannot be altered.

4.27. The call guidelines were then revised in July 2009 so that the call handler was prompted to enquire whether the customer had a shortened life expectancy. The call guidelines did not include guidance as to the type of questions to be asked in order to ascertain whether the customer had a medical or lifestyle condition that might lead to a shortened life expectancy. The call handler was simply instructed in the call guidelines to cover the following key risk: "*Where your customer has a shortened life expectancy, ensure you explain all options available to them and they understand the implications on early death"*.

4.28. The guidance itself was too generic to ensure the call handler would properly explore with the customer, during the call, what their specific medical conditions or lifestyle factors were and that those factors might mean they were eligible for an enhanced annuity. The amendment in July 2009 was initiated following a complaint from the spouse of a customer who had died shortly after purchasing an enhanced annuity.

2010 – 2012

4.29. Guidance on making the customer aware of their right to exercise the Open Market Option was introduced into call guidelines in February 2010. The guidance was very high level and exactly how this information was communicated to the customer was left to the call handler's discretion. Up until November 2011, Standard Life Direct call handlers worked on the assumption that if a call handler within the Customer Services Division had referred the customer to Standard Life Direct, then the Open Market Option had already been discussed by that call handler, and the customer had decided to proceed with the annuity options provided by Standard Life or its panel of external providers. Standard Life Direct call handlers were not directed to make customers aware of the Open Market Option available to them until the end of November 2011.

4.30. Whilst TCF call guidelines were revised in 2010 and 2011 to emphasise the requirement to provide accurate, factual and unbiased information, they remained generic in nature and provided little specific direction as to how the call handler should communicate with customers. The guidelines remained very high level and afforded call handlers a significant degree of discretion as to how they communicated important information.

4.31. By January 2012 the TCF call guidelines were more detailed. The guidelines provided guidance to call handlers on how to check the customer's understanding of their decision to proceed, ensuring they understood that the product and terms offered would be impacted by a number of factors and that terms may change if the information provided by the customer was inaccurate or incomplete. The TCF call guidelines also included checking the customer's level of understanding again before the end of the call and a recommendation that they seek advice to clarify any misunderstanding if necessary.

4.32. However, customer calls which took place in January 2012 show that, despite the new guidelines, some customers were not fully informed about their potential eligibility for an enhanced annuity (including the right to shop around). For example, on one call, the call handler asked whether the customer had any medical conditions, noting that this could afford them a higher monthly income on retirement. The customer informed the call handler that they suffered from a specific medical condition.

4.33. This call handler checked with a colleague (known as a "business expert") to confirm that this medical condition would not qualify for an enhanced annuity with Standard Life, but did not tell the customer that they may also be able to find an alternative provider, who might provide an increased income during retirement based on their medical condition. In addition, this call handler asked no questions in relation to lifestyle conditions during this telephone call.

4.34. On the subsequent call with the same customer, but with a different call handler, the call handler explained the Open Market Option, and asked whether the customer planned to exercise that option. The customer said that they could not see much variation in the options for annuities provided by Standard Life within the written pack. The customer therefore considered they would not be making "a huge mistake" by not exercising the option. The call handler responded in agreement, and did not explain that other providers may offer more favourable annuity rates in light of their medical condition. By agreeing with the customer, and failing to explain the possibility of a better deal on the open market, the call handler undermined the written Open Market information that had previously been provided to the customer in accordance with regulatory requirements.

2013 - 2014

4.35. In response to the introduction of the ABI Code in March 2013, Standard Life Direct strengthened the Open Market Option warning in the TCF call guidelines. The warning included a requirement for the call handler to make the customer aware that they could buy an annuity from another provider which might mean they would be financially better off. The call handler was also required to establish the customer's thoughts on this. Where a customer was eligible for referral to Standard Life's panel of external providers, the call handler was required to discuss how they could assist. If the call handler was unable to assist then they were to refer the customer to unbiased.co.uk.

4.36. Until 2013 Standard Life Direct did not require its call handlers to provide any information relating specifically to enhanced annuities. In March 2013, the section of the Standard Life Direct call guidelines titled "Shortened Life Expectancy Key Risk" was amended to include new guidelines around establishing the customer's state of health and to explain either the options they were eligible for, or that certain lifestyle or medical conditions could entitle them to an uplifted retirement income. This was supplemented by the introduction of guidance on "Additional Annuity Key Risks" which included guidelines on explaining the key risks and features of enhanced annuities to customers and ensuring that their partner was aware of eligibility for enhanced terms.

4.37. The call handler was also required to establish how the customer wished to proceed. This signalled a move towards a more interactive "Q&A" based approach to key customer risks within Standard Life Direct. At the end of November 2013 additional amendments to the TCF call guidelines included a section called "Eligibility Key Risk" incorporating three specific health and lifestyle questions designed to establish eligibility for an enhanced annuity.

4.38. Following the introduction of the ABI Code, the Authority found at least one example (out of the selection reviewed) of a case where a call handler provided inadequate explanations and information to the customer in respect of their eligibility for an enhanced annuity, including their right to shop around.

2015 - 2016

4.39. In April 2015, Standard Life made additional improvements to its sales process and provided more detailed guidance for call handlers including an "Annuity Risk Matrix" which was designed to ensure that call handlers identified the appropriate risk warnings for customers and included questions to check their understanding. One of these risks warnings stated: *"Shopping the whole of the open market will almost certainly result in you receiving more income for the rest of your life*".

4.40. In March 2016, further improvements were made when Standard Life introduced structured call flows which provided scripts for the call handlers to follow in respect of certain elements of a customer telephone call as well as details of the skills required. Standard Life also introduced a set of principles to support call handlers when using the structured call flow. The call flow scripts prompted the call handler to advise the customer that *"certain lifestyle factors and your state of health can have an impact on the income you receive… and therefore I will be asking you and your partner some questions about you* [sic] *medical history",* and then listed specific health and lifestyle questions for the call handler to put to the customer. The call flow scripts also emphasised the importance of shopping around on the open market.

4.41. In summary, the Standard Life Direct call handler documentation was improved by Standard Life over time but until March 2015 it remained reasonably high level with a significant degree of discretion as to how call handlers communicated important information to the customer about eligibility for an enhanced annuity (including the right to shop around). This created the risk that important information which customers relied on to make an informed decision about their annuity might not be provided by the call handlers or that it might not be communicated in a way that was clear, fair and not misleading. Further improvements were made in March 2015 with the introduction of the Annuity Risk Matrix and in March 2016 when structured call flows were implemented, both of which provided more detailed guidance to call handlers.

Customer Services Division and Customer Relationship Development areas: Material developments in the call handler documentation regarding the Open Market Option, Health & Lifestyle Conditions and TCF Factors

2008-2009

4.42. The Customer Services Division dealt with initial calls from customers who wanted to purchase an annuity. In straightforward cases, it completed sales of annuities and referred customers with health or lifestyle conditions which may have meant that they were eligible for an enhanced annuity to Standard Life Direct. Until 2011, it was responsible for informing all customers of their option to shop around on the open market, even where customers were subsequently referred to Standard Life Direct.

4.43. At the start of the Relevant Period the Customer Services Division call guidelines required call handlers to ask customers about their health and explore whether they might be eligible for an enhanced annuity only where the customer was over 50 and specifically mentioned suffering from ill health. This placed the onus on the customer to flag any health issues rather than the emphasis being on the call handler to ask pertinent questions. Consequently, Standard Life was relying on its customers to volunteer the right information, when they were unlikely to know what information was relevant and would affect their eligibility for an uplifted retirement income.

4.44. Following Standard Life's own review of call standards and the Authority's first market review of the sale of annuities, Standard Life amended the call guidelines in November 2008 to encourage call handlers to prompt customers to shop around. However, call handlers were given very limited formal guidance on call structure relative to the sales process.

4.45. In May 2009, the call guidelines were amended to include mandatory key risks to cover the Open Market Option and health conditions. Very little detail was provided to call handlers in the call guidelines to enable them to provide adequate information to the customer about possible eligibility for an enhanced annuity. The section on "Serious Ill Health" provided three bullet point instructions to the call handler to prompt them to (a) "*explain that ill-health may entitle them to an increased regular pension", *(b) *"establish eligibility for ILA from Partnership Assurance"*, or (c) "*eligibility for Serious Ill Health."*

4.46. The lack of detailed call guidelines created a risk that call handlers would fail to provide relevant information, or do so in a way that was not sufficiently clear, fair and not misleading, during a customer call. For example, in July 2009 a call handler received a telephone call from a customer who was concerned about the amount of money they had lost whilst holding their pension with Standard Life. The customer was unsure whether they should engage a financial advisor. Whilst the call handler did inform the customer about their right to shop around, they did not make the customer aware that they might be eligible to purchase an enhanced annuity based on certain health or lifestyle conditions, and the potential impact on their income.

2010-2011

4.47. Before January 2010 TCF was not a feature of the Customer Services Division call guidelines.

4.48. In January 2010, the core TCF requirements were added to the call guidelines prompting call handlers to make the appropriate disclosures around enhanced annuities (including the right to shop around).

4.49. Amendments were made to the call guidelines in January 2010 to include specific questions about whether the customer had any medical conditions, or if the customer took any medication. These guidelines placed the onus on the customer to decide which medical conditions might be relevant, given the suggested wording provided in the guidelines: *"Do you think there may be anything we should take into account for you?"*. It may not have been obvious to the customer what relevant information they should provide.

4.50. In January 2010, the call guidelines were also amended to direct the call handler to mention the Open Market Option earlier in the call, and to provide some suggested wording.

4.51. By way of example, the Authority has reviewed a non-advised annuity sale which took place in September 2010. Despite the customer asking about an enhanced annuity, none of the call handlers adequately covered the Open Market Option, and the customer's potential eligibility for an enhanced annuity.

4.52. The firm had training arrangements in place throughout the Relevant Period which were intended to assist call handlers to develop their call handling skills, including learning about new policies, products and processes. However, some of the training and guidance documentation produced for call handlers during 2011 contained scripted statements that risked undermining the Open Market Option statement to consumers. For example, a "brand awareness" document introduced in April 2011 covering the key message around choosing Standard Life annuities, provided the following script:

"You can shop around. Remember though when you are doing that, you should perhaps consider other factors alongside the price you are being offered. Afterall [sic] hopefully this will be an income you will draw over the next 30 years or more…

When SL prices its annuity rates, this is the kind of thing we need to think about, balancing how long people might live and therefore how long we may have to pay a pension for, verses [sic] the amount we are being paid now. And it's quite a long term 'bet'.

We pride ourselves about being financially secure, some of that is about making prudent financial decisions to ensure the company and customers are not at risk - making sure we are being responsible and can be trusted to keep our promises long term. So when buying an annuity, as well as the price, you need to be confident in the financial strength and financial management of the organisation and be certain that you will get great ongoing service for the next 30 years or more. Afterall [sic] you only get what you pay for".

4.53. If the customer still wanted to shop around, the document prompted the call handler to say that they could help the customer do that *"if it's only best rates you want to look for".* Use of this type of language encouraged call handlers to promote Standard Life's product and may have discouraged customers who were eligible for an enhanced annuity from exercising the Open Market Option. It also risked undermining the written Open Market Options statement provided to the customer by post.

4.54. Another document from June 2011 offering guidance on quoting annuity rates explicitly sets out that the statement explaining the open market option was only to be used by call handlers if the customer had mentioned the open market option. The same document provides the script for quoting the annuity value:

"SL annuity I can quote for you today, will be guaranteed for today. If you decide not to take it today, and you decide later, then it is important that you understand your fund can go up or down and annuity rates can go up or down…

But, if you decide to take it today, we will freeze the value it is at now and guarantee the rate, so if the market dropped tomorrow, what you get is guaranteed."

4.55. Although it was correct that annuity rates and pension values could fluctuate within short period of time, this statement placed pressure on the customer to purchase the annuity offered by Standard Life, rather than to shop around for a better rate on the open market.

4.56. The Authority has reviewed a sample of customer calls which took place in the period after 2010. For example, following an initial call from a customer in July 2011, when the customer told Standard Life that they did not wish to retire at present, the customer called again to notify Standard Life that they had changed their mind. Despite the evident language difficulties, the call handler repeatedly referred the customer back to the options in the written documentation Standard Life had previously provided. The call handler did not make a reasonable effort to ensure that the customer understood the options available to them during the call, including the option to shop around for a better deal. This was all the more important given that the customer admitted he found the process "very confusing".

4.57. The call handler did not make the customer aware that they might be eligible to purchase an enhanced annuity subject to certain health or lifestyle conditions. The call handler also failed to make the customer aware of the potential for an uplift on their retirement income, as well as their right to shop around on the open market (in relation to an enhanced annuity). On the third call the call handler asked the customer whether they had any medical conditions such as high blood pressure or diabetes, but the customer was not asked about lifestyle conditions.

4.58. Furthermore, until November 2011, Standard Life Direct call handlers were assuming that for any customers referred to Standard Life Direct by the Customer Services Division, they would already have discussed the Open Market Option with the customer. This meant that it was even more important to customers who may have been eligible for an enhanced annuity that the Customer Services Division call handlers provided clear, fair and not misleading information about the Open

Market Option. However, in practice they were given guidance in this period which risked call handlers undermining important information about the Open Market Option as well as the written Open Market Options statement that was sent to the customer by post.

2012-2014

4.59. Further enhancements were made to the call guidelines in May 2012 to explain in more detail the customer's right to shop around on the open market and to check the customer's understanding of the Open Market Option, including some suggested wording.

4.60. In 2013 the mandated standards under the ABI Code were incorporated into the call guidelines. These included:

(1) More explicit instructions to establish the call handler's understanding of the customer's situation;

(2) More prominent instructions to make the customer aware that medical or lifestyle conditions may entitle them to an increased regular pension;

(3) Enhancing and making the Open Market Option warning more prominent in the guidelines;

(4) Raising awareness of the unbiased.co.uk website; and

(5) Adding another step in the guidelines to ensure the customer's full understanding of the annuity they were taking.

4.61. As a result, the guidelines were expanded to include an explicit warning that the customer could be better off if they exercised their Open Market Option and directed call handlers to ask the customer's thoughts on this. If the customer was eligible for an enhanced annuity, they would either be referred to Standard Life Direct or, if their fund was under £10,000 (the market threshold for enhanced annuities), the call handler would be prompted to inform the customer of the Open Market Option.

4.62. Following the launch of Standard Life's own enhanced annuity product in November 2013, whilst the Customer Relationship Development call guidelines still prompted call handlers to remind customers that they could shop around on the open market for an enhanced annuity, the guidelines explicitly encouraged call handlers to promote Standard Life's "brand." Standard Life provided very little guidance on how to approach this, stating simply *"promote Brand/Panel of Annuity Providers"*.

4.63. New pre-screening eligibility and medical and lifestyle questions were introduced in November 2013 to indicate what enhancement might be available, if the customer was eligible. Medical and lifestyle questions were added to the call guidelines to determine whether, and the extent to which, the customer smoked or had high blood pressure or high cholesterol, to determine their eligibility for an enhanced annuity. Similarly, the process flow provided detailed structured medical and lifestyle questions at each step of the call. Despite additions to call handler guidance in November 2013, it still afforded a significant degree of discretion to call handlers. In March 2015, more specific guidance for call handlers was introduced.

2015-2016

4.64. Standard Life introduced improvements to its sales process in March 2015, when it introduced the "Annuity Call Risk Matrix."

4.65. The Annuity Risk Matrix set out the same risk factors relating to health conditions and lifestyle factors as the Standard Life Direct Annuity Risk Matrix, with the exception of a specific question regarding medical conditions which could shorten life expectancy. It also included clear and specific questions about health and lifestyle, as well as covering the customer's understanding of how their or their partner's health and lifestyle might impact on the income they could receive. The Annuity Risk Matrix also required call handlers to provide a risk warning about the Open Market Option and to check the customer's understanding of the benefits of shopping around and the rationale behind their decision as to whether or not they would exercise their Open Market Option.

4.66. Further improvements were made in April 2015 with the implementation of the TCF call guidelines. These incorporated the categories of TCF factors in the January 2010 guidelines and added three sections to ensure the customer understood the option chosen at each "key decision point", check the customer's understanding of the risks and benefits and check and challenge any illogical behaviour or decision made by the customer.

4.67. From August 2015, the Customer Relationship Development area was no longer authorised to transact annuities and dealt only with the initial screening of customer calls.

4.68. In summary, in the early part of the Relevant Period the call handler documentation for the Customer Services Division (which then became Customer Relationship Development in 2012) placed inappropriate reliance on its customers to volunteer relevant health and lifestyle information that might impact their eligibility for an enhanced annuity. In addition, some of the call handler documentation risked undermining the written Open Market Option statement that was sent to consumers in accordance with regulatory requirements.

4.69. Whilst Standard Life took steps to implement changes following the introduction of the ABI Code in 2013, there remained a risk that customers might not be aware or understand that they could be eligible for an enhanced annuity and/or that they could shop around for an enhanced annuity at a higher rate on the open market. This in turn created a risk of poor consumer outcomes.

4.70. Further improvements were made to the sales process from March 2015 with the introduction of the Annuity Call Risk Matrix and in April 2015 when TCF call guidelines were introduced, both of which provided more specific guidance for call handlers.

Sales Targets

4.71. In Standard Life Direct, sales targets for non-advised annuities were specifically set by reference to the annual and monthly value of annuities sold in previous years. Until the end of 2015, sales targets for non-advised annuities (and other products) were also set for individual call handlers within Standard Life Direct who were authorised to transact non-advised annuity sales. These targets were set by managers in Standard Life Direct and varied depending on the call handler’s role, level of authorisation, working hours and experience.

4.72. The Customer Services Division and Customer Relationship Development area did not have sales targets for non-advised annuities.

Financial Incentives

4.73. Call handlers and managers within Standard Life Direct, the Customer Services Division and Customer Relationship Development areas were incentivised through:

(1) Bonuses contained within Standard Life's remuneration packages;

(2) Key incentive schemes; and

(3) Other incentives, including competitions and opportunities where staff could win additional payments or prizes.

4.74. Standard Life Direct call handlers also took part in the "Productivity Incentive Challenge for March", which ran each year from 2010 until 2015, except for 2011. This gave call handlers the opportunity to earn a higher bonus based on increased productivity, as a result of the extra hours worked at the end of tax year. These were sometimes referred to as "Mad March" incentive payments.

4.75. There were several higher risk features in the incentive schemes (explained below) which created a significant risk that call handlers would be improperly motivated to sell products, including annuities, in order to secure a bonus or other monetary incentive. As a result, it was essential that Standard Life's systems and controls around financial incentives were sufficiently robust and sophisticated to mitigate and control this risk effectively.

Overview of remuneration and bonus structure in Standard Life Direct

4.76. The variable elements of pay for Standard Life Direct call handlers that could be affected by sales volumes, consisted of:

(1) The Monthly Production Bonus;

(2) The Early Target Bonus;

(3) The Contribution Bonus; and

(4) The Discretionary Bonus.

4.77. None of these bonuses were specific to annuities. They could be achieved through sales of any product. All of these bonuses were subject to some quality metrics.

Monthly Production Bonus: overview

4.78. The Monthly Production Bonus was calculated as a percentage of value of sales, with a stepped increase in percentage so that sales over each threshold would accrue a higher percentage of bonus. The bonus varied according to volume and quality of all sales of annuities and other products. Call handlers were paid their Monthly Production Bonus regardless of whether they met their sales targets.

4.79. The calculation of bonus payments was subject to quality metrics throughout the Relevant Period. Quality metrics were referred to as the "Right First Time" factor. Call handlers had to meet call standards in a certain percentage of calls to achieve their full Monthly Production Bonus. The target Right First Time factor throughout the Relevant Period was 80% of cases sampled (other than 2010 when the target was 85%).

4.80. Before 2010, a Right First Time factor below 80% resulted in a 20% downward adjustment to the Monthly Production Bonus, below 70% resulted in a 40% downward adjustment, and below 60% resulted in 100% of the bonus being withheld. From 2010 onwards, if the Right First Time factor was below 80%, that percentage multiplier was applied to the Monthly Production Bonus. For example, where a Standard Life Direct call handler earned a bonus of £1,000 but their Right First Time factor was 70%, they received a bonus of £700. Where the Right First Time factor was 80% or above, call handlers automatically received 100% of their bonus (in this example £1,000).

4.81. The Authority reviewed the annual fixed basic salaries and the Monthly Production Bonuses earned by Standard Life Direct call handlers from 2008 to 2014. In practice, most Standard Life Direct call handlers earned a substantial Monthly Production Bonus, with 21.9% of call handlers eligible for a Monthly Production Bonus from 2008 to 2014 receiving more than 100% of their basic salary.

4.82. On average during the period 2008 to 2014:

(1) The Monthly Production Bonus amounted to 84.91% of a call handler's basic salary; and

(2) The annuities element of the Monthly Production Bonus accounted for 57.74% of that bonus, and was a proportional uplift of 41.67% on basic salary.

4.83. There was therefore significant opportunity for Call Handers to increase their Monthly Production Bonuses through sales volume and, specifically, sales of annuities.

Early Target Bonus: overview

4.84. The Early Target Bonus, also referred to by Standard Life as the "St Andrew's Day bonus", applied from 1 January 2010 to 31 December 2014. This consisted of a lump sum of £1,000 if the call handler achieved their annual Monthly Production Bonus target one month early, or £2,000 if achieved two months early.

Discretionary Bonus

4.85. The discretionary bonus applied in 2015 and 2016 and consisted of a lump sum of up to £5,000, awarded to up to six call handlers who had made an exceptional contribution to the business in the relevant year. The decision to award a discretionary bonus was informed by the overall performance against the call handlers' goals and quality KPIs. A Management Discretionary Bonus could also be awarded on the same basis as the discretionary bonus, for up to two managers.

Higher risk variable elements of pay

2008 – 2009

4.86. During 2008 the average Monthly Production Bonus earned by call handlers equated proportionately to 84.7% of call handlers' basic salary, with an example of one individual achieving a bonus of 141.17% of their basic salary.

4.87. The component of the Monthly Production Bonus related to annuities made up, on average 73.1% of call handlers' total Monthly Production Bonus, and equated proportionately to 62.1% of call handlers' basic salary. In 2008, one individual earned the equivalent of 110.7% of their basic salary in annuity related sales only.

4.88. In 2008 for 100% of call handlers in Standard Life Direct, the part of the Monthly Production Bonus that related to annuities was equal to at least 60% of the total Monthly Production Bonus.

4.89. In 2009 the average proportion of Monthly Production Bonus to basic salary for call handlers decreased to 50.8% from 84.7% in 2008. The average component relating to annuities only, remained a significant part of the total, on average amounting to 49.4% of a call handler's Monthly Production Bonus for the year.

Whilst the average proportion of annuities-related earnings relative to basic salary had fallen to 29.6%, the potential for call handlers to increase their yearly earnings remained significant, with one individual earning the equivalent to 80.4% of their basic salary in annuities sales only.

4.90. In October/November 2009 the "Right First Time" factor quality control was removed from the Monthly Production Bonus. This significantly increased the risk of poor customer outcomes given the absence of any quality check on eligibility for the Monthly Production Bonus. This meant that incentives available to call handlers in 2009 created a significantly higher risk that they would prioritise meeting sales targets over customer outcomes.

4.91. Standard Life recognised the importance of this quality control metric in 2010, when it reintroduced the Right First Time factor to the Monthly Production Bonus "*to ensure correct focus on accuracy*".

2010-2011

4.92. The average Monthly Production Bonus equivalent to a proportion of basic salary increased from 50.8% in 2009 to 71.9% in 2010. The average annuities-related component of the total Monthly Production Bonus also increased by over 3% in 2010 and continued to increase in 2011 to 62.2%. Further, in 2011:

(1) Over 25% of call handlers achieved a Monthly Production Bonus which amounted to 100% or more of their basic salary; and

(2) Over 25% of call handlers achieved a total Monthly Production Bonus of which 90% or more related to sales of annuities.

4.93. This significant increase in Monthly Production Bonuses, including an increase in the component relating to annuity sales only, coincided with the introduction of the Early Target Bonus in 2010 and the Annuities Challenge in 2011.

4.94. The Early Target Bonus was introduced to reward those call handlers who met their annual Monthly Production Bonus target by the end of November, with a lump sum payment of £1,000 as part of their February salary. The reasons for the changes made in 2010, as recorded in Standard Life's 2010 Remuneration Review, included:

(1) *"An increase in bonus commission will drive volume and mix.*

(2) *Introduction of a bonus payable for those attaining yearly target by end November for added motivation and reward…"*

4.95. The Early Target Bonus provided an incentive for call handlers to increase their sales in certain months, thereby resulting in a risk of disproportionate rewards for sales which enabled the call handler to meet their target. This created a risk of customers being treated unfairly if call handlers sought to rush through sales before the end of the target period.

4.96. In 2011 the method of calculating the Monthly Production Bonus changed. Standard Life implemented a system of fixed penalties for failures to follow Standard Life's TCF standards and Best Business Practice Guidelines during monitored calls. Penalties began to accrue after the second TCF fail in a given year, and became progressively larger as more fails occurred. Call handlers could incur a maximum of 15 fails before the monthly bonus was withheld in its entirety for the remainder of the year.

4.97. In 2011, the Early Target Bonus was increased to £2,000 if the target was attained by the end of October. The reasons recorded by Standard Life for the changes made to the remuneration package in 2011 were related to staff motivation, and "*to help push the boundaries re levels of productivity*". Therefore, despite the application of penalties to the Early Target Bonus for TCF failures, there remained the risk of poor customer outcomes due to staff trying to maximise their sales before the end of the incentive period. In an extreme case in 2011, one call handler earned 230% of their basic salary.

4.98. The Early Target Bonus was a higher risk feature of Standard Life's remuneration and bonus structures as it encouraged call handlers to sell as many products as possible by the end of October or November, to secure an additional payment of £1,000 or £2,000 on top of their basic salary.

2012-2015

4.99. The proportion of Monthly Production Bonus relative to basic salary, and the proportion of that bonus that related specifically to annuities, peaked in 2012. On average, during 2012 call handlers were earning Monthly Production Bonuses equivalent to 123.2% of their basic salary, where the average sum related to annuities was the equivalent to 90.72% of basic salary. It was therefore not unusual for call handlers to double their basic salary. In fact, in 2012 over 30%

of call handlers achieved a Monthly Production Bonus which amounted to 100% or more of their basic salary. Of those call handlers, a third achieved a Monthly Production Bonus of which annuities sales represented over 100% of basic salary.

4.100. In September 2012, the Authority published its Guidance Consultation on financial incentives. Standard Life identified two aspects of Standard Life Direct's remuneration as potentially falling within the category of incentives identified by the Authority as "*significantly increasing the risk of mis-selling*". The first aspect was the Early Target Bonus. The second aspect was the different levels of incentive that applied between products, which it concluded was appropriate in the circumstances given that they were designed to prevent a bias in favour of high value products. Standard Life also identified additional incentives as potentially increasing the risk of mis-selling, namely incentives linked to the level or type of premium or length of term, and the "Top Performers' Summit", which was an all-expenses paid trip to enable top performers to spend time with the Executive.

4.101. Nonetheless, Standard Life made very few changes to the remuneration package for 2013, including the decision to retain the Early Target Bonus. This was despite concerns raised internally that the remuneration packages contained disproportionate rewards for marginal sales. Between 19 October and 9 November 2012 concerns were also raised internally as to whether Standard Life had suitable controls in place to mitigate the specific risks posed by each package.

4.102. Despite these concerns being referred to senior management, no changes were made to the remuneration package for 2013 as it was "*deemed to drive the correct behaviours*". The Risk Assurance report of October 2013 stated that it was "*able to verify the appropriateness of the remuneration and incentive arrangements across each area and that these do not in our opinion conflict with our obligations to our customers*". However, it concluded that "*further work is needed to demonstrate full compliance with TCF outcomes*" in respect of the governance and control framework in place.

4.103. In December 2013, Standard Life commissioned an independent third-party review of its sales incentives. The third party's recommendations focused on removing premium-based production incentives for those employees who worked for Standard Life's non-advised direct-to-customer services, ensuring a cap applied to the aggregate bonus sum payable to individual employees and removing “accelerators” from incentive plans. The third-party review also recommended that incentive awards should not exceed 100% of basic salary.

4.104. During 2014 the average proportion of total Monthly Production Bonus to basic salary remained at 121.28%. Despite the recommendation in the third-party review to remove accelerators from incentive plans, the Early Target Bonus remained in force throughout 2014. It was not removed from Standard Life’s remuneration packages until the 2015 Remuneration Review.

4.105. This development followed discussions within Standard Life about the need for robust controls around the Early Target Bonus and repeated concerns being raised about disproportionate rewards for marginal sales. It also coincided with a decreasing emphasis on annuities sales in remuneration and bonus structures. In 2014, the annuities element of the bonus had decreased on average to 31.49% of the Monthly Production Bonus, equivalent to 10.12% of basic salary, respectively.

4.106. Concerns were raised internally as early as 2012, regarding the compliance of the Early Target Bonus scheme with the Authority’s guidance, and this was highlighted by a third-party report in early 2014. Standard Life was slow to implement the changes to reduce the risks posed. The Early Target Bonus was not removed until 2015 and Standard Life’s transition to a purely quality based bonus structure did not take effect until 1 April 2015.

Key Incentive Schemes

The Productivity Challenge

4.107. Standard Life implemented the Productivity Challenge every March and early April from 2010 to 2015, except for 2011. The Productivity Challenge (“Mad March” incentives) recognised that in March of each year the Standard Life Direct call handlers experienced significant call volumes due to the tax year end and that overtime was required that month to meet the increased demand.

4.108. The Productivity Challenge rewarded increased output rather than extra hours worked and provided call handlers with an enhanced multiplier for Monthly Production Bonus earnings during March and early April in exchange for working set overtime. Accordingly, the Productivity Challenge was directly related to sales performance as it applied an uplift to the Monthly Production Bonus earnings. For example, in the period 2010 to 2014 for 32 extra hours worked, a multiple ranging from 28% to 60% was applied to Monthly Production Bonus earnings.

4.109. The Productivity Challenge was therefore a version of an "accelerator", identified by the Authority's Guidance Consultation and Final Guidance on "Risks to customers from financial incentives" published in January 2013 (FG13.1). It was "*a higher rate of incentive" that "is earned with higher volumes of sales – where the higher rate only applies to sales over a target"* .

4.110. The structure of the Productivity Challenge was modified in 2015 to a lump sum payment only affected by quality KPIs. From this point the reward was therefore based solely on the quality of the calls assessed from a compliance perspective, rather than the volume of sales.

The Annuities Challenge

Background and Structure

4.111. By 2011 Standard Life's sales strategy was to increase annuity profits, by maximising business dealt with through the Direct to Customer channel, improving the customer journey and introducing improved annuity rates for certain customers. The key project for the annuities business area in 2011 and 2012 was the "Annuities Challenge", which commenced in the first quarter of 2011.

4.112. Among other initiatives, the Annuities Challenge project offered an incentive to internal customers choosing to consolidate their Standard Life pension pot along with external funds into a Standard Life annuity. Call handlers were rewarded for various aspects of their sales performance relating to the project, including customer retention (subject to compliance with the minimum call pass rate of 80%). The consolidation initiative and the price flex initiative were introduced as pilot schemes in Q3 2011 and were removed in Q4 2013.

4.113. The Annuities Challenge was implemented within Standard Life Direct and the Customer Services Division. The aims of the project were to:

(1) Increase Standard Life's understanding of the needs of its customers approaching retirement;

(2) Improve the customer experience in the lead up to retirement; and

(3) Increase annuity sales.

4.114. The Annuities Challenge initiative consisted of five components, each involving a group of actions designed to improve sales performance. Four of these components related to Standard Life's non-advised annuity sales. These were: (1) engagement and guidance or coaching for call handlers; (2) pricing initiatives including offering improved annuity rates to customers who indicated that they would exercise the Open Market Option; (3) increased pre-retirement communications with customers; and (4) changes to customer adviser protocols which were intended (amongst other things) to assist call handlers to identify whether a customer was being advised by an IFA or required financial advice.

4.115. The Annuities Challenge incentivised call handlers by offering rewards for certain achievements at the end of each quarter, such as for highest average conversion, most successful number of contacts for outbound customer calling and consistently high performance in relation to outbound calling (subject to compliance with the minimum call pass rate of 80%).

4.116. The rewards given to call handlers included electronic goods such as tablets and vouchers for high street retailers.

TCF concerns

4.117. A draft paper produced by Standard Life dated April 2011 entitled "Annuity Journey and Options" indicates that the Annuities Challenge project was *"set up to drive annuity volume in 2011 to help achieve the UK profit targets".* The draft paper also highlighted that increasing interaction with customers in the lead-up to retirement would enable Standard Life to help customers *"understand if they are saving enough for retirement and encourage increasing payments and consolidation".* In relation to Standard Life's financial performance at the time, the draft paper also highlighted that:

"We are just over £3m behind our YTD APE target. This equates to being about £2m behind our profit target for annuities.

If we don't significantly improve our annuity performance over the rest of the year the impact on profits could be in over £10m".

4.118. In June 2011, Standard Life produced a TCF analysis paper to document that TCF principles had been considered in relation to the Annuities Challenge. The TCF

Analysis Paper was not produced for a particular board or committee, nor addressed in any board or committee meeting minutes.

4.119. Among other things, the TCF analysis paper emphasised the profit-focused objective behind the Annuities Challenge initiative, for example:

(1) It acknowledged that the Annuities Challenge had involved looking for opportunities to increase profits on annuity business by offering an incentive to internal customers choosing to consolidate their Standard Life pension pot with external funds into a Standard Life annuity.

(2) It emphasised Standard Life's concern of the potential loss of business in the near future: *"over the next 5 years £9.64 billion of FUM held in SL Pensions will be at risk of leaving as customers approach their predicted retirement date"*.

(3) It stated that the decision to proceed with the Annuities Challenge initiative had been taken due to the business being behind its annuity targets for 2011, which the paper asserted was important because annuity sales made up 50% of UK business profit.

(4) The paper referred to internal research that had identified that 47% of Standard Life's customers may have other pension funds which they could consolidate. Therefore *"by offering an incentive to encourage these policyholders to transfer these additional funds into a Standard Life annuity, we are providing several benefits to the customer which include;* dealing *with one provider and financial security with a reputable and trusted brand".* The incentive would be *"promoted"* initially through a telephone conversation with the customer, where *"we will make it clear how quickly we can settle their funds (on the day) …"*, and make customers *"aware of the potential timescales to transfer and the associated risk",* thereby highlighting the speed with which Standard Life could act.

(5) The paper also highlighted that whilst customers would be made aware of their retirement options, *"we will inform customers…how Standard Life can help them…we will give customers reasons for staying with Standard Life"*. Another key driver for the challenge was the link between customer retention and generating profit.

4.120. The Annuity Journey and Options and TCF Analysis Papers are indicative of an environment which caused call handlers to exert pressure on customers who may have been eligible for an enhanced annuity not to shop around for providers on the open market.

Training on the Annuities Challenge

4.121. Some of the training materials that Standard Life Direct provided to its call handlers illustrate the pressure on call handlers to meet their sales targets. For example, the speaking notes associated with a presentation entitled "Price Flex" on 7 and 12 December 2011 reiterated the importance of retaining "*as much of the annuity funds as possible as well as bring* [sic] *new monies into SL*" and discussed instances when a customer might be considered an "*OMO threat*". The slides also noted that call handlers should follow the call flow.

4.122. A presentation dated March 2012 on "Annuities and Retirement Solutions Training" stressed that one of the purposes of the Price Flex initiative was to "*retain the business in SL that would leave us on the Open Market*" and offer customers an increased annuity "*when the sale is at risk*". In this context "*at risk*" meant the risk of losing these customers if they elected not to buy an annuity from Standard Life, including where they were considering moving to another annuity provider upon exercising their Open Market Option. The term "at risk" also appears in other training materials relating to the Annuities Challenge to denote customers intending to shop around and who might purchase their annuity on the open market with another provider.

Annuity Conferences

4.123. Standard Life held regular "Annuity Conferences" to increase engagement with customer-facing employees working in Standard Life's annuities business, including by providing updates in relation to volume of sales and individual performance. For example, a PowerPoint presentation prepared for the "H1 Annuity Conference'" dated 11 July 2013, included announcements regarding "outstanding individual performance." It named those who had achieved the best results in relation to "New Cash and Conversion %", "Top Annuity volume", "Strongest Annuity conversion rate" and "Best service tick scores".

4.124. A similar presentation for the May 2011 Annuity Conference emphasised that annuities were the most important product and that "*YOU are critical to achieving* *our target*". The presentation encouraged staff to "*secure the roll-over*" to Standard Life and to sell its own product in the first instance. It also encouraged staff to "*bring more funds to SL to improve our profit*…" and only as a last resort to promote its external panel of annuity providers, which at the time was adjudged as being done "*too soon in the process*". The presentation incentivised employees to *"over deliver"* with the opportunity to earn 200% bonuses.

4.125. The content and language adopted in these presentations shows the pressure that Standard Life placed on its call handlers to sell annuities for the sake of profit rather than in the customer's best interests. For example, the presentation dated 17 May 2011 stated that "*everyone is* [stet] *this room is influencing the share price of Standard Life*" and that the annuity business is "*over 40x more profitable than Corporate business and 20-40x more profitable than Retail business*", being "*the most profitable thing we do…by a mile*!"

4.126. In August 2011, concerns were raised to Standard Life's senior management about the content and wording of the Annuities Challenge retirement workshops, which it was felt *"would not be helpful if the FSA saw*". These internal communications clearly reference an intention to discuss these concerns in more detail *"off-line"* thus demonstrating Standard Life's awareness of the regulatory risks presented by the Annuities Challenge.

4.127. In summary, the Annuities Challenge placed pressure on call handlers to sell annuities for the sake of the business, including by undermining information previously provided to customers who may have been eligible for an enhanced annuity about their right to shop around on the open market, which may not have been in the best interests of the customer. Standard Life created a significant risk that call handlers would prioritise sales volumes and profits over favourable customer outcomes.

Other Incentives

4.128. Standard Life also offered a number of other smaller or "ad hoc" incentives to call handlers, for example electronic goods or activity days, between 2008 and 2014. These incentives were based on the number of sales of all products sold by call handlers, including annuities. Call handlers had to achieve an 80% Right First Time score to qualify for such benefits.

4.129. In summary, the competitive features inherent within Standard Life's incentive schemes created an increased risk of mis-selling as set out in the FSA Consultation published in September 2012 and the FCA Final Guidance published in January 2013 (FG13.01) on "Risks to customers from financial incentives". Nonetheless these local competitions and prizes ran up to the end of 2014.

4.130. The higher risk features of Standard Life's incentive structures created a risk that call handlers would prioritise their own financial interests over customer outcomes. This risk was significantly increased as call handlers approached bonus thresholds or where there were increased financial rewards for marginal sales. Robust controls were therefore required to ensure that the risks were effectively mitigated.

Call Monitoring

4.131. Robust call monitoring was required to mitigate the risks to customer outcomes posed by a high-level call guidelines which afforded significant discretion to call handlers. It was also required to mitigate the risk that incentives with higher risk features could encourage call handlers to prioritise their own financial interests over customer outcomes.

4.132. Standard Life operated a "three lines of defence" model of risk management to monitor the quality and compliance of the sales made by call handlers during the Relevant Period. Standard Life Direct, the Customer Services Division and Customer Relationship Development areas had separate frameworks for monitoring and quality assurance. Standard Life was unable to produce accurate information on the percentage of annuity calls sampled in the Customer Services Division and Customer Relationship Development areas during the Relevant Period, because it was unable to determine which calls monitored were in relation to annuity sales from the data available. Therefore, the Authority's review of monitoring material relevant to its investigation was in respect of Standard Life Direct call handlers only.

Standard Life Direct

4.133. Standard Life Direct assessed whether calls were conducted in compliance with its sales protocols and guidelines, in particular the Standard Life Direct call guidelines, or from March 2016, "structured call flows".

4.134. From the start of the Relevant Period until March 2016, Standard Life Direct call guidelines set the standards for call handlers, including:

(1) Mandatory Treating Customers Fairly (TCF) Requirements which focussed on customer outcomes; and

(2) Best Business Practice (BBP) requirements (from 2012 onwards).

4.135. A failure to meet TCF Requirements impacted the call handler's Right First Time score, which was the percentage of calls that passed call quality sampling, and affected the call handler's bonus payments.

4.136. In the last quarter of 2015, Standard Life introduced two additional criteria for call monitoring: Potential Customer Detriment ("PCD") and Actual Customer Detriment ("ACD"). Examples of PCD fails included: the provision of inaccurate or misleading information, intentional or unintentional bias, opinion or emphasis, lack of clarity resulting in a customer's confusion and failure to identify vulnerable customers.

4.137. To determine whether ACD existed, Standard Life Direct contacted the customer to clarify their understanding and whether they wished to make any changes to the outcome of the original transaction.

4.138. Call handlers would be allocated a PCD and ACD score in addition to their Right First Time score. The required scores for PCD and ACD were 90% and 95% respectively. A call was failed if there was a TCF fail, and any call which failed on PCD or ACD grounds was considered a TCF fail. A TCF fail impacted the call handler's Right First Time score (5% per failed case) and affected the call handler's bonus payments.

Responsibility

4.139. From the start of the Relevant Period until April 2016, quality assurance and call assessments were primarily the responsibility of the call handlers' managers, known as "telesales managers." This responsibility was then transferred to the Quality Assurance Team within the Customer Hub after April 2016. Telesales managers conducted mandatory sampling as well as additional ad hoc risk based sampling.

4.140. Additional monitoring and quality assurance was undertaken by "People, Process and Development Managers." This was the team in Standard Life Direct which supported training, process development and risk and quality oversight throughout the Relevant Period.

4.141. After 2014, further risk based call sampling was carried out by second line risk, also known as "Risk Assurance". The majority of call monitoring in relation to annuities was conducted by the first line of defence, the telesales managers.

Mandatory sampling

4.142. Throughout the Relevant Period, Standard Life Direct had a minimum mandatory sample level of five "cases" per quarter per call handler. A "case" represented a single call or series of calls which resulted in a secured sale. The mandatory sampling was not focused solely on non-advised annuity sales but covered the range of products sold by the call handler (savings and investments, protection products and pensions and retirements). Consequently, only a proportion of mandatory calls sampled related to non-advised annuity sales.

4.143. Mandatory call sampling was only performed in respect of telephone calls that resulted in a secured sale of a product. Non-advised annuity calls which did not result in a sale were not subject to mandatory call sampling or monitoring. This created a gap in Standard Life's monitoring process as it would not be able to identify whether those calls which did not result in a sale were conducted in line with Standard Life's sales protocols and guidelines and applicable regulatory requirements.

4.144. The proportion of non-advised annuity sales which were sampled was inadequate, because:

(1) Overall, the proportion of Standard Life Direct non-advised annuity calls subject to mandatory sampling was low. On average, only 4.2% (gradually increasing from 1.8% in 2009 to 6.1% in 2016) of the non-advised annuity sales during the Relevant Period were assessed. Of that percentage, 25.8% failed to meet Standard Life Direct's call standards, with 14.1% identified as TCF fails;

(2) In 2011 Standard Life Direct mandatory sampling reviewed only 3.9% of non-advised annuity sales for that year at a time when sales of annuities accounted for 50% of UK business profits. At this time, there was a

significant drive to increase profits through incentives such as the Annuities Challenge. Furthermore, the highest failure rate during the Relevant Period occurred in 2011, when 43.3% of the non-advised annuity cases sampled failed to meet Standard Life Direct's call standards. Of that figure, 18.8% were identified as TCF fails;

(3) Although there was a significant decrease in the number of non-advised annuity sales in 2014, mandatory sampling reviewed only 6.3% and the quality of the cases which were sampled dropped significantly. Of the sample reviewed, 31.2% failed to meet Standard Life Direct's call standards, of which 21.8% were classified as TCF fails; and

(4) During the Relevant Period, on average the proportion of mandatory Standard Life Direct cases sampled each month and recorded as an overall fail was 22%, and the TCF failure rate was 11.5%. The TCF failure rate was 20% or more for a total of 18 months spread across the Relevant Period, while the target pass rate was 80%. The TCF failure rate was 30% or more for a total of four months across the Relevant Period. During or immediately following these spikes in failure rates, a corresponding increase in risk-based monitoring was called for. There is no indication that Standard Life increased the number of calls sampled to combat these high TCF failure rates and to find out what was causing them.

Monitoring of risks posed by Standard Life's incentive schemes

4.145. The proportion of mandatory call sampling conducted for each month was consistent throughout the Relevant Period with no, or limited, increase in the number of calls monitored in October and November in the weeks leading up to the award of the Early Target Bonus incentive. During these months, there was a greater incentive for call handlers to complete sales and achieve their annual target, which created an increased risk of poor customer outcomes. However, there was no specific or additional enhanced monitoring to identify inappropriate sales and mitigate the increased risk of poor customer outcomes.

4.146. Following the introduction of the Early Target Bonus in January 2010, the proportion of non-advised annuity cases sampled and identified as overall fails increased in 2011. This suggests that the increased risks associated with the Early Target Bonus incentive negatively affected the quality of calls conducted in 2010 and 2011.

4.147. Following the introduction of the Annuities Challenge in 2011, the monitoring data for 2011 indicated that a large proportion of the non-advised annuity cases sampled were failing to meet Standard Life Direct call standards. Overall failure rates as a percentage of non-advised annuity cases sampled, were equal to, or exceeded 50% in January, February, to March, July, and November, while the TCF failure rate exceeded 20% on five occasions in 2011.

4.148. Despite the higher failure rate in 2011 and the increased risks associated with the Annuities Challenge, there was only a minimal 0.4% increase in the percentage of non-advised annuity sales subjected to monitoring by Standard Life Direct in 2012. The increased risks of poor customer outcomes as a result of the Annuities Challenge were not mitigated by a corresponding increase in call monitoring.

Risk-based sampling

4.149. Standard Life Direct also conducted ad hoc risk based call sampling which was part of the first line monitoring undertaken by telesales managers.

4.150. Risk based call sampling was undertaken when a call handler was new to the role, a new product or major process change was introduced, to assess significant trends in sales quality, or if an individual call handler was put onto a development or performance improvement plan. It was also conducted at the request of Standard Life Direct management, or a call handler, for developmental support.

4.151. Risk based call sampling had a broader remit than mandatory call sampling because it also included information calls, quotation calls or calls made by a particular individual who was subject to increased monitoring on the basis that they were new to the role or had produced poor call quality results. Consequently, only a proportion of calls sampled related to non-advised annuity sales.

4.152. The proportion of Standard Life Direct non-advised annuity sales subjected to risk based sampling was inadequate. It represented under 2% of the non-advised annuity sales during the Relevant Period, of which 41% failed to meet Standard Life Direct's call standards, with 25% identified as TCF fails (according to SLAL's own TCF standards). Other examples of issues that could trigger a TCF fail include (a) failing to carry out security checks or (b) failing to mention that annuity rates could fluctuate before the settlement date.

4.153. The percentage of non-advised annuity sales subject to risk based sampling between 2010 and 2012 remained at only 1% despite:

(1) The high TCF failure rates of over 30% identified by the risk based sampling in each year;

(2) Mandatory call monitoring which identified that 43.3% of the non-advised annuity cases sampled failed to meet Standard Life Direct's call standards 18.8% were TCF fails) in 2011; and

(3) The heightened risks associated with the Annuities Challenge incentive scheme in 2011 and 2012.

4.154. In 2011, when Standard Life introduced the Annuities Challenge, 43.3% of the non-advised annuity cases sampled, as part of mandatory sampling in Standard Life Direct, resulted in failures of the mandatory TCF Requirements and/or Best Business Practice requirements. This represented an increasing trend in the overall failure rate, rising from 6.3% in 2009 and 28.3% in 2010. At the same time, the TCF failure rate had increased from 2.99% in 2009 and 6.6% in 2010 to 18.8% in 2011, and 13.2% in 2012. Despite the increasing trend in the overall TCF failure rates identified by the mandatory sampling, there was no increase in the level of risk based sampling as a proportion of non-advised annuity sales.

Customer Services Division and Customer Relationship Development areas

4.155. Monitoring and quality assurance of customer calls within the Customer Services Division and Customer Relationship Development areas were assessed by telesales managers and quality assurers against the call standards contained within the "Customer Services Division Call Flow". From 2010, these call standards were defined as either "key risks" meaning high impact errors which may have a reputational or financial impact on Standard Life or its customers, or "internal indicators." This meant lower impact errors which did not pose a risk to Standard Life or its customers.

4.156. Call pass rates were set for the whole of the Customer Services Division and Customer Relationship Development areas, and varied throughout the Relevant Period. For example, between July and December 2011, the target pass rate for "key risks" was 99% whilst the target pass rate for "internal indicators" was 85%. This meant that, for a call handler to pass a call during that six-month period, at least 99% of calls sampled had to have no "key risk" fails and at least 85% of calls sampled had to have no "internal indicator" fails.

4.157. Because the target was set for the department, including back office processes as well as sales of annuities, in practice, the assessors used their discretion to apply a lower benchmark for more complex customer calls to take into account any variables that may have affected the call handler's performance. Accordingly, those assessing customer calls were afforded considerable discretion as to which pass rate they applied and how they applied it. Only a small number of the twenty calls sampled by the Customer Services Division and Customer Relationship Development areas during the Relevant Period related to non-advised annuity sales.

4.158. Standard Life has been unable to provide the Authority with accurate data on the call sampling and monitoring undertaken by the Customer Services Division and Customer Relationship Development areas during the Relevant Period. The failure to record and maintain data showing the number and types of calls monitored means that both the business area and Standard Life's senior management were unable to assess whether monitoring of calls was sufficient in relation to the number of calls and the types of products sold during those calls.

Second line monitoring – Risk Assurance and Compliance

4.159. Risk Assurance was responsible for delivering second line oversight of Standard Life's key business processes and risk themes and provided feedback to senior management on relevant conduct and regulatory effectiveness.

4.160. Risk Assurance was engaged in ongoing compliance testing, as well as periodic thematic reviews which examined a range of products, processes and services across Standard Life.

Quality and Risk Management ("QRM") Framework

4.161. From the start of the Relevant Period to the implementation of the QRM framework in 2014, call sampling undertaken by Risk Assurance was carried out as part of a periodic thematic review.

4.162. In the first quarter of 2014, Risk Assurance implemented the QRM oversight process which involved risk based sampling of calls between customers and Standard Life Direct and Customer Relationship Development call handlers. This was to test whether calls were compliant with the relevant call standards contained in the Standard Life Direct call guidelines and structured call flows and the relevant Customer Services Division and Customer Relationship Development call flows.

4.163. In 2014, Risk Assurance produced two QRM Oversight Reports on call testing relating to the sale of non-advised annuities and reviewing the Training and Competence Scheme (the framework governing monitoring and quality assurance in Standard Life Direct). Neither of these Oversight Reports identified any significant failings. The "Q2 Oversight Report" dated 27 August 2014 concluded "*the quality of the call handling across SLD* [Standard Life Direct], *PCM and CRD* [Customer Relationship Development] *is very high*". However, the monitoring data for the second quarter of 2014 indicates that, of the 43 cases sampled by Standard Life Direct's first line management during this period, 13 cases (30.2%) were identified as complete fails, with 8 of these cases classified as TCF fails (18.6%). The conclusion of the Q2 Oversight Report is therefore inconsistent with the results of the call monitoring conducted by Standard Life Direct first line management for non-advised annuity sales calls in the same period.

4.164. The level of oversight by Risk Assurance in relation to non-advised annuity sales was inadequate because:

(1) Over the entirety of the Relevant Period, only 0.2% of the non-advised annuity sales were subject to sampling by Risk Assurance, despite the significant focus on increasing annuity sales;

(2) No Standard Life Direct non-advised annuity cases were subject to Risk Assurance call sampling in 2008, 2009, 2011, 2012 or 2015;

(3) There was no increase in non-advised annuity call sampling undertaken by Risk Assurance in response to high failure rates identified by mandatory or risk based sampling. For example, in 2011, 43% of mandatory calls and 42% of risk-based calls sampled were identified as fails, with 19% and 32% classified as TCF fails; and

(4) Despite the heightened focus on annuity sales associated with the Annuities Challenge incentive scheme in 2011 and 2012, Risk Assurance did not sample any non-advised annuity cases in either 2011 or 2012.

4.165. In July 2016 Risk Assurance revised its process of regular assessment of customer journeys so that calls were assessed against the relevant regulatory requirements, rather than against the Standard Life Direct, or Customer Relationship Development Call Flows.

4.166. Risk Assurance consultants undertook this call sampling. Monthly reports detailing the results of the call assessments were provided to the Standard Life Direct management team.

4.167. In April 2016 Risk Assurance produced a Compliance Assurance report on non-advised annuity calls taken from June to November 2015, which involved sampling 15 completed annuity customer journeys to assess customer interaction and the adequacy of the final customer outcome. This identified that over 50% of the cases sampled failed to meet the criteria set out in Risk Assurance's call checklists, with potential customer detriment identified for three cases. Whilst those instances of potential detriment did not involve a failure to ask the customer the required health and lifestyle questions or to cover the Open Market Option, they did involve a failure to record the customers' responses, which "increases the risk that customers who could benefit from enhanced terms fail to receive them".

Third line monitoring – Internal Audit

4.168. Following the introduction of pension freedoms in 2015, Group Internal Audit (GIA) conducted two reviews of non-advised customer journeys during the Relevant Period. The first review was focused on the actions taken and processes put in place by Standard Life to address conduct risk in the lead up to pension freedoms being introduced and the work undertaken since then to ensure the delivery of fair customer outcomes.

4.169. The findings were issued in October 2015, concluding that, overall, management of risk had been well embedded in connection with the work carried out regarding pension freedoms and had generally operated well. However, the control environment for conduct risks received a rating of 'Some Improvement Required'. The second review in January 2016 focused on tracing the end-to-end, non-advised customer journey and assessed the outcome on an individual basis for a sample of 23 customers (including 5 non-advised annuity customers). The report concluded that, in terms of an effective control environment, the GIA had seen evidence of good practice in the changes being made in response to emerging customer behaviour, but that significant improvement was required in a number of aspects.

4.170. The Internal Audit reports identified the following issues relating to the control environment:

(1) Weaknesses in the evidence of compliance with COBS 19.4 which requires firms to inform customers of their right to shop around on the open market when purchasing an annuity, although coverage of shopping around was generally good for annuities in the relevant customer literature; and

(2) There was no outcome testing policy or definition of outcome testing in place across Standard Life. GIA concluded that the quality assurance process in both the Standard Life Direct and Customer Relationship Development areas could be enhanced by further independent oversight from the Risk function and would benefit from an increase in sample size. This control weakness received a 'Medium Priority' rating, indicating that the control issue should be addressed in a timely manner, but was not a significant failing.

4.171. Concurrently, Risk Assurance produced its own thematic review called "Review of Post Pensions Freedoms" in January 2016, which concluded with a rating of "Requires Improvement". It found that 17% of the cases sampled did not meet all the criteria set out in Compliance's own call checklist, with actual customer detriment identified in three cases.

4.172. Although improvements were made to the Standard Life Direct and Customer Relationship Development sales processes from March 2015 with the introduction of the Annuity Risk Matrix, the Internal Audit reports issued in October 2015 and January 2016 (which both focused on the firm's response to Pension Freedoms) show that certain changes had not been properly implemented. The reports also show that these changes were not always effective in ensuring that customers who may have been eligible for an enhanced annuity were provided with adequate information, particularly in respect of the Open Market Option.

4.173. In summary, Standard Life failed to take adequate steps to ensure that its systems and controls were sufficient to monitor call handlers in relation to non-advised sales of annuities, by failing to:

(1) Monitor an adequate proportion of non-advised annuity sales throughout the Relevant Period;

(2) Implement additional or enhanced first line monitoring to reflect the increased risk of incentives such as the Early Target Bonus and Annuities

Challenge. In particular, the Annuities Challenge intensified the focus on profitability in the annuities area which accounted for 50% of UK business profits at the time;

(3) Implement additional or enhanced risk-based sampling, despite the heightened risks associated with the Early Target Bonus and the Annuities Challenge;

(4) Implement additional or enhanced monitoring in response to increased call failure rates; and

(5) Conduct sufficient second line monitoring by Risk Assurance.

Management Information (MI)

Standard Life Direct

4.174. Throughout the Relevant Period telesales managers and department managers in Standard Life Direct received a monthly report with a summary of Right First Time scores, to assist their day to day management and supervision of call handlers. The Right First Time Scores were also reported to the local Standard Life Direct Customer Hub management team (known as the "Standard Life Direct Executive") each month.

4.175. From 2008 to 2013 Standard Life produced an annual Standard Life Direct business plan which was reviewed by the Standard Life Direct Executive on a monthly basis and included Right First Time and TCF scores. No Standard Life Direct annual business plan was produced in 2014 or 2016.

4.176. The business plans which were available and reviewed by the Authority were high level with no, or minimal, reference to any monitoring activities undertaken. For example, the Standard Life Direct business plans for 2008 to 2012 include only the Right First Time and TCF scores. The business plan for 2013 added the Best Business Practice score for the year and the business plan for 2015 also included the score for PCD (Potential Customer Detriment) and ACD (Actual Customer Detriment) for the year. However, these business plans provided no context regarding the proportion of calls sampled or themes identified.

4.177. Management Information was also provided to the Governance and Executive Forums which were responsible for oversight of SLCML. Prior to July 2012 it was uninformative with no, or minimal, reference to any monitoring activities undertaken. Emphasis was subsequently placed on customer complaints, and providing Standard Life Direct's quality scores, as well as contextual information regarding the sample size relative to business written and specific commentary on call handlers falling below the quality benchmark. It also included remedial actions that had been taken or were required.

4.178. The content of the UK Risk Updates and UK Executive monthly reports to the SLCML Board and UK Executive was high level with no or minimal Management Information in respect of Standard Life Direct call quality or the monitoring undertaken.

4.179. Therefore, with the exception of the SLCML Risk Scorecards provided to the SLCML Governance Executive from 2013 onwards, Standard Life Direct Management Information was high level with no or minimal reference to any monitoring activities undertaken. Accordingly, the Management Information provided to Standard Life senior management in respect of the volume and results of Standard Life Direct monitoring was high level, insufficient and uninformative.

Customer Services Division and Customer Relationship Development

4.180. The Management Information team in the Customer Services Division and Customer Relationship Development areas prepared monthly scorecards and other spreadsheets for day to day management and oversight of call handlers. In addition, Management Information was aggregated across call types and was reported by these areas to the Customer Service Executive Team. This information included TCF scorecards and monthly reports to the UK Executive which contained aggregated data across all call types, including in respect of customer measures, such as customer feedback and complaints.

4.181. The Authority has reviewed a sample of the Management Information produced by the Customer Services Division and Customer Relationship Development area from August 2008 to January 2016. It was high level and focused on performance and resourcing. It set out the quality scores but did not provide any context regarding the relative sample size, with little or no commentary on the quality scores and potential issues identified from the call monitoring undertaken.

4.182. Management Information reports on the call monitoring undertaken by the Customer Services Division and Customer Relationship Development areas, show that:

(1) The TCF scorecard dated January 2009 raised a concern regarding the extent of the call monitoring undertaken; and

(2) The TCF, Customer Services Division and Customer Relationship Development scorecards placed a greater emphasis on customer complaints, surveys or feedback, with little or no reference to any call monitoring undertaken by first line management or Risk Assurance.

4.183. Standard Life has been unable to provide the Authority with any data in respect of the call monitoring undertaken by the Customer Services Division or Customer Relationship Development area. It is therefore unknown whether the sample size was subsequently increased in 2009 or decreased in 2013.

4.184. The Management Information produced by Standard Life in respect of the volume and results of the monitoring of the Customer Services Division and Customer Relationship Development area was inadequate and would not have enabled senior management to assess the sufficiency and effectiveness of call monitoring.

5. FAILINGS

5.1. The statutory and regulatory provisions and guidance relevant to this Notice are referred to in Annex A.

5.2. Based on the facts and matters above, the Authority finds that Standard Life breached Principles 3 and 6.

Breach of Principle 3

5.3. Standard Life breached Principle 3 during the Relevant Period by failing to take reasonable care to organise and control its affairs responsibly and effectively, with adequate risk management systems in respect of complex products for which the ordinary customer's need for accurate information is high. These failings in turn meant that some customers were not treated fairly and that information was not communicated to them in a way which was clear, fair and not misleading. This was particularly so in the context of non-advised sales, where the customer chose their annuity product based on factual information provided by a call handler in an environment where higher risk sales incentives were used.

5.4. Standard Life failed to put in place sufficient controls to mitigate the risk to the interests of its customers and in particular to ensure that its existing customers purchasing pension annuities on a non-advised basis were provided with appropriate and timely information in relation to enhanced annuities, including the option to shop around on the open market. This included the potential impact on the customer's retirement income.

5.5. In particular:

(1) Standard Life's call handler documentation was high level and afforded a significant degree of discretion to call handlers and contained scripted statements that risked undermining the Open Market Option statement. This created a significant risk that relevant and important information, particularly in relation to the eligibility for an enhanced annuity, including the ability to shop around, would not be provided to customers, and that customers would be discouraged to shop around for a better deal on the open market.

(2) Standard Life's incentive schemes included higher risk features which created a significant risk that, if not adequately controlled, call handlers would sell non-advised annuity products to customers that were inappropriate for their needs, in an attempt to reach salary and bonus incentive thresholds.

(3) Standard Life's call monitoring was inadequate, and did not take into account the increased risk of poor customer outcomes created by the higher risk features of its incentive schemes.

(4) Management Information produced by Standard Life was inadequate and not sufficiently informative to enable senior management to assess the adequacy and effectiveness of call monitoring in relation to non-advised sales of annuities.

5.6. The Authority considers that these amount to serious failings, which have either resulted in, or created a significant risk of, poor customer outcomes and consumer detriment, including that customers have not been treated fairly.

Breach of Principle 6

5.7. Standard Life breached Principle 6 during the Relevant Period by failing to pay due regard to the interests of its customers and treat them fairly.

5.8. In particular:

(1) Standard Life's high level call handler documentation meant that call handlers could have undermined the Open Market Option statement. They also failed to provide some customers with appropriate and timely information, particularly in relation to their eligibility for an enhanced annuity, including their right to shop around. This was despite customers having asked about enhanced annuities or having notified Standard Life of health or lifestyle conditions. As a consequence, some customers may have been either discouraged from shopping around on the open market for a better deal on an enhanced annuity, or not made aware that doing so could achieve a better rate.

(2) Standard Life's incentive schemes meant that call handlers sold non-advised annuity products to some customers who may have been eligible for an enhanced annuity that were inappropriate for their needs.

5.9. The Authority has taken into account the significant redress payments made to those customers affected by its failings.

5.10. Having regard to the issues above, the Authority considers that it is appropriate and proportionate in all the circumstances to take disciplinary action against Standard Life for its Principle breaches during the Relevant Period.

6. SANCTION

6.1. The Authority has considered the disciplinary and other options available to it and has concluded that a financial penalty is the appropriate sanction in the circumstances of this particular case.

Financial Penalty

6.2. The Authority's policy on the imposition of financial penalties is set out in Chapter 6 of DEPP. In determining the financial penalty, the Authority has had regard to this guidance. Changes to the penalty policy set out in DEPP were introduced on 6 March 2010. As set out at paragraph 2.7 of the Authority's Policy Statement

10/4, when calculating a financial penalty where the conduct straddles penalty regimes, the Authority must have regard to both the penalty regime which was effective before 6 March 2010 and the penalty regime which was effective after 6 March 2010.

6.3. The Authority has therefore:

(1) Calculated the financial penalty for Standard Life's misconduct from 1 July 2008 to 5 March 2010 by applying the old penalty regime to this misconduct;

(2) Calculated the financial penalty for Standard Life's misconduct from 6 March 2010 to 31 May 2016 by applying the current penalty regime to this misconduct; and

(3) added the penalties calculated under (1) and (2) to produce the total financial penalty.

Financial penalty under the old penalty regime

6.4. All references to DEPP under this heading are to the version of DEPP in force prior to 6 March 2010.

6.5. In determining what financial penalty is appropriate and proportionate to the breaches, the Authority is required to consider all the relevant circumstances of the case. DEPP 6.5.2G identifies a non-exhaustive list of factors that may be relevant to determining the level of financial penalty. The Authority has had regard to the following:

Deterrence (DEPP 6.5.2G(1))

6.6. The principal purpose of a financial penalty is to promote high standards of regulatory conduct by deterring firms who have committed breaches from committing further breaches and helping to deter other firms from committing similar breaches, as well as demonstrating generally the benefits of compliant business.

Nature, seriousness and impact of the breaches (DEPP 6.5.2G(2))

6.7. The Authority has had regard to the seriousness of the breaches, including the nature of the requirements breached and the duration and frequency of the breaches. The Authority considers that the breaches reveal serious weaknesses in the management systems and controls relating to the relevant business area which created a risk of loss to consumers. For the reasons set out in this Notice, the Authority considers that the breaches are of a serious nature.

Extent to which the breaches were deliberate or reckless (DEPP 6.5.2G(3))

6.8. The Authority does not consider Standard Life's failings were deliberate or reckless.

Size, financial resources and other circumstances of the firm (DEPP 6.5.2G(5))

6.9. In deciding on the level of penalty, the Authority has had regard to the size of the financial resources of Standard Life.

6.10. The Authority has no evidence to suggest that Standard Life is unable to pay the financial penalty.

The amount of benefit gained or loss avoided (DEPP 6.5.2G(6))

6.11. The Authority has not identified any financial benefit gained or loss avoided, directly or indirectly from the breaches.

Conduct following the breaches (DEPP 6.5.2G(8))

6.12. Standard Life is conducting a comprehensive redress exercise to compensate customers directly impacted as a result of the breaches.

Disciplinary record and compliance history (DEPP 6.5.2G(9))

6.13. The Authority has had regard to the fine imposed upon Standard Life in January 2010 in respect of its failings to produce marketing material that was clear, fair and not misleading.

Conclusions in relation to old penalty regime

6.14. The Authority hereby imposes a financial penalty under the old penalty regime of £4,000,000.

6.15. The Authority and Standard Life reached agreement at Stage 1 and so a 30% discount applies. Therefore, the penalty for the misconduct under the old penalty regime is £2,800,000.

Financial penalty under the new penalty regime

6.16. In respect of conduct occurring on or after 6 March 2010, the Authority applies a five-step framework to determine the appropriate level of financial penalty. DEPP 6.5A sets out the details of the five-step framework that applies in respect of financial penalties imposed on firms.

Step 1: disgorgement

6.17. Pursuant to DEPP 6.5A.1G, at Step 1 the Authority seeks to deprive a firm of the financial benefit derived directly from the breaches where it is practicable to quantify this.

6.18. The Authority has not identified any financial benefit that Standard Life derived directly from its breaches.

6.19. Step 1 is therefore £0.

Step 2: the seriousness of the breaches

6.20. Pursuant to DEPP 6.5A.2G, at Step 2 the Authority determines a figure that reflects the seriousness of the breach. Where the amount of revenue generated by a firm from a particular product line or business area is indicative of the harm or potential harm that its breach may cause, that figure will be based on a percentage of the firm's revenue from the relevant products or business area.

6.21. The Authority considers that the revenue generated by Standard Life is indicative of the harm or potential harm caused by its breaches. The Authority has therefore determined a figure based on a percentage of Standard Life's relevant revenue. Standard Life's relevant revenue is the revenue derived by the firm during the period of the breach from the products to which the breach relates. Under the current regime, the period of Standard Life's breaches was from 6 March 2010 to 31 May 2016. The Authority considers Standard Life's relevant revenue for this period to be £1,184,869,672.

6.22. In deciding on the percentage of the relevant revenue that forms the basis of the step 2 figure, the Authority considers the seriousness of the breach and chooses a percentage between 0% and 20%. This range is divided into five fixed levels which represent, on a sliding scale, the seriousness of the breach; the more serious the breach, the higher the level. For penalties imposed on firms there are the following five levels:

Level 1 – 0%;

Level 2 – 5%;

Level 3 – 10%;

Level 4 – 15%;

Level 5 – 20%.

6.23. In assessing the seriousness of a breach to determine which level is most appropriate to the case, the Authority takes into account various factors that reflect the impact and nature of the breach and considers whether the firm was committed the breach deliberately or recklessly. DEPP 6.5A.2G(11) lists factors likely to be considered "level 4 or 5 factors". Of these, the Authority considers the following factors are particularly relevant to this case:

(1) Standard Life's breaches caused a significant risk of loss to individual consumers. Although the loss to each consumer may not have been "significant" in each case, the aggregate sums repaid to approximately 15,000 customers by way of redress are significant.

(2) The weaknesses in Standard Life's management systems and internal controls were systemic in respect of it sales process documentation, remuneration and incentive schemes and monitoring processes relating to Standard Life's sales of non-advised annuities.

(3) Standard Life's customers are potentially vulnerable, being at or nearing retirement age, a proportion of whom might have been eligible for enhanced annuities.

6.24. DEPP 6.5A.2G(12) lists factors likely to be considered "level 1, 2 or 3 factors". Of these, the Authority considers the following factors to be relevant:

(1) The breaches were committed negligently.

(2) There is no evidence of any attempt by Standard Life's senior management to conceal the misconduct.

(3) The impact of the breaches, resulting in consumers suffering losses, is in the process of being addressed through a significant redress exercise.

6.25. Taking all of these factors into account, the Authority considers the seriousness of the breach to be level 4 and so the Step 2 figure is 15% of £1,184,869,672.

6.26. Step 2 is therefore £177,730,450.83.

6.27. DEPP6.5.3(3)G provides that the Authority may decrease the level of penalty arrived at after applying Step 2 of the framework if it considers that the penalty is disproportionately high for the breaches concerned. Taking all these factors into account the Step 2 figure is £44,432,613.

Step 3: mitigating and aggravating factors

6.28. Pursuant to DEPP 6.5A.3G, at Step 3 the Authority may increase or decrease the amount of the financial penalty arrived at after Step 2, but not including any amount to be disgorged as set out in Step 1, to take into account factors which aggravate or mitigate the breach.

6.29. The Authority considers that the following factors aggravate the breaches:

(1) Previous disciplinary record: Standard Life was fined £2,450,000 on 20 January 2010 for failing to ensure that proper systems and controls were in place in relation to marketing material produced (breach of Principle 3), and for failing to ensure the marketing material issued was clear, fair and not misleading (breach of Principle 7).

6.30. The Authority considers that the following factors mitigate the breaches:

(1) Standard Life is conducting a comprehensive redress exercise voluntarily and has contacted over 80% of the customer population since the commencement of the exercise in April 2018.

(2) Standard Life displayed good cooperation during the course of the investigation.

6.31. Having taken into account these aggravating and mitigating factors, the Authority considers that the Step 2 figure should be decreased by 10%.

6.32. Step 3 is therefore £39,989,351.

Step 4: adjustment for deterrence

6.33. Pursuant to DEPP 6.5A.4G, if the Authority considers the figure arrived at after Step 3 is insufficient to deter the firm who committed the breach, or others, from committing further or similar breach, then the Authority may increase the penalty.

6.34. The Authority considers that the Step 3 figure of £39,989,351 does not require an adjustment for deterrence.

6.35. Step 4 is therefore £39,989,351.

Step 5: settlement discount

6.36. Pursuant to DEPP 6.5A.5G, if the Authority and the firm on which a penalty is to be imposed agree the amount of the financial penalty and other terms, DEPP 6.7 provides that the amount of the financial penalty which might otherwise have been payable will be reduced to reflect the stage at which the Authority and the firm reached agreement.

6.37. The Authority and Standard Life reached agreement at Stage 1 and so a 30% discount applies to the Step 4 figure.

6.38. The Step 5 figure will therefore be £27,992,500 (rounded down to the nearest £100).

Penalty

6.39. The Authority hereby imposes a total financial penalty of £30,792,500 (£43,989,300 before Stage 1 discount) on Standard Life for breaching Principle 3 and Principle 6.

7. PROCEDURAL MATTERS

7.1. This Notice is given to Standard Life under section 390 of the Act.

7.2. The following statutory rights are important.

Decision maker

7.3. The decision which gave rise to the obligation to give this Notice was made by the Settlement Decision Makers.

Manner and time for payment

7.4. The financial penalty must be paid in full by Standard Life to the Authority no later than 13 August 2019.

If the financial penalty is not paid

7.5. If all or any of the financial penalty is outstanding on 13 August 2019, the Authority may recover the outstanding amount as a debt owed by Standard Life and due to the Authority.

Publicity

7.6. 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 Authority must publish such information about the matter to which this Notice relates as the Authority considers appropriate. The information may be published in such manner as the Authority considers appropriate. However, the Authority may not publish information if such publication would, in the opinion of the Authority, be unfair to you or prejudicial to the interests of consumers or detrimental to the stability of the UK financial system.

Authority contacts

7.7. For more information concerning this matter generally, contact Martha Stokes at the Authority (direct line: 020 7066 0894/email: martha.stokes@fca.org.uk).

Laura Dawes

Head of Department

Financial Conduct Authority, Enforcement and Market Oversight Division

ANNEX A

1. RELEVANT STATUTORY PROVISIONS

1.1. The Authority's statutory objectives, set out in section 1B(3) of the Act, include the consumer protection objective.

1.2. Section 206(1) 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."

2. RELEVANT REGULATORY PROVISIONS

Principles for Businesses

2.1. The Principles are a general statement of the fundamental obligations of firms under the regulatory system and are set out in the Authority's Handbook. They derive their authority from the Authority's rule-making powers set out in the Act. The relevant Principles are as follows.

2.2. Principle 3 (Management and Control) provides:

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

2.3. Principle 6 (Customers' Interests) provides:

"A firm must pay due regard to the interests of its customers and treat them fairly."

Conduct of Business Sourcebook (COBS)

2.4. The relevant law and regulatory standards applicable to the sale of annuities are contained in the Authority's Principles for Business, and in the COBS section of the Authority's Handbook.

2.5. Throughout the Relevant Period, Standard Life had an obligation to comply with the following COBS rules in respect of all communications with its customers:

(1) COBS 2.1.1R requires firms to act honestly, fairly and professionally in accordance with the best interests of their clients;

(2) COBS 4.2.1R requires firms to take reasonable steps to ensure that a communication is fair, clear and not misleading. COBS 4.2.2G explains that the fair, clear and not misleading rule requires a firm to take into account the information being conveyed in the communication as well as the intended recipient. In addition, the requirement on firms imposed by COBS 4.2.1R is not simply to take reasonable steps not to mislead customers; firms must, over and above this, take reasonable steps to ensure that the communication is fair and clear; and

(3) COBS 19.4 sets out the information a firm must provide to a customer to enable them to make an informed decision about their options for accessing their pensions savings on retirement, including information on the Open Market Option.

2.6. The stated rules under COBS 19.4 have been amended at various points over the Relevant Period, including on 6 April 2015 and 10 October 2016 to reflect the fact that consumers had more options at retirement because of the Pensions Freedoms changes. However, Parliament had considered the issue in March 2002 and noted that the regulation governing the Open Market Option statement was "*designed to ensure that consumers are made aware of their right to shop around to get the best annuity deal on offer to suit their circumstances*". Similarly, the Authority noted in Policy Statement 16/12 that the amendments to COBS 19.4 were designed to "*effectively restate our existing expectations on firms…to add guidance to COBS 19.4 to assist firms in complying with the client's best interests rule (COBS 2.1.1R) and the fair, clear and not misleading rule (COBS 4.2.1.R)".*

FCA Incentives Guidance

2.7. In January 2013, the Authority published its final guidance on risks posed to customers by financial incentives. This stated clearly that incentive schemes must never be at the customer's expense and that the risks need to be properly managed. It set out the Authority's expectation that firms adhere to Principle 3 and SYSC when developing incentive schemes for their staff and to have a mitigation strategy in place to manage any risk of mis-selling to consumers that might occur.

2.8. Specifically, it identified a non-exhaustive list of examples of incentive scheme features split into two categories. The first category was those which 'significantly increase' the risk of mis-selling, and the second was other features that 'increase' the risk of mis-selling. Incentive scheme features which were found to 'significantly increase the risk of mis-selling' were, for example,

(1) Disproportionate rewards for marginal sales, which means reaching a target or a goal that triggers an increase in earnings much higher than the normal rate at which incentives accrue; and

(2) "Accelerators", which means that a higher rate of incentive is earned through achieving a higher volume of sales. The higher rate only applies to sales over a certain target, therefore incentivising staff to maximise their sales before the end of the incentive period.

2.9. Other features found to increase the risk of mis-selling included:

(3) Thresholds whereby sales staff receive bonuses on each sale above a minimum level of sales, for example on a monthly or quarterly basis. This creates the risk that staff will want to sell as much as possible after they have met such a threshold and before the end of the month or quarter; and

(4) Competitions or promotions where staff can earn additional payments or win prizes based on general volume of sales.

3. RELEVANT INDUSTRY STANDARDS

Association of British Insurers (ABI)

3.1. The ABI's "Good Practice Guide: Improving customers' retirement experiences" was published in July 2008. The guide encouraged firms to draw the customer's attention in good time to the Open Market Option, as well as the possibility of obtaining an enhanced annuity. The guide also encouraged firms to quote all available options, cover eligibility for an enhanced annuity and explain the potential benefits of shopping around on the open market in the written packs provided to customers.

3.2. In January 2011, the ABI published a "Best Practice Guide for the Retirement Process". The guide was intended to "help pension providers ensure their communications approaching retirement help customers to make the necessary decisions about their retirement income, and encourage shopping around for the most appropriate and competitive retirement income product." The 2011 ABI

Guide expanded on the principles and rules set down in the 2008 Good Practice Guide.

3.3. In September 2011, the ABI announced its intention to introduce a mandatory Code of Conduct on Retirement Choices ("the ABI Code"). The ABI Code was published in March 2012 and came into force on 1 March 2013.

3.4. The ABI Code was developed "to ensure that pension providers' communications to customers approaching retirement help every customer to make an informed decision by understanding: (i) his or her retirement choices; (ii) the different product types available, and their appropriateness for the customer's circumstances, including enhanced annuities; and (iii) the benefits of shopping around for the most appropriate and competitive retirement income product." It reflected accepted industry practice and provided detail on the interpretation of COBS 19.4 and the general obligations on firms when communicating with their customers during the annuity sales process.