Financial Conduct Authority

FINAL NOTICE

To:	**Aviva Investors Global Services Limited**
Firm Reference Number:	**119178**
Address:	**No. 1 Poultry** **London** **EC2R 8EJ**
Date:	**24 February 2015**

1. ACTION

1.1. For the reasons given in this notice, the Authority hereby imposes a financial penalty of £17,607,000 on Aviva Investors Global Services Limited ("Aviva Investors" or "the Firm").

1.2. Aviva Investors agreed to settle at an early stage of the Authority's investigation and therefore 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 £25,152,900 on Aviva Investors.

2. SUMMARY OF REASONS

2.1. Asset managers act as agents for their customers, making investment decisions in financial markets on their behalf. Confidence that asset managers will conduct themselves properly when acting on behalf of customers is central to the relationship of trust between the industry and its customers, particularly where because of a lack of information customers are unable to judge for themselves whether they are being treated fairly. This means that when making investment decisions for customers, asset managers should not let conflicts of interest interfere with their obligations to customers.

2.2. The Authority has stressed the importance of asset managers managing conflicts of interest effectively, including by way of a thematic review report and a Dear CEO letter in November 2012. This will continue to be an area of focus for the Authority.

2.3. The Authority expects an asset manager to ensure that it:

a) takes reasonable care to organise and control its affairs responsibly and effectively with adequate risk management systems; and

b) manages conflicts of interest fairly, both between itself and its customers and between customers and other clients.

2.4. Aviva Investors failed to do so. From 20 August 2005 to 30 June 2013 ("the Relevant Period") it failed to control the conflicts inherent in the management of funds that paid differing levels of performance fees on the same desk within its Fixed Income business. Managing funds together in this way is referred to as 'Side-by-Side' management.

2.5. Aviva Investors had an incentive structure that created conflicts of interest whereby Side-by-Side traders had an incentive to favour funds paying higher performance fees. This incentive was higher on desks where hedge funds were managed alongside long-only funds that paid lower or no performance fees.

2.6. In addition, Aviva Investors had a poor control environment meaning that Fixed Income traders could delay recording the allocation of executed trades for several hours without being detected. Aviva Investors found that two former Fixed Income traders had taken advantage of these weaknesses.

2.7. The combination of a poor control environment and an incentive for Side-by-Side traders to prefer their interests over those of customers led to an increased risk that they would seek to increase incentive payments by allocating trades that benefited from favourable intraday price movements to some funds and allocating trades that did not to other funds. This practice is commonly known as 'Cherry Picking'.

2.8. In May 2013, Aviva Investors found evidence of delayed booking and improper allocation of trades, including Cherry Picking, by two former Fixed Income traders between August 2005 and November 2012. Compensation of £132,000,000 was paid to eight funds managed on behalf of other companies within the Aviva Group that may have been adversely impacted as a result of Aviva Investors' poor control environment.

2.9. As a consequence, during the Relevant Period Aviva Investors breached Principle 3 (Management and control) and Principle 8 (Conflicts of interest) of the Authority's Principles for Businesses ("the Principles") and related Rules.

2.10. Aviva Investors breached Principle 3 by failing to exercise adequate and effective control over its Side-by-Side management of funds. Aviva Investors operated a 'three lines of defence model' of risk management. Aviva Investors primarily relied upon the first line of defence, the business, to identify, assess and manage risk. The business failed to do so in relation to the inherent conflicts of interest and risks associated with the Side-by-Side management of funds. Weaknesses in compliance oversight and monitoring, along with flaws in the approach to closing audit issues meant that the business's failure to address the risks went unaddressed.

2.11. Aviva Investors breached Principle 8 by failing to manage fairly the inherent conflicts of interest between itself and its customers, and between customers and other clients, that arose from managing funds that paid differing levels of performance fees on a Side-by-Side basis.

2.12. Details of the Relevant Principles and Rules breached by Aviva Investors (and other relevant regulatory provisions) are set out in Annex A to this Notice.

2.13. The Authority has taken into account that:

a) the weaknesses in Aviva Investors' systems and controls went unaddressed for almost eight years and created an unacceptable risk of trader misconduct;

b) the failings revealed systemic weaknesses in Aviva Investors' management, systems and controls in the Fixed Income business;

c) the failings caused an unacceptable risk of significant loss to certain long-only funds managed on a Side-by-Side basis, a risk Aviva Investors found had crystallised and may have caused detriment to eight long-only funds;

d) Aviva Investors' Internal Audit function identified the systems and controls weaknesses, but the steps taken by the Firm failed to adequately address them;

e) it does not consider that the Firm's failings were deliberate or reckless;

f) Aviva Investors promptly notified the Authority of the breaches before it ascertained the full extent of the breaches;

g) since discovering the failings, Aviva Investors and its senior management have worked in an open and cooperative manner with the Authority, far above and beyond the level expected;

h) since February 2012 Aviva Investors has committed significant resources to investigating and addressing the weaknesses in its control environment making significant improvements, which include enhancing governance, strengthening its control framework and seeking to embed an appropriate culture under the leadership of a new management team;

i) prompt compensation was made to the eight funds Aviva Investors identified may have been adversely affected by its breaches, ensuring that they were not adversely impacted by its failings. While the amount of compensation paid was significant, because of the size, structure and nature of each of the funds and the large number of consumers with an interest in each of them, the risk of loss to each individual retail consumer was relatively small; and

j) this action supports the Authority's operational objectives of securing an appropriate degree of protection for consumers and protecting and enhancing the integrity of the UK financial system.

2.14. The Authority therefore imposes a financial penalty on Aviva Investors in the amount of £17,607,000 pursuant to section 206 of the Act.

3. DEFINITIONS

3.1. The definitions below are used in this Final Notice.

‘the Act’ means the Financial Services and Markets Act 2000

‘the Authority’ means the corporate entity previously known as the Financial Services Authority and renamed on 1 April 2013 as the Financial Conduct Authority

‘Aviva Group’ means the group of entities owned by Aviva plc

‘Aviva Investors’ or ‘the Firm’ means Aviva Investors Global Services Limited

‘Cherry Picking’ refers to the practice of delaying the allocation of trades in order to assess their performance before allocating trades to particular funds

‘COBS’ means the Conduct of Business Sourcebook

‘Conflict Log’ means the log that Aviva Investors kept of identified conflicts of interest and the measures taken to mitigate them

‘DEPP’ means the part of the Authority’s Handbook entitled ‘Decisions Procedure and Penalties Manual’

‘Hedge Funds’ means Aviva Investors’ funds that employed trading strategies that took long and short positions with the aim of maximising returns

‘Impacted Funds’ means the Long-Only Funds that were compensated

‘Long-Only Funds’ means funds managed with the strategy of only taking long, rather than short, positions

‘MI’ refers to Management Information

‘Principle’ or ‘Principles’ means the Authority’s Principles for Businesses

‘Relevant Period’ means 20 August 2005 to 30 June 2013

‘Side-by-Side management’ is the practice of having the same individuals manage funds with different strategies and investment structures

'Side-by-Side Traders' means Traders who managed funds on a Side-by-Side basis

'Traders' means fund managers and other employees of Aviva Investors, who had authority to decide on trades, place orders, execute, book and allocate trades on behalf of funds managed by Aviva Investors

'the Tribunal' means the Upper Tribunal (Tax and Chancery Chamber)

4. FACTS AND MATTERS

Background

4.1. Aviva Investors is an asset management company and part of the Aviva Group. It has global assets under management of £234 billion in fixed income, equities, real estate and multi-asset solutions. Of this, approximately 80% are managed for Aviva Group customers, which in turn provide investments, insurance and pensions to their retail customers. Each of Aviva Investors' customers has a specific investment objective and the Firm follows investment strategies designed to meet these objectives.

Side-by-Side fund management

4.2. During the Relevant Period, Aviva Investors employed a Side-by-Side management strategy on certain desks within its Fixed Income area whereby funds that paid differing levels of performance fees were managed on a Side-by-Side basis.

4.3. For example, a Hedge Fund, which paid a 20% outperformance fee, was managed alongside Long-Only Funds that paid lower or no performance fees. A significant proportion (50-60%) of these performance fees were paid to Side-by-Side Traders in Aviva Investors' Fixed Income area based on their role and contribution to the Hedge Fund's performance.

4.4. This type of incentive structure created conflicts of interest as these Traders had an incentive to favour one fund over another. This risk was particularly acute on desks where funds traded in the same instruments, creating the opportunity for misconduct, including Cherry Picking.

4.5. The conflicts of interest and risks inherent in the Side-by-Side management of funds require robust risk management systems and controls. Aviva Investors identified this and recorded in its Conflict Log that in its Fixed Income business *'...*

fund managers manage both long only and hedge funds. Remuneration on hedge funds is likely to be higher and it is possible this will incentivise to give priority over long funds.' Despite this, throughout the Relevant Period there were significant weaknesses in Aviva Investors' risk management framework and the systems and controls that operated in the Fixed Income area. This meant that it failed to adequately manage the inherent conflict in its Side-by-Side management arrangements and the risk Side-by-Side Traders would put their interests ahead of customers' interests.

Cherry Picking

4.6. Aviva Investors' various desks would decide on the overall trading strategy for the funds they managed, including Hedge Funds and Long-Only Funds. Individual Traders then implemented these strategies, but had discretion to pick specific instruments within the strategy as long as those trades complied with the investment mandates of the specific fund for which they were trading. Aviva Investors had a system in place to check compliance with investment mandates; however, this was not able to identify whether specific instruments had been cherry picked.

4.7. Aviva Investors' policy required trades to be allocated to specific funds at the time of, or immediately after, the order. However weaknesses in Aviva Investors' systems and processes (see paragraphs 4.16 - 4.17 below) meant Traders could delay recording the allocation of executed trades for several hours. By delaying the allocation of trades, Side-by-Side Traders could assess a trade's performance during the course of the day and, when it was recorded, allocate trades that benefitted from favourable intraday price movements to one fund and trades that did not to other funds. For example, a Side-by-Side Trader could buy an instrument at 9 am intending to allocate it to the Hedge Fund, but by 3 pm, seeing that the instrument had fallen in value, allocate it to a Long-Only fund. This is commonly known as Cherry Picking.

4.8. By Cherry Picking trades, Side-by-Side Traders could enhance the performance of Hedge Funds so that they benefitted from favourable intraday price movements and avoided the consequences of adverse price movements. The effect of this could be increased performance fees paid to Aviva Investors and thus increased incentive payments paid to Side-by-Side Traders within Fixed Income. During the Relevant Period, £27.4m was paid to certain traders as a result of Hedge Fund performance.

4.9. In May 2013, Aviva Investors found evidence to suggest that two former Fixed Income Traders had been delaying the booking of, and improperly allocating, trades. Aviva Investors sought to ensure that none of the funds it managed were adversely impacted by this conduct and compensation of £132,000,000 was paid to eight Impacted Funds.

Weaknesses in Aviva Investors' first line of defence – systems and controls

4.10. Aviva Investors operated a 'three lines of defence' model of risk management. The first line of defence, the business, was meant to have primary responsibility for the identification and management of risks.

4.11. On certain desks within Aviva Investors' Fixed Income business there was no segregation of investment decision-making, order placement, trade execution, allocation and booking of trades during the Relevant Period. Instead, Traders on these desks were responsible for all of the above. Where firms do not segregate dealing, it is essential that they implement adequate systems and controls to ensure that a compliant order process is followed. This was particularly important where employing a strategy of Side-by-Side management. Despite this, there were significant deficiencies in:

a) Responsibilities;

b) Policies and procedures;

c) Systems;

d) Management Information; and

e) Culture.

4.12. The combination of these deficiencies meant that the first line of defence, which had primary responsibility for the identification and management of risks, failed to adequately manage the risks associated with Side-by-Side management.

a) Responsibilities

4.13. During the Relevant Period, the division of risk management responsibilities between the first and second line of defence lacked clarity. For part of the Relevant Period, Compliance sat within the first line of defence, thereby combining what are normally separate lines of risk management.

4.14. In addition, the accountability and ownership of oversight and monitoring over Fixed Income was not clearly defined. There were a number of structural and risk management changes at Aviva Investors during the Relevant Period, which meant that responsibilities, reporting lines and personnel frequently changed. This resulted in a lack of clarity within Fixed Income as to who had responsibility for oversight of the area. Further, the roles and responsibilities of those with direct-line management responsibility of Fixed Income Traders were not documented. This resulted in a lack of accountability and oversight on individual desks, with the consequence that oversight of Fixed Income Traders was informal and not recorded.

b) Policies and procedures

4.15. Despite acknowledging the inherent conflicts of interest in the Side-by-Side management of funds in its Conflict Log, Aviva Investors failed to implement controls within the first line of defence to specifically manage the risks associated with this strategy. There were a number of general policies relating to order placement, execution, allocation and booking of trades; none of these addressed the specific risks associated with the Side-by-Side management of funds.

c) Systems

4.16. Trades for the Long-Only Funds were processed through an order management system, while details of executed Hedge Fund trades were emailed to the middle office. Neither process required Traders to record the intended allocation of a trade on the system or with Aviva Investors' middle office prior to booking the trade. This meant that there was no contemporaneous record of the intended allocation when an order was placed. Where funds were managed on a Side-by-Side basis this increased the risk of Cherry Picking and that it would go undetected.

4.17. In addition, both systems were potentially open to abuse in that Traders, when booking trades on the system or with Aviva Investors' middle office, could misreport the time they had been executed. Because data relating to when trades were executed was not readily available, Aviva Investors' ability to monitor compliance with the requirement for prompt recording and allocation of trades was impaired. Delays would only be apparent should trades not be executed and allocated in the same day; this meant that exception reports could only be produced to show trades booked across days and widespread delays in the booking and allocation of trades intraday could go undetected.

d) Management Information

4.18. There were significant weaknesses in the MI provided to, and produced by, the business. There was little MI to enable line managers to gain comfort that Traders were following processes and that the controls that existed were operating effectively. MI that was produced was not timely, which meant that it was of limited utility in managing risk or checking compliance with process.

4.19. Further, MI about funds tended to focus on financial performance, which, in turn, meant that there was limited MI on trading in funds that customers intended to be passively managed, including the Impacted Funds. Certain quarterly reports or turnover reports were not provided for these funds and positions were only reported on an exception basis when a change in maturity profile occurred. As such, there was limited oversight of trading within these funds by the first line of defence.

e) Culture

4.20. The culture within the Fixed Income business was heavily focused on performance. Risk and controls were wrongly perceived by some as hindering performance. Risk awareness or compliance with regulatory obligations was not adequately promoted, which meant that compliance training was not viewed as a mandatory obligation.

4.21. Performance management also often overlooked the importance of risk and control. Promotions tended to be based on reported investment performance and insufficient consideration was given to wider risk management skills.

4.22. This culture contributed to the poor control environment. Parts of the business were naïve, relying on a culture of assumed trust rather than control. This meant that they were slow to remedy control weaknesses identified in audit or compliance reports, often relying on strategic change projects to remedy weaknesses.

Weaknesses in Aviva Investors' second line of defence - monitoring and oversight

4.23. The second line of defence at Aviva Investors was meant to act as a safety net to catch issues that were not prevented or detected by the first line policies, systems and controls. However, during the Relevant Period there were significant weaknesses in Aviva Investors' second line of defence which meant that it did not operate effectively as an independent check on the business.

a) Inadequate compliance monitoring

4.24. The significant weaknesses in the first line of defence's systems and controls impacted the second line's ability to act as an independent check on the business. Trade compliance monitoring, such as monitoring the timely recording and fair allocation of trades, was largely manual, as a consequence of which, sample sizes were often limited. This was not adequate for the Fixed Income area which executed a large volume of high value trades on a daily basis. Further, monitoring of the Side-by-Side management of Hedge Funds and other funds was complicated because trading data was held on different systems.

4.25. In addition, the only specific control over the Side-by-Side management of funds listed on Aviva Investors' Conflict Log, enhanced compliance monitoring, rarely took place.

4.26. The weaknesses in compliance monitoring were compounded by the lack of investment risk monitoring, which included assessing fund activities against benchmarks. Where certain funds had no benchmarks against which to assess performance, Aviva Investors excluded them from investment risk monitoring. This decision, when combined with weaknesses in compliance monitoring, meant that there was little, if any, monitoring of such funds by the second line of defence.

b) Inadequate compliance resource and capability

4.27. Compliance was under-resourced and lacked the necessary skills and experience to challenge business practices. This, in turn, meant that Compliance lacked the credibility and respect within Aviva Investors to robustly challenge decisions made by the business or engender a risk-aware culture.

Weaknesses in Aviva Investors' third line of defence – independent assurance

4.28. Internal Audit, as part of the third line of defence within Aviva Investors, was meant to provide independent assurance on the overall governance of risk within the Firm. However, weaknesses in Internal Audit's approach to closing audit issues meant that it failed to provide adequate assurance during the Relevant Period.

4.29. Aviva Investors' Internal Audit conducted at least four audits, which raised issues directly relevant to the significant control weaknesses highlighted in this Notice. Despite this, flaws in the approach to closing audit issues were present until 2011 and included:

a) an unclear process in relation to decisions by the business to 'risk accept' control weaknesses;

b) a high dependency on strategic change projects to address issues without adequate consideration of whether the projects would adequately address the issue or operational testing to support closure of the issue; and

c) a lack of and/or gaps in testing of the closure of audit issues, which meant that, on occasion, issues were closed with no independent assessment of whether controls would cover off the specific risk that had been identified.

4.30. This meant that significant control weaknesses highlighted in reports were not addressed in a timely or effective manner. Aviva Investors' trading business therefore continued with inadequate risk management systems meaning that poor trading practices remained unchallenged.

Remediation of weaknesses

4.31. The Authority recognises that, by the end of June 2013, Aviva Investors had taken steps to address the deficiencies in its risk management framework. These steps included: ending the Side-by-Side management of Hedge Funds and Long-Only Funds on the same desk, introducing segregated dealing on all desks within Fixed Income, instituting a system that enforced a compliant trade process, refocusing and increasing compliance resource and increasing the level of management scrutiny over the Fixed Income business.

5. FAILINGS

5.1. Based on the facts and matters described above, the Authority concludes that Aviva Investors has breached Principle 3 and 8. The regulatory provisions relevant to the Notice are referred to in Annex A.

5.2. Aviva Investors breached Principle 3 by failing to organise its affairs responsibly and effectively with adequate risk management systems. This included a failure to have effective controls in place over the actions of Traders within its Fixed Income business who were involved in the Side-by-Side management of funds and to undertake adequate compliance monitoring, as well as a failure to effectively close audit issues.

5.3. Aviva Investors breached Principle 8 by failing to manage fairly the inherent conflicts of interest between itself and its customers, and customers and other clients, that arose from managing funds that paid differing levels of performance fees on a Side-by-Side basis. In particular, Aviva Investors failed to implement any specific controls within the first line of defence to manage these conflicts. Further, enhanced compliance monitoring by the second line of defence often did not take place.

5.4. In addition, Aviva Investors breached COBS 11.3.2 and COBS 11.5.2 by failing to ensure that orders executed on behalf of clients were promptly and accurately recorded and allocated.

5.5. Having regard to the issues above, the Authority considers it appropriate and proportionate in all the circumstances to take disciplinary action against Aviva Investors for its breaches of the Principles and associated Rules 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.

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.

6.3. Aviva Investors' failings occurred before and after 6 March 2010. As set out in paragraph 2.7 of the Authority's Policy Statement 10/4, when calculating a financial penalty where the misconduct occurred under both penalty regimes, the Authority will consider both the penalty regime that was effective before 6 March 2010 (the "old penalty regime") and the penalty regime that was effective after 6 March 2010 (the "current penalty regime").

6.4. The Authority has:

a) calculated the financial penalty for Aviva Investors' failings from 20 August 2005 to 5 March 2010 by applying the old penalty regime to that misconduct;

b) calculated the financial penalty for Aviva Investors' misconduct from 6 March 2010 to 30 June 2013 by applying the current penalty regime to that misconduct; and

c) added the penalties calculated under both regimes together to produce the total penalty.

Financial penalty calculation under the old regime

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

6.6. 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 in determining the level of financial penalty. The Authority considers that the following factors are particularly relevant in this case.

<u>Deterrence (DEPP 6.5.2G (1))</u>

6.7. The principal purpose of a financial penalty is to promote high standards of regulatory conduct by deterring firms that have breached regulatory requirements from committing further breaches, helping to deter other firms from committing contraventions and demonstrating generally to firms the benefits of compliant behaviour. The Authority considers that the need for deterrence means that a significant fine on Aviva Investors is appropriate.

<u>Nature, seriousness and impact of the breach (DEPP 6.5.2G (2))</u>

6.8. The Authority has had regard to the seriousness of the breaches, including the nature of the requirements breached and the number and duration of the breaches. For the reasons set out in paragraph 2.13(a) to (i) above, the Authority considers that Aviva Investors' breaches are of a serious nature.

<u>Extent to which the failings were deliberate or reckless (DEPP 6.5.2G (3))</u>

6.9. The Authority does not consider that the Firm's failings were deliberate or reckless.

The size, financial resources and other circumstances of the Firm (DEPP 6.5.2G (5))

6.10. The Authority has considered Aviva Investors' size and its financial resources. There is no evidence to suggest that it is unable to pay a significant financial penalty.

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

6.11. Aviva Investors profited as a result of its failings, in the form of enhanced performance fees. However, the Authority is satisfied that the adversely Impacted Funds were compensated and the Firm has foregone any financial benefit.

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

6.12. Aviva Investors promptly brought the breaches to the attention of the Authority and has worked in an open and cooperative manner with the Authority, far above and beyond the level expected.

6.13. As outlined in paragraph 6.31a, prompt and comprehensive action was taken to compensate any funds which may have been adversely impacted as a result of the breaches.

6.14. Since identifying the systems and controls failings, Aviva Investors has committed significant resources to remediating the weaknesses in its systems and controls and restructured its business to reduce risks associated with conflicts of interest.

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

6.15. The Authority has taken into account the fact that Aviva Investors has not been the subject of previous disciplinary action.

Other actions taken by the authority (DEPP 6.5.2G (10))

6.16. In determining whether and what financial penalty to impose on Aviva Investors, the Authority has taken into account action taken by the Authority in relation to other authorised persons for comparable behaviour.

Conclusions in relation to the old penalty regime

6.17. Taking the above factors into consideration, the Authority imposes a financial penalty under the old penalty regime of £12,000,000.

6.18. The Authority and Aviva Investors reached agreement at Stage 1 and so a 30% discount applies. Therefore, the penalty for the misconduct under the old penalty regime is £8,400,000.

Financial penalty calculation under the new regime

6.19. All references to DEPP under this heading are to the version of DEPP implemented on 6 March 2010 and currently in force.

6.20. Under the current penalty regime, the Authority applies the five-step framework outlined in DEPP 6.5A to determine the appropriate level of financial penalty.

Step 1: disgorgement

6.21. Pursuant to DEPP 6.5A.1G, at Step 1, the Authority first deprives the firm of the financial benefit derived directly from the breach where it can be quantified practicably. Given that substantial compensation was paid to Aviva Investors' customers, the Authority has not identified any financial benefit that Aviva Investors derived directly from its failings.

6.22. Step 1 is therefore £0.

Step 2: the seriousness of the breach

6.23. 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.

6.24. The Authority considers that in this case revenue is indicative of the harm or potential harm caused by its failings. The Authority considers Aviva Investors' relevant revenue for this period to be £146,143,838.

6.25. In deciding the percentage of the 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 failings; the more serious the breaches, 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%

6.26. In assessing the seriousness level, the Authority takes into account various factors that reflect the impact and nature of the breach and considers whether the firm committed the breach deliberately or recklessly. DEPP 6.5A.2G (11) lists factors likely to be considered Level 4 or Level 5. Of these, the Authority considers the following to be relevant:

a) Serious/systemic weakness: Aviva Investors' failings revealed systemic weaknesses in its management systems and controls in an area of its business;

b) Risk of loss to clients: the failings caused an unacceptable risk of significant loss to Long-Only Funds. A risk which Aviva Investors found had crystallised and may have caused detriment to eight Impacted Funds.

6.27. DEPP 6.5A.2G (12) lists factors likely to be considered 'level 1, 2 or 3 factors'. Of these, the Authority considers that the breach had no effect on the orderliness of, or confidence in, financial markets (in that there is no evidence to suggest that there was any manipulation or wider impact on the markets) and that they were committed negligently rather than intentionally or recklessly.

6.28. Taking these factors into account, the Authority considers the seriousness of the breaches to be Level 4.

6.29. Step 2 is therefore 15% of £146,143,838 which equals £21,921,575.

<u>Step 3: mitigating and aggravating factors</u>

6.30. 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.

6.31. The Authority considers that the following factors mitigate the breach.

a) The Authority recognises that the Firm commenced its compensation exercise promptly, devoted significant resources to it and, in calculating redress, adopted factual assumptions that ensured that appropriate compensation was made.

b) The Authority expects regulated firms and individuals to work with the Authority in an open and cooperative manner at all times. The Authority considers that Aviva Investors' cooperation was exceptional from the point it identified and self-reported the failings and throughout the investigation. Senior management were fully engaged from the start of the investigation, seeking to assist where ever possible, saving the Authority significant time and resource.

6.32. Having taken into account these factors, the Authority has concluded that the Step 2 figure should be decreased by 40%.

6.33. Step 3 is therefore £21,921,576 less 40% equals £13,152,945.

Step 4: adjustment for deterrence

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

6.35. The Authority considers the Step 3 figure of £13,152,945 a sufficient deterrent to Aviva Investors and others and has not increased the penalty at Step 4.

6.36. Step 4 is therefore £13,152,945.

Step 5: settlement discount

6.37. Pursuant to DEPP 6.5A.5G, if the Authority and the firm on whom a penalty is to be imposed agree to the amount of the financial penalty and other terms, DEPP 6.7G 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.

6.38. The Authority and Aviva Investors reached agreement at Stage 1 and so a 30% discount applies to the Step 4 figure.

6.39. Step 5 is therefore £9,207,062.

Conclusion as to the financial penalty

6.40. The Authority imposes a total penalty under both the old and new penalty regimes of £17,607,000 (pre-discount £25,152,900).

7. PROCEDURAL MATTERS

Decision maker

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

7.2. This Final Notice is given under, and in accordance with, section 390 of the Act.

Manner of and time for payment

7.3. The financial penalty must be paid in full by Aviva Investors to the Authority by no later than 10 March 2015, 14 days from the date of the Final Notice.

If the financial penalty is not paid

7.4. If all or any of the financial penalty is outstanding on 11 March 2015, the Authority may recover the outstanding amount as a debt owed by Aviva Investors and due to the Authority.

Publicity

7.5. Sections 391(4), 391(6) and 391(7) of the Act apply to the publication of information about the matter to which this notice relates. Under those provisions, the 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

7.6. For more information concerning this matter generally, contact Laura Dawes (direct line: 020 7066 1994) of the Enforcement and Market Oversight Division of the Authority.

Guy Wilkes

Financial Conduct Authority, Enforcement and Market Oversight Division

ANNEX A

RELEVANT STATUTORY AND REGULATORY PROVISIONS

1 RELEVANT STATUTORY PROVISIONS

1.1 The Authority's operational objectives are set out in section 1B (3) of the Act and include the objectives of securing an appropriate degree of protection for consumers; and protecting and enhancing the integrity of the UK financial system.

1.2 Section 206(1) of the Act provides:

"If the [Authority] considers that an authorised person has contravened a relevant requirement imposed on the person, 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 ("Principles")

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) states that:

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

2.3 Principle 8 (Conflicts of interest) states that:

'*A firm must manage conflicts of interest fairly, both between itself and its customers and between a customer and another client.'*

Conduct of Business ("COBS")

2.4 COBS is the part of the Authority's Handbook which sets out the Authority's requirements in relation to the conduct of designated investment business and connected activities.

2.5 COBS 11.3.2 states that:

'*A firm must satisfy the following conditions when carrying out client orders:*

(1) it must ensure that orders executed on behalf of clients are promptly and accurately recorded and allocated;

(2) it must carry out otherwise comparable orders sequentially and promptly unless the characteristics of the order or prevailing market conditions make this impracticable, or the interests of the client require otherwise; and

(3) it must inform a retail client about any material difficulty relevant to the proper carrying out of orders promptly upon becoming aware of the difficulty.'

2.6 COBS 11.5.2 states that:

'*Immediately after executing a client order, or, in the case of investment firms that transmit orders to another person for execution, immediately after receiving confirmation that an order has been executed, investment firms shall record the following details of the transaction in question:*

(1) the name or other designation of the client;

(2) the details specified in points 2, 3, 4, 6, and in points 16 to 21, of Table 1 of Annex I;

(3) the total price, being the product of the unit price and the quantity;

(4) the nature of the transaction if other than buy or sell;

(5) the natural person who executed the transaction or who is responsible for the execution.'

Decision Procedure and Penalties Manual ("DEPP")

2.7 Chapter 6 of DEPP, which forms part of the Authority's Handbook, sets out the Authority's statement of policy with respect to the imposition and amount of financial penalties under the Act.

The Enforcement Guide

2.8 The Enforcement Guide sets out the Authority's approach to exercising its main enforcement powers under the Act.

2.9 Chapter 7 of the Enforcement Guide sets out the Authority's approach to exercising its power to impose a financial penalty.