FINAL NOTICE

To: **Cheshire Mortgage Corporation Limited**

FSA Reference Number: **305253**

Address: **Lake View**
Lakeside
Cheadle
SK8 3GW

Date: **6 December 2012**

ACTION

1. For the reasons given in this notice, the Financial Services Authority (the "FSA") hereby imposes on Cheshire Mortgage Corporation Limited ("CMCL") a financial penalty of £1.225 million.

2. CMCL agreed to settle at an early stage of the FSA's investigation and therefore qualified for a 30% (stage 1) discount under the FSA's executive settlement procedures. The FSA would have otherwise imposed a financial penalty of £1.75 million on CMCL.

SUMMARY OF REASONS

3. CMCL is a small mortgage lender that operates in niche market sectors, previously including lending to the impaired credit market. CMCL is part of a group of companies (the "Group") and is the only regulated entity in the Group.

4. The FSA has found that during the period 31 October 2004 to 31 December 2009 CMCL could not always demonstrate that it had taken sufficient steps to ensure that all loans were affordable for customers, sometimes treated customers unfairly when they fell into arrears and did not always communicate regularly or accurately with customers.

5. On lending practices, CMCL:

    i. could not always demonstrate that it had taken sufficient steps to ensure that loans were affordable for customers or that all the supporting documentation provided by the customer was always sufficiently evidenced to ensure it was reliable;

    ii. did not always adequately test the plausibility of the information provided by customers applying for self-certified mortgages;

    iii. had Underwriting Guidelines and a Responsible Lending Policy in place but did not always follow them as a senior director of the Group and the CEO would on limited occasions be involved in the underwriting process and, on occasion, waive standard requirements; and

    iv. did not have adequate compliance systems and controls in place to identify the issues raised above and rectify them.

6. On treatment of customers in arrears, CMCL:

    i. operated a bonus system to motivate staff to collect cash from customers in arrears;

ii. did not always take reasonable steps to reach agreement with customers in arrears over payment arrangements or inform them of the range of options available to them;

iii. allowed an incorrect impression that an account of a customer in arrears had been transferred to a third party debt recovery agent when it was referred to a different company within the Group (as opposed to outsourcing the debt recovery), and charged £150 (a fee which would have been charged by an outsourced firm) for this action;

iv. set-up informal payment plans with customers in arrears with, in certain cases, either no assessment or an inadequate assessment of whether they were affordable or sustainable;

v. set-up visits by debt collection agents for which there was a charge and failed to send a letter giving customers the opportunity to cancel the visit and therefore avoid the charges;

vi. failed to carry out any formal calculation to justify the level of their arrears handling charges and to ensure that charges were representative of their administration costs;

vii. failed to ensure that arrears handling charges were always correctly and consistently applied;

viii. did not collect sufficient Management Information to demonstrate that it was treating customers fairly or that would have enabled it to assess whether there was any link between underwriting decisions and customers falling into early arrears; and

ix. failed to communicate regularly or fully with customers in arrears or complainants.

7. In light of the above matters (and as more fully particularised in paragraphs 70 to 76 below), the FSA considers that CMCL has breached Principles 3, 6 and 7 of the Principles for Businesses.

8. CMCL also breached section 59(1) of the Financial Services and Markets Act 2000 by not applying for and obtaining advance approval for an individual who was carrying out a controlled function (namely that of CF1 (Director)). The individual was not approved by the FSA to perform the function of CF1 until more than a year after the appointment.

9. A Skilled Person Report into the regulated mortgage lending and arrears management practices at CMCL dated 8 June 2010 provides support for the FSA's conclusions.

10. The CEO accepts the FSA's findings. The FSA considers that the failings identified in this case have been mitigated to a considerable extent by the Firm's decision from 2008 to make positive wide-ranging changes to the organisational, governance and compliance arrangements at CMCL to achieve high regulatory standards and ensure that customers are treated fairly. Assurance as to the implementation of the improvements made by CMCL was provided in the Skilled Person Follow-up Review dated September 2011. In addition, CMCL business represents a small part (approximately 10%) of the total business of the Group and was the only regulated entity in the Group.

11. The CEO is firmly committed to continuing this process of change; however he has decided, with the support of the Board, within the next three to six months to:

    i. step down from his position as CEO of CMCL (withdrawing his CF3 (CEO) controlled function) thereby giving up his casting vote on the Board; and

    ii. step down from his position as an executive director (withdrawing his CF1 (Director) controlled function) and become a non-executive director (a CF2 (Non-executive director) controlled function).

12. The CEO has not held the controlled function CF8 (Apportionment and Oversight) since March 2009.

DEFINITIONS

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

    i. "Board" means the board of directors of CMCL;

ii. “CEO” means Chief Executive Officer;

iii. “CMCL” means Cheshire Mortgage Corporation Limited;

iv. “Collections Department” means the arrears handling department of CMCL;

v. “Collections Director” means the employee responsible for arrears handling at CMCL and the Group and holding that title;

vi. “Compliance Department” means the department responsible for compliance at CMCL and the Group;

vii. “Compliance Director” means the employee responsible for compliance at CMCL and the Group and holding that title;

viii. “COO” means Chief Operating Officer;

ix. “Counsellors” means field collection agents employed by CMCL to visit customers in arrears;

x. “I&E Form” means income and expenditure assessment form;

xi. “IPP” means informal payment plan;

xii. “Management Information” means information that is collected within the firm and used by senior management to identify areas of concern and to support decision making;

xiii. “MCOB” means the Mortgages and Home Finance: Conduct of Business sourcebook (as in force at the relevant time);

xiv. “Monarch Recoveries” means a debt recovery company within the Group;

xv. the “Act” means the Financial Services and Markets Act 2000;

xvi. the “FSA” means the Financial Services Authority;

xvii. the “Group” means the Group of companies of which CMCL is part;

xviii. the “Principles” means the FSA’s Principles for Businesses;

xix. the “Relevant Period” means the period between 31 October 2004 to 31 December 2009;

xx. the “Skilled Person Report” means the report prepared pursuant to the requirement under section 166 of the Act into the regulated mortgage lending and arrears management practices at CMCL, dated 8 June 2010. The Skilled Person Report includes a review of a sample of 75 arrears handling cases handled between 1 January 2008 and 1 February 2010;

xxi. the "Skilled Person Follow-up Review" means the follow-up review to the section 166 report into the regulated mortgage lending and arrears management practices at CMCL, dated 9 September 2011, and voluntarily undertaken by CMCL;

xxii. the “Skilled Person” means the firm responsible for preparing the Skilled Person Report;

xxiii. the “Tribunal” means the Upper Tribunal (Tax and Chancery Chamber);

xxiv. “Underwriting Department” means the department that is responsible for underwriting at CMCL;

xxv. “Underwriting Director” means the director responsible for underwriting at CMCL and the Group; and

xxvi. “Underwriting Guidelines” means the Underwriting and Processing Guidelines, which incorporate the Responsible Lending Policy.

FACTS AND MATTERS

CMCL Business and Management

14. CMCL was authorised by the FSA on 31 October 2004 to conduct regulated mortgage business. During the Relevant Period, CMCL entered into approximately 3,200 FSA regulated mortgage contracts with a total amount of approximately £226 million.

15. During the Relevant Period, the Board of CMCL consisted of seven members, five of whom held the controlled function of CF1 (Director) and the other two were non-

executives. One of the directors also held approval for CF3 (CEO) and held approval for CF8 (Apportionment and Oversight) between 31 October 2004 and 31 March 2009.

16. Until August 2008, the Board supervised CMCL's activities through a 'matrix' management structure. The operation of the matrix structure involved Board members and the Compliance Director providing input from their respective areas of expertise to different CMCL departments. This meant that while the Board had a collective responsibility for CMCL there were not always formal lines of responsibility.

17. This changed materially in August 2008 after the new Chief Operating Officer ("COO") was brought in to whom, for example, the Collections Director then reported.

CMCL's lending activities

Assessing customers' ability to service mortgages

18. Although the Underwriting Guidelines referred to the affordability model, which involved an assessment of a customer's income and expenditure based on figures the customer provided (as opposed to an income multiple model), when considering an application CMCL underwriting staff did not always assess adequately affordability in that they did not always:

    i. challenge or sufficiently challenge the customer's declared income and foreseeable expenses; and

    ii. assess the sufficiency of supporting documentation to evidence its reliability.

19. The Skilled Person found that in 26 of the 75 reviewed cases handled since 1 January 2008, there was no evidence recorded on the customer's file of a change in a customer's circumstances which had led to that customer falling into arrears. CMCL was not always able to demonstrate that it had taken sufficient steps at the underwriting stage to ensure that the loan was affordable. The Skilled Person concluded that, in some cases, CMCL's failure to take sufficient steps at the

underwriting stage to ensure that the loan was affordable could have been a material factor in causing a customer to fall into arrears.

Self Certified Income

20. During the Relevant Period CMCL also offered mortgages to self employed customers. As part of the application process the customer was required to submit self-certification documents relating to their income and self-employment and sign a declaration confirming the accuracy of their declared income and expenditure. In some instances, the Underwriting Department failed adequately to test the plausibility of the information provided and/or sometimes failed to request the relevant supporting documentation.

21. At quarterly compliance review meetings that took place during the Relevant Period concerns were raised regarding the insufficient documentation and implausible information that was being accepted to support the self-certification applications. As a result of feedback from the FSA in July 2008 following a visit in December 2007, a Self Employment Verification Form was introduced in mid-2008 in which a series of plausibility questions were asked and, following discussion with the customer, it was a requirement that the plausibility rationale was documented.

22. Following a further FSA visit in September 2009, CMCL ceased to offer self-certified loans from October 2009. A requirement for proof of income for self-employed applicants was implemented in October 2009, followed by a suspension of lending to all such applicants in December 2009.

Underwriting Guidelines and the Responsible Lending Policy

23. During the Relevant Period CMCL had in place the Underwriting Guidelines, which had been drafted by the Compliance Department and which incorporated the 'Responsible Lending Policy'. The first policy commenced in October 2004 and a further policy was introduced on 30 July 2007 and updated annually thereafter.

24. The Underwriting Guidelines stipulated that underwriting was under the direction of the Underwriting Director and that regulated mortgages could only be handled by members of the "CMCL team" and, in particular, those who were part of the

"Training and Competency regime". These Underwriting Guidelines were not always followed, however, because the CEO and another director would on limited occasions be involved in the approval process of regulated loan applications. This involvement was not always documented despite advice from the Compliance Director to the Underwriting Director.

25. Where other non-regulated lending parts of the Group (and appointed representatives of CMCL) acted as a broker to CMCL by introducing applications, in some instances, pressure was placed on the Underwriting Department by other individuals from within these companies, to process quickly the approval of applications for which they effectively acted as broker. When the underwriters endeavoured to follow the Underwriting Guidelines, the brokers sometimes challenged the need for the underwriters to make requests for further information or ask further questions of the customer to ensure that the Underwriting Guidelines were met.

Compliance Department

26. During the Relevant Period the Compliance Department conducted quarterly file reviews. The compliance reviews were conducted retrospectively so the applications reviewed had already been approved and funds released. As a consequence, the Compliance Department was unable to assess and respond to potential breaches of the Underwriting Guidelines and the Responsible Lending Policies early enough to prevent or mitigate such a breach.

27. The Underwriting Department occasionally raised concerns directly with a director and the Compliance Department and at monthly arrears meetings regarding certain applications not following appropriate procedure and the information supporting the application not being sufficient or plausible. Neither the director nor the Compliance Department took adequate remedial action.

Arrears Handling

28. CMCL was aware that there were significant issues with its arrears handling from an internal audit report dated March 2008 that graded its arrears handling practices as "unsatisfactory". CMCL recognising that its increasing size warranted a more sophisticated and co-ordinated approach to its operations, had begun a search for a

COO approximately two years prior to his arrival in June 2008. Thereafter, in October 2008, CMCL instigated a Collections Change Programme and in May 2009 undertook a Compliance Monitoring Review of arrears handling. Although changes were made to practices as a result of these initiatives and an FSA visit in September 2009, the Skilled Person in its report dated 8 June 2010 still found that in 62 of the 75 reviewed cases which were handled since 1 January 2008 (namely prior to the changes outlined above), there was at least one instance of a material weakness in the handling of the arrears, which resulted in the customer not being treated fairly at some point in the process.

29. The failings in relation to arrears handling are set out in more detail below.

Collections Department

30. The Collections Director was responsible for the arrears handling within CMCL during the Relevant Period. The historic culture of the Collections Department had been to focus on the quick recovery of arrears.

31. When the MCOB rules were introduced in October 2004, CMCL focused on the impact of these rules on responsible lending and underwriting rather than arrears handling. The Compliance Department failed to conduct a review of the arrears handling process or introduce new policies and processes in this area in order to comply with MCOB. Further, the Compliance Department failed to put in place new processes to deal with the change in regulations.

32. Until August 2008 there was no formal supervisory oversight of CMCL's Collections Department. The Collections Director, who was not a CF1 or attendee at Board meetings, informally reported to various people under the matrix management structure. Her performance was not formally monitored and she consequently felt that she did not have to report to a specific individual on a day to day basis.

Incentives

33. Prior to March 2008 a key performance indicator for the Collections staff was a target of obtaining a payment or an arrangement for a payment from 20 customers a day. This meant that prior to seeking any information regarding the customer's reason for

arrears, or state of their finances, the telephone Collections process included the question "are you able to make a payment immediately?", and, if the customer was able to confirm they could make the payment and authorised the collector to do so, an immediate card payment would be made to reduce or clear the arrears.

34. As arrears were predicted to increase in March 2008, CMCL started to operate a formal bonus system to motivate staff to focus on collecting cash from customers in arrears. The system involved cash targets as well as call targets, which would directly link to their bonus. The bonus was based on a personal cash collected target and an overall department target, adjusted downward if issues were raised during compliance checks on calls. Team managers within the Collections Department were awarded an average of their team's bonus (albeit certain breaches of procedure resulted in no bonus being payable).

35. The FSA acknowledges that CMCL gradually phased out the cash incentive for Collections. From October 2009 all cash collective incentives were removed from the helpdesk and a revised incentive scheme for the Collections Department was introduced in March 2010. As the Skilled Person made additional recommendations about the cash collection element, CMCL further revised the incentive scheme in July 2010, eliminating all links to cash collection.

Communication with customers and reaching agreement over arrears repayment

36. When Collections staff communicated with customers in order to ascertain their financial situation, their questions were not scripted. In addition there was no set list of options that the Collections staff had to make available to customers in arrears. The Collections Director was aware that prior to January 2008 staff did not always discuss or offer customers all of the options available.

37. The Skilled Person found that in 54 out of 75 reviewed cases handled since 1 January 2008, CMCL had failed to make reasonable efforts to reach agreement with the customers over the method of paying arrears.

    i. In 20 cases the collector did not establish the reason for arrears at an early stage.

ii. In 10 cases the collectors did not always demonstrate a flexible, helpful and sympathetic approach to the customer (in 8 cases threats of litigation or bailiffs were used).

iii. In 7 cases the collector failed to take account of information that had previously been established or recorded in the customer records.

iv. In 27 cases potential forbearance options were not considered or discussed with the customer at an appropriate stage in the process.

v. In 19 cases the collector did not make the customer aware of the appropriate sources of independent debt advice, potential entitlement to benefits or government schemes, local authority housing or PPI insurance.

38. These matters resulted in CMCL failing in some instances to ensure that reasonable efforts were made to reach agreement with customers over payment arrangements.

Informal payment plans

39. Prior to January 2010, when a customer wished to set up an informal payment plan ("IPP") CMCL would categorise the plan as either:

i. "green" when the customer could pay 150% of the monthly instalment;

ii. "amber" when a customer could pay between 120-150% of the instalment; or

iii. "red" when a customer said that they could not afford to pay anything up to 120% of the instalment, and would be transferred to the helpdesk where forbearance options should have been discussed with more experienced staff, although this did not always happen.

40. Whilst no formal targets were in place, the aim of the Collections staff was to make all plans "green".

41. If a plan was assessed as being "amber" then staff should have completed an I&E Form to analyse the customer's financial position. The system was, however, initially informal and was dependent on the customer's willingness to complete the form. Further, prior to the introduction of the minimum amounts for essential expenditure in

January 2008, CMCL rarely questioned the arrangements which were suggested by customers and did not verify the information provided by customers (although staff were expected to challenge "unreasonable" amounts there is no evidence that they did so). Prior to the introduction of minimum amounts for essential expenditure, a customer could declare and therefore be assessed as having no, or very little expenditure and thus more income could be assessed as being available to pay arrears. Equally customers might inflate their expenditure to reduce their payments. In addition the customer's I&E Forms were not always retained on their file to be available for comparison with any new information received about the customer.

42. If the plan was assessed as being "red" then the customer should have been referred to the helpdesk, an I&E Form should have been completed and any non-essential or unrealistically high expenditure would be challenged to seek to increase the possible payments that a customer could make.

43. From January 2008 minimum amounts of essential expenditure as set by the British Banking Association would be referred to by Collections staff in reviewing the income and expenditure of customers.

44. The Skilled Person has found that in 26 of the 75 reviewed cases handled since 1 January 2008, a regular payment arrangement or a single promise to pay had been set up under an IPP without CMCL establishing that it was either affordable or sustainable through an assessment of the customer's circumstances. In almost all such instances the IPP failed, and the majority failed without any payment being made.

45. In addition the Skilled Person found that since mid-2009 I&E Forms have been completed by CMCL in most instances where an IPP was agreed (although as stated above in paragraphs 39 to 41, not in cases where the arrangement was for 150% of the monthly instalment). However, in 13 of the 75 reviewed cases, the assessment was not considered adequate.

Monarch Recoveries

46. After a mortgage account had been in arrears for two months it could be transferred to Monarch Recoveries. Monarch Recoveries was the Group's in-house debt recovery company. This was not, however, made clear in correspondence with clients. The fee

that was charged to the account for the transfer from collections to Monarch Recoveries was £150, which figure was benchmarked against competitors who instead used to outsource this business to external agents.

47. It was intended by CMCL that the involvement of an ostensibly separate debt collection agency would encourage the customer to pay. However as the same staff were used to administer both the CMCL and Monarch accounts it was often unclear to the customer whether they had been transferred to Monarch or not.

Field collection agents

48. CMCL also used the services of field collection agents (called "Counsellors" by CMCL) during the Relevant Period. The Skilled Person found that the use of field collection agents in each of the cases reviewed was appropriate, either as a method of providing a face-to-face arrears management service or as part of the process of determining whether litigation action should proceed following a period of non-response from the customer in a worsening arrears situation. However, the Skilled Person considered that the description Counsellor was inappropriate and misleading to customers as this did not reflect the actual service being offered or delivered, and the individuals acting for CMCL were not trained counsellors.

49. Monarch Recoveries charged customers a fee of £110 for the visit of a Counsellor. However, whether the customer was responsive or not, customers were not always advised by letter in advance of the visit that this service was not compulsory and that they had the right to refuse the visit (and thus avoid the fee). Further, given customers were not given the opportunity to arrange a convenient time for the visit, there was a risk that they would not be available when the Counsellor attended and thus the said fee would be incurred.

Calculation of arrears charges

50. During the Relevant Period CMCL had four documents called "*Tariff for Secured Loans*" that detailed the charges that customers would incur when in arrears. In the 2008 and 2009 Tariff documents the charges were explained by reference to the "*administrative cost*" of the respective activity. For the reasons set out in the following paragraphs, this was inaccurate.

51. Prior to 2008 CMCL failed to carry out any formal calculation to justify the level of their charges or analyse what the administration cost was. CMCL merely benchmarked its tariff to those of other high street mortgage lenders and impaired credit lenders. In April 2008 a formal exercise was carried out to review charges but nevertheless CMCL continued to benchmark its charges to that of other lenders.

52. CMCL's Compliance Director was aware from 2004 of the requirement under MCOB only to charge customers a reasonable estimate of the cost of the additional administration required as a result of the customer being in arrears, and that it was not being followed by CMCL. The Compliance Director failed to advise the Board or take action to remedy the failure and said that he did not consider the rule properly as he did not understand its application.

53. It is acknowledged that after the Relevant Period, CMCL implemented a new arrears charges tariff, which has been reviewed and approved by the Skilled Person and reviewed by the FSA.

Application and disclosure of arrears charges

54. In some instances, CMCL arrears charges have been incorrectly and/or inconsistently applied, and not fully disclosed. There were issues with arrears charges in 27 of the 75 cases reviewed by the Skilled Person, in that:

    i. in 13 cases customers appear to have been overcharged;

    ii. in 21 cases there appeared to have been an unfair application of the tariff (for example where insufficient action had been taken to minimise the charges under the account); and

    iii. it was found that although charges were notified to the customer after they had been incurred by sending written statements, collectors were not raising awareness in advance of or whilst the charge was being incurred, (for example during telephone contact, they did not inform the customer that they were being charged both for the telephone call as well as any other activity on their arrears account).

55. Many of these issues were identified as part of the Change Programme and were in the process of being addressed through the development of automated systems within the Relevant Period.

Management Information

56. During the Relevant Period CMCL collected limited Management Information to analyse trends in its business. Various members of the management team would hold monthly meetings to discuss the performance of arrears accounts and, in particular, to review individual accounts. The CEO regularly attended these meetings. These meetings would not, however, analyse the arrears accounts further (for example by looking at account performance by broker). The CEO stated that, as there had historically been low arrears up to 2007, the conclusion of these meetings was that there were insufficient trends to analyse.

57. The Compliance Director failed to have any systems to analyse the data that his department had obtained by way of the quarterly compliance reviews of underwriting files. In addition Management Information was not used to reduce the risk to customers.

58. Due to the fact that up to 2008 I&E forms were completed manually on an ad-hoc basis and were not retained on the customer files, there was no record of the number of I&E forms completed that could be compared against the number of agreed payment plans of customers in arrears. There was also no analysis done of the effectiveness of the I&E assessments against the failure rate of payment plans.

59. A report produced in July 2008 as part of the Change Programme set out various issues with Management Information including "trends in underwriter performance not being monitored post-completion". The report recommended various measures to improve the collection and analysis of Management Information including greater automation of systems, which began to be addressed soon after this report was delivered.

60. However the Skilled Person review in 2010 identified that although these changes bought about some improvement, there was still no formal analysis or documented connection between the front-end underwriting of loans and the subsequent arrears

experience. The Skilled Person also concluded that, whilst information was available, there was:

i. no analysis of trending data or commentary in relation to IPPs and/or visits by field collection agents;
ii. limited quantitative data; and
iii. an absence of a clear link to the six Treating Customers Fairly outcomes (although work was ongoing to put in place a "TCF dashboard" using the six customer outcomes).

Communication with customers

61. The Skilled Person found that in 100% of cases where a customer account had gone into arrears prior to May 2009, CMCL could not evidence that it had provided the customer with information required under MCOB 13.4.1R in relation to the arrears details and advice on mortgage repayments. In addition CMCL's arrears documentation does not set out the additional communication of matters required by MCOB 13 in repossession proceedings (for example, communicating to customers in a prescribed written format that there was a surplus or shortfall from selling the property). CMCL acknowledged this was a historic issue which was corrected in May 2009 when an automated system was introduced.

62. In particular when communicating with customers in arrears, CMCL failed to:

i. provide customers with regular statements of account, which created the risk of customers being unable to challenge or question the administration of their accounts. As a result of this CMCL was in breach of MCOB 13.5.1R;

ii. communicate with customers in arrears in a durable medium on request. As a result of this CMCL was in breach of MCOB 13.4.1 R;

iii. ensure that all inbound communications from customers or their representatives were dealt within a reasonable timescale or at all; and

iv. provide the customers in arrears with the account information required within the appropriate timescale under MCOB 13.4.1 R and MCOB 13.5.1 R.

63. The Skilled Person also found a number of historical failings in relation to communications with complainants including failures to keep the customer informed of progress and to use durable and individually tailored response letters.

64. Between 2004 and 2007 there were no dedicated personnel responsible for complaints at CMCL – instead, the individual business areas would deal with any complaints and the Compliance Director did not consider it was part of his department's remit to take steps to maintain any oversight of responses to complaints.

65. At the time of the Skilled Person review CMCL had already started to enhance its complaints handling policies and procedures.

Holding a controlled function without approval

66. During the Relevant Period, an individual who accepted an appointment as a director of CMCL and commenced working for CMCL in that capacity, was not approved by the FSA to perform the function of CF1 (Director) until more than a year after the appointment.

67. The Compliance Director, who was responsible for ensuring that controlled function holders applied for and obtained FSA approval, confirmed this was as a result of his oversight. CMCL has admitted that it failed to ensure that the individual did not perform a controlled function without the requisite advance approval.

FAILINGS

68. The regulatory provisions relevant to this Final Notice are referred to in Annex A.

69. CMCL has breached Principles 3, 6 and 7 of the FSA's Principles during the Relevant Period as set out below.

Principle 3

70. CMCL breached Principle 3 during the Relevant Period in that it failed to take reasonable care to organise and control its lending activities adequately and effectively, with appropriate risk management systems, by failing to:

i. have procedures in place that required underwriting decisions to be taken by the correct people, but not ensuring that these were followed in every instance;

ii. ensure that the Compliance Department was sufficiently robust to challenge non-compliance with the Underwriting Guidelines, which could have resulted in poor underwriting decisions, and to raise issues with management when they became aware of them;

iii. obtain and review sufficient Management Information to enable it to identify and deal with areas of concern within its underwriting and arrears management processes to ensure the fair treatment of customers in all cases;

iv. record, in all instances, adequate information about customers in arrears. As a result of this CMCL was also in breach of MCOB 13.3.9R; and

v. ensure that one of its directors obtained the FSA's approval to perform the CF1 (Director) controlled function before assuming that role. This is more fully discussed in paragraph 77 below.

71. In addition CMCL failed to have adequate systems and controls to ensure that appropriate and sufficient compliance checks were conducted in relation to the breaches identified in paragraphs 72 to 76 below.

Principle 6

72. CMCL breached Principle 6 during the Relevant Period in that it failed to pay due regard to the interests of its customers and treat them fairly. In particular CMCL failed to:

i. make adequate affordability assessments in all cases by sufficiently challenging the declared financial circumstances of mortgage applicants, thereby failing to mitigate in all instances the potential risk of customers entering into long term loan agreements that they could not afford. As a result of this CMCL was also in breach of MCOB 11.3.1R; and

ii. in some instances deal fairly with customers in arrears, as set out in more detail in paragraphs 73 to 75 below.

73. In relation to charges, CMCL breached Principle 6 as it failed to:

    i. review its fee charging policy prior to 2008 and on occasions inconsistently applied fees from the Tariff of Charges resulting in certain customers being overcharged. As a result of this CMCL was also in breach of MCOB 12.4.1R and MCOB 12.5.1R;

    ii. conduct an appropriate cost-based approach to the calculation of its arrears charges and therefore did not ensure that they were a reasonable estimate of the cost of administering an account in arrears. As a result of this CMCL was also in breach of MCOB 12.4.1R; and

    iii. make it clear to customers that the debt recovery agent which was used by CMCL and for which customers were charged a fee, was not a third party recovery agent but was a Group company. As a result of this CMCL was also in breach of MCOB 12.5.1R.

74. In relation to its field collection agents (i.e. "Counsellors"), CMCL was also in breach of Principle 6 because it failed to inform customers in writing, whether responsive or not:

    i. of their right to refuse a visit from a Counsellor; and

    ii. that a Counsellor had been instructed and/or to notify them of the date and time of the intended visit by the Counsellor.

    CMCL thereby sometimes deprived customers of the opportunity to respond in order to refuse or cancel the visit without incurring a significant charge for the customer if they were unavailable at their homes at the arranged time. As a result of this CMCL was also in breach of MCOB12.5.1R and 13.3.1R.

75. In relation to Collections staff, CMCL was also in breach of Principle 6 because it failed to take reasonable steps to ensure that they:

    i. always had an adequate understanding of and implemented the requirement to treat customers fairly in their arrears activities, for example by applying charges

that did not reflect a reasonable estimate of their administration cost. As a result of this CMCL was also in breach of MCOB 13.3.1R;

ii. always took the opportunity when communicating with customers to inform them that they were being charged both for that communication (for example, the phone-call) and any future activity on their arrears account. As a result of this CMCL was also in breach of MCOB 13.3.1R;

iii. always treated customers fairly notwithstanding that the Collections staff were incentivised to maximise the amount of money collected from customers in arrears (despite the fact that the bonus could be and was reduced for non-compliance issues);

iv. always informed customers of the existence of any applicable Government Schemes or sources of advice to assist borrowers who were having difficulty meeting their mortgage payment(s);

v. always made reasonable efforts to reach agreement with customers over the method of repaying arrears. As a result of this CMCL was also in breach of MCOB 13.3.1R; and

vi. always established at an early stage the reason for the customer entering into arrears.

Principle 7

76. CMCL breached Principle 7 during the Relevant Period in that CMCL did not always pay due regard to the information needs of its customers, or communicate information to them in a way which was clear, fair and not misleading. In particular CMCL:

i. failed to provide customers in arrears with regular annual statements of account, which may have created the risk of customers being unable to challenge or question the administration of their accounts. As a result of this CMCL was also in breach of MCOB 13.5.1R;

ii. misinformed customers in written communications about the basis of the calculation for the Tariff of Charges. As a result of this CMCL was also in breach of MCOB 13.3.1R;

iii. did not always communicate with customers in arrears in a durable medium on request. As a result of this CMCL was also in breach of MCOB 13.4.1R;

iv. did not always ensure that all communications from customers or their representatives were dealt within a reasonable timescale or at all. As a result of this CMCL was also in breach of MCOB 13.4.1R;

v. were not always clear in telephone communications with customers whether the caller was representing CMCL or Monarch Recoveries. As a result of this CMCL was also in breach of MCOB 13.3.1R;

vi. failed to provide the customers in arrears with the account information required within the appropriate timescale under MCOB 13.4.1R and MCOB 13.5.1R; and

vii. did not always communicate with customers and complainants accurately or fully for example by failing to keep the customer informed of progress and not individually tailoring complaint response letters.

Breach of Section 59 of the Act

77. For more than a year CMCL contravened section 59(1) of the Act in that CMCL failed to take reasonable care to ensure that no person performed a controlled function (in this case the CF1 (Director) function) in relation to the carrying on of its regulated activities unless the FSA had approved the performance by that person of the controlled function.

SANCTION

78. The FSA hereby imposes a financial penalty of £1.75 million (reduced to £1.225 million with a 30% discount) on CMCL because of the failings outlined above.

79. The FSA's relevant policy on the imposition of financial penalties as detailed in this Notice is set out in Chapter 6 of the version of the FSA's Decision Procedure and

Penalties Manual ("DEPP") in force prior to 6 March 2010, which formed part of the FSA Handbook during the Relevant Period. All references to DEPP in this section are references to that version of DEPP. In determining the appropriate level of financial penalty the FSA has also had regard to Chapter 7 of its Enforcement Guide.

80. The principal purpose of a financial penalty is to promote high standards of regulatory conduct by deterring authorised firms who have committed breaches from committing further breaches, helping to deter other persons from committing similar breaches and demonstrating generally the benefits of compliant behaviour (DEPP 6.1.2G).

81. The FSA will consider the full circumstances of each case when determining whether or not to take action for a financial penalty. DEPP 6.5.2G sets out, as guidance, a non-exhaustive list of factors that may be of relevance in determining the level of a financial penalty.

82. The FSA considers that a financial penalty would be an appropriate sanction in this case, given the serious nature of the breaches, the risks created for customers of CMCL and the need to send out a strong message of deterrence to others. The FSA considers that the following factors are particularly relevant in this case.

Deterrence

83. The financial penalty will deter CMCL from further breaches of regulatory rules and Principles. In addition it will promote high standards of regulatory conduct by deterring other firms from committing similar breaches and demonstrating generally the benefit of compliant behaviour.

The nature, seriousness and impact of the breach in question

84. In determining the appropriate sanction, the FSA has had regard to the seriousness of the breaches by CMCL, including the nature of the requirements breached, the number and duration of the breaches, the number of customers who have suffered or may suffer financial loss and the fact that the breaches revealed serious failings in CMCL's systems and controls.

85. The FSA considers CMCL's failings to be serious because:

i. the failings persisted over a significant period of time and impacted a substantial number of customers; and

ii. arrears rates in the credit impaired sector are higher than those in the rest of the mortgage market - a number of customers have therefore suffered charges that were excessive or unfair and been put at risk of financial detriment.

The size, financial resources and other circumstances of the firm

86. There is no evidence to suggest that CMCL is unable to pay the financial penalty.

The amount of benefit gained or loss avoided as a result of the breaches

87. The FSA has taken account of the volume of relevant business done and turnover generated by CMCL from the sale of regulated mortgage products in the Relevant Period which amounted to approximately £48.5 million.

88. The FSA has not determined that CMCL deliberately set out to accrue additional profits or avoid a loss through the way it operated its systems and controls and processes.

Conduct following the breaches

89. In deciding upon the appropriate disciplinary sanction, the FSA recognises the following factors which mitigate the seriousness of the failings identified in this case:

i. CMCL has been open and co-operative with the FSA's investigation and has worked with the FSA to ensure early resolution of the matter.

ii. CMCL has accepted the findings of the Skilled Person set out in its report dated 8 June 2010 and has implemented the vast majority of the recommendations of the Skilled Person. Furthermore, it voluntarily arranged for the Skilled Person to carry out a Follow-up Review in order for there to be independent verification of the changes made.

iii. CMCL has committed to ensuring that appropriate redress will be provided to any customers that the Skilled Person identifies may have suffered loss as a

consequence of CMCL's failings. Furthermore, CMCL voluntarily took the decision to offer redress to customers dating back to 2004.

iv. CMCL also made significant improvements to its responsible lending and arrears handling procedures from 2008 onwards. In particular:

a. CMCL took a proactive approach, initiating a wide ranging change programme in 2008 (including underwriting and arrears handling) and a Compliance Monitoring Review in May 2009, prior to a visit by the FSA in September 2009. For example, in March 2008, in the Collections area, CMCL introduced a helpdesk function for customers who were in arrears, offering a number of forbearance options with no charge to customers co-operating and adhering to plans set up by the helpdesk;

b. The Responsible Lending Policy and aspects to the processes for assessing affordability were improved from mid 2008 and included a telephone call to challenge the plausibility of the customer's declared income and expenditure;

c. A range of other changes were introduced following the arrival of the COO, including the automation of systems in May 2009, with the aim of ensuring that customers were provided with the required information automatically;

d. CMCL has implemented further material changes to policies, procedures and systems and controls both following the FSA's visit in September 2009 and as a result of recommendations made by the Skilled Person in June 2010; and

e. CMCL greatly enhanced its corporate governance structure as attested to in the Skilled Person Follow-up Review in September 2011.

Disciplinary record and compliance

90. CMCL has not been the subject of previous disciplinary action by the FSA.

Other action taken by the FSA

91. In determining the level of financial penalty, the FSA has taken into account penalties imposed by the FSA on other authorised persons for similar behaviour.

92. The FSA, having regard to all the circumstances, considers the appropriate level of financial penalty to be £1.75 million before any discount for early settlement.

PROCEDURAL MATTERS

Decision maker

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

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

Manner of and time for Payment

95. The financial penalty must be paid in full by CMCL to the FSA by no later than 20 December 2012, 14 days from the date of the Final Notice.

If the financial penalty is not paid

96. If all or any of the financial penalty is outstanding on 21 December 2012, the FSA may recover the outstanding amount as a debt owed by CMCL and due to the FSA.

Publicity

97. Sections 391(4), 391(6) and 391(7) of the Act apply to the publication of information about the matter to which this notice relates. Under those provisions, the FSA must publish such information about the matter to which this notice relates as the FSA considers appropriate. The information may be published in such manner as the FSA

considers appropriate. However, the FSA may not publish information if such publication would, in the opinion of the FSA, be unfair to you or prejudicial to the interests of consumers.

98. The FSA intends to publish such information about the matter to which this Final Notice relates as it considers appropriate.

FSA contacts

99. For more information concerning this matter generally, contact Kate Tuckley (direct line: 020 7066 7086 /email: kate.tuckley@fsa.gov.uk) of the Enforcement and Financial Crime Division of the FSA.

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Bill Sillett
Head of Department
FSA Enforcement and Financial Crime Division

Annex A

STATUTORY AND REGULATORY PROVISIONS

Statutory provisions

1. The FSA's statutory objectives, set out in section 2(2) of the Act, include the protection of consumers.

2. Section 138 of the Act provides that the FSA may make such rules applying to authorised persons with respect to the carrying on by them of regulated activities as appear to it to be necessary or expedient for the purpose of protecting consumers.

3. 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".

4. The procedures to be followed in relation to the imposition of a financial penalty are set out in section 207 and 208 of the Act.

5. Section 59(1) of the Act provides:

   "An authorised person ('A') must take reasonable care to ensure that no person performs a controlled function under an arrangement entered into by A in relation to the carrying on by A of a regulated activity, unless the Authority approves the performance by that person of the controlled function to which the arrangement relates".

The FSA's policy on the imposition of financial penalties

6. In considering the appropriate sanction, the FSA has had regard to its published guidance. The FSA's policy in relation to the imposition of financial penalties prior to 6 March 2010 was set out in Chapter 6 of the section of the FSA's Handbook entitled the Decision Procedure and Penalties manual ("DEPP"). Until 27 August 2007, it was set out in Chapter 13 of the Enforcement Manual (ENF), to which the FSA has had regard in this case.

7. DEPP 6.1.2G provides that the principal purpose of imposing a financial penalty is to promote high standards of regulatory and/or market conduct by deterring persons who have committed breaches from committing further breaches, helping to deter other persons from committing similar breaches, and demonstrating generally the benefits of compliant behaviour.

   The FSA will consider the full circumstances of each case when determining whether or not to take action for a financial penalty (DEPP 6.2.1G). DEPP 6.2.1G sets out guidance on a non-exhaustive list of factors that may be of relevance in determining whether to take action for a financial penalty, which include the following:-

   - DEPP 6.2.1G(1): The nature, seriousness and impact of the suspected breach, including whether the breach was deliberate or reckless, the duration and frequency of the breach, the amount of any benefit gained or loss avoided as a result of the breach, the loss or risk of loss caused to consumers or other market users, and the nature and extent of any financial crime facilitated, occasioned or otherwise attributable to the breach.
   - DEPP 6.2.1G(2): The conduct of the person after the breach, including how quickly, effectively and completely the person brought the breach to the attention of the FSA, and the degree of co-operation the person showed during the investigation of the breach.
   - DEPP 6.2.1G(5): Action taken by the FSA in previous similar cases.

8. DEPP 6.5.1G(1) provides that the FSA will consider all the relevant circumstances of a case when it determines the level of financial penalty (if any) that is appropriate and in proportion to the breach concerned.

9. DEPP 6.5.2G sets out a non-exhaustive list of factors that may be relevant to determining the appropriate level of financial penalty to be imposed on a person under the Act. The following factors are relevant to this case:

   (1) Deterrence: DEPP 6.5.2G(1)

   When determining the appropriate level of penalty, the FSA will have regard to the principal purpose for which it imposes sanctions, namely to promote high standards

of regulatory and/or market conduct by deterring persons who have committed breaches from committing further breaches and helping to deter other persons from committing similar breaches, as well as demonstrating generally the benefits of compliant business.

(2) The nature, seriousness and impact of the breach in question: DEPP 6.5.2G(2)

The FSA will consider the seriousness of the breach in relation to the nature of the rule, requirement or provision breached. Relevant considerations include the duration and frequency of the breach, the loss or risk of loss caused to consumers, investors or other market users and the nature and extent of any financial crime facilitated, occasioned or otherwise attributable to the breach.

(3) Whether the person on whom the penalty is to be imposed is an individual: DEPP 6.5.2G(4)

When determining the amount of a penalty to be imposed on an individual, the FSA will take into account that individuals will not always have the resources of a body corporate, that enforcement action may have a greater impact on an individual, and further, that it may be possible to achieve effective deterrence by imposing a smaller penalty on an individual than on a body corporate. The FSA will also consider whether the status, position and/or responsibilities of the individual are such as to make a breach committed by the individual more serious and whether the penalty should therefore be set at a higher level.

(4) The size, financial resources and other circumstances of the person on whom the penalty is to be imposed: DEPP 6.5.2G(5)

The FSA may take into account whether there is verifiable evidence of serious financial hardship or financial difficulties if the person were to pay the level of penalty appropriate for the particular breach. The FSA regards these factors as matters to be taken into account in determining the level of a penalty, but not to the extent that there is a direct correlation between those factors and the level of penalty.

The purpose of a penalty is not to render a person insolvent or to threaten the person's solvency. Where this would be a material consideration, the FSA will consider, having regard to all other factors, whether a lower penalty would be

appropriate. This is most likely to be relevant to a person with lower financial resources; but if a person reduces its solvency with the purpose of reducing its ability to pay a financial penalty, for example by transferring assets to third parties, the FSA will take account of those assets when determining the amount of a penalty.

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

The FSA may take into account the conduct of the person in bringing (or failing to bring) quickly, effectively and completely the breach to the FSA's attention, and the degree of co-operation the person showed during the investigation of the breach by the FSA.

(6) Other action taken by the FSA (or a previous regulator): DEPP 6.5.2G(10)

Action that the FSA has taken in relation to similar breaches by other persons may be taken into account. As stated at DEPP 6.5.1G(2), the FSA does not operate a tariff system. However, the FSA will seek to apply a consistent approach to determining the appropriate level of penalty.

Principles for Businesses

10. Under the FSA's rule-making powers the FSA has published in the FSA Handbook the Principles, which apply in whole, or in part, to all authorised firms.

11. The Principles are a general statement of the fundamental obligations of authorised firms under the regulatory system and reflect the FSA's regulatory objectives. An authorised firm may be liable to disciplinary sanction where it is in breach of the Principles.

12. The Principles relevant to this matter are the following.

13. Principle 3 which provides that:

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

14. Principle 6 which provides that:

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

15. Principle 7 which provides that:

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

Conduct of Business

16. The Mortgages and Home Finance: Conduct of Business sourcebook ("MCOB"), which is part of the FSA Handbook, applied to authorised firms with effect from 31 October 2004, although parts of MCOB relating to home purchase plans only came into effect on 6 April 2007.

17. All of the provisions of MCOB set out below apply in relation to regulated mortgage business and were applicable (either in the same or a substantially similar form) throughout the entirety of the Relevant Period.

MCOB 11

18. MCOB 11 sets out rules and guidance in relation to responsible lending. In particular, MCOB 11.3.1R sets out that:

"A firm must be able to show that before deciding to enter into or making a further advance on a regulated mortgage contract, account was taken of the customer's ability to repay" (MCOB 11.3.1R(1)); and

"A mortgage lender must make an adequate record to demonstrate that it has taken account of the customer's ability to repay for each regulated mortgage contract that it enters into…The record must be retained for a year from the date at which the regulated mortgage contract is entered into or the further advance is provided" (MCOB 11.3.1R(2)).

19. MCOB 11.3.5G(1) sets out that in determining the factors to take into account when assessing a customer's ability to repay, a firm should assume that, in the absence of evidence to the contrary, any regular payments will be met from a customer's income, and should therefore take account of the customer's actual or reasonably anticipated income, or both, in reaching a decision on whether to enter into a regulated mortgage contract with that customer.

20. MCOB 11.3.5G(2) sets out that firms should consider the level of both initial and subsequent repayments in considering a customer's ability to repay as well as whether the customer has the ability (and intends) to repay from resources other than income.

MCOB 12

21. MCOB 12.4 sets out the rules on charges which may be levied on a customer who has fallen into arrears on a regulated mortgage contract. In particular, MCOB 12.4.1 states that:

"A firm must ensure that any regulated mortgage contract that it enters into does not impose, and cannot be used to impose, a charge for arrears on a customer except where that charge is a reasonable estimate of the cost of the additional administration required as a result of the customer being in arrears".

22. MCOB 12.5.1R sets out that:

"*A firm must ensure that any regulated mortgage contract, that it enters does not impose and cannot be used to impose, excessive charges upon a customer*."

MCOB 13

23. MCOB 13 sets out rules and guidance relating to arrears and repossessions.

24. In particular, MCOB 13.3.1R sets out that a firm must deal fairly with any customer who is in arrears and put in place (and operate in accordance with) a written policy and procedures for ensuring that it does so.

25. MCOB 13.3.9R , requires that:

"A mortgage lender or administrator must make and retain an adequate record of its dealings with a customer whose account is in arrears or who has a sale shortfall , which will enable the firm to show its compliance with this chapter."

26. MCOB 13.4.1R sets out that a firm must, within 15 business days of becoming aware that a customer has fallen into arrears on a regulated mortgage contract, provide the following in a durable medium:

i. the current FSA information sheet on mortgage arrears;

ii. a list of the due payments either missed or only paid in part;

iii. the total sum of the payment shortfall;

iv. the charges incurred as a result of the payment shortfall;

v. the total outstanding debt, excluding charges that may be added on redemption; and

vi. an indication of the nature (and where possible the level) of charges that the customer is likely to incur unless the payment shortfall is cleared.

27. MCOB 13.5.1R requires that:

"*Where an account is in arrears, and the payment shortfall or sale shortfall is attracting charges, a firm must provide the customer with a regular written statement (at least once a quarter) of the payments due, the actual payment shortfall, the charges incurred and the debt.*"