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**FINAL NOTICE**

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**To: Guardian Assurance plc  
Guardian Linked Life Assurance Limited**

**Of: Ballam Road  
Lytham St Annes  
Lancashire FY8 4JZ**

**Date: 9 January 2006**

**TAKE NOTICE: The Financial Services Authority of 25 The North Colonnade, Canary Wharf, London E14 5HS (“the FSA”) gives you final notice about a requirement to pay a financial penalty:**

**1. THE PENALTY**

1.1 The FSA gave Guardian Assurance plc and Guardian Linked Life Assurance Limited (together referred to hereinafter as “Guardian/the Firm”) a Decision Notice dated 4 January 2006 which notified the Firm that pursuant to section 206 of the Financial Services and Markets Act 2000 (“the Act”) the FSA had decided to impose a financial penalty of £750,000 on the Firm in respect of breaches of:

- (1) FSA rules 1.2.1, 1.2.16 and 1.2.22 in the part of the FSA Handbook entitled: Dispute Resolution: Complaints (“DISP”);
- (2) Principles 2 (Skill, care and diligence) and 6 (Customers’ interests) of the FSA’s Principles for Businesses; and

(3) FSA rule 15.3.1 in the part of the Handbook entitled: Supervision (“SUP”) and Principle 11 (Relations with regulators).

1.2 The Firm has confirmed that it will not be referring the matter to the Financial Services and Markets Tribunal.

1.3 Accordingly, for the reasons set out below, and having agreed with the Firm the facts and matters relied on, the FSA imposes a financial penalty on the Firm in the amount of £750,000.

## **2. REASONS FOR THE ACTION**

2.1 The financial penalty is in respect of breaches of the FSA Rules and Principles identified in paragraph 1.1 that occurred between January 2003 and December 2004 and relate to:

- the introduction in January 2003 of new endowment complaint handling procedures which were not appropriate or effective in terms of ensuring the fair handling and appropriate investigation of Guardian's mortgage endowment complaints;
- Guardian's failure subsequently to identify and remedy timeously systemic problems in the handling of mortgage endowment complaints arising from the new complaint handling procedures; and
- Guardian's failure to notify the FSA about its concerns over the risks and systemic problems associated with the new complaint handling procedures.

2.2 The Firm's failings are viewed by the FSA as being particularly serious for the following reasons.

(1) The purchase of a house is, for many people, the most significant financial transaction of their lives. Consumers whose endowment mortgage complaints were rejected inappropriately were exposed to the risk that they would not receive compensation to which they were entitled.

(2) The failings in Guardian's mortgage endowment complaints handling continued over a two year period and were systemic in nature. Guardian was aware in advance that the changes to its complaint handling process would be likely to reduce, very significantly, the proportion of complaints which it upheld. In the event, following the introduction of the new procedures in January 2003, the Firm's uphold rate fell to an overall figure of 22.6% in the first half of 2003, as compared to an overall rate in the second half of 2002 of 71%. There was also a significant increase from April 2003 onwards in the proportion of the decisions to reject complaints which were overturned by the

Financial Ombudsman Service ('the FOS'), rising to an overturn rate in excess of 80% during 2004.

- (3) Guardian had ongoing concerns about risks and systemic problems associated with its new complaints handling process, but it did not bring these concerns to the attention of its FSA supervisors. Instead, the matter only came to the FSA's attention during a thematic visit in November and December 2004.
- (4) Guardian sold 233,341 mortgage endowments between 1988 and 1995, when it ceased marketing such policies. The size of Guardian's mortgage endowment book meant that the Firm's failings exposed a large number of consumers to financial loss. The total number of customer complaints rejected in the period of breach was in the region of 5,600. In practice, the risk of actual loss will be limited to those customers whose complaints have been wrongly rejected.
- (5) The failings occurred at a time when there was a high level of awareness within the financial services industry of the importance of handling mortgage endowment complaints properly. This was emphasised in the letter John Tiner, then a Managing Director of the FSA, wrote in April 2002 to chief executives of mortgage endowment product providers ('the Tiner Letter') setting out the FSA's concerns about mortgage endowment complaint handling.

2.3 While the failings in this case merit a significant financial penalty, the FSA recognises that these failings have been mitigated by Guardian, in particular for the reasons below.

- (1) Guardian has shown a willingness to identify and remedy any consumer loss which may have resulted from inappropriate complaint handling decisions, and it has given the FSA an assurance that those consumers will be appropriately compensated. The Firm has put forward a voluntary proposal to review certain rejected complaints, in connection with which it has already put significant resources into a pilot review of nearly five hundred complaints originally decided under the process in place during 2003/4. The Firm's report on the outcome of the pilot demonstrated an understanding of its complaint handling obligations and a strong commitment to meeting its obligations to treat customers fairly.
- (2) The Firm will put significant resources into the next stage of the review, which will cover, inter alia, most complaints rejected during the period from January 2003 to December 2004. It has agreed that the review will be overseen by an independent firm of accountants, and has given the FSA an assurance that the costs arising from the review will not be charged to Guardian policyholders. By virtue of the co-operation with the FSA displayed by Guardian and the remedial action being taken, actual consumer detriment to customers should be minimised.

- (3) Guardian has co-operated fully and proactively with the FSA's investigation. The Firm has moved quickly to agree the facts of the case, which has ensured the prompt and efficient resolution of the matter, and the Firm has received credit for settlement of the disciplinary case at an early stage.
- (4) While the Firm did not, in the FSA's view, react swiftly or robustly enough to the significant reduction in its complaint uphold rate from January 2003, the FSA has taken into account that Guardian initiated a high level review of the new process by a firm of management consultants later in 2003, and that the Firm started to address defects in its complaint handling process from March 2004 (though not adequately in the FSA's view).

2.4 Without this level of co-operation and other mitigating factors, the financial penalty would have been substantially higher.

### **3. RELEVANT STATUTORY PROVISIONS AND REGULATORY REQUIREMENTS**

3.1 Section 206 of the Act provides:

*“If the Authority considers that an authorised person has contravened a requirement imposed on him by or under this Act, it may impose on him a penalty, in respect of the contravention, of such amount as it considers appropriate”.*

#### **Complaint handling**

- 3.2 FSA rule DISP 1.2.1 provides that a firm must have in place and operate effective internal complaint handling procedures.
- 3.3 FSA rule DISP 1.2.16 provides that a firm's internal complaint handling procedures must make provision, inter alia, for responses to complaints to address adequately the subject matter of the complaint.
- 3.4 FSA rule DISP 1.2.22 provides that a firm must put in place appropriate management controls and take reasonable steps to ensure that it handles complaints fairly, consistently and promptly and that it identifies and remedies any recurring or systemic problems as well as any specific problem identified by a complaint.

#### **Notification requirement**

- 3.5 FSA rule SUP 15.3.1 provides that a firm must notify the FSA immediately it becomes aware, or has information which reasonably suggests that, inter alia, the following circumstances have occurred, may have occurred or may occur in the foreseeable future:

- any matter which could have a significant adverse impact on the firm's reputation; and
- any matter which could affect the firm's ability to continue to provide adequate services to its customers and which could result in serious detriment to a customer of the firm.

### **FSA's Principles for Businesses**

- 3.6 FSA Principle 2 provides that a firm must conduct its business with due skill, care and diligence.
- 3.7 FSA Principle 6 provides that a firm must pay due regard to the interests of its customers and treat them fairly.
- 3.8 FSA Principle 11 provides that a firm must deal with its regulators in an open and cooperative way, and must disclose to the FSA appropriately anything relating to the firm of which the FSA would reasonably expect notice.

## **4. FACTS AND MATTERS RELIED ON**

### **The Firm - background**

- 4.1 Guardian was regulated by the Life Assurance and Unit Trust Regulatory Organisation ("LAUTRO") from 29 April 1988 to 7 May 1995 and, thereafter, by the Personal Investment Authority ("PIA") until 1 December 2001, when the FSA took over responsibility for its regulation.
- 4.2 Guardian sold 233,341 mortgage endowment policies between 1988, when regulation commenced under the Financial Services Act 1986, and 1995 when it ceased marketing such policies. Guardian has effectively operated as a closed book since 1999, when it was acquired by AEGON UK plc ('Aegon').
- 4.3 Since January 2000, Guardian's mortgage endowment complaint handling has been carried out on its behalf by a service company within the Guardian Group. The complaint handling is undertaken by the Business Review Unit ("the BRU") in the service company, which is based in Lytham St Annes in Lancashire.
- 4.4 Guardian was directly involved in the monitoring of the work of the BRU and development of the complaint handling processes used by the unit on its behalf to investigate complaints made against it.

### **Regulatory context**

- 4.5 Guardian's failings should be placed in their regulatory context, namely that the failings occurred at a time when there was a high level of awareness within the

industry of the issues surrounding mortgage endowment sales and associated concerns regarding the handling of complaints regarding mortgage endowment sales.

- 4.6 The FSA publicly stated in December 1999 that an industry-wide review of mortgage endowment sales along the lines of the Pensions Review would be disproportionate and in October 2000 that the appropriate mechanism for delivering redress in relation to mis-sales of mortgage endowments was through the complaints handling processes of firms. The October 2000 statement was contained in the FSA's "Progress Report on Mortgage Endowments" which confirmed that the existing complaints handling process, in conjunction with the issue and promotion of factsheets, was viewed by the FSA as the most effective way of ensuring redress for those consumers who had lost out as a result of mis-selling and that there were no grounds for a blanket industry-wide review.
- 4.7 The FSA's factsheet "Endowment Mortgage Complaints" was also released in October 2000. It explained that the customer may have incurred no loss at that date, but that if a mortgage endowment holder had any complaint, this should be taken up with the firm which sold him the endowment. The factsheet outlined how to take a case to the FOS if the firm's response was unsatisfactory. It included information about how consumers could seek compensation if they felt they were in any way misled at the point of sale and may have lost out financially as a result. This factsheet was updated at regular intervals and was included in the reprojected letters that firms were required to send out to all mortgage endowment holders.
- 4.8 The importance of mortgage endowment complaint handling processes was highlighted again in November 2000, via PIA Regulatory Update 80, and again in July 2001, via PIA Regulatory Update 91.

#### **The "Tiner Letter" of 4 April 2002**

- 4.9 On 4 April 2002, the Tiner Letter was sent to all major firms who acted as product providers or financial advisers in relation to mortgage endowment policies. This letter set out the FSA's concerns about the way in which complaints about mortgage endowments were being dealt with. Most notably, its purpose was to accentuate the importance of fair handling of complaints. Firms were asked to respond to the letter and to review and, if necessary, to revise their complaints-handling procedures in the light of the concerns expressed.
- 4.10 The Tiner Letter included an annex which listed nine specific action points for firms wanting to avoid unfairness in respect of their handling of mortgage endowment complaints ("the Tiner Points") which advised firms to:
  - recognise in the assessment of the complaint that the key risk for the consumer is that the endowment may not repay the mortgage loan ("TP1");
  - avoid too narrow a view of the scope of the advisory duty in the context of

mortgage advice (“TP2”);

- recognise that oral evidence can be good and sufficient evidence, avoiding too ready a dismissal of evidence from the consumer which is not supported by documentary proof (“TP3”);
- investigate the issue diligently, in particular so as to take into account the selling practices at the time, the training, instruction, sales scripts and incentives given to advisers at the time and the track record of the particular adviser (“TP4”);
- go the extra mile to clarify ambiguous issues or conflicts of evidence before finding against the consumer (“TP5”);
- avoid making a conclusive assumption that a pre-existing endowment held at time of sale, whether for purposes of savings or mortgage repayment, is sufficient evidence of understanding and acceptance of the key risk (“TP6”);
- avoid making too literal and narrow an interpretation of the issue of the complaint as expressed by the consumer (“TP7”);
- avoid rejecting complaints solely on the basis that the consumer signed a proposal form or failed to exercise the cancellation right and so must have presumed to have been satisfied with the advice and the product at time of sale (“TP8”); and
- avoid claiming as evidence of a risk warning at time of sale (so as to justify rejection of the complaint) either: the absence of a statement in product literature that repayment of the mortgage was guaranteed; or a statement in product particulars that the firm will monitor the plan and advise the consumer if the level of contribution is insufficient for the target amount to be repaid (“TP9”).

4.11 Firms were asked to respond to the Tiner Letter and to review and, if necessary, revise their complaints handling process in the light of the concerns expressed. Guardian's response to the letter explained how it complied with the Tiner Points.

### **Mortgage Endowment Complaint Handling**

#### ***(a) Complaint numbers***

4.12 In the period from 1 April 2000 to 31 December 2004, Guardian received a total of 19,774 mortgage endowments complaints.

4.13 In the 12 months to June 2002, Guardian received an average of 270 new mortgage endowment complaints per month, and in the period July 2002 to September 2002, a monthly average of 285 new complaints. From October 2002, Guardian experienced a sudden increase in the volume of its mortgage endowment complaints, averaging 771

per month in the six months to March 2003. The rate fell back to 491 per month in the 12 months to April 2004.

- 4.14 The total number of complaints received between 1 January 2003 and 31 March 2004 was 7,675. The total between 1 April 2004 and 31 December 2004 was 3,893.

**(b) Changes to the process for handling complaints and complaint uphold rates**

***2001/2002 complaint handling process***

- 4.15 Between May 2001 and December 2002, the approach taken to Guardian's complaint handling was to follow the decision trees and assessment templates produced by the FOS. Central to this approach was to ask the customer, as part of the Endowment Mortgage Questionnaire ("EMQ") which was issued to all complainants, to indicate their Attitude to Risk ("ATR") using a scale of 1 to 10, from Cautious to Adventurous. In September 2002, Guardian amended the EMQ by replacing the single ATR question with a series of questions designed to determine more accurately what the complainant's ATR was at the point of sale.
- 4.16 The overall uphold rates during the period were 59% during the second half of 2001, 65% during the first half of 2002, and 71% during the second half of 2002.

***2003 complaint handling process***

- 4.17 In about the middle of 2002, Guardian agreed to the development of new procedures for handling its mortgage endowment complaints. A document produced in August 2002 dealing with reserves for the costs of complaints arising from Guardian's unit linked mortgage endowments, known as 'Homebuilder' contracts, stated in a section headed 'Revised Complaint Process' as follows:

*'The very high upheld rate on Post FSA cases led to a review of the procedure for assessing whether to uphold a complaint or not. ....*

*The main reason that the cases were being upheld was with respect to 'attitude to risk'. At the meeting it was concluded that we had drifted too far in the complainants favour and our upheld rate was becoming out of line with the market.*

*It was therefore concluded that it was appropriate to use the following as evidence that the risk of a mortgage had been explained to the policyholder*

*Fact Find          Discussion of repayment versus mortgage endowment*

*Illustration        Deficit shown on Basis 1  
                          Clearly states not guaranteed*

*Customer care mailing          Revised illustrations issued on policies taken*



.....'

Under a section of the document headed 'Anticipated Post FSA Upheld Rate' reference was made to an expected future uphold rate of 37.5%.

- 4.18 Also by late 2002, Guardian was becoming increasingly concerned about the rising cost of complaint handling in terms of the time taken to make decisions and staff resources, especially in light of the significant increase in the volume of complaints it was receiving from October 2002 onwards. This also, therefore, became one of the motivating factors for what was termed the 'streamlining' of the process. The new complaint handling process was piloted in January 2003 and introduced to all complaint handlers from 31 January 2003. The core principle of the new complaint handling process was that a complaint could be rejected if there was evidence (as outlined in paragraphs 4.27 and 4.28) that the customer understood and accepted the risk that their mortgage endowment policy was not guaranteed to repay the sum assured without increases in premiums. In the event, the overall uphold rate during the first half of 2003 was 22.6% and 45.3% during the second half of the year.
- 4.19 In the Autumn of 2003, Guardian initiated a high level review of the new process by a firm of management consultants. In December 2003, the external firm reported to Guardian the outcome of the review noting, amongst other matters, that all aspects of complaints were not being investigated, that decision letters contained assumptions based on generic information and that inappropriate evidence was being used to reject complaints. The management consultants concluded that the new complaint handling process:
- “... may not measure well in isolation against FSA’s broader approach as expressed in the Tiner letter. Guardian should aim to develop an audit trail that more clearly demonstrates that case conclusions have been reached following a diligent, balanced and comprehensive review of all the salient facts and circumstances surrounding the sale”.*

***Procedures from March 2004***

- 4.20 In March 2004, Guardian introduced adjustments to the 2003 complaint handling process, while retaining the core principle of establishing whether the customer understood and accepted the risk. The main change at this time was the introduction of a stage under which a complainant would be sent an initial rejection letter and invited to provide any additional information or evidence.
- 4.21 The complaint handling process was adjusted further in August 2004, with the introduction of a new stage under which complaints were upheld at an earlier stage in the investigative process where there was insufficient documentary evidence on the file to support the sale of the endowment policy, i.e. where there was insufficient evidence to show that the advice in question was not negligent. During Q3 2004, the

average uphold rate increased to 61%.

**(c) FOS overturn rates**

- 4.22 A customer whose mortgage endowment complaint is refused has a right to refer the matter to the FOS. The FOS may overturn a firm's decision to reject a complaint and require it to pay compensation to the customer. During the second half of 2002, FOS overturned 31.5% of the Guardian cases that had been referred to it following a decision to reject. However, Guardian's FOS overturn rate was 50% during the period March to June 2003, and 54% during the period July to October 2003. During the second half of 2004, the overturn rate exceeded 80%.

**(d) Discovery of the current issues**

- 4.23 In October and November 2004, the FSA's Retail Firms Division ('RFD') carried out a supervision visit to the BRU, the purpose of which was to review Guardian's complaints handling. On 25<sup>th</sup> February 2005, RFD wrote to Guardian outlining a number of concerns. A referral was subsequently made to the FSA's Enforcement Division ("Enforcement").

**(e) Remedial action**

- 4.24 Following the commencement of Enforcement's investigation, Guardian put forward a voluntary proposal to review the majority of the complaints that had been previously rejected during the period January 2003 to March 2004 under the complaint handling process introduced in January 2003. The Firm completed a pilot review of five hundred complaints in September 2005, and its report on the pilot included the following finding in respect of the complaint handling process in place between January 2003 and March 2004.

*"...the approach to complaint handling in the period under review (1 January 2003 to 31 March 2004) led to a high proportion of decisions which, when judged against Guardian's current standards, were incorrect".*

The report noted that in 69.8% of 431 cases previously rejected under the 2003 process, the application of Guardian's current standard of complaint handling resulted in a decision to uphold the complaint. The report also contained a conclusion that the complaint handling process introduced in 2003 was the primary cause of the decline in the uphold rate experienced during the relevant period, and not errors by individual complaint handlers. As part of the pilot, a review was also carried out of a sample of 33 cases which were rejected during the period March and December 2004. The Firm's report on the pilot stated that 63.6% of these rejections were overturned when the Firm's current procedures were applied.

**Breaches**

- 4.25 As specified below, in the period from 1 January 2003 to 31 December 2004 (“the relevant period”), Guardian breached regulatory rules and principles in relation to its handling of mortgage endowment complaints received from customers.

***DISP Rules 1.2.1, 1.2.16 and 1.2.22***

- 4.26 As a result of the matters set out in paragraphs 4.27 to 4.39, Guardian breached, during the relevant period DISP Rule 1.2.1, DISP Rule 1.2.16 and DISP Rule 1.2.22 in respect of the handling of its mortgage endowment complaints.

**Defects in the complaint handling process**

***(a) 2003 process (in effect January 2003 to March 2004)***

***Reliance on fact finds and illustrations***

- 4.27 Under the new complaint handling process, and with the exception of cases involving certain specified categories of customer<sup>1</sup>, complaint handlers were directed to reject a complaint that the policy had been mis-sold if the sale was *'supported by a "satisfactory" Fact Find and Illustration'*. The process indicated that a fact find or illustration should be treated as 'satisfactory' if, for example, there was evidence in the fact find that repayment versus endowment had been discussed and/or the illustration showed a shortfall on maturity at the lowest assumed rate of return or clearly stated that the illustrated maturity value was not guaranteed.
- 4.28 In following this process, complaint handlers were not expressly required to take into account the actual terms of the complaint (e.g. *'...the sales adviser assured me that this policy was guaranteed to pay off my mortgage at the end of the term and provide a cash lump sum'*). Nor were they obliged to consider other evidence that the original sale may not have been suitable in all the circumstances. They could therefore reject complaints purely on the basis of a 'satisfactory' fact find and illustration, without obtaining any other evidence such as a report from the sales adviser and/or more information using a version of the Endowment Mortgage Questionnaire ('EMQ') recommended by FOS.
- 4.29 This approach conflicted with TP5 of the Tiner letter of April 2002 in that complaint handlers were not required to seek to clarify ambiguous issues or conflicts of evidence before finding against a customer.

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<sup>1</sup> Single customers with no dependents, customers whose endowment policies will extend into retirement, and customers exercising their right to buy a council property.

### ***Endowment Mortgage Questionnaires and sales advisers' reports***

- 4.30 In following the 2003 process, if the fact find and illustration did not contain sufficient evidence to reject a complaint, the complaint handlers would seek a report from the sales adviser and a completed EMQ from the complainant.
- 4.31 However, the procedures did not advise the complaint handler to refrain from relying, in support of a decision to reject a complaint, on 'generic responses' from sales advisers along the lines, for example, that they would have followed the sales and training guidelines in place at the time and would therefore have explained the risks associated with Guardian's endowment policies. Indeed, complaint handlers included in their decision letters (for rejected cases only) a standard paragraph containing a general assumption to that effect, implying that the handlers were allowed under the procedures to rely on such evidence. There were a number of inherent weaknesses in the approach of relying on such a general assumption for the following reasons.
- (i) It was not necessarily supported by prima facie evidence.
  - (ii) Relevant original sales aids, training materials and general marketing material used by sales advisers were not routinely taken into consideration under the complaint handling process, and as a result it was inappropriate to make such an assumption.
  - (iii) Some, although not all, of the contemporaneous sales and marketing material designed for the sales advisers' use strongly implied that Guardian's mortgage endowment policies (with the applicable premium review feature) were guaranteed to repay a mortgage. Accordingly, it was not a safe assumption in principle that customer representatives would have explained risks properly.

This approach occurred despite the fact that in July 2002, in response to the Tiner letter, Guardian had, amongst other matters, assured the FSA that it would exercise caution when making standard assumptions about what was likely to have been said by sales advisers to customers at the point of sale.

### ***Non responders***

- 4.32 Under the 2003 complaint handling process, complaint handlers were required unless the documentation showed a missale to reject complaints where an EMQ had been requested but not returned by the complainant. This meant that a complaint handler could reject a complaint without making a proper assessment of all the evidence already available to them. This approach to non responders inappropriately restricted the ability of a complaint handler to consider all aspects of a complaint before reaching a view and was inconsistent with TP 5.

### ***Adviser complaint history***

- 4.33 The procedures failed to instruct complaint handlers to consider the sales adviser's complaint history, even though such evidence may have assisted the complaint handler in deciding which version of events was likely to be the most credible.

***Conclusion***

- 4.34 The overall effect of the new process was that complaints could be rejected on the basis of limited evidence, and through reliance on generic sales advisers' reports and without proper consideration of the specific allegations made by the customer (or of the overall suitability of the sale). The FSA considers that the conclusion that the procedures were defective and had the potential to result in the rejection of complaints that would otherwise have been upheld under an appropriate complaint handling process is supported by:

- the significant reduction in the complaint uphold rate in 2003, as compared to the 2002 complaint uphold rates (see paragraphs 4.16 and 4.18);
- the significant increase in the proportion of FOS overturns from April 2003 onwards (see paragraph 4.22);
- the findings of the external consultant, as set out in their report of December 2003 referred to in paragraph 4.19;
- Guardian's own report on the outcome of its pilot review of rejected complaints in which it overturned 69.8% of the 431 cases within the sample population which had originally been rejected under the process in place between January 2003 and March 2004 (see paragraph 4.24).

***(b) The complaint handling process from March 2004***

- 4.35 Despite the adjustments made, as outlined in paragraphs 4.20 to 4.21, to the 2003 process in March 2004, and on an incremental basis over the following months, significant deficiencies remained in the procedures when in November 2004 the FSA visited the Firm. The key defects were as follows:

***(1) Consideration of suitability and specific allegations:***

As described in paragraph 4.20 some adjustments to the 2003 process were introduced in March 2004. This included the addition of a stage whereby the client was contacted to request further information that might support a re-evaluation of an initial decision to reject a complaint. However, the examples referred to in the procedures of 'satisfactory fact finds and illustrations' remained unchanged. Further, the procedures contained no clear guidance regarding wider suitability issues or the need to pay proper attention to specific or strong allegations. The FSA recognises, however, that the process was further improved in August 2004 through the introduction of a fast track process whereby a handler could make an offer if they considered the fact find or illustration did not support the original sale.

(2) *Use of sales adviser reports:*

Despite the external consultant's recommendations on this point, no further guidance was added in relation to the weight to be placed on general comments in sales adviser reports. The procedures were therefore seriously flawed in this respect, as described in paragraph 4.31 above.

(3) *Non-responders:*

The approach to non-responders described in paragraph 4.32 effectively remained unchanged. It was not until June 2005 that Guardian finally stopped its practice in this regard.

4.36 The FSA considers that the fact that these deficiencies had the potential to result in the rejection of complaints that would otherwise have been upheld under an appropriate complaint handling process is supported by the following.

- (1) Although the complaint uphold rate increased during 2004 it remained well below the 2002 complaint uphold rate (see paragraphs 4.16 and 4.21).
- (2) The continuing very significant proportion of cases that were overturned by FOS during 2004.
- (3) Guardian's own review of 33 complaints previously rejected during the period after March 2004 in which it overturned 63.6% of these decisions when the Firm's current procedures were applied.

*Failure to remedy the deficiencies promptly*

4.37 During the pilot stage of the new complaint handling process in January 2003, Guardian found, as predicted, that there was a significant reduction in the complaint uphold rate. Also in January 2003, Guardian received internal advice that the core principle of the process was out of step with the rest of the industry. Guardian was therefore aware very early on of the impact on customers of the introduction of the new complaint handling process. It recognised that there were some inherent risks in continuing with the process, but it decided to continue to use the new procedures “*unless there is incontrovertible evidence that they are wrong or a regulatory directive forces us to reconsider*”. Despite the low uphold rate over the following months and the increase in the FOS uphold rate, Guardian decided to continue using the process. Guardian initiated a high level review of the new process by an external compliance consultant in about August 2003. However, having received in December 2003 the consultant's report, Guardian concluded, inappropriately in the FSA’s view, that the management consultants had agreed the principles of the 2003 complaint handling process.

4.38 In March 2004, Guardian introduced changes to the complaint handling process aimed

at ensuring that there was fair handling and adequate investigation of mortgage endowment complaints. However, as described above, the procedures continued to suffer from significant failings.

- 4.39 For the reasons set out above, the FSA considers that Guardian did not act promptly or adequately to address the defects in the new complaint handling process until the FSA's thematic visit towards the end of 2004.

***Breaches of FSA Principles 2 and 6***

- 4.40 The extent and seriousness of Guardian's failings, as set out above, in connection with its handling of mortgage endowment complaints together with its failure to remedy adequately the problems before the intervention of the FSA, indicate that Guardian also failed to meet the regulatory standards required of it by the FSA Principles.
- 4.41 The seriousness of Guardian's failings are further demonstrated by the fact that they occurred during a period when there was a high level of industry awareness of the importance of fair and adequate complaint handling. Despite a number of specific measures aimed at raising standards in the area of complaint handling and which highlighted regulatory expectations, Guardian failed to ensure that it handled its mortgage endowment complaints consistently and fairly.
- 4.42 In addition, the failings occurred after Guardian received the detailed guidance set out in the Tiner Letter.
- 4.43 Before the new complaint handling process was introduced, Guardian knew that it would be capable of resulting in a much lower rate of complaints upheld, and that it would therefore be likely to produce significant savings in terms of administration costs and the amount of compensation payable. As described in paragraph 4.37, Guardian: found during the pilot stage of the new complaint handling process in January 2003, as predicted, that there was a significant reduction in the complaint uphold rate; received internal advice in January 2003 that the core principle of the process was out of step with the rest of the industry; and recognised that there were some inherent risks in continuing with the process. Nevertheless, it decided to continue to use the process.
- 4.44. Accordingly, by virtue of the failings identified above, it appears to the FSA that Guardian breached the following regulatory principles during the relevant period:
- In breach of FSA Principle 2, Guardian failed to conduct its business with due skill, care and diligence in relation to the handling of mortgage endowment complaints.
  - In breach of FSA Principle 6, Guardian did not, in relation to its handling of mortgage endowment complaints, pay due regard to the interests of its customers and treat them fairly.

### ***Breaches of Principle 11 and SUP 15.3.1***

- 4.45 As Guardian was aware at the beginning of 2003 that the new complaint handling process carried certain risks, that a large proportion of complaints were being rejected, and that the core principle of the process was out of step with the industry, it should have drawn these matters to the FSA's attention in January 2003.
- 4.46 Over the following months, Guardian had ongoing concerns about the new process against the background of the continuing low uphold rate and increase in the FOS overturn rates. Later in the year this concern caused them to appoint an external consultant whose findings indicated that changes to the process should be made. However, Guardian did not notify the FSA of these matters before the FSA's thematic visit in late 2004.
- 4.47 By virtue of the above matters, Guardian breached FSA Principle 11 and SUP 15.3.1 in that it failed to notify the FSA of its concerns over the risks and systemic problems associated with the new complaint handling procedures.

## **5. RELEVANT GUIDANCE ON PENALTY**

- 5.1 The principal purpose of a financial penalty is to promote high standards of regulatory conduct by deterring firms who have breached regulatory requirements from committing further contraventions, helping to deter other firms from committing contraventions and demonstrating generally to firms the benefits of compliant behaviour.
- 5.2 The FSA's policy on the imposition of financial penalties is set out in Chapter 13 of the Enforcement Manual ("ENF 13") which forms part of the FSA Handbook. Paragraph 13.3 of the Enforcement Manual sets out a non-exhaustive list of factors of particular relevance in determining the appropriate level of financial penalty.
- 5.3 The FSA considers all the relevant circumstances of the case in determining the level of financial penalty (if any) that is appropriate and proportionate in relation to the contravention in question. The FSA considers the following facts to be of particular relevance in this case.

### **Enf 13.3.3(1) - The seriousness of the misconduct or contravention**

- 5.4 The level of the financial penalty should be proportionate to the nature and seriousness of the contraventions. For the reasons detailed below, the FSA considers that the rule breaches identified in this notice are of a serious nature.
- (1) The failings in complaint handling related to mortgage endowments – investment policies used by customers to repay their mortgage loan at maturity. Customers whose endowment mortgage complaints were rejected



inappropriately were exposed to the risk that they would not receive compensation to which they were entitled.

- (2) The failings in mortgage endowment complaints handling continued over a two year period and were systemic in nature. Guardian was aware in advance that the changes to the handling process would be likely to reduce, very significantly, the complaint uphold rate.
- (3) The failings exposed a large number of customers to the risk of financial loss.
- (4) The failings occurred at a time when there was a high level of industry awareness about the importance of proper mortgage endowment complaint handling.
- (5) Guardian had ongoing concerns about risks associated with its new complaints handling process, but failed to notify the FSA about these concerns.

**Enf 13.3.3(2) – The extent to which the contravention or misconduct was deliberate or reckless**

- 5.5 The FSA does not consider that Guardian intentionally breached FSA's rules and Principles. However there is evidence indicating that Guardian was aware of, and understood, the risks associated with the new complaint handling processes but decided to proceed with them nevertheless.

**Enf 13.3.3(3) – The size, financial resources and other circumstances of the firm**

- 5.6 The FSA has no reason to believe that Guardian will be unable to pay the proposed penalty.

**Enf 13.3.3(4) – The amount of profits accrued or loss avoided**

- 5.7 The Firm could potentially have benefited as a result of the contravention because it owned a proportion of a with profits fund from which compensation to endowment holders was being paid. The FSA also considers that one of the Firm's motivations in introducing the flawed complaints handling procedures in 2003 was to cut costs.

**Enf 13.3.3(5) – Conduct following the contravention**

- 5.8 Following its referral to Enforcement the Firm has fully cooperated with the FSA's investigation and been proactive in taking remedial steps to identify and compensate those consumers who suffered a loss as a result of the inappropriate procedures. The Firm has also taken steps to ensure that similar problems cannot arise in the future by means of amending and improving its current complaint handling procedures on an ongoing basis.

**Enf 13.3.3(6) – Disciplinary record and compliance history**

5.9 Guardian has no previous disciplinary record.

**Enf 13.3.3(7) – Previous action taken by the FSA**

5.10 The FSA seeks to ensure consistency when it determines the appropriate level of penalty. The outcome of disciplinary actions taken against other firms for similar misconduct is a relevant factor. Accordingly the FSA has taken into account the penalties levied by the FSA against Friends Provident Life and Pensions Ltd, Allied Dunbar Assurance Plc and Abbey National Plc in relation to their failures in the handling of mortgage endowment complaints.

**6. DECISION MAKER**

6.1 The decision which gave rise to the obligation to give this Final Notice was made by Executive Settlement Decision Makers on behalf of the FSA.

**7. IMPORTANT**

7.1 This Final Notice is given to Guardian in accordance with section 390 of the Act.

**Manner of and time for payment**

7.2 The financial penalty must be paid in full by the Firm to the FSA by no later than 25 January 2006, being not less than 14 days beginning with the date on which the Final Notice is deemed served on you.

**If the financial penalty is not paid**

7.3 If all or any of the financial penalty is outstanding on 26 January 2006, the FSA may recover the outstanding amount as a debt owed by the Firm and due to the FSA.

**Publicity**

7.4 Sections 391(4), 391(6) and 391(7) of the Act apply to the publication of information about the matter to which this notice relates. Under those provisions, the FSA must publish such information about the matter to which this notice relates as the FSA considers appropriate. The information may be published in such manner as the FSA considers appropriate. However, the FSA may not publish information if such publication would, in the opinion of the FSA, be unfair to you or prejudicial to the interests of consumers.

7.5 The FSA intends to publish such information about the matter to which this Final

Notice relates as it considers appropriate.

**FSA contacts**

- 7.6 For more information concerning this matter generally, you should contact Richard Brady (tel: 020 7066 1242) or Chris Walmsley (tel: 020 7066 5894) of the Enforcement Division of the FSA.

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**Georgina Philippou**  
FSA Enforcement Division