
FINAL NOTICE

To: **Richard Hayes**

Of: **Hadenglen House
Smisby Road
Ashby de la Zouch
Leicestershire
LE65 2UG**

Date: **6 September 2007**

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.

THE PENALTY

1. The FSA gave Richard Hayes (Mr Hayes) a Decision Notice on 3 September 2007 which notified Mr Hayes that pursuant to section 66 of the Financial Services and Markets Act 2000 (FSMA), the FSA had decided to impose a financial penalty of £49,000 on Mr Hayes. This penalty is in respect of breaches of Principles 6 and 7 of the Statement of Principles for Approved Persons, issued under section 64 of FSMA, and for being knowingly concerned in the failure of a firm to comply with FSA requirements between 31 October 2004 and 15 June 2007 (the relevant period).
2. Mr Hayes confirmed on 31 August 2007 that he will not be referring the matter to the Financial Services and Markets Tribunal.
3. Accordingly, for the reasons set out below and having agreed with Mr Hayes the facts and matters relied on, the FSA imposes a financial penalty on him in the amount of £49,000.
4. Mr Hayes agreed to settle this matter at an early stage of the proceedings and therefore qualified for a 30% reduction in penalty, pursuant to the FSA's executive settlement procedures. Were it not for this discount the FSA would have sought to impose a financial penalty of £70,000 on Mr Hayes.

REASONS FOR THE ACTION

5. The FSA has imposed a financial penalty on Mr Hayes for breaches of Principles 6 and 7 of the FSA's Statements of Principles for Approved Persons (the Principles), in Mr Hayes' capacity as Controlled Function 1 (Director), Controlled Function 3 (Chief Executive) and Controlled Function 8 (Apportionment and Oversight), at Hadenglen Home Finance plc (Hadenglen), during the relevant period. These breaches, which are described in more detail in paragraphs 22-38 below, relate to Mr Hayes' failure:
 - a) to exercise due skill, care and diligence in managing the business of Hadenglen for which Mr Hayes was responsible; and
 - b) to take reasonable steps to ensure that the business practises of Hadenglen, for which Mr Hayes was responsible, complied with the relevant requirements and standards of the regulatory system.
6. The FSA views Mr Hayes' conduct as serious, because his actions exposed approximately 1,900 customers who were sold PPI, and 2,000 customers who were sold re-mortgages to an unacceptably high risk of being sold re-mortgage products and PPI which were unsuitable for their needs and therefore to the risk of financial loss. His failings in respect of PPI continued despite the fact that he was put on notice of the FSA's concerns regarding sales of PPI in a Dear CEO letter on 4 November 2005. His failings in respect of re-mortgages continued until June 2007 despite the FSA communicating its concerns to him prior to and during the enforcement investigation.
7. The FSA has also issued a Final Notice against Hadenglen for failings in relation to the sale and monitoring of re-mortgages and PPI. The primary responsibility for ensuring that Hadenglen's systems and controls were appropriate for its business and for ensuring that Hadenglen complied with its regulatory requirements belonged to Mr Hayes. The following failings have been identified:
 - a) Mr Hayes designed and implemented Hadenglen's sales strategy for re-mortgages. He did so without regard to, or seeking to mitigate, the risk that the strategy would result in customers incurring a significant early redemption charge (ERC) and other charges, including a fee payable to Hadenglen, when re-mortgaging might not be suitable;
 - b) Mr Hayes did not ensure that the sales process for PPI was adequate to ensure that customers would not be sold products which were unsuitable. From January 2005 to June 2006 Hadenglen did not check the suitability of its sales of PPI. Thereafter, Hadenglen performed a check which did not consider all the relevant criteria necessary to ensure the suitability of the product recommended;
 - c) Mr Hayes delegated responsibility for compliance with FSA requirements to individuals within Hadenglen but failed to exercise a sufficient degree of oversight to ensure that those individuals performed their tasks with the necessary competence or knowledge;

- d) Mr Hayes failed to require adequate reports from those to whom he had delegated his compliance management responsibilities. This meant that he was unable properly to oversee Hadenglen's business. For example, he was unaware that 45% of claims made by Hadenglen's customers had been rejected by the product provider;
 - e) Mr Hayes failed to take reasonable steps to oversee, through the Compliance department, Hadenglen's compliance with FSA requirements; and
 - f) despite investing in the training and competence function, Mr Hayes failed to take reasonable steps to ensure Hadenglen's staff were aware of the need for compliance with FSA requirements, by failing to implement adequate training and competency testing of sales advisers.
8. Mr Hayes' failings therefore merit the imposition of a financial penalty. In deciding upon the level of disciplinary sanction, the FSA recognises the following measures taken by Mr Hayes which have served to mitigate the seriousness of the failings:
- a) following the FSA's visit in October 2006, Mr Hayes understood the seriousness of the issues and implemented a comprehensive review of all its systems and controls and retained external consultants to advise on that process. This has led to significant and ongoing changes being adopted on all areas of the firm's business including training, compliance, management information and sales processes. These changes were effected in consultation with Hadenglen's external advisers and monitored by the FSA.
 - b) delegating Mr Hayes' responsibility for oversight of the Compliance function to another appropriate director;
 - c) engaging independent consultants to review new sales of PPI and re-mortgages and, following discussions with the FSA, implementing a remedial action plan for past sales which involves a customer contact exercise and compensation where appropriate; and
 - d) co-operating with the enforcement action and agreeing the facts quickly to ensure efficient resolution of the matter. Accordingly, he has received credit for settlement at an early stage. Without this level of co-operation the financial penalty would have been higher.

BACKGROUND

The firm

9. Mr Hayes formed Hadenglen in April 1997. Initially, Mr Hayes ran Hadenglen as a sole trader but, as the business expanded, he hired increasing numbers of sales advisers. Hadenglen has been authorised by the FSA since 31 October 2004 to advise on and arrange regulated mortgage contracts. Since 14 January 2005, Hadenglen has also held permissions for advising on and arranging non investment insurance contracts. During the relevant period Hadenglen had between 12 and 20 advisers.

The products sold

10. Mr Hayes' business plan for Hadenglen concentrated on advising and arranging mortgage contracts for local authority tenants who want to purchase their property under the "Right to Buy" scheme. Hadenglen also advises on re-mortgages, largely for its existing right to buy clients. Following the successful purchase of the property, Hadenglen contacts its customers to discuss transferring the debt to a new mortgage. This can be with a different mortgage provider and is usually on different terms and conditions. Customers pay a fee to Hadenglen of typically £1,995 for advice in relation to the re-mortgage.
11. Hadenglen's customer base for re-mortgages is typically "sub-prime". Sub-prime mortgages are generally sold to customers with low or impaired credit ratings who may find it difficult to obtain finance from traditional sources. In addition to mortgages and re-mortgages Hadenglen conducts secured loan business. Secured loans are not regulated by the FSA.
12. Hadenglen also offers PPI to its customers to protect repayment of a mortgage, re-mortgage or secured loan in the event of accident, sickness or involuntary unemployment. Hadenglen sells predominantly single premium PPI policies, typically with a term of five years. The cost of PPI is added to the cost of the mortgage and incurs interest during the term of the mortgage. The PPI premium and interest is typically between 2 and 4% of the total mortgage debt.

RELEVANT STATUTORY AND HANDBOOK PROVISIONS

13. Section 66 of FSMA provides:

- (1) *The Authority may take action against a person under this section if –*
 - (a) *it appears to the Authority that he is guilty of misconduct; and*
 - (b) *the Authority is satisfied that it is appropriate in the circumstances to take action against him.*
- (2) *A person is guilty of misconduct if, while an approved person –*
 - (a) *He has failed to comply with a statement of principle issued under section 64...*
- (3) *If the Authority is entitled to take action under this section against a person, it may –*
 - (a) *impose a penalty on him of such amount as it considers appropriate...*

14. The Statements of Principle for Approved Persons, issued under section 64 of FSMA, are contained in the part of the FSA Handbook entitled APER, in particular Principles 6 and 7.

15. In determining whether Mr Hayes' conduct amounts to a breach of a Statement of Principle, the FSA has had regard to the guidance and examples in APER 4.6 and APER 4.7, in particular, 4.6.3E, 4.6.4E(3), 4.6.5E, 4.6.6E, 4.6.7E(2), 4.6.8E and 4.7.3E.
16. When exercising its powers, the FSA seeks to act in a way it considers most appropriate for the purpose of meeting its regulatory objectives, which are set out in section 2(2) of FSMA. The FSA considers that imposing a financial penalty of £49,000 on Mr Hayes meets the regulatory objectives of consumer protection and market confidence.
17. In deciding to take this action, the FSA has had regard to the guidance set out in section 6.2.1G and sections 6.2.4G to 6.2.9G of the FSA's Decision Procedure and Penalties manual (DEPP), which is part of the FSA's Handbook. DEPP 6.2.1G states that the FSA will consider the full circumstances of each case and that the criteria listed are not exhaustive. In particular, DEPP 6.2.4G states that the FSA will only take disciplinary action against an approved person where there is evidence of personal culpability on his part, which arises from his behaviour and, amongst others, the standard of behaviour fell below that which would be reasonable in all the circumstances.
18. The FSA has also had regard to its Enforcement Guide (EG), in particular, EG 2.2(2)G states that the FSA will seek to exercise its enforcement power in a manner that is transparent, proportionate and consistent with its publicly stated policies.
19. Having regard to the matters set out in paragraph 7 above, the FSA considers it proportionate and appropriate in all the circumstances to take disciplinary action against Mr Hayes.

BREACHES OF THE FSA'S STATEMENTS OF PRINCIPLE AND CODE OF PRACTICE FOR APPROVED PERSONS (APER)

Principle 6

20. Principle 6 of APER provides that:

An approved person performing a significant influence function must exercise due skill, care and diligence in managing the business of the firm for which he is responsible in his controlled function.

Facts and matters relied on

21. By reason of the facts and matters detailed in paragraphs 22 to 30 below, the FSA has found that Mr Hayes contravened Principle 6 of APER by failing to exercise due skill, care and diligence in managing the business of Hadenglen, for which he was primarily responsible. These failures relate to the sale of re-mortgages and PPI. In determining whether Mr Hayes' conduct amounts to a breach of Principle 6 of APER, the FSA has had regard to the guidance and examples in APER 4.6 in particular, 4.6.3E, 4.6.4E(3), 4.6.5E, 4.6.6E and 4.6.7E(2).

Re-mortgage sales

22. Historically, Hadenglen's primary source of revenue was income generated from advising on and arranging new mortgages. Between 2003-2005, Mr Hayes realised that this revenue stream was decreasing. This was due to changes in the discounts available and longer qualification periods for council tenants wishing to buy their homes reducing demand for new right to buy mortgages. In order to maintain Hadenglen's revenue streams and in an effort to retain existing customers, Mr Hayes therefore decided to place greater emphasis on utilising Hadenglen's existing customer database to generate re-mortgage business. At the beginning of the relevant period approximately 90% of re-mortgage sales were made to existing customers.
23. Mr Hayes introduced a formal diary system to maximise the opportunity of securing new re-mortgage business and to mitigate the risk that customers may be approached by Hadenglen's competitors to effect a re-mortgage. This strategy required Hadenglen's sales advisers to contact their existing sub-prime mortgage customers ten months after completion of their initial mortgage. In designing and implementing this strategy Mr Hayes failed to give consideration to the fact that, on the mortgages typically sold by Hadenglen, an ERC of between 5-6% of the value of the mortgage was imposed by the lender if the mortgage was redeemed in the first three years of the mortgage term.
24. The risks arising from the implementation of this strategy meant that Mr Hayes needed to ensure that Hadenglen had in place appropriate systems and controls to ensure that any recommendation to re-mortgage took account of those risks. For example, customer files often indicated that a customer wanted to re-mortgage in order to raise additional capital. In such cases it was important that the customer was made aware of the total cost of re-mortgaging relative to the additional capital that could be raised. It was therefore important that Mr Hayes exercised due skill, care and diligence to put in place systems and controls, including appropriate monitoring, to ensure that advisers had the training necessary to be able to explain the cost of securing that additional capital to the customer and took account of this cost prior to making their recommendation. Mr Hayes failed to do so and this failure put customers at an unacceptable risk of financial loss.
25. In the files sampled by the FSA, the total charges for re-mortgaging, as a proportion of the funds raised, were significant and included a typical ERC of 5-6% of the value of the existing mortgage and a fee to Hadenglen of £1,995. In some cases the combined costs incurred by the customer in re-mortgaging were significantly greater than the capital raised but the file did not record an adequate reason why the re-mortgage was recommended despite the significant costs to the customer. The FSA could not therefore determine that these sales were suitable on the basis of the information recorded on the file. Mr Hayes' failure to put in place systems and controls to ensure that the total cost of the re-mortgage was considered by Hadenglen's advisers before making the recommendation meant that such sales were able to proceed without ensuring that they were in the best interests of the customers concerned.

PPI Sales

26. Similarly, the sales process that Mr Hayes established was inadequate to ensure that the PPI recommendations made by Hadenglen's sales advisers were suitable for customers. In particular, Mr Hayes failed to put in place appropriate procedures to collect sufficient

information about a customer's personal circumstances. For example, there were no processes in place to collect details of existing insurances. This failing arose due to Mr Hayes' assumption that Hadenglen's customers were unlikely to have any relevant existing cover or other resources available to cover their mortgage repayments in the event of accident, sickness or unemployment. This assumption did not have any factual basis. Mr Hayes' failings in establishing and maintaining the sales process meant that there was an unacceptable risk that PPI would be sold to customers when it was not suitable. The FSA set out its concerns on PPI in a Dear CEO letter, sent to him on 4 November 2005. There is no evidence that he paid regard to the content of the letter.

Senior management arrangements

27. Mr Hayes failed to give adequate consideration to the delegation of duties at Hadenglen and the delegation was not formally documented. In particular, he did not adequately consider and, therefore, clearly delegate responsibility for ensuring Hadenglen's advice was suitable. As a result, Mr Hayes was insufficiently aware of what procedures Hadenglen had in place to ensure that sales were suitable. Mr Hayes also failed to ensure that there were adequate procedures outlining when issues should be escalated and who they should be escalated to. For example, where Compliance and an adviser disagreed about whether a recommendation was suitable, there were no clear procedures for how the issue should be escalated and resolved.
28. Mr Hayes did not take reasonable steps to inform himself of the requirements of the FSA's Approved Persons regime and especially the regulatory requirements applicable to Hadenglen. In particular, Mr Hayes was unaware of the significant influence function roles that he held and the responsibilities that came with them. The FSA considers that these deficiencies in his knowledge are indicative of his failure to take reasonable steps to ensure that the business of Hadenglen complied with the FSA's requirements.
29. Mr Hayes delegated responsibility for Compliance to individuals but then failed adequately to oversee those individuals to ensure they were able to perform their tasks appropriately. This was particularly important due to the lack of experience within the Compliance function. Mr Hayes himself had only a limited knowledge of the compliance requirements for re-mortgages and PPI. As a consequence, he allowed Compliance a large degree of autonomy. This resulted in Hadenglen having inadequate compliance monitoring arrangements and controls in respect of sales of re-mortgages and PPI. Hadenglen was therefore unable properly to assess the suitability of its sales of re-mortgages and PPI.
30. Mr Hayes aggravated this failing by failing to provide adequate oversight of Compliance. He was insufficiently aware of which individuals and processes within Hadenglen had responsibility for ensuring that recommendations were suitable. This meant that Mr Hayes was unable to challenge and review the adequacy of the Compliance function.

Principle 7

31. Principle 7 of APER provides that:

An approved person performing a significant influence function must take reasonable steps to ensure that the business of the firm for which he is responsible in his

controlled function complies with the relevant requirements and standards of the regulatory system.

Facts and matters relied on

32. By reason of the facts and matters detailed in paragraphs 33-38 below the FSA has found that Mr Hayes has contravened Principle 7 of APER by failing to take reasonable steps to ensure that Hadenglen's business, for which he was responsible, complied with the relevant requirements and standards of the regulatory system. These failures relate to the sales of re-mortgages and PPI. In determining whether or not Mr Hayes' conduct amounts to a breach of Principle 7 of APER, the FSA has had regard to the guidance and examples in APER 4.7, in particular 4.7.3E.

Compliance arrangements

33. Mr Hayes did not give proper consideration to the full scope of Hadenglen's regulated activities and failed to ensure that all regulated activities fell within the remit of the compliance function or an alternative appropriate system and control. Mr Hayes oversight failings (set out in paragraph 29) meant that relevant sales of PPI products to protect secured loans were not checked until June 2006 to determine that they were appropriate for a client's demands and needs.

34. Mr Hayes' failure to provide adequate oversight of the Compliance function meant that he was unable properly to assess the effectiveness of the Compliance function and, as a result, he was unaware of the risk that customers might receive advice that was unsuitable. This meant that he was unaware whether, in relation to the advice provided to any of Hadenglen's customers, remedial action was necessary.

Management information

35. Mr Hayes did not arrange to receive sufficient management information to enable him effectively to manage the regulatory risks that Hadenglen faced. He failed to give consideration to the need to obtain key performance indicators (KPIs) such as cancellation and claims information for PPI policies. This would have helped him monitor the quality of advice given by advisers. For example, Mr Hayes was unaware that 45% of claims made by Hadenglen's customers had been rejected by the product provider. This was insufficient and ineffective in enabling him to identify the systemic failings in the sales of re-mortgages and PPI.

36. Mr Hayes also took a disproportionate amount of comfort from the management information he did receive. For example, Hadenglen received a relatively low level of complaints, which Mr Hayes assumed meant that the advice being provided by its advisers was suitable. This was an erroneous assumption and meant that, essentially, Mr Hayes was content to reply upon customers to identify instances of unsuitable sales, rather than to take active steps to identify the risk of such instances himself.

Training and competence

37. Mr Hayes failed to ensure that appropriate training and competence (T&C) arrangements were implemented throughout the relevant period. Staff competency was assessed at the

recruitment stage but there were insufficient KPIs collected and no regular reviews of staff to assess their competency. Mr Hayes did not therefore take adequate steps to ensure that Hadenglen's staff remained competent.

38. Further, in respect of PPI products sold with secured loans there was no training provided to staff until June 2006, after a visit by the FSA. The failure to recognise that training was required on these products amounted to recklessness.

RELEVANT GUIDANCE ON PENALTY

Determining the level of the financial penalty

39. The FSA's policy in relation to the imposition of financial penalties is set out in Chapter 6 of the Decision Procedure and Penalties Manual (DEPP) which forms part of the FSA Handbook. Paragraph 6.5.2G of DEPP sets out the factors that may be of particular relevance in determining the appropriate level of financial penalty for an approved person or a firm. Paragraph 6.5.1(1)G states that the criteria listed in DEPP 6.5.2G are not exhaustive and all relevant circumstances of the case will be taken into consideration.
40. DEPP 6.1.2G states that the principal purpose of the imposition of a financial penalty is to promote high standards of regulatory 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.
41. In deciding to take the action, the FSA has considered the seriousness of the misconduct, the nature of the requirements breached and the number and duration of the breaches as stated in DEPP 6.5.2(2)G. The breaches occurred over a protracted period of 32 months.
42. The FSA has considered the extent to which Mr Hayes actions were reckless or deliberate as set out in DEPP 6.5.2(3)G. The FSA has concluded that the contraventions by Mr Hayes were not deliberate. However, the FSA considers that the decision to introduce the sales strategy described in paragraph 23 was made by Mr Hayes alone, without appropriate systems and controls in place to mitigate the risks that the sales process presented. In this regard it amounted to reckless misconduct. Mr Hayes' actions were below the standard of behaviour that could reasonably be expected of an approved person in that, despite knowing that re-mortgaging at the time dictated by the sales strategy would result in customers incurring significant ERC charges, he decided to implement the strategy in any event.
43. Mr Hayes failed to ensure that re-mortgages were only allowed to be completed when the benefits of re-mortgaging outweighed the costs. Mr Hayes did not apportion responsibility for considering this to anyone else within the business.
44. Mr Hayes' failings created a risk for Hadenglen's customers that they would be advised to re-mortgage and significantly to increase the sums of money secured on their homes when it was not evident that it was suitable for them to do so. This was particularly significant given that Hadenglen's customers typically had impaired credit ratings and limited choices in the market.

45. Mr Hayes has held a significant shareholding in Hadenglen throughout the relevant period, and has therefore profited from sales of PPI and re-mortgages. The FSA has no reason to consider that Mr Hayes is unable to pay the financial penalty.
46. The FSA has had regard to the fact that the remedial action to which Hadenglen has committed will ensure that customers receive appropriate compensation, and to Mr Hayes' overall financial circumstances.

Mitigation

47. Mr Hayes has engaged an independent consultant to review and assist in the implementation of changes to Hadenglen's compliance arrangements and systems, sales processes, training and competence and its TCF procedures. The independent consultant's reports were provided to the FSA and demonstrated that Hadenglen has improved its systems and controls. The independent consultant is continuing to work with Hadenglen to test how its revised systems and controls operate in practice.
48. Mr Hayes has also committed Hadenglen to a remedial action plan. The plan involves contacting customers and where appropriate paying compensation.
49. Mr Hayes has co-operated fully with the FSA and agreed the facts quickly ensuring efficient resolution of the matter. By agreeing the facts with the FSA, he has admitted his misconduct and allayed the FSA's immediate concern that he might pose an ongoing risk to consumers. This has given the FSA sufficient comfort to conclude that the appropriate sanction for him is the imposition of a financial penalty rather than the imposition of a form of prohibition. He has not previously been the subject of disciplinary action by the FSA.

CONCLUSION

50. Having regard to the seriousness of the breaches and the risk they posed to the FSA's statutory objectives of maintaining confidence in the financial system and securing the appropriate degree of protection for consumers, the FSA has imposed a financial penalty of £49,000 on Mr Hayes.

DECISION MAKERS

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

IMPORTANT

52. This Final Notice is given to Mr Hayes in accordance with section 390 of FSMA.

Manner of and time for payment

53. The financial penalty must be paid in full by Mr Hayes to the FSA by no later than 16 October 2007, 40 days from the date of the Final Notice.

If the financial penalty is not paid

54. If all or any of the financial penalty is outstanding on 17 October 2007, the FSA may recover the outstanding amount as a debt owed by Mr Hayes and due to the FSA.

Publicity

55. Sections 391(4), 391(6) and 391(7) of FSMA apply to the publication of information about the matter to which this Final 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.

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

FSA contacts

57. For more information concerning this matter generally, you should contact Catherine Harris of the Enforcement Division of the FSA (direct line: 020 7066 4872/ fax: 020 7066 4873).

William Amos
Head of Retail 1
FSA Enforcement Division