

*THIS FINAL NOTICE WAS ORIGINALLY ISSUED IN AUGUST 2009.*

*THE FINDINGS IN THIS FINAL NOTICE HAVE BEEN CONSIDERED IN SUBSEQUENT PROCEEDINGS CONCERNING MR CHRISTOPHER OLLERENSHAW AND MR THOMAS REEH BEFORE THE UPPER TRIBUNAL (TAX AND CHANCERY CHAMBER) ("THE TRIBUNAL"). THE FINDINGS CONTAINED HEREIN, PARTICULARLY THOSE RELATING TO THE FILE REVIEW (SEE PARAGRAPHS 4.37 – 4.39), REPRESENT THE FSA'S FINDINGS IN AUGUST 2009, RATHER THAN THOSE OF THE TRIBUNAL.*

*FOR MORE INFORMATION SEE THE TRIBUNAL'S DECISION IN OLLERENSHAW & REEH v FSA(FS/2010/0026 & FS/2010/0028) AT:*

[www.tribunals.gov.uk/financeandtax/Decisions.htm#fs](http://www.tribunals.gov.uk/financeandtax/Decisions.htm#fs)

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## FINAL NOTICE

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To: Black and White Group Limited (in liquidation)  
Of: c/o Begbies Traynor, The Old Barn, Caverswall Park, Caverswall  
Lane, Stoke on Trent, Staffordshire ST3 6HP  
Date: 18 August 2009

**TAKE NOTICE:** The Financial Services Authority of 25 The North Colonnade, Canary Wharf, London E14 5HS ("the FSA") gives you final notice that it has decided to take the following action:

### **1. THE PENALTY**

- 1.1. The FSA gave the Black and White Group Ltd ("Black and White") a Decision Notice on 27 July 2009 that for the reasons listed below, the FSA has decided that it will publish a public censure in relation to Black and White for breaches of Principles 6, 9, 4, and 11 of the Principles for Businesses, pursuant to section 205 of the Financial Services and Markets Act 2000 ("the Act").

- 1.2. The FSA decided to publish a public censure in relation to Black and White for breaches of the Principles in connection with cultural and other failings between September 2006 and November 2007 (“the Relevant Period”). These failings meant that Black and White failed to treat customers fairly when advising and arranging the sale of regulated mortgage contracts and associated Payment Protection Insurance (“PPI”). Black and White also failed to provide all relevant material information to the FSA regarding its financial position and, from at least December 2006, failed to maintain adequate financial resources.
- 1.3. Had these matters been known to the FSA while Black and White was conducting regulated business, the FSA would have given serious consideration to removing Black and White’s regulatory permissions. The serious nature of the breaches identified in this Notice would have led the FSA to impose a financial penalty of £2.2 million were it not for the fact that the Black and White is in liquidation.
- 1.4. Black and White confirmed on 17 July 2009 that it will not be referring the matter to the Financial Services and Markets Tribunal.
- 1.5. Accordingly, for the reasons set out below and having agreed with Black and White the facts and matters relied on, the FSA has decided that it will publish a public censure in relation to Black and White.

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

- 2.1. The breaches of the Principles outlined below relate to a number of serious failings by Black and White which meant that it failed to treat customers fairly when advising on and arranging residential mortgage and associated PPI contracts during the Relevant Period. During this period, Black and White’s conduct fell below the standards expected under the regulatory system. In particular, the following failings in respect of Black and White’s dealings with customers were identified:
  - (1) a culture that focussed on maximising income by actively placing sales advisers under significant pressure to meet sales targets without regard to the risk that this would result in customers not being treated fairly in breach of Principle 6;
  - (2) a remuneration and incentive structure that was designed to incentivise and motivate sales advisers to sell products that were profitable for Black and White with no regard to whether those products were suitable for customers in breach of Principle 6;
  - (3) an assumptive approach to the sale of PPI, in particular, an assumption that single premium PPI would be suitable for all customers without regard to individual customers’ demands and needs, in breach of Principle 6; and
  - (4) systems and controls that created an unacceptably high risk of misselling and were inadequate to ensure the suitability of its

recommendations and the advice it gave to customers. The FSA's file review of Black and White's mortgage files shows a failure to demonstrate affordability and, in choice of lender, suitability in breach of Principle 9.

- 2.2. These failings resulted in an unacceptably high risk of unsuitable sales and customers not being treated fairly.
- 2.3. Black and White's failings are particularly serious in view of the fact that a substantial number of Black and White's customers were sub-prime in that they had impaired credit histories, restricted access to credit and limited financial means. The financial impact on such customers of unsuitable advice was likely to be significant. This was particularly true in relation to mortgages, the most important financial transaction customers would be likely to commit to in their lives. Black and White's failure to pay due regard to customer's interests and to take reasonable steps to ensure that the recommendations were suitable, exposed customers to the risk of significant financial detriment.
- 2.4. In addition, Black and White was in breach of its capital resources requirement during 2007 in breach of Principle 4.
- 2.5. The firm failed to report its financial position accurately to the FSA for seven months during 2007. This failure prevented the FSA from being able to assess properly Black and White's ability to meet its capital adequacy requirements. Even after Black and White had been alerted to its true financial position by its auditors, it failed to provide all relevant material information to the FSA in breach of Principle 11.

### **3. RELEVANT STATUTORY PROVISIONS, GUIDANCE AND FSA PUBLISHED MATERIALS**

- 3.1. The FSA's statutory objectives are set out in section 2(2) of FSMA. The relevant objective for the purpose of this case is the protection of customers.

#### **Provisions of the Act**

- 3.2. Section 138 of FSMA provides that the FSA may make such rules applying to authorised persons as appear to be necessary or expedient for the purpose of protecting the interests of consumers.
- 3.3. Section 205 of FSMA provides:

*"If the Authority considers that an authorised person has contravened a requirement imposed on him by or under this Act, the Authority may publish a statement to that effect."*

#### **The Principles**

- 3.4. The Principles, as set out in the FSA's Handbook, are general statements of the fundamental obligations of firms under the regulatory system. They

derive their authority from the FSA's rule-making powers as set out in the Act and reflect the FSA's objectives.

- 3.5. Principle 4 provides that:

*"A firm must maintain adequate financial resources."*

- 3.6. Principle 6 provides that:

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

- 3.7. Principle 9 provides that:

*"A firm must take reasonable care to ensure the suitability of its advice and discretionary decisions for any customer who is entitled to rely upon its judgment."*

- 3.8. 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."*

#### **FSA published materials**

- 3.9. Since 2004, the FSA has published considerable material on the importance of regulated firms treating customers fairly ("TCF"). In particular, in March 2006, the FSA published a notice setting out that firms should be focused on delivering the six TCF consumer outcomes, which include the following:

- (a) consumers can be confident that they are dealing with firms where the fair treatment of customers is central to the corporate culture (Outcome 1); and
- (b) consumers are provided with products that perform as firms have led them to expect, and the associated service is both of an acceptable standard and also as they have been led to expect (Outcome 5).

- 3.10. In July 2006, the FSA set a deadline for all firms to be at least implementing TCF in a substantial part of their business by the end of March 2007. In May 2007, the FSA detailed firms' progress against that deadline and stated that a sizeable number of firms had failed to demonstrate that they were implementing TCF. This meant that senior management at firms had failed to take sufficiently seriously the need to address TCF risks in their business. The FSA warned that, where firms failed sufficiently to engage with TCF, it would use its enforcement powers where necessary.

- 3.11. The FSA expects all regulated firms to be able to demonstrate that they are consistently treating their customers fairly.

## **FACTS AND MATTERS RELIED ON**

### **Background**

#### *Black and White*

- 3.12. Black and White was authorised by the FSA from 31 October 2004 with permission to advise on and arrange regulated mortgage contracts, and associated non-investment insurance contracts. Black and White specialised in re-mortgages and associated insurance.
- 3.13. Black and White's Head Office was based in Rugeley, Staffordshire. Between January and July 2007, Black and White had approximately 1,000 customers. Over the Relevant Period, Black and White generated turnover of approximately £11 million from residential mortgages, re-mortgages and associated PPI sales.
- 3.14. Black and White went into administration on 15 February 2008 and liquidation on 23 June 2008.
- 3.15. Black and White's primary business was advising and arranging mortgage contracts. 82% of Black and White's mortgage business concerned advising and arranging remortgages. A remortgage involves the transfer of the sum outstanding on the existing mortgage to a new provider on new terms and conditions.
- 3.16. A substantial number of Black and White's customers were 'sub-prime'. Mortgage lenders provide sub-prime mortgages to customers with low or impaired credit ratings who may find it difficult to obtain finance from traditional sources.
- 3.17. Black and White had a panel of between 20 to 25 mortgage lenders. Black and White's sale advisers ("advisers") were obliged to consider all of the mortgage products offered by the lenders on its panel when considering the most suitable mortgage product for a customer.
- 3.18. Black and White also sold single premium and regular monthly premium PPI, (also known as Accident, Sickness and Unemployment ("ASU") insurance), in connection with mortgages and re-mortgages. PPI is an insurance policy that will pay out a sum of money to cover monthly repayments on a mortgage for a set period of time, in the event that a customer is unable to work through accident or sickness or becomes unemployed subject to the customer meeting certain qualifying conditions.
- 3.19. Customers could pay for a PPI contract in a lump sum at the outset of the contract ("single premium PPI") or through regular monthly payments ("regular premium PPI"). The cost of single premium PPI was added to the amount the customer borrowed as part of the mortgage and would have interest charged on it over the term of the mortgage. Single premium PPI was more profitable to Black and White than regular premium PPI.

- 3.20. PPI providers typically paid higher commission on sales of single premium PPI.

#### *The Sales Process*

- 3.21. Black and White's advisers were divided into two teams, each headed by a sales manager.
- 3.22. Advisers would meet a customer to obtain information regarding their mortgage and insurance needs. Thereafter, the adviser would make a recommendation and pass the customer file to Black and White's processing department. The processing department liaised with the mortgage lender and obtained any missing documentation in order for the mortgage and PPI to be completed at a subsequent meeting with the customer.

#### **Remuneration, incentives and culture**

- 3.23. The structure of Black and White's remuneration and incentive scheme for advisers together with the prevailing culture at Black and White, resulted in advisers being placed under considerable pressure to generate sales. Black and White's senior management issued communications to advisers on a daily basis highlighting those sales that had generated the most income for Black and White. The purpose of the communications was to motivate advisers and illustrate the expectations that Black and White had of the advisers in terms of quantity and types of sales.
- 3.24. The communications from Black and White's senior management to its advisers were unbalanced as they focussed exclusively on the need to make sales. Black and White did not communicate to advisers the need to ensure that the advice they provided to customers was suitable.

#### *Remuneration*

- 3.25. Black and White incentivised its sales advisers to make sales through a combination of commission, bonuses and incentives ("the remuneration scheme").
- 3.26. The remuneration scheme incentivised advisers to recommend particular products which were profitable for Black and White with no regard to whether they were suitable for customers.

#### *PPI*

- 3.27. Black and White designed its remuneration scheme to incentivise advisers to sell single premium PPI. Black and White incentivised advisers to sell single premium PPI over and above regular premium PPI, by ensuring that advisers received more commission for single premium PPI sales.
- 3.28. Advisers received approximately three times more commission for selling single premium PPI than regular premium PPI. In the Relevant Period, advisers' average commission for selling single premium PPI was

approximately £250. The average commission advisers received for selling regular premium PPI was approximately £80.

### *Mortgages*

- 3.29. Throughout the Relevant Period, Black and White instructed its advisers to focus on recommending mortgages from a specific mortgage lender (“the Preferred Lender”). During the relevant period, Black and White placed 42% of its mortgage applications with the Preferred Lender. This was more than three and a half times the amount of business put with any other lender.
- 3.30. Black and White had a significant financial relationship with the Preferred Lender. The Preferred Lender had granted a £1 million loan facility to Black and White. Black and White received financial benefit from this arrangement (such as offsetting repayments against commission due). Throughout the Relevant Period, Black and White instructed its advisers to consider mortgages offered by the Preferred Lender before any other mortgage provider.

### *Incentives*

- 3.31. Black and White also ran a number of stand-alone incentive schemes during the Relevant Period. The purpose of the incentives was to motivate and influence advisers to recommend those products that were most profitable for Black and White. For example:
- (1) A prize of £1,000 cash for the greatest number of single premium PPI policies sold between 1 October 2007 and 14 December 2007;
  - (2) A competition to win a week’s first class Caribbean cruise. The prize was available to Black and White’s top five advisers. The qualification criteria were based around certain categories relating to the volume and value of sales generated by the advisers. One category was based on the percentage of single premium PPI against mortgage sales. Regular premium PPI was not a qualifying criteria; and
  - (3) One-off incentives designed to reward sales of single premium PPI and the Preferred Lender. Black and White advertised one such incentive to sales advisers in the following terms:

*The top 3 producers for the month will receive a pack of wine. Every sub-prime case up to 90% LTV within their lending criteria should be placed with [the Preferred Lender]. 10 cases offered last week within 12 days and 1 within 2 days, 4 cases a month in theory gives you a monthly salary!!!!!!....Guys and Gals everything is in place for another storming month, just remember SPPPI [single premium PPI] and [the Preferred Lender].”*

### *Conclusion*

- 3.32. Black and White's remuneration scheme generated an unacceptably high risk that Black and White's advisers would recommend the Preferred Lender's mortgages and / or single premium PPI even where other products were more suitable for the customer. In designing and implementing the remuneration structure, Black and White failed to give any consideration to whether the bias inherent within the remuneration scheme would result in advisers recommending Preferred Lender mortgage products and single premium PPI even when it was not suitable for the customer.
- 3.33. Black and White failed to recognise the risks generated by its remuneration structure and, consequently, failed to take action to mitigate it. For example, Black and White failed to give any consideration to whether sales of single premium PPI and / or mortgages with the Preferred Lender should be subject to monitoring over and above that applied to other products. In addition, Black and White failed to consider whether the risks generated by its remuneration structure could be mitigated by including factors relating to an assessment of the quality of advice within the remuneration scheme.
- 3.34. While it may be appropriate for advisers to have a proportion of their remuneration determined by reference to the number of sales, firms must be alert to the risks that this can create. For example, firms should consider the risks that a remuneration scheme with targets weighted towards the sale of certain products generates and put in place effective systems and controls to manage those risks. Without appropriate systems and controls, advisers may make recommendations to customers to purchase products, not because they are suitable for the customer, but because the recommendation increases the rewards the adviser is able to derive from a remuneration scheme. Black and White failed to put appropriate systems and controls in place to mitigate such risks.

### *Culture*

- 3.35. The emphasis on sales generally, and sales of specific products generated by the remuneration structure was reinforced by the prevailing culture at Black and White.
- 3.36. Advisers were separated into two, competing teams; one reporting to the Chairman and the other to the Chief Executive Officer. Black and White fostered an atmosphere of intense competition between the two teams. This competition was based around which team would make the most sales in each month. Black and White gave no recognition for the quality of the advice that each team gave to customers.
- 3.37. Black and White's focus on sales was reflected in the type of management information provided to its senior management. The management information escalated to Black and White's senior management focussed on completion figures, daily revenue generated by fees and the number of applications received compared to the previous month.



- 3.38. Black and White's senior management monitored advisers' sales figures daily. Particular focus was given to monitoring advisers' PPI penetration rate (the percentage of mortgage products sold with PPI). Senior management encouraged advisers to "*keep the pedal to the floor for PPI*". Advisers who failed to meet target penetration rates would be criticised by Black and White's senior management.
- 3.39. Black and White's senior management made it clear to advisers that they considered the "*deal of the day*" to be a sale including a Preferred Lender mortgage and / or single premium PPI<sup>1</sup>. Advisers who placed mortgages with the Preferred Lender would receive additional praise such as "*Full Monty*" and "*Full marks!*" in emails sent to them by Black and White's senior management.

### **Suitability**

#### *Suitability of Preferred Lender's product*

- 3.40. Black and White applied pressure to advisers to place business with the Preferred Lender, instructing the advisers to focus on recommending mortgages from the Preferred Lender. Black and White had a significant financial relationship with the Preferred Lender. The Preferred Lender granted a £1 million loan facility to Black and White and it offset loan repayments against commission due to Black and White.
- 3.41. The Preferred Lender had an on-site underwriter in Black and White's offices. The Preferred Lender had access to Black and White's 'New Business Register', which enabled it to process applications for Black and White faster than other lenders.
- 3.42. The advisers were required to choose between the mortgage products offered by members of Black and White's mortgage lender panel. In order to assist the advisers to select the mortgage product that was most suitable for a customer's particular circumstances, the advisers had access to a software programme that allowed them to compare, contrast and rank the mortgage products offered by the panel members.
- 3.43. However, Black and White's senior management instructed its advisers to consider speed of service over and above all other factors, including cost, in order to ensure that the Preferred Lender would appear to be the most suitable mortgage product:

*"With sub-prime clients speed is king. Forget rate. Forget Trigold....Don't let your hard work go to waste by chasing a rate!... [Preferred Lender] – 28 days to completion. The Rest? Onsite underwriting, offer production and completions...Remember even at the near prime end they are quicker than everyone on our prime panel too...and the rates are competitive."*

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<sup>1</sup>

- 3.44. In order to justify the selection of the Preferred Lender, Black and White instructed advisers to:

*“Record on your KFI...customer needed Money ASAP.. the evidence below backs up why that’s good advice. Quicker comps, less cancellations, less declines, less time for local pub expert to cost you a deal.”*

- 3.45. Black and White knew that, if advisers followed the instruction to record speed of service as a customer’s priority, it would be likely that the software program would show a mortgage from the Preferred Lender to be the most suitable mortgage.
- 3.46. The instructions from Black and White’s senior management generated an unacceptable risk that advisers would recommend the Preferred Lender when it may not have been the most suitable product for the customer. While speed of completion may have been the most important criteria in certain circumstances (for example, if a customer is faced with the prospect of having his/her property re-possessed as a result of a failure to meet the monthly repayments, and has to lower the monthly repayment immediately), other customers may have had other priorities. Black and White’s advisers should have taken steps to identify customers’ priorities through discussion and then carefully determine which priority was the most important.
- 3.47. Black and White’s instructions to advisers to prioritise speed of service created an unacceptably high risk that advisers would recommend a mortgage product from the Preferred Lender when that product was not necessarily the most suitable for a customer’s specific needs.

*The FSA’s file review*

- 3.48. As set out above, Black and White sought to ensure that advisers recommended mortgages with the Preferred Lender. The FSA reviewed 42 files where the customer had been advised to re-mortgage with the Preferred Lender to determine the extent to which this impacted on the quality of advice provided by Black and White’s advisers.
- 3.49. The key findings from the review are:
- (1) In 23 of the 42 files reviewed (54%), there were no clear reasons for recommending the Preferred Lender over other lenders;
  - (2) In 22 of the 42 (52%) files insufficient information about the customer had been recorded and gathered to support the recommendation;
  - (3) In 7 of the 42 (165) files the customer was in a worse financial position as their committed outgoings did not decrease as a result of the recommendation;
  - (4) In 12 of the 42 files (28%), the customer was in a marginally better financial position as a result of the recommendation during the initial fixed rate period, but the affordability of the product, once the fixed period expired, was not demonstrated; and

- (5) In 13 of the 42 of the files (31%) it was not possible to assess, from the information on file, whether the customer's outgoings had decreased as a result of the re-mortgage.

3.50. The FSA's file review established that Black and White failed to ensure that a recommendation was affordable or, in the case of a re-mortgage, whether a customer was better off as a result of the re-mortgage. Further, in a substantial number of cases insufficient evidence had been gathered to demonstrate why the Preferred Lender's product had been recommended as being the most suitable.

### **Suitability of PPI sales**

#### *Pressure to sell PPI*

3.51. Black and White told advisers that the sale of PPI was in the interests of both it and the customer: *"If we sell protection, we drive income, if we drive income that's good for the business, if we sell protection that's good for the consumer, fact."*

3.52. Black and White advisers were placed under significant pressure to sell single premium PPI. Advisers were instructed to ensure that they discussed single premium PPI at every opportunity and to *"sell the benefit to customers"*. Black and White's senior management applied pressure to advisers to sell PPI. For example:

*"A simple message. If you can't fit a lump sum into the frame or it's not appropriate...then get a monthly policy at the very least. Every little helps and we are missing dozens of these every month. Some of you [...] have **never even** sold a monthly policy. Don't leave your customers exposed...and remember insurance is sold not bought";* and

*"£1000 marketing allowance to the top performer overall, £500 for 2<sup>nd</sup> and 3<sup>rd</sup> place. We had a crap month last month for PPI sales, emphasis is on PPI, you will all need to focus on it, not only for best advice to your clients but also for your own pocket, every B&W lead should have SPPPI written on it, I'll be speaking to you all today, every effort needs to be concentrated on SPPPI sales."*

#### *Black and White's attitude to PPI*

3.53. Single premium PPI generated approximately 20-25% of Black and White's revenue over the Relevant Period.

3.54. As set out at 4.41 above, Black and White considered that PPI was a product that was likely to be suitable for all of its customers. Black and White sought to justify this to its advisers by reference to an independent report that referred to a 'government target' of 50% of home owners protecting their mortgages with insurance.

- 3.55. Black and White's senior management relied on the report and quoted the 'government target' to sales advisers, informing them that: "*the government's own target for PPI on mortgage sales is 50% - yes fifty percent.*" Relying on that report, Black and White informed advisers that they should aim to sell PPI in 50% of all mortgage sales. Black and White misrepresented information contained in promotional material produced by PPI providers.
- 3.56. Black and White relied on the 'government target' to encourage and justify an assumptive approach to the sale of PPI without any consideration of individual customer circumstances. Black and White did not give any consideration to reports issued and actions taken by the FSA up to the end of the relevant period. For example in November 2005, the FSA issued a 'Dear CEO' letter entitled "*Sale of Payment Protection Insurance*". The letter highlighted concerns in the selling practices of firms, such as Black and White, operating outside of the prime market and recommending single premium PPI. Despite this, Black and White took no action to review its approach to selling PPI following receipt of the letter.
- 3.57. In October 2006 the FSA published a report entitled "*The Sale of Payment Protection Insurance – results of follow-up thematic work*". The report highlighted concerns with sales practices around single PPI stating that "*where a choice between regular and single premium is available, some firms biased the sales conversation towards a single premium policy*". Despite this, Black and White took no action to review its approach to selling PPI following publication of the report.
- 3.58. The FSA published eight enforcement actions up to the end of the relevant period concerning selling practices relating to PPI. Black and White took no action to review its approach to selling PPI following publication of any of the enforcement actions.
- 3.59. Black and White also failed to take any steps to consider the extent to which there was any conflict between the higher commission available to advisers for the sale of single premium PPI and the cheaper cost of regular premium PPI for customers. Black and White did not put in place systems or controls to monitor and mitigate this risk; on the contrary, the remuneration scheme was deliberately structured to ensure that single premium PPI was recommended by advisers.

### **Compliance**

- 3.60. Black and White failed to put in place adequate systems and controls to monitor sales of mortgages and PPI and ensure the suitability of the advice given by its advisers. As a consequence, Black and White failed to ensure that the recommendations provided by its advisers were suitable for the needs of its customers. This failing is particularly serious because Black and White created an unacceptably high risk that advisers would make recommendations based on the rewards available from the remuneration scheme, not the needs of individual customers.

- 3.61. Black and White had three review processes; adviser scorecards, suitability audits and an audit checklist for PPI sales.

*Adviser scorecards*

- 3.62. Black and White's 'adviser scorecards' directed the reviewer to record certain categories of information including fee income, insurance policies sold, whether or not certain documents are held on file (e.g. fact find, mortgage application form and suitability letter) and the training and competence status of the adviser.
- 3.63. If the adviser scorecard identified and highlighted missing documentation, the Processing Department would take steps to gather any missing documentation. However, the adviser scorecard did not require the reviewer to undertake any analysis of the information recorded on the documents or make any assessment of suitability. Accordingly, the scorecard was merely a completion checklist and not an effective control to ensure the suitability of recommendations.

*Suitability audits*

- 3.64. Suitability audits took place after a product was sold. In the event that a new mortgage was recommended, the mortgage was completed and approved by the lender before a suitability audit was conducted. In some cases, there was a two-month delay between completion of the mortgage and the suitability audit taking place.
- 3.65. The number of suitability audits conducted as a proportion of Black and White's overall business decreased during the relevant period. While firms may decide to reduce the extent to which recommendations are reviewed, it is important that firms have a rational basis for doing so. For example, if a firm who sees an increase in the quality of advice produced over a period of time from a particular adviser, it may be appropriate to reduce the extent to which that adviser's files are reviewed accordingly. Black and White, however, had no rational basis for reducing the frequency of its suitability audits.
- 3.66. In September 2006, Black and White conducted suitability audits on 44 customer files. This equated to approximately 22% of the customer files completed during that month. However, by March 2007 only 5% of applications were subject to a suitability audit and, after March 2007, no suitability audits were conducted. Black and White reduced the frequency of suitability audits despite the fact that between October 2006 and February 2007, compliance audits identified concerns with approximately a third of cases reviewed.
- 3.67. Even where suitability audits were conducted and issues identified, the Compliance department failed to ensure that any remedial action was carried out or to conduct any analysis to determine the extent to which the issues identified put customers at risk of financial loss.

### *PPI Audit Checklist*

- 3.68. The only process that Black and White had to ensure the suitability of PPI was the 'PPI Audit Checklist'. The PPI audit checklist set out a number of categories including length of cover, age and employment status that should have been checked by the reviewer prior to the transaction being completed.
- 3.69. The checklist referenced a number of items that might affect the suitability of a recommendation. However, the checklist only required the reviewer to consider whether information relating to that item had been gathered by the adviser. The checklist did not require the reviewer to consider whether the information could affect the suitability of the recommendation. The checklist was therefore merely a completion checklist and an ineffective tool to monitor the suitability of PPI sales.
- 3.70. While the checklist referenced 12 items in total, only six had to be complete for the sale to be considered suitable. None of the items were mandatory.

### *The Compliance Department*

- 3.71. Black and White did not hold Compliance in high regard. Senior management at Black and White considered Compliance to be a burden. In reaching this conclusion, the FSA has paid particular regard to the following:
- (1) Black and White had approximately seven staff working in Compliance during the Relevant Period. However, compliance staff were transferred to the processing department when there was a risk of the processing department failing to meet its targets. For example, until 13 June 2007 three members of Compliance worked in the processing department as the processing department was short-staffed. When Compliance requested additional experienced auditing and compliance staff, it received only two administrative staff who had little compliance experience;
  - (2) Where Compliance did identify issues at Black and White it failed to address these issues. For example, in March 2007, Compliance analysed the proportion of mortgages placed with each panel lender. As a result, Compliance identified that a significant proportion of business was placed with the Preferred Lender and escalated this as a risk to senior management. However, no further work was undertaken to determine whether or not this represented a risk that customers were being recommended Preferred Lender mortgages when they were not suitable; and
  - (3) More generally, compliance issues were dealt with on an ad hoc basis and in response to a specified event, rather than on a proactive risk management basis. For example, a specific complaint by a customer where an issue had been raised that put at risk the completion of a sale.

### **Capital adequacy and financial reporting to the FSA**

- 3.72. All authorised firms are under an obligation to meet, and continue to meet, the FSA's Threshold Conditions. The FSA's Threshold Conditions require firms to maintain adequate financial resources. The FSA monitors firms' financial resources by reviewing regulatory returns, in the form of Retail Mediation Activities Returns ("RMAR"), that all firms are obliged to submit. It is necessary, therefore, for firms to ensure that they put in place and maintain appropriate systems and controls to monitor and accurately calculate their financial position to enable them to file accurate and timely RMARs.

#### *Breach of capital adequacy requirement*

- 3.73. On 31 March 2007, Black and White submitted a RMAR to the FSA, which stated that it had a capital excess of £211,796 above its capital adequacy requirement. Black and White was required to submit a further RMAR on 30 June 2007. It failed to do so.
- 3.74. On 5 July 2007, Black and White's auditors informed Black and White that it had not met its capital resource requirements since 31 December 2006. The auditors anticipated that the shortfall was at least £1,075,000 and told Black and White that it should notify the FSA of the breach.
- 3.75. Black and White did not notify the FSA of the breach until 26 July 2007. Thereafter, Black and White sought to rectify the breach by capital injections from its Directors. However, the FSA remained concerned regarding Black and White's financial position.

#### *Failure to disclose H. M. Revenue and Customs ("HMRC") liabilities to the FSA*

- 3.76. On 2 November 2006, HMRC wrote to Black and White in respect of a debt of £93,860.62 plus interest. Black and White agreed to repay HMRC £10,000 per month. HMRC explained to Black and White that if future liabilities were unpaid, it would result in a withdrawal of the arrangement and winding-up proceedings being instigated.
- 3.77. By 4 July 2007, Black and White's debt to HMRC had risen to £401,986. HMRC indicated that if a payment was not made, a winding-up petition would be issued.
- 3.78. On 3 August 2007, Black and White sent the FSA a letter setting out its financial position. Under the heading "*Comfort that The Black and White Group are not trading while insolvent*" the letter stated that:

*"The company is trading successfully and meeting its commitments in full [...] Black and White is in receipt of no winding up orders, and payment schedules are in place and have been met for all major creditors. The Trade Creditor position as at the end of December 2006 was £364K - and as at the end of June 2007 the figure was £362K – a very credible performance given*

*the company has processed significantly higher volumes of business in 2007. The average creditors days in December 2006 was 96, in June 2007 the number has fallen to just 46 days. ”*

- 3.79. In purporting to set out all relevant liabilities, emphasising the improvement in the trade creditors’ position and maintaining that it was meeting its liabilities as and when they fell due, Black and White gave an untrue and misleading picture of its financial position to the FSA. In particular, Black and White knew it had failed to meet other creditors’ demands for payment in mid 2007. Further, at that time, Black and White knew there was a realistic prospect of a winding up petition being served on it by HMRC.
- 3.80. Between August and October 2007, Black and White negotiated a number of repayment schedules with HMRC. However, each time an agreement was reached Black and White fell behind in its payments. Consequently, in October 2007 HMRC informed Black and White it would initiate winding up proceedings if payment of the outstanding debt was not made in full. Black and White failed to pay the outstanding debt and was served with a winding-up petition on 10 December 2007. As a result Black and White went into voluntary administration.

*Adequacy of the Firm’s systems and controls*

- 3.81. The RMARs submitted by Black and White to the FSA set out a misleading picture of its capital position. There is no evidence that Black and White took steps to ascertain the accuracy of these returns. It is vital that firms have appropriate systems and controls in place so that they can monitor and accurately calculate their financial position. Black and White accepted in July 2007 that its financial systems and controls had been inadequate and undertook to review and improve them.
- 3.82. Black and White’s internal systems and controls were wholly inadequate to identify and monitor its capital adequacy. Black and White’s auditors, not Black and White itself, identified the breach when auditing Black and White’s annual accounts.

#### **4. ANALYSIS OF BREACHES**

*Principle 6*

- 4.1. Principle 6 requires that a firm must pay due regard to the interests of its customers and treat them fairly. In doing so, firms should ensure that the fair treatment of customers is central to their culture and that the advice that they receive is suitable and takes account of their circumstances.
- 4.2. The culture at Black and White was focused, not on the fair treatment of customers, but on maximising income by actively placing advisers under significant pressure to make as many sales as possible. Black and White’s remuneration scheme was weighted in favour of lenders and products that benefited Black and White, not on whether those lenders and products were appropriate for individual customers. In designing the remuneration



structure and creating and maintaining a culture focussed on selling, Black and White failed to pay due regard to the interests of its customers, in breach of Principle 6.

#### *Principle 9*

- 4.3. Principle 9 requires a firm to take reasonable care to ensure the suitability of its advice for any customer who is entitled to rely in its judgement. Black and White's business concerned providing advice to retail customers. Black and White was obliged to take reasonable care to ensure the suitability of the recommendations its advisers made to customers by having in place appropriate systems and controls.
- 4.4. In particular, Black and White's remuneration scheme rewarded sales without any regard to the suitability of the sale. This created an unacceptable risk that advisers would make recommendations based on the design of the remuneration structure, not the needs of individual customers. Black and White took no steps to mitigate this risk by, for example, building qualitative factors into the scheme or monitoring this risk through effective compliance controls.
- 4.5. Further, the inadequacy of Black and White's systems and controls for ensuring that its customers received suitable advice served to aggravate the risk that customers would not receive suitable advice. Black and White's processes for reviewing the suitability of advice were either conducted post sale or failed to require the reviewer to assess suitability. Where cases were reviewed post sale, Black and White failed to have any processes in place to ensure that customers did not suffer any detriment if it identified any issues relating to suitability.
- 4.6. These failings created an unacceptably high risk that customers would not receive suitable advice. The FSA's file review of Black and White's mortgage files showed a failure to demonstrate affordability and, in choice of lender, suitability. These failings meant that Black and White did not take reasonable care to ensure the suitability of its advice and was therefore in breach of Principle 9.

#### *Principle 4*

- 4.7. Principle 4 requires a firm to maintain adequate financial resources. Black and White failed to maintain adequate financial resources and was unable to accurately monitor and report its financial position to the FSA. Accordingly, the firm was in breach of Principle 4.

#### *Principle 11*

- 4.8. Principle 11 requires a firm to deal with its regulators in an open and co-operative way and disclose to the FSA appropriately anything relating to the firm of which the FSA would reasonably expect notice. Black and White failed to disclose to the FSA the HMRC debt and true financial position of

the firm. These failures mean that Black and White was in breach of Principle 11.

## **5. SANCTION**

5.1. The principal purpose of a public censure 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 issue of public censure is set out in Chapter 6 of the Decision Procedures and Penalties Manual ("DEPP 6") in respect of conduct occurring after 28 August 2007. In coming to this decision the FSA has also considered Chapter 12 of the Enforcement Manual ("ENF") which forms part of the FSA Handbook in relation to conduct occurring prior to 28 August 2007. DEPP 6.4.2 sets out a non-exhaustive list of factors of particular relevance in determining whether it is appropriate to issue a public censure. The FSA considers the following factors to be particularly important:

(1) *The nature, seriousness and impact of the breach:*

- (a) The FSA considers that Black and White's conduct was serious as the cumulative impact of the firm's failings represented a significant risk to the FSA's objectives of securing the appropriate degree of protection for consumers. It occurred at a time when there was a high level of awareness within the financial services industry of the importance of treating customers fairly.
- (b) Black and White's failings were cultural and originated from the senior management of the firm. The failings created a high risk of misselling and related to all the main business activities of the firm, namely the sale of mortgages and associated PPI.
- (c) It involved the firm in breaching a Threshold Condition and in failing to tell the FSA information that it could have reasonably expected to have received in relation to the firm's capital adequacy position.

(2) *The impact on the person concerned:*

The above factors would ordinarily merit the imposition of a substantial financial penalty. However, the FSA considers that there are exceptional circumstances which make it appropriate to issue a public censure rather than impose a financial penalty. In this case, it is clear that Black and White has no resources to pay a financial penalty given that it is now in liquidation.

(3) *The FSA's approach in similar previous cases:*

The FSA has, in cases where the person is insolvent and no financial penalty can be paid, published a public censure to promote high standards of regulatory conduct by making it clear from the public censure the nature and seriousness of the breaches and by giving an indication of the appropriate financial penalty that would have been imposed but for the insolvency.

**6. DECISION MAKERS**

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

**7. IMPORTANT**

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

*Publicity*

- 7.2. 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.

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

*FSA Contacts*

- 7.4. For more information concerning this matter generally, you should contact Suzanne Burt of the Enforcement Division of the FSA (direct line: 020 7066 1062 /fax: 020 7066 1063).

**Georgina Philippou**  
**FSA Enforcement Division**