Financial Services Authority

FINAL NOTICE

To: **The Carphone Warehouse Limited** (FSA ref: 312912)

Of: **1 Portal Way**
London
W3 6RS

Date: **5 September 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 you a Decision Notice on 5 September 2006 which notified you that, pursuant to section 206 of the Financial Services and Markets Act 2000 ("the Act"), the FSA had decided to impose a financial penalty on The Carphone Warehouse Limited ("Carphone/the Firm").

1.2. The Firm has confirmed that it will not be referring the matter to the Financial Services and Markets Tribunal. Accordingly, for the reasons set out below and having agreed with the Firm the facts and matters relied on, the FSA imposes on the Firm a financial penalty of £245,000.

1.3. The penalty is imposed in respect of breaches of the following FSA's Principles for Businesses solely in relation to general insurance sold via the Firm's telephone sales channels:

(1) failing to conduct its business with due skill, care and diligence (Principle 2);

(2) failing to take reasonable care to organise and control its affairs responsibly and effectively, with adequate risk management systems (Principle 3);

(3) failing to pay due regard to the interests of its customers and failing to treat them fairly (Principle 6); and

(4) failing to disclose matters of which the FSA would reasonably expect notice (Principle 11).

2. REASONS FOR THE PENALTY

2.1. In the period from 14 January 2005 until 24 October 2005 ("the relevant period") the Firm breached Principles 2, 3, and 6 in relation to its insurance telesales channels. As a result, the Firm failed to send 118,000 customers who had bought mobile phone insurance through its telephone sales channels a Statement of Demands and Needs ('SDN') in a durable format as required by ICOB rules 4.4.1 and 4.4.2 (2), and the Firm also failed to send 56,000 of those customers a policy summary setting out the main features of the policy as required by ICOB rules 5.3.8 and 5.3.6.

2.2. The Firm also breached Principle 11 by failing to provide complete and timely information to the FSA regarding the failure to send SDNs to customers. The Firm discovered the SDN omission in March 2005. The Firm notified the FSA of the breach in October 2005.

2.3. These matters are viewed as serious by the FSA because they demonstrate a failure on the part of the firm to apply the TCF principle ("Treating Customers Fairly") in a practical and timely manner. In particular:

(1) from March to October 2005 the Firm continued to sell insurance via its telephone sales channel when it knew it was not complying with the requirement to send SDNs to those customers;

(2) the defects in the Firm's systems and controls were such that it was not aware until October 2005 that some of its telephone sales channels also had no mechanism for sending policy summaries to customers; and

(3) the Firm failed to resource its compliance function in a manner proportionate to risks posed by the complex nature of the multi-channel distribution model which it chose to operate.

2.4. The FSA considers that the conduct has been mitigated to some extent in that the Firm:

(1) co-operated with the FSA in agreeing to carry out a retrospective mailing of policy summaries and SDNs to the relevant customers;

(2) has committed to an appropriate remedial action plan to investigate and redress any consumer detriment which may have arisen in relation to the affected customers;

(3) has committed to a comprehensive programme of reviewing and strengthening its systems and controls in relation to all of its general insurance sales channels; and

(4) reported the SDN breach to the FSA following discussions with its external consultants and was proactive in proposing an interim remedial action plan to amend its procedures to ensure that the required documents would be sent to all new telesales customers from November 2005 onwards.

2.5. The FSA considers that this proposal to investigate and redress any consumer loss is a significant step in demonstrating the Firm's commitment to the TCF principle. This

action should minimise the risk of customers being disadvantaged by the Firm's omissions. Investigating consumer detriment and offering redress where appropriate is an important part of the TCF principle and one which firms should not overlook. In addition, a proposal to pay redress on a voluntary basis is an important mitigating factor which, along with all other relevant factors, will be taken into account by the FSA in making its decision on the level of penalty.

2.6. The FSA has had regard to the nature of the insurance being sold and the maximum likely financial impact on the customer. For many consumers, mobile phone insurance will not be as significant a transaction as some other types of insurance such as motor vehicle, buildings and contents, unemployment or personal injury insurance. In addition, the FSA has had regard to the fact that in March 2005 the firm was new to regulation and the conduct of the firm following the initial discovery of the SDN omission must be seen in that context.

2.7. The Firm has moved quickly to agree the facts of the case, ensuring efficient resolution of the matter, and the Firm has received full credit for settlement of the disciplinary case at any early stage. The Firm has received the full 30% discount for settling the case at stage 1. Without this commitment to redress, remedial action and early settlement the financial penalty would have been substantially higher.

3. RELEVANT STATUTORY PROVISIONS

3.1. Section 206 of the Act states:

"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."

3.2. The FSA's Principles for Businesses, as set out in the FSA's Handbook of Rules and Guidance ('the FSA Handbook') represent a general statement of the fundamental obligations of firms under the regulatory system.

3.3. Principle 2 provides:

"A firm must conduct its business with due skill, care and diligence."

3.4. Principle 3 provides:

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

3.5. Principle 6 provides:

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

3.6. Principle 11 provides:

"A firm must deal with its regulators in an open and co-operative way, and must disclose to the FSA appropriately anything relating to the firm of which the FSA would reasonably expect notice."

3.7. The FSA has also had regard to:

(1) ICOB 4.4 which contains detailed rules which require firms selling general insurance to provide customers with Statements of Demands and Needs (SDNs); and

(2) ICOB 5, which contains detailed rules in relation to the information which firms must disclose to customers in connection with sales of general insurance; including detailed rules requiring firms to provide retail customers with a Policy Summary which sets out key information about the insurance contract in a way which does not overload the customer with detail.

The FSA's Rules and Principles constitute requirements imposed on authorised persons under the Act.

4. FACTS AND MATTERS RELIED ON

Background

4.1. The Firm is a wholly owned subsidiary of Carphone Warehouse Group plc. The Firm's primary business is the sale of mobile phone handsets and airtime contracts through its high street branches, telephone sales ('telesales') and the internet. In addition, the Firm offers a range of insurance policies (marketed as "Lifeline"), which variously cover loss and theft of, and accidental damage to, mobile phone handsets, any related unauthorised expenditure the customer may incur, and the cost of cancelling airtime contracts. The Firm has been undertaking this type of general insurance business since 1993, and was previously a member of the General Insurance Standards Council. The Firm is now authorised and regulated by the FSA. Its permitted business activities are advising on, arranging, assisting in the administration and performance of, and dealing in, non-investment insurance contracts.

4.2. The Firm sells insurance provided by only one company – New Technology Insurance Limited ("NTI"), which is also a subsidiary of the Carphone Warehouse Group Plc. The Firm also carries out the administration involved in the collection of premiums and claims handling on behalf of NTI.

4.3. The Firm sells the insurance on an advised and on a non-advised basis depending on the particular sales channel used. The majority of the Firm's insurance sales are face to face transactions carried out on an advised basis in its retail stores. The Firm also sells insurance via the internet on a non advised basis through its "e2save" brand.

4.4. The Firm operates a number of telesales channels and provides various telephone numbers which its customers can call. This includes an 'e2save telephone channel' for internet customers who do not want to complete the entire process online. Customers contacting the Firm via the 'e2save telephone channel' are offered insurance on a non-advised basis. Other customers who contact the Firm by telephone to purchase or upgrade a mobile phone are offered insurance on an advised basis. Customers who have not taken up insurance at the point of sale when purchasing or upgrading a mobile phone handset or airtime contract in a branch are subsequently contacted by telesales staff who offer insurance to the customer on an advised basis.

4.5. The breaches referred to in this notice solely relate to insurance sold through the Firm's telesales channels.

4.6. In the financial year 2005/2006 the Firm employed approximately 3,500 sales staff across approximately 600 retail stores throughout the UK. In addition the Firm had 300 telesales staff at its two dedicated call centres. It sold over 766,000 insurance policies generating a gross premium income of approximately £32 million, on which the firm retained net profits of £6.5 million before tax. In total the firm has over 1 million insurance customers.

4.7. In the relevant period between January and October 2005 the Firm sold approximately 570,000 insurance policies, over 20% of which (approximately 118,000) were sold through the Firm's various telesales channels. Having regard to the size of the Firm's insurance business, and the complex variety of its distribution channels, the Firm's resourcing of its compliance function throughout the relevant period was inadequate.

4.8. The failure to provide SDNs applied to all 118,000 customers who purchased mobile phone insurance through any of the Firm's telesales channels between January and October 2005. The additional failure to provide policy summaries applied to a subset of those customers (primarily those who bought insurance through the e2save telesales channel) – approximately 56,000 customers.

Disclosure Procedures

4.9. Prior to 14 January 2005, the Firm engaged external consultants to assist it with its preparations for the commencement of general insurance regulation. The external consultants advised the Firm about the requirement to send SDNs to customers, but when regulation commenced on 14 January 2005 the Firm failed to appreciate that the advice to send SDNs applied to all of its sales channels, including its telesales channels. As a result, the Firm failed to implement procedures to ensure that SDNs were sent to customers who bought insurance through its various telesales channels.

4.10. In March 2005, as a result of a request for information from the FSA, the Firm became aware that it was not complying with the SDN requirement in relation to its telesales channels. The Firm responded to the FSA's information request by stating that it intended to use generic SDNs from May 2005 onwards. The letter did not state that the Firm had omitted to send SDNs to its telesales customers up to that point. Whilst working on a solution for the procedural defect, the Firm continued to sell insurance through its telesales operation in the knowledge that the SDNs were not being sent.

4.11. A new procedure for sending the SDNs following telephone sales was planned to take effect in May 2005. This solution was due to be implemented as part of a wider IT project. The whole IT project was delayed and, as a result, the new procedure for sending SDNs did not come into operation in May. No monitoring or controls were in place to verify that the new SDN procedure was operational. The Firm continued to sell insurance via its telesales channels based on an assumption that the new procedure had been implemented in May.

4.12. A compliance audit of insurance sales carried out by the Carphone Warehouse Group internal audit team in June/July 2005 identified that the new SDN procedure had not in fact been implemented. The FSA was not notified of this failure. Thereafter, in the face of an on-going delay, there was a continuing expectation at the Firm that the IT project would complete imminently. The project did not complete and, in the meantime, the Firm continued to sell insurance via its telesales channels when it knew that it was not complying with the requirement to send SDNs. This situation continued until October 2005 when the Firm was advised by its external consultants to report the matter to the FSA.

4.13. On 21 October 2005, the Firm notified the FSA that it had failed to send SDNs to approximately 70,000 telesales customers. The FSA requested further details of this omission, and asked the Firm to check and confirm that it was complying with other ICOB requirements in relation to disclosure of information to customers.

4.14. Prompted by this request, the Firm conducted further enquiries and discovered that it had no mechanism or procedure in place to ensure that a number of customers who bought insurance through its telesales channels (primarily e2save telephone customers) would be sent a policy summary as required by the FSA's rules. On 24 October 2005 the Firm notified the FSA that it had failed to send policy summaries to approximately 26,000 telesales customers.

4.15. On 12 January 2006 the FSA appointed investigators under section 168(5) FSMA, as a result of section 168(4). Further enquiries made by the Firm in response to the Enforcement investigation revealed that the systems failure in relation to SDNs had affected approximately 118,000 customers, and the systems failure in relation to policy summaries had affected approximately 56,000 customers.

Principle Breaches

4.16. By reason of the facts and matters set out above, the FSA considers that the Firm has contravened Principles 2 and 3 of the FSA's Principles for business. In particular the Firm:

(1) failed to exercise due skill, care and diligence in interpreting and/or implementing the advice which it received in relation to the regulatory requirements applicable to its business. As a result, the Firm failed to establish any mechanism or procedure for sending SDNs to customers who bought insurance through any of the Firm's telesales channels;

(2) failed to exercise due care, skill and diligence in establishing and implementing its procedures for sending policy summaries to a subset of the above customers. This resulted in a significant number of customers not receiving policy summaries;

(3) failed to establish effective controls for reviewing the operation of its procedures once general insurance regulation had commenced and, in particular, failed to check whether the IT project containing the proposed SDN solution had become operational; and

(4) failed to take reasonable care to implement a risk management system which was proportionate to the operational model that the firm employed. Where a firm chooses to operate through a more complex distribution model, Principle 3 requires such firms to have in place processes, systems and controls which are tailored to the risks posed by that business model.

4.17. In addition, by reason of the facts and matters set out above, the FSA considers that the Firm has contravened Principle 6 of the FSA's Principles by failing to pay due regard to the interests of its customers and failing to treat them fairly. In particular, the Firm:

(1) failed to issue important documents to customers which should have given key information to the customer about the insurance provided and about the Firm's understanding of the type of insurance cover needed by the customer. Such information may, in some cases, have made the customer aware that the insurance was unnecessary or inappropriate for their particular circumstances - thus enabling them to cancel the policy within the 14 day cooling-off period;

(2) continued to sell the insurance to customers when it knew that it was not providing the required information to the customer; and

(3) proposed a solution for new sales but did not consider the interests of those affected customers who had already been sold insurance. The Firm did not consider remedial action such as retrospective mailing of the missing documents or steps to investigate customer detriment or to pay redress until prompted to do so by the FSA.

4.18. In addition, by reason of the facts and matters set out above, the FSA considers that the Firm has contravened Principle 11 of the FSA's Principles by failing to disclose to the FSA appropriately matters of which the FSA would reasonably expect notice. In particular, the Firm failed in March 2005 to notify the FSA in clear and complete terms that it had not implemented any procedures for sending SDNs to telesales customers; and that it was proposing to continue to sell insurance via its telesales channel without complying with the requirement to provide customers with SDNs. Further in June/July 2005 the Firm failed to notify the FSA that its proposed remedy for the SDN omission had not been implemented.

5. PENALTY

5.1. The FSA has considered the disciplinary and other options available to it and has concluded that a financial penalty is the appropriate sanction in the circumstances of this particular case. The principal purpose of the imposition of a financial penalty is to promote high standards of regulatory conduct. It seeks to do this 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 benefit 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. Section 13.3 of the Enforcement Manual sets out some of the factors that may be of particular relevance in determining the appropriate level of financial penalty. These

have been taken into account by the FSA in determining the appropriate level of penalty in this case. Chapter 13 of the Enforcement Manual at paragraph 13.3.4 states that the criteria listed in the Manual are not exhaustive and all relevant circumstances of the case will be taken into consideration. In determining whether a financial penalty is appropriate and its level, the FSA is required therefore to consider all the relevant circumstances of the case. The FSA considers the following factors to be particularly relevant in this case:

Seriousness

5.3. The FSA has had regard to the seriousness of the contraventions, including the nature of the requirements breached, the number and duration of the breaches and the number of consumers who may have been impacted. The level of financial penalty must be proportionate to the nature and seriousness of the contravention. Details of the breaches identified in this case are set out above. As stated in paragraph [2.6] above, in determining the seriousness of the contraventions the FSA has had regard to the nature of the insurance being sold and the potential impact on the affected consumers. The FSA acknowledges that the potential consumer detriment for this type of insurance product is not as significant as with some other types of insurance. However, for the reasons detailed below the FSA considers that the breaches identified in this case are significant contraventions:

(1) defects in the procedures of large firms such as this are particularly serious because the failure to have adequate procedures, or adequate monitoring to ensure that procedures are implemented and adhered to, have the potential to expose a large number of customers to an unacceptable level of risk;

(2) the Firm became aware of the defect in the SDN procedure in March 2005, but the nature of the systems deficiencies were such that the Firm was not aware until October 2005 of the defects in relation to its procedures for delivering policy summaries;

(3) a large number of customers were exposed to a risk of modest financial loss because the omission of important information could result in customers paying for unnecessary insurance, paying for insurance which does not meet their needs or which may be inappropriate for their circumstances.

The extent to which the conduct was deliberate or reckless

5.4. The FSA considers it particularly serious that the Firm continued to sell insurance through its telesales channels when it knew that it was not complying with the requirement to provide customers with SDNs. In addition, having initiated the implementation of a new procedure to remedy the SDN defect, the Firm was reckless in proceeding on an assumption that the proposed new procedure had been implemented. The Firm subsequently discovered that its new procedure had not been implemented and again it carried on selling insurance when it knew that it was not complying fully with the requirement to provide information to customers.

The size, financial resources and other circumstances of the Firm, and the amount of profits accrued or loss avoided

5.5. The details in relation to the size and resources of the Firm are set out above. The Firm had sufficient financial resources to staff its compliance function to a level commensurate with the amount of general insurance business being transacted, and proportionate to the complexity of the business model adopted by the firm. It had adequate financial resources which could have been used to resolve the problem once it had been identified, both in terms of new systems and remedial steps in relation to affected customers.

5.6. The FSA has had regard to the fact that the Firm has sufficient resources to pay the penalty.

Conduct following the contravention

5.7. The details of the Firm's conduct following the discovery of the contraventions are set out above in paragraphs 4.10 to 4.18. The Firm knew about the on-going omission of SDNs from March 2005. The FSA considers it particularly serious that the Firm failed to bring the SDN omission to the attention of the FSA quickly, effectively and completely. In this breach of Principle 11, the FSA has had regard to the fact that in March 2005 the Firm was relatively new to regulation.

5.8. It is to the Firm's credit that it has agreed the facts quickly ensuring an efficient resolution of the investigation and full credit is given for settlement at the earliest opportunity. The level of financial penalty imposed in this case has been subject to a full, stage 1 discount of 30%.

5.9. In addition to providing the required documents retrospectively to customers, the Firm has committed itself to a remedial action plan to investigate and redress any consumer detriment which may have arisen as a result of its failure to provide customers with the required documents. The Firm's remedial action will include undertaking a customer contact exercise on the following basis:

- whereby customers who did not receive policy summaries and whose claims were previously rejected, will be invited to apply to have their claim reconsidered;

- whereby customers who did not receive SDN's whose claims were previously rejected, will be offered an opportunity to apply for a refund of premiums if they consider they have suffered detriment as a result of the Firm's failure to provide the required documents; and

- whereby customers who did not receive the required documents and cancelled the insurance at any time up to the end of February, will be offered an opportunity to apply for a refund of premiums if they consider that they suffered detriment as a result of the Firm's failure to originally provide the required documents.

5.10. The FSA considers this redress proposal to be a significant step forward in demonstrating the Firm's practical commitment to the principle of TCF.

5.11. In addition, the Firm is taking steps to improve its systems and controls to prevent a reoccurrence. This includes undertaking a full compliance audit of all sales channels

in order to ensure all relevant disclosures are being made to customers in a timely manner, strengthening the insurance team, restructuring the compliance function and committing considerable additional resource to the compliance function.

Disciplinary record and compliance history

5.12. The Firm became regulated by the FSA in January 2005. It has not been subject to any previous enforcement action by the FSA.

Previous action taken in relation to similar failings

5.13. In deciding on the level of penalty, the FSA has taken into account previous action taken by the FSA in relation to similar contraventions by other firms.

6. DECISION MAKERS

6.1. 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.

7. IMPORTANT

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

Manner of and time for payment

7.2. The financial penalty of £245,000 must be paid in full by The Carphone Warehouse Limited to the FSA by no later than 19 September 2006, 14 days from the date of the Final Notice.

If the financial penalty is not paid

7.3. If all or any of the financial penalty is outstanding on 20 September 2006, the FSA may recover the outstanding amount as a debt owed by The Carphone Warehouse Limited 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 Bill Sillett (Tel: 020 7066 5880) of the Enforcement Division of the FSA.

William Amos
Head of Retail 1
Enforcement Division