Financial Services Authority

FINAL NOTICE

To: **Council Homebuyers (Midlands & North) Limited**

Of: **13 Halesowen Road**
Halesowen
West Midlands
B62 9AE

FSA Reference: **306022**

Date **30 July 2007**

TAKE NOTICE: The Financial Services Authority of 25 The North Colonnade, Canary Wharf, London E14 5HS ("the FSA") gives final notice about a decision to impose a financial penalty on Council Homebuyers (Midlands & North) Limited.

1. ACTION

1.1. The FSA gave Council Homebuyers (Midlands & North) Limited ("CHL") a Decision Notice on 30 July 2007 which notified CHL that the FSA had decided, pursuant to section 206 of the Financial Services and Markets Act 2000 ("the Act"), to impose a

financial penalty of £10,500 on CHL, for failing to comply with Principles for Businesses, and for failing to treat its customers fairly, between 31 October 2004 and 23 October 2006 ("the relevant period").

1.2. CHL breached:

(1) Principle 3 (Management and control); and

(2) Principle 7 (Communications with clients)

in respect of the operation of its mortgage sales process.

1.3. CHL also breached the following rules contained in the FSA's Handbook of rules and guidance:

(1) Mortgages and Home Finance: Conduct of Business Sourcebook ("MCOB") 4.7.2R; 4.7.4R; 4.7.17R; and 5.5.1R; and

(2) Training and Competence ("T&C") 2.3.1R; and 2.8.1R.

1.4. CHL agreed to settle at an early stage of the FSA's investigation and therefore qualified for a 30% (stage 1) discount under the FSA's executive settlement procedures[1]. The FSA would otherwise have imposed a financial penalty of £15,000 on CHL based on the facts and the matters described in this Final Notice.

1.5. CHL agreed that it would not be referring the matter to the Financial Services and Markets Tribunal.

1.6. Accordingly, for the reasons set out below and having agreed with CHL the facts and matters relied on, the FSA imposes a financial penalty on CHL in the amount of £10,500.

[1] Guidance on discounts for early settlement is contained in ENF 13.7 (part of the FSA's Handbook of rules and guidance).

2. REASONS FOR THE ACTION

2.1. The FSA concluded that, during the relevant period, CHL failed to exercise adequate management and control over its sales process and advisers in relation to regulated mortgage business and failed to treat its customers fairly.

2.2. The FSA made the following findings.

(1) There was inadequate management and control over CHL's mortgage sales process, particularly in terms of the absence of a formal arrangement for recording customers' personal and financial information to support any assessment of affordability and suitability of recommended mortgage contracts (Principle 3).

(2) There was inadequate monitoring of the suitability of advice and of compliance with regulatory requirements by CHL's management (Principle 3).

(3) CHL also failed to provide information, such as Key Facts Illustrations, to its clients in an appropriate and timely manner (Principle 7).

(4) There was no formal T&C regime in place for CHL's mortgage advisers. T&C reviews of advisers did not take place (Principle 3).

2.3. The above failures are regarded by the FSA as serious because the inadequate management and control of the sales process, and over-reliance on advisers' informal knowledge of clients' personal and financial circumstances and on lenders applying their lending criteria to check the affordability of recommended mortgage contracts, means there is a risk that customers may potentially not be able to afford to keep up mortgage payments in the longer term. That amounts to a failure by CHL to treat its customers fairly. Furthermore, lenders may have entered into mortgage contracts in circumstances where all relevant information about the client's financial position had not been made available by CHL. Also, the widespread record keeping failures identified by the FSA would hinder any independent assessments completed by a third party such as the FSA's supervision staff, and the Financial Ombudsman Service if any customer complaints needed to be investigated.

2.4. The FSA took into account the following steps taken by CHL which are regarded as mitigating factors:

(1) CHL has been open and fully co-operative with the FSA's investigation.

(2) CHL accepted there had been management and control failures during the relevant period. It appointed external compliance consultants immediately after the FSA drew the failures to its attention and implemented a series of changes to its practices and procedures. The remedial action included: new documentation for the IDD and fact find; a new affordability assessment for customers; a personalised mortgage suitability letter; regular compliance monitoring of client files; and the implementation of a T&C regime for its advisers.

2.5. While the FSA found no particular evidence of unsuitable advice, CHL's records were not adequate and it was not possible to make a proper assessment of the quality and suitability of advice. A third party will therefore undertake a past business review and report the outcome to the FSA, to help mitigate any risk to consumers. If it is established that, behind the record keeping failures, CHL failed to take reasonable care to ensure the suitability of its advice and actual detriment to consumers is identified, the FSA has reserved its right to take further action.

3. RELEVANT STATUTORY PROVISIONS, REGULATORY REQUIREMENTS AND GUIDANCE

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

3.2. The FSA has the power, pursuant to section 206 of the Act, to impose a financial penalty of such amount as it considers appropriate where the FSA considers an authorised person has contravened a requirement by or under the Act.

Principles for Businesses

3.3. Section 138 of the Act provides that the FSA may make such rules applying to authorised persons as appear to it to be necessary or expedient for the purpose of protecting consumers.

3.4. Under the FSA's rule-making powers, the FSA published the Principles for Businesses ("Principles").

3.5. Principle 3 states that a firm must take reasonable care to organise and control its affairs responsibly and effectively, with adequate risk management systems.

3.6. Principle 7 states that a firm must pay due regard to the information needs of its clients, and communicate information to them in a way which is clear, fair and not misleading.

MCOB

3.7. MCOB 4.7.2R states that a firm must take reasonable steps to ensure that it does not make a personal recommendation to a customer to enter into a regulated mortgage contract, or to vary an existing regulated mortgage contract, unless the regulated mortgage contract is, or after the variation will be, suitable for that customer.

3.8. MCOB 4.7.4R provides, for the purposes of MCOB 4.7.2R, that a regulated mortgage contract will be suitable if, having regard to the facts disclosed by the customer and other relevant facts about the customer of which the firm is, or should reasonably be, aware, the firm has reasonable grounds to conclude that: (a) the customer can afford to enter into the regulated mortgage contract; (b) the regulated mortgage contract is appropriate to the needs and circumstances of the customer; and (c) the regulated mortgage contract is the most suitable of those that the firm has available to it within the scope of the service provided to the customer.

3.9. MCOB 4.7.17R states that a firm must make and retain a record (1) of the customer information, including the customer's needs and circumstances, that it has obtained for the purposes of MCOB 4.7; and (2) that explains why the firm has concluded that any personal recommendation given in accordance with MCOB 4.7.2R satisfies the suitability requirements in MCOB 4.7.4R(1).

3.10. MCOB 5.5.1R states that a firm must provide the customer with an illustration for a regulated mortgage contract before the customer submits an application for that particular regulated mortgage contract to a mortgage lender.

T&C

3.11. T&C 2.3.1R provides that where a firm's employees engage in or oversee an activity with or for private customers, the firm must, at appropriate intervals, determine the training needs of those employees and organise appropriate training to address these needs; and ensure that training is timely, planned, appropriately structured and evaluated. Under T&C 2.8.1R a firm must make appropriate records to demonstrate compliance with the Training and Competence rules and such records should be retained by the firm for at least three years.

4. FACTS AND MATTERS RELIED ON

Background

4.1. CHL is a mortgage broker which was incorporated in 1997 and has been authorised by the FSA since 31 October 2004. It advises on regulated mortgage contracts principally for tenants of local authorities and housing associations in relation to the purchase of their homes at a discounted market rate under the right to buy scheme ("RTB"). CHL is also involved in arranging insurance contracts.

4.2. RTB was introduced under the Housing Act 1980 and gave qualifying tenants the right to buy their homes.

4.3. The majority of CHL's completed cases relate to RTB mortgages and re-mortgages for customers who could not obtain "high street" mortgages.

4.4. CHL has one managing director and a non-executive director. There are two mortgage advisers and a small team of administrative staff.

4.5. CHL was one of 65 mortgage brokers (78 firms in total) to be visited by the FSA in 2006 as part of its "mortgages quality of advice process" project. It was one of six firms referred to the FSA's Enforcement Division ("Enforcement") from the project.

4.6. The FSA's Small Firms Division ("SFD") visited CHL in July 2006. During the visit, SFD identified the following main issues of concern about CHL's systems and controls, sales processes, and training and competence regime.

(1) The standard of advice provided by CHL's advisers and the way that the advice was recorded appeared to be inadequate.

(2) The sales processes and information gathering prior to making recommendations to customers and, in particular, the assessment of clients' needs and circumstances and disclosure of fees by CHL, appeared to be inadequate.

(3) The monitoring of advice given by CHL's advisers by management and the recording of such compliance monitoring appeared to be inadequate.

(4) There was no evidence of a T&C scheme in place for CHL's advisers.

Enforcement investigation

4.7. Enforcement visited CHL on 21 November 2006. A sample of eighteen of CHL's client files were reviewed by the investigators.

Breaches of Principles

4.8. The following main issues of concern were identified.

(1) CHL exercised inadequate management and control over its sales process. It failed to ensure that there was sufficient information gathering and recording of clients' personal and financial circumstances to demonstrate whether CHL had made suitable recommendations (Principle 3).

(2) In the absence of a formal system in place to assess affordability of recommended mortgage contracts, CHL relied on its advisers' informal and undocumented knowledge of clients' circumstances. CHL also said that it relied on lenders applying their lending criteria to ensure ultimately that the recommended mortgage contracts were affordable (Principle 3).

(3) As such, CHL could not demonstrate whether its clients could afford to enter into the regulated mortgage contracts or that the recommended mortgage contracts were suitable in terms of affordability (Principle 3). For example:

(a) costs such as utilities, food and travel were not taken into consideration and the level of the client's disposable income was not recorded;

(b) retirement ages of customers were not recorded and CHL could not demonstrate that affordability into retirement had been assessed; and

(c) where fees had been added to the mortgage, CHL could not demonstrate how or whether customers had been made aware of the additional cost implications.

(4) CHL could not demonstrate why particular mortgages and lenders had been recommended to its customers. There was inadequate evidence of product research on file. In one case there was a printout of a specific lenders product list to show a "Top 10" listing but the product selected did not appear to be the cheapest listed and there was no documented explanation of the reason for the selection. Even in the instances where a "product selector" was on file, it was difficult to identify the basis on which the particular products had been selected (Principle 3).

(5) CHL failed to provide information to clients in an appropriate and timely manner (Principle 7).

(a) The relevant Key Facts Illustrations ("KFIs") were not always on the client files or there were several different KFIs on the same client file with no explanation or indication of which mortgage contract had been recommended and in what circumstances (i.e. advised or non-advised). This failure would have hindered the ability of CHL's management to carry out effective monitoring and checking of the suitability of recommendations to enter into regulated mortgage contracts.

(b) In two of the 18 cases, the KFI was issued after the mortgage offer had been received by the client. In one case the mortgage offer preceded the date of issue of the KFI by some 20 days.

(6) There was no evidence of monitoring of advisers by CHL's management (Principle 3).

(7) There was no formal T&C regime in place and no T&C reviews of CHL's mortgage advisers took place (Principle 3).

(8) There was no defined system in place for recognising and dealing appropriately with non-advised sales (Principle 3).

4.9. When CHL's management was interviewed by the investigators in March 2007 it accepted the FSA's findings as to the inadequacy of CHL's mortgage sales process and training and competence regime during the relevant period. CHL's management demonstrated that remedial action had since been undertaken with support from external compliance consultants.

Breaches of MCOB

4.10. CHL failed to take reasonable steps to ensure that the personal recommendation it made to a customer to enter into a regulated mortgage contract was suitable for that customer. There was insufficient detail on client files to show how the mortgage contract had been selected. CHL has breached MCOB 4.7.2R and 4.7.4R.

4.11. No affordability calculations were recorded and CHL could provide no evidence of product research being undertaken, in breach of MCOB 4.7.4R.

4.12. CHL failed to retain adequate records of customer information and by doing so has breached MCOB 4.7.17R.

4.13. In two cases, CHL issued KFIs after the mortgage offers had been received by clients, in breach of MCOB 5.5.1R.

Breaches of T&C

4.14. There was no training programme in place for advisers at CHL which there must be in accordance with T&C 2.3.1R. Appropriate records of training should also have been kept by CHL but they failed to keep such a record and have therefore breached T&C 2.8.1R.

5. ANALYSIS OF THE SANCTION

5.1. The FSA's general approach to taking disciplinary action is set out in Chapter 11 of the Enforcement Manual ("ENF"), which is part of the FSA's Handbook of rules and guidance. The purpose of taking disciplinary action, generally, is to show that regulatory standards are being upheld.

5.2. The FSA's policy on the imposition of financial penalties is set out in ENF 13. The principal purpose of financial penalties is to promote high standards of regulatory conduct by deterring firms and approved persons who have breached regulatory requirements from committing further contraventions, helping to deter other firms and approved persons from committing contraventions and demonstrating, generally, to firms and approved persons, the benefit of compliant behaviour (ENF 13.1.2G).

5.3. In determining whether a financial penalty is appropriate and proportionate, the FSA will take into account all the relevant circumstances of a case. ENF 13.3.3G sets out guidance on a non-exhaustive list of factors that may be of relevance in determining the amount of a financial penalty, which include the following:

ENF 13.3.3G(1): The seriousness of the misconduct or contravention

5.4. The FSA had regard to the seriousness of the contraventions by CHL, including the nature of the requirements breached, the number and duration of the breaches, the systemic weaknesses of the management systems and the number of customers placed at risk. Consideration was given, in particular, to the fact that the misconduct hindered the ability of CHL's management to monitor and check the suitability of advice, and also hindered the ability of any third parties to make assessments as necessary.

ENF 13.3.3G(2): The extent to which the misconduct was deliberate or reckless

5.5. The FSA found no evidence that the conduct in issue was deliberate or reckless and there was no particular evidence of detriment to clients. Nevertheless, a third party will conduct a review of past business and report on whether, beneath the record keeping failures, CHL's advisers made unsuitable recommendations to customers, to help mitigate any risk to consumers.

ENF 13.3.3G(3): Size, financial resources and other circumstances of the firm

5.6. The FSA is satisfied that CHL has the means to pay the level of financial penalty imposed on it. In determining the level of penalty, the FSA has also taken into account the likely cost of the past business review.

ENF 13.3.3G(4): The amount of profits accrued or loss avoided

5.7. The FSA found no evidence that CHL sought to make profit or avoid loss by the approach taken to its record keeping or by the failure in its systems and controls.

ENF 13.3.3G(5): Conduct following the contravention

5.8. The FSA has taken into account CHL's co-operation with the FSA's investigation and its willingness to take all reasonable steps to satisfy the FSA that regulatory requirements will be met by CHL on an on-going basis. CHL has agreed to a review of past business and to take any further remedial steps considered to be appropriate. CHL also reviewed the documents used during its sales process and, with input from external compliance consultants, made suitable changes to address the FSA's concerns.

ENF 13.3.3G(6): Disciplinary record and compliance history

5.9. CHL has no previous disciplinary record.

ENF 13.3.3G(7): Previous action taken by the FSA

5.10. The FSA has taken into account penalties imposed on other authorised persons for similar and more serious conduct and to previous cases where private warnings were given to authorised persons for less serious conduct or more limited record-keeping failures.

6. DECISION MAKERS

6.1. The decision which gave rise to the obligation to give this Final Notice was made by the executive decision makers on behalf of the FSA.

7. IMPORTANT

7.1. This Final Notice is given to CHL in accordance with section 390 of the Act. The following statutory rights are important.

Manner of and time for Payment

7.2. The financial penalty must be paid in full by CHL to the FSA by no later than 13 August 2007, 14 days from the date of this Final Notice.

If the financial penalty is not paid

7.3. If all or any of the financial penalty is outstanding on 14 August 2007 the FSA may recover the outstanding amount as a debt owed by CHL 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 CHL 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, please contact Chris Walmsley (direct line: 020 7066 5894) of the Enforcement Division of the FSA.

Jonathan Phelan
Head of Department
FSA Enforcement Division