Financial Services Authority

FINAL NOTICE

To: **Hadenglen Home Finance Plc**

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

Date: **6 September 2007**

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

THE PENALTY

1. The FSA gave Hadenglen Home Finance Plc (Hadenglen) a Decision Notice on 3 September 2007 which notified Hadenglen that pursuant to 206 of the Financial Services and Markets Act 2000 (FSMA), the FSA had decided to impose a financial penalty of £133,000 on Hadenglen. This penalty is in respect of breaches of Principles 3 and 9 of the FSA's Principles for Businesses (the Principles) and associated rules between 14 January 2005 and 2 November 2006 in relation to the sale and monitoring of payment protection insurance (PPI) and between 31 October 2004 and 15 June 2007 in relation to the sale and monitoring of re-mortgages (together, the relevant period).

2. Hadenglen confirmed on 31 August 2007 that it will not be referring the matter to the Financial Services and Markets Tribunal.

3. Accordingly, for the reasons set out below and having agreed with Hadenglen the facts and matters relied on, the FSA imposes a financial penalty on Hadenglen in the amount of £133,000.

4. Hadenglen agreed to settle this matter at an early stage of the proceedings. It therefore qualified for a 30% reduction in penalty, pursuant to the FSA's executive settlement procedures. Were it not for this reduction, the FSA would have sought to impose a financial penalty of £190,000 on Hadenglen.

REASONS FOR THE ACTION

5. The FSA has imposed a financial penalty on Hadenglen for breaches of the FSA's Principles and rules. These breaches relate to failures by Hadenglen in relation to the systems and controls surrounding the sale and monitoring of re-mortgages and PPI, senior management arrangements and the training and competence arrangements for its sales advisers. They also relate to the suitability of advice being given to customers in the course of advised sales of PPI and re-mortgages. These breaches, which are described in more detail in paragraphs 30-62 below, relate to Hadenglen's failure:

   a) to take reasonable care to organise and control its affairs responsibly and effectively, with adequate risk management systems; and

   b) to take reasonable care to ensure the suitability of its advice for customers who are entitled to rely upon its judgement.

6. The FSA views Hadenglen's failings as serious because its actions exposed approximately 1,900 customers who were sold PPI, and 2,000 customers who were sold re-mortgages, to an unacceptably high risk of being sold re-mortgage and PPI products which were unsuitable for their needs and therefore to the risk of financial loss.

7. Hadenglen is a mortgage broker specialising in sub-prime and right to buy mortgages and associated sales of insurance. Its customer base consists largely of customers with impaired credit ratings who may therefore have limited financial choices available to them. In respect of re-mortgages, the impact of any unsuitable advice was potentially high as the re-mortgage was typically financing the customers' homes. Certain significant aspects of the re-mortgage failings continued until June 2007 despite the FSA communicating its concerns to Hadenglen prior to and during the Enforcement investigation.

8. In relation to PPI, Hadenglen from January 2005 to June 2006 did not check the suitability of its sales of PPI. Thereafter Hadenglen performed a check which did not consider all the relevant criteria necessary to ensure the suitability of the product recommended. These failings continued despite the fact that it was put on notice of the FSA's concerns regarding sales of PPI in a Dear CEO letter on 4 November 2005.

9. The following failings in Hadenglen's systems and controls were identified:

   a) it failed properly to establish its customers' needs in relation to re-mortgage sales. This meant that customers re-mortgaged and incurred significant charges, including an early redemption charge (ERC) and fee payable to Hadenglen, when there were other, potentially more suitable options available to them;

   b) when customers re-mortgaged to raise additional capital or secure a lower rate of interest, Hadenglen's advisers did not consider information sufficient to compare the benefits of re-mortgaging with the costs prior to making a recommendation;

c) customers who re-mortgaged on the basis of raising additional capital incurred significant charges, without Hadenglen being able to demonstrate that this was in their best interests;
d) it failed to ensure that the total costs of re-mortgaging were disclosed to customers prior to them accepting Hadenglen's recommendation to re-mortgage;

e) it failed appropriately to establish a customer's demands, needs and eligibility for PPI before making a recommendation. This meant that there was an unacceptable risk customers would be sold a product they could not claim on or was not suitable;

f) prior to June 2005, it failed to provide customers with a Statement of Demands and Needs (SODAN) for PPI. After June 2005, the SODAN provided to customers failed to set out that Hadenglen had made a personal recommendation and the reasons for the recommendation; and

g) it failed to gather adequate management information to effectively monitor the risks to customers arising from its sales process. Consequently, it was unaware that 45% of claims made by Hadenglen's PPI customers had been rejected by the product provider.

10. Hadenglen's failings therefore merit the imposition of a financial penalty. In deciding upon the level of disciplinary sanction, the FSA recognises the following measures taken by Hadenglen which have served to mitigate the seriousness of its failings:

a) following the FSA's visit in October 2006, Hadenglen understood the seriousness of the issues and implemented a comprehensive review of all its systems and controls and retained external consultants to advise on that process. This has led to significant and ongoing changes being adopted on all areas of Hadenglen's business including training, compliance, management information and sales processes. These changes were effected in consultation with the external advisers and monitored by the FSA;

b) reviewing its existing PPI sales processes in 2006 in order to ensure that Hadenglen's sales advisers only recommend PPI when it is suitable for the customer. However there were significant delays in implementing effective changes to the re-mortgage process;

c) engaging independent consultants to review new sales of PPI and re-mortgages and, following discussions with the FSA implementing a remedial action plan for past sales which involves a customer contact exercise and compensation where appropriate;

d) re-organising its compliance function, during 2007, to ensure that it is an effective control to mitigate the risk of Hadenglen's sales advisers providing unsuitable advice; and

e) co-operating fully with the Enforcement action. Hadenglen has agreed the facts quickly ensuring efficient resolution of the matter and has received credit for settlement at an early stage. Without this level of co-operation the financial penalty would have been higher.

BACKGROUND

The firm

11. Hadenglen has been authorised by the FSA since 31 October 2004 to advise on and arrange regulated mortgage contracts. Since 14 January 2005, Hadenglen also has held permissions in respect of advising on and arranging non- investment insurance contracts. During the relevant period Hadenglen had between 12 and 20 advisers.

The products sold

12. Hadenglen's primary business is advising on and arranging mortgage contracts for local authority tenants who want to purchase their property under the "Right to Buy" scheme. Hadenglen also advises on re-mortgages, largely for its existing right to buy clients. Following the successful purchase of the property, Hadenglen contacts its customers to discuss transferring the debt to a new mortgage. This can be with a different mortgage provider and is usually on different terms and conditions. Customers pay a fee to Hadenglen of typically £1,995 for advice in relation to the re-mortgage.

13. Hadenglen's customer base for re-mortgages is typically "sub-prime". Sub-prime mortgages are generally sold to customers with low or impaired credit ratings who may find it difficult to obtain finance from traditional sources. In addition to mortgages and re-mortgages Hadenglen conducts secured loan business. Secured loans are not regulated by the FSA.

14. Hadenglen also offers PPI to its customers to protect repayment of a mortgage, re-mortgage or secured loan in the event of accident, sickness or involuntary unemployment. Hadenglen sells predominantly single premium PPI policies, typically with a term of five years. The cost of PPI is added to the cost of the mortgage and incurs interest during the term of the mortgage. The PPI premium and interest is typically between 2 and 4 % of the total mortgage debt.

15. The FSA's investigation has focused on Hadenglen's sales of re-mortgages and PPI sold in connection with the original mortgage, re-mortgage or secured loan. During the relevant period, Hadenglen sold approximately 2,000 re-mortgage contracts and 1,900 PPI policies.

The sales process

16. Mortgages, re-mortgages and accompanying PPI are sold on an advised basis via its sales advisers. Hadenglen's sales advisers are situated throughout the UK and work from home. In the first instance, customers are contacted by telephone to make an appointment for a sales adviser to visit the customer's home.

17. In respect of re-mortgages, at the first appointment with the customer, the sales adviser completes a fact find document. This document is then provided to an in-house team who, having considered the information completed as part of the fact finding process, selects a mortgage provider and contract for the customer. The sales adviser then visits the customer for a second time to discuss the details of the re-mortgage and completes the mortgage application form. The sales adviser will also consider whether the customer

requires PPI cover and, dependent on this consideration, recommends that the customer purchases PPI. A third appointment is then made with the customer once the mortgage offer has been received to confirm the details and complete the transaction.

18. Secured loans were sold by a separate department primarily over the telephone. Any PPI sold in conjunction with the secured loan would also be sold by the secured loans sales staff.

FSA thematic work

19. On 4 November 2005, the FSA wrote a Dear CEO letter to the industry, outlining the findings of the thematic project concerning PPI, and highlighting a number of key areas, where firms were not treating their customers fairly.

20. FSA Supervision carried out a visit on 10 May 2006, as part of phase two of a thematic project into the sale of PPI. FSA Supervision visited Hadenglen again on 9-10 October 2006 to carry out a review of the sale of re-mortgages. In addition to a number of issues identified with the sale of PPI during the 10 May 2006 visit, FSA Supervision identified additional concerns with the sale of re-mortgages during the 10 October 2006 visit.

21. The concerns identified by FSA Supervision during these visits included:

    a) practices that suggested Hadenglen did not treat its customers fairly, for example a significant number of customers re-mortgaged and incurred a substantial ERC;

    b) failure to gather and record sufficient information to demonstrate that the sales of re-mortgages and PPI were suitable;

    c) inadequate monitoring by Compliance of the sale of re-mortgages and PPI;

    d) management information used by senior management would not allow Hadenglen to effectively monitor risks of regulatory concern; and

    e) the training and competence regime, particularly for staff selling PPI in the secured loans department, was inadequate.

Remedial Action Plan

22. Following discussions with the FSA a remedial action plan for customers has been implemented which involves a customer contact exercise and compensation where appropriate.

RELEVANT STATUTORY AND HANDBOOK PROVISIONS

23. Section 206 of FSMA provides:

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

FSA Principles and Rules

24. The FSA's rule making power is set out in Chapter I of Part X of FSMA (Rules and Guidance). In accordance with the powers and provisions under this Part of FSMA the FSA has made Rules in respect of, amongst other things, senior management arrangements, systems and controls, training and competence, the conduct of mortgage business and the conduct of insurance business.

25. The FSA's Principles for Businesses are a general statement 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 FSMA and reflect the FSA's regulatory objectives.

26. The rules and Principles which are relevant to this case are set out at appendix 1.

BREACHES OF THE FSA PRINCIPLES FOR BUSINESSES AND RULES

Suitability

27. Principle 9 provides that:

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

28. In considering the standards required under this Principle, the FSA also has considered the specific requirements set out in Training and Competence (TC), Senior Management Arrangements, Systems and Controls (SYSC), Mortgages and Home Finance: Conduct of Business (MCOB), and Insurance: Conduct of Business (ICOB). The text of these rules can be found at Appendix 1.

Facts and matters relied on

29. By reason of the facts and matters detailed in paragraphs 30-53 the FSA has found that Hadenglen has breached Principle 9 of the FSA's Principles for Businesses and breached MCOB 4.7.2R, 4.7.4R, 4.7.6R, 4.7.17R, ICOB 4.3.1R, 4.3.2R, 4.3.6R, 4.4.1R, SYSC 3.1.1R and TC 2.3.1R and 2.6.1R. In certain respects the FSA considers that Hadenglen's conduct was reckless. In determining this the FSA has had particular regard to the guidance at DEPP 6.5.2(3)G.

Training and competence

30. Hadenglen failed to implement appropriate training and competence (T&C) requirements and procedures throughout the relevant period and therefore failed to take reasonable care to ensure that its advisers were capable of providing suitable advice.

31. Staff competency was assessed at the recruitment stage but competency was not appropriately assessed on an ongoing basis, in breach of TC 2.6.1R. For example, no data was collected on significant key performance indicators such as failings noted by Compliance or sales penetration rates and staff were not subject to regular review to assess competency on an ongoing basis. Hadenglen did not therefore take adequate steps to ensure its staff remained competent.

32. No training was provided to staff in respect of PPI products sold to protect the repayment of secured loans until June 2006, after a visit by the FSA. The failure to recognise that training was required on these products amounted to recklessness.

Compliance arrangements

33. Hadenglen failed to put in place adequate compliance monitoring arrangements and controls in respect of its sales of re-mortgages and PPI. As a consequence of this failing, Hadenglen was unable properly to assess its sales of re-mortgages and PPI and to take reasonable care to ensure that the recommendations provided by its advisers were suitable for the needs of its customers.

34. During the relevant period all mortgage and re-mortgage sales and any accompanying PPI sales were checked by Compliance twice. Files were initially checked by a compliance assistant after the customer fact find had been completed and a lender selected. The customer files would then be checked again by Compliance, prior to completion. However, Compliance's review was inadequate in that the only tool available to direct Compliance staff in their assessment of suitability and to record their consideration of a case was a perfunctory checklist which did not adequately consider all the matters relevant to compliance with FSA requirements.

35. The checklist was inadequate to consider the factors which are relevant to the suitability of a re-mortgage. Prior to August 2005, Compliance did not ensure that the charges which a customer would incur from early redemption of their existing mortgage were properly considered when the recommendation was made. After this time the checklist was amended to include one question: "Has the client been made aware of Early Repayment Charges". It was not, however, possible for Compliance to answer the question because there was no information recorded on the file to confirm a discussion about the ERC had taken place. The checklist also failed to direct Compliance staff to consider whether the ERC and other charges had been taken account of when advisers considered whether to make a re-mortgage recommendation. The compliance check was therefore inadequate to determine if the charges incurred had been properly considered and communicated to the customer.

36. In addition, the checklist contained only one question related to PPI "Has the (PPI) been sold in an appropriate manner?" All that was necessary to complete the checklist and answer the question was to indicate "yes" or "no". There were no procedures to direct Compliance staff's assessment of suitability. In addition, prior to May 2006 Compliance staff did not give any consideration to the suitability of the recommendation and only reviewed the customer's eligibility for PPI cover. Further, Compliance was not required to check sales of PPI sold to protect repayments in respect of secured loans.

37. Compliance either failed to identify issues relating to quality of advice or, in the limited number of instances where issues were identified, failed to ensure that appropriate remedial action was taken. Typically, the findings noted by Compliance in relation to re-mortgage and PPI sales related to administrative failings (such as duplicate copies of documentation) rather than issues relating to the quality of the advice provided by the sales advisers.

38. The FSA has therefore concluded that the compliance function at Hadenglen had systemic weaknesses and was inappropriate for its business. This failure was a breach of SYSC 3.1.1R.

Re-mortgage sales

39. Hadenglen had a process in place to gather personal and financial information from customers. However, that process was inadequate and therefore Hadenglen failed to gather sufficient information to establish whether a re-mortgage was suitable for a customer prior to making a recommendation. This failure was a breach of MCOB 4.7.2R. As a result Hadenglen failed to give proper consideration to the particular circumstances of each customer. This was particularly significant because, by re-mortgaging, customers typically incurred significant charges which increased the amount of debt assigned to the customer's primary asset: their family home.

40. During the relevant period, as a consequence of declining new right to buy mortgage business and in an effort to retain existing clients, Hadenglen decided to place greater emphasis on utilising its existing customer database to conduct re-mortgage business. At the beginning of 2005, Hadenglen determined that it was necessary to introduce a formalised diary system to maximise the opportunity to sell re-mortgages and mitigate the risk that customers may be approached by its competitors to effect a re-mortgage. This system required that all existing sub-prime mortgage customers be contacted to discuss re-mortgaging ten months after completion of their initial mortgage. At the beginning of the relevant period approximately 90% of re-mortgage sales were made to existing customers.

41. In designing and implementing this system, Hadenglen did not pay sufficient regard to the fact that on the sub-prime mortgages typically sold by Hadenglen, an ERC of between 5-6% of the value of the mortgage was imposed by the lender if it was redeemed in the first three years of the mortgage term. The ERC has the effect of increasing the redemption cost of the existing mortgage. In addition to the ERC, customers would also incur additional charges for effecting a re-mortgage. This included a fee payable to Hadenglen for advising on and arranging the re-mortgage. These fees are rolled up into the new mortgage increasing further the amount of debt secured against the property.

42. Hadenglen's customer files often noted that customers re-mortgaged in order to secure additional funds. In such instances it was imperative that Hadenglen's sales advisers gave consideration to alternative means of raising capital (for example, unsecured loans). However, the sales process did not require this and Hadenglen's sales advisers did not consider alternative options prior to recommending the re-mortgage. Hadenglen did not offer secured loans until January 2006 or unsecured loans until July 2007 nevertheless Hadenglen did not require its advisers to inform its customers of the availability of alternative forms of funding where appropriate. There is also no evidence on the sales files to demonstrate that customers were made aware of the full costs of re-mortgaging and that the cost had been considered by the adviser prior to making the recommendation. Given the additional costs arising from an ERC, the tactic of contacting sub-prime customers ten months after completion of the initial mortgage gave rise to a significant risk of unsuitable sales.

43. The sales process failed to ensure that Hadenglen took reasonable steps to ensure that the regulated mortgage contract was suitable for the customer, breaching MCOB 4.7.2R. The FSA finds that the sales process for re-mortgages was devised and implemented by Hadenglen without apparent consideration of the consequences of the process. To this extent, Hadenglen's behaviour amounted to recklessness.

44. Hadenglen provides a document to customers called "reasons for recommendation". This document does not include sufficient information to demonstrate that a recommendation to re-mortgage is suitable. In particular, the document does not detail the charges which will be incurred by re-mortgaging and there is no consideration of whether those charges represent value for money in the context of the amount of capital which will be raised. This deficiency meant that Hadenglen did not take reasonable steps to ensure the suitability of its advice, in breach of MCOB 4.7.2R.

45. In a number of cases the re-mortgage term extended into the customer's retirement but the sales process did not require and Hadenglen's advisers did not collect sufficient information about any pension or other provisions in place. As a result Hadenglen did not have reasonable grounds to conclude that the customer was able to meet the mortgage repayments in retirement, in breach of MCOB 4.7.4R.

46. Hadenglen's customer files also often noted that customers re-mortgaged in order to consolidate existing debts. In such instances it was important that Hadenglen's sales advisers gave consideration to whether the benefits of consolidating debt outweighed the cost of re-mortgaging. Hadenglen's sales process did not require, and its advisers did not give consideration to, the costs associated with increasing the period over which the debt is to be repaid or to whether it was appropriate to secure a previously unsecured debt. Where a customer was known to have payment difficulties, it also failed to require its advisers to consider whether it would have been more appropriate for the customer to negotiate an agreement with their creditors rather than take out a regulated mortgage contract. These failings are a breach of MCOB 4.7.6R.

47. In the files sampled by the FSA, the total charges for re-mortgaging, as a proportion of the funds raised, were significant and typically included an ERC of 5-6% of the value of the existing mortgage and a fee to Hadenglen of £1,995. In some cases the combined costs incurred by the customer in re-mortgaging were significantly greater than the capital raised. However, Hadenglen's sales process did not require and its advisers did not give

an adequate reason for why the re-mortgage had continued despite the significant cost. The FSA could not therefore determine that these sales were suitable on the basis of the information recorded on customer files, in breach of MCOB 4.1.17R.

PPI sales

48. Hadenglen's sales process was inadequate to ensure that its PPI recommendations were suitable for its customers. The fact finding process was inadequate, as the information gathered was insufficient for the adviser to consider fully a customer's demands and needs. This meant that advisers did not take reasonable steps to ensure the suitability of their recommendation to purchase PPI, in breach of ICOB 4.3.1R. The failings in the fact finding process arose from an assumption that its customers would not have any existing insurance cover or other resources from which mortgage repayments could be made. This resulted in Hadenglen breaching ICOB 4.3.2R.

49. Firms have been required to provide customers with a SODAN since 14 January 2005. A SODAN must set out the customer's demands and needs for the product; confirm whether a personal recommendation has been made; and, where a personal recommendation has been made, explain the reasons for that recommendation. Providing customers with clear and understandable information about how the product meets their demands and needs and the reasons for the advice given is important to allow them to reflect on the recommendation.

50. The design of the SODAN simply required the sales adviser to identify whether a number of generic statements were applicable to that client's circumstances but did not require the sales adviser to explain the reasons for personally recommending the contract. The advisers also did not make an assessment of the affordability of the PPI contract that resulted in Hadenglen breaching ICOB 4.3.6R. For example, they did not consider whether funding the PPI contract through single or regular premiums was more suitable.

51. Hadenglen's advisers systematically recommended single premium as they considered it to be beneficial for both the customer and Hadenglen. Hadenglen considered that its customers would be insufficiently disciplined to commit to funding PPI through regular premium policies and that customers would be tempted to cancel the policy (despite it being in their interests to maintain the policy) if they were required to make monthly payments. Single premium generated higher initial commissions for Hadenglen.

52. In the sample of PPI sales reviewed by the FSA the customer's total debt was increased by between 2% and 4% through the addition of the premium and associated interest.

53. The FSA finds that the sales process adopted in respect of PPI sales had insufficient regard to FSA rules governing such sales and the interests of Hadenglen's customers. In particular, the FSA finds that Hadenglen was reckless in so far as no apparent consideration was given to the consequences of adopting a PPI sales process that did not require an assessment of suitability. The failings in respect to sales of PPI continued until November 2006.

Systems and Controls

54. Principle 3 provides that:

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

55. In considering the standards required under this Principle, the FSA has also considered the specific requirements of SYSC and ICOB.

Facts and matters relied on

56. By reason of the facts and matters detailed in paragraphs 57-62 the FSA has found that Hadenglen has breached Principle 3 of the FSA's Principles for Businesses and breached SYSC 3.1.1R and ICOB 4.4.1R by failing to control and organise its affairs responsibly and effectively.

Senior management arrangements

57. The delegation of duties at Hadenglen was not adequately considered by senior management and not formally documented. There were also no adequate procedures outlining when issues needed to be escalated. In particular, senior management did not consider what responsibilities each department had for ensuring Hadenglen's advice was suitable. For example, where Compliance and an adviser disagreed about whether a recommendation was suitable, there were no adequate procedures for how the issue should be escalated and resolved. This is a breach of SYSC 3.1.1R.

58. Senior management had only limited knowledge and experience of the compliance requirements for re-mortgages and PPI. Senior management allowed Compliance an inappropriate degree of autonomy and did not assess the appropriateness of the monitoring systems implemented by Compliance in breach of SYSC 3.1.1R. For example, senior management failed to enquire what assessment of suitability was made by Compliance in respect of PPI and was therefore unaware that no assessment was made by Compliance prior to May 2006.

59. Hadenglen reviewed the FSA's Dear CEO letter on PPI sent to firms on 4 November 2005. The Dear CEO letter asked firms consider the appropriateness of their systems and controls with regard to PPI. However, any assessment undertaken by Hadenglen was ineffective in that, whilst Hadenglen's response to the FSA stated that it had reviewed its SODAN in light of the Dear CEO letter, the SODAN remained inadequate to meet the requirements of ICOB (see paragraph 50). The Dear CEO letter also encouraged firms to review the adequacy of their T&C arrangements. Despite this Hadenglen continued to operate a PPI training programme that failed to consider the training needs of staff in the secured loan department (see paragraph 32).

Management information

60. Hadenglen did not produce appropriate management information to enable it adequately to manage the risk that its advisers might make unsuitable sales in breach of SYSC 3.1.1R. For example, senior management failed to request any management information

from its PPI product provider, such as cancellation and claims information, which would have allowed it to monitor the advice given by advisers. Consequently, Hadenglen was unaware that 45% of PPI claims made by Hadenglen's customers had been rejected by the product provider. Senior management did not therefore adequately consider Hadenglen's sales process and whether it resulted in an unacceptably high risk of sales to customers who would be unable to claim on their policy.

61. Inadequate management information was considered at Board level. The lack of appropriate management information meant that senior management could not adequately monitor the risks to customers posed by the re-mortgage and PPI sales processes, in breach of SYSC 3.1.1R.

PPI sales

62. Despite SODANs being a requirement after 14 January 2005, Hadenglen failed to have processes in place to provide SODANs to its customers until June 2005 in breach of ICOB 4.4.1R. After this time a SODAN was introduced, but it was inadequate to set out the customer's demands and needs and to explain the rationale for the recommendation. Further, despite all sales being made on an advised basis, the wording of the SODAN was unclear whether a personal recommendation had been given. This meant that, as well as being inadequate to provide a customer with a clear explanation of the reasons for recommendation, it was insufficient to allow Compliance the information it needed to review the case and to manage the risk that the recommendation given was unsuitable for a customer.

RELEVANT GUIDANCE ON PENALTY

Determining the level of the financial penalty

63. The FSA's policy in relation to the imposition of financial penalties is set out in Chapter 6 of the Decision Procedure and Penalties Manual (DEPP) which forms part of the FSA Handbook. Paragraph 6.5.2G of DEPP sets out the factors that may be of particular relevance in determining the appropriate level of financial penalty for a firm or approved person. Paragraph 6.5.1(1)G states that the criteria listed in DEPP 6.5.2G are not exhaustive and all relevant circumstances of the case will be taken into consideration.

64. As set out in DEPP 6.5.2(2)G, the FSA has had regard to the seriousness of the contraventions, including the nature of the requirements breached and the number and duration of the breaches. For the reasons set out at paragraph 6 and having regard to the impact on Hadenglen's customers, the FSA considers that the breaches are of a serious nature. The seriousness is further increased by the fact that the breaches occurred over a period of 32 months.

65. The FSA has considered the extent to which Hadenglen's actions were reckless or deliberate as set out in DEPP 6.5.2(3)G. The FSA has not concluded that the contraventions by Hadenglen were deliberate. However, the FSA considers that the decision to introduce the system where customers were contracted every ten months to discuss re-mortgaging was one which was taken without due regard being given to the fact that re-mortgaging at that time would result in customers incurring potentially significant ERCs. This failing is further aggravated by the fact that Hadenglen had failed

to put in place appropriate systems and controls to ensure that re-mortgages were only recommended when the effect of the imposition of an ERC had been fully considered. Further, the delegation of responsibilities by senior management to Compliance, without first having agreed and understood the manner in which Compliance would review re-mortgage and PPI advice also indicates a failure to give proper consideration to the FSA requirements.

66. In summary, the FSA considers that the sales processes devised and implemented by Hadenglen in respect of both re-mortgages and PPI, were of such a nature that Hadenglen's conduct, to the extent referred to above, amounted to reckless misconduct. In this respect the FSA had particular regard to the extent that failings could have put customers at risk. This misconduct was then further compounded by the other failures, in respect of systems and controls, which failed to mitigate the risks created by the non-compliant sales processes.

67. Hadenglen derived considerable revenues through sales of re-mortgage and PPI. The remedial action that Hadenglen has committed to will ensure that any customer who has suffered financial detriment as a consequence of unsuitable advice provided by Hadenglen will receive appropriate compensation.

Mitigation

68. Hadenglen has engaged an independent consultant to review and assist in the implementation of changes to its compliance arrangements and systems, sales processes, training and competence and its TCF procedures. The independent consultant's reports were provided to the FSA and demonstrated that Hadenglen has improved its systems and controls. The independent consultant is continuing to work with Hadenglen to test how its revised systems and controls operate in practice.

69. Hadenglen has also committed to a remedial action plan. The plan involves contacting customers and where appropriate paying compensation.

70. Hadenglen has co-operated fully with the FSA and agreed the facts quickly ensuring efficient resolution of the matter. Further, Hadenglen has not previously been the subject of disciplinary action by the FSA.

CONCLUSION

71. Having regard to the seriousness of the breaches and the risk they posed to the FSA's statutory objectives of maintaining confidence in the financial system and securing the appropriate degree of protection for consumers, the FSA has imposed a financial penalty of £133,000 on Hadenglen.

DECISION MAKERS

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

IMPORTANT

73. This Final Notice is given to Hadenglen in accordance with section 390 of FSMA.

Manner of and time for payment

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

If the financial penalty is not paid

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

Publicity

76. Sections 391(4), 391(6) and 391(7) of FSMA 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 Hadenglen or prejudicial to the interests of consumers.

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

FSA contacts

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

William Amos
Head of Retail 1
FSA Enforcement Division

Appendix 1

The Principles

Principle 3 – A firm must take reasonable care to organise and control its affairs responsibly and effectively, with adequate risk management systems.

Principle 9 – 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.

The Rules

Systems and Controls

SYSC 3.1.1 R - A firm must take reasonable care to establish and maintain such systems and controls as are appropriate to its business.

Insurance Sales

ICOB 4.3 Suitability

ICOB 4.3.1 R Requirement for Suitability -
(1) An insurance intermediary must take reasonable steps to ensure that, if in the course of insurance mediation activities it makes any personal recommendation to a customer to buy or sell a non-investment insurance contract, the personal recommendation is suitable for the customer's demands and needs at the time the personal recommendation is made.

(2) The personal recommendation in (1) must be based on the scope of the service disclosed in accordance with ICOB 4.2.8 R (6).

(3) An insurance intermediary may make a personal recommendation of a non-investment insurance contract that does not meet all of the customer's demands and needs, provided that:

> there is no non-investment insurance contract within the insurance intermediary's scope, as determined by ICOB 4.2.8 R(6), that meets all of the customer's demands and needs; and
>
> the insurance intermediary identifies to the customer, at the point at which the personal recommendation is made, the demands and needs that are not met by the contract that it personally recommends.

ICOB 4.3.2 R - Information about the customer's demands and needs -
In assessing the customer's demands and needs, the insurance intermediary must:

(1) seek such information about the customer's circumstances and objectives as might reasonably be expected to be relevant in enabling the insurance intermediary to identify the customer's requirements. This must include any facts that would affect the type of insurance recommended, such as any relevant existing insurance;

(2) have regard to any relevant details about the customer that are readily available and accessible to the insurance intermediary, for example, in respect of other contracts of insurance on which the insurance intermediary has provided advice or information; and

(3) explain to the customer his duty to disclose all circumstances material to the insurance and the consequences of any failure to make such a disclosure, both before the non-investment insurance contract commences and throughout the duration of the contract; and take account of the information that the customer discloses.

ICOB 4.3.6 R - Assessing the suitability of a contract against the customer's demands and needs -
In assessing whether a non-investment insurance contract is suitable to meet a customer's demands and needs, an insurance intermediary must take into account at least the following matters:

(1) whether the level of cover is sufficient for the risks that the customer wishes to insure;

(2) the cost of the contract, where this is relevant to the customer's demands and needs; and

(3) the relevance of any exclusions, excesses, limitations or conditions in the contract.

ICOB 4.4 - Statement of demands and needs

ICOB 4.4.1 R -
(1) Unless ICOB 4.4.2 R applies, where an insurance intermediary arranges for a customer to enter into a non-investment insurance contract (including at renewal), it must, before the conclusion of that contract, provide the customer with a statement that:

(a) sets out the customer's demands and needs;

(b) confirms whether or not the insurance intermediary has personally recommended that contract; and

(c) where a personal recommendation has been made, explains the reasons for personally recommending that contract.

(2) The statement in (1) must reflect the complexity of the contract of insurance proposed.

(3) Unless (4) applies, the statement in (1) must be provided in a durable medium.

(4) An insurance intermediary may provide the statement in (1) orally if:

(a) the customer requests it; or
(b) the customer requires immediate cover;

but in both cases the insurance intermediary must provide the information in (1) immediately after the conclusion of the contract, in a durable medium.

Re-mortgage sales

MCOB 4.7 Advised sales - Suitability

MCOB 4.7.2 R -
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 (see MCOB 4.3.4 R (2), MCOB 4.3.5 G and MCOB 4.3.6 G).

MCOB 4.7.4 R –
For the purposes of MCOB 4.7.2 R:
(1) 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;

(2) no recommendation must be made if there is no regulated mortgage contract from within the scope of the service provided to the customer which is appropriate to his needs and circumstances; and

(3) if a firm is dealing with an existing customer in arrears and has concluded that there is no suitable regulated mortgage contract for the purposes of MCOB 4.7.2 R, the firm must nonetheless have regard to MCOB 13.3.2 E(1)(a), (e) and (f) (see also MCOB 13.3.4 G(1)(a) and (b)).

MCOB 4.7.6 R –
In relation to MCOB 4.7.4 R(1)(a) and (b), where a firm makes a personal recommendation to a customer to enter into a regulated mortgage contract where a main purpose is to consolidate existing debts it must also take account of the following, where relevant, in assessing whether the regulated mortgage contract is suitable for the customer:

(1) the costs associated with increasing the period over which a debt is to be repaid;

(2) whether it is appropriate for the customer to secure a previously unsecured loan; and

(3) where the customer is known to have payment difficulties, whether it would be more appropriate for the customer to negotiate an arrangement with his creditors than to take out a regulated mortgage contract.

MCOB 4.7.17 R – Record keeping -
(1) A firm must make and retain a record:

(a) of the customer information, including that relating to the customer's needs and circumstances, that it has obtained for the purposes of MCOB 4.7; and

(b) that explains why the firm has concluded that any personal recommendation given in accordance with MCOB 4.7.2 R satisfies the suitability requirements in MCOB 4.7.4 R(1). This explanation must include, where this is the case, the reasons why a personal recommendation has been made on a basis other than that described in MCOB 4.7.13 E(1).

(2) The record in (1) must be retained for a minimum of three years from the date on which the personal recommendation was made.

Training and Competence

TC 2.3.1 R –
If a firm's employees engage in or oversee an activity with or for private customers, the firm must:

(1) at intervals appropriate to the circumstances, determine the training needs of those employees and organise appropriate training to address these needs; and

(2) ensure that training is timely, planned, appropriately structured and evaluated.

TC 2.6.1 R –
A firm must have appropriate arrangements in place to ensure that an employee who has been assessed as competent to engage in or oversee an activity maintains competence.