
FINAL NOTICE

To: **Home and County Mortgages Limited**
Of: **3 Royal Court
Gadbrook Park
Northwich
Cheshire
CW9 7UT**

Date: 6 December 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. ACTION

- 1.1. For the reasons listed below and pursuant to section 206 of the Financial Services and Markets Act 2000 (“the Act”), the FSA decided to impose a financial penalty in the sum of £52,500 on Home and County Mortgages Limited (“HCML”) for breaches of the following Principles for Businesses (“Principles”) between 31 October 2004 and 7 December 2005 (“the period in issue”):

- (1) Principle 2 (Skill, care and diligence), and
 - (2) Principle 3 (Management and control).
- 1.2. HCML confirmed on 20 November 2006 that it will not be referring the matter to the Financial Services and Markets Tribunal.
 - 1.3. Accordingly, for the reasons listed below and having agreed with HCML the facts and matters relied on, the FSA imposes a financial penalty on HCML in the sum of £52,500.
 - 1.4. HCML agreed to settle at an early stage of the FSA's investigation. It therefore qualified for a 30% (stage 1) discount under the FSA's executive settlement procedures. The financial penalty was therefore reduced from £75,000 to £52,500 based on the facts and matters described in this Final Notice.

2. REASONS FOR THE ACTION

- 2.1. The FSA decided to impose a financial penalty on HCML in respect of breaches of the FSA's Principles identified in section 1 above that occurred in the period in issue.
- 2.2. HCML operates principally in the right to buy market, in which council tenants are able to purchase council houses from their local authorities at a discount to market value.
- 2.3. The conduct in issue may be summarised as follows:
 - (1) failure to take appropriate and timely action to prevent an adviser, Adviser A, from placing customers at risk (**Principle 3**);
 - (2) failure to monitor data entry staff to ensure that correct procedures were being followed and accurate information recorded (**Principle 2**);
 - (3) failures in respect of management and control to ensure compliance with HCML's documented sales processes including the retention of customers' income verification documents to evidence affordability (**Principle 3**);
 - (4) failure to exercise due skill care and diligence that resulted in two customers being recommended and sold a mortgage with an unauthorised lender (**Principle 2**);
 - (5) failure to ensure that, in every case, complaints handling procedures were adhered to and that all complaints were therefore dealt with appropriately and on a consistent basis (**Principle 2**); and
 - (6) failure to exercise due skill care and diligence in relation to the sales processes and sale of accident sickness and unemployment ("ASU") policies to customers (**Principle 2**).

3. RELEVANT STATUTORY PROVISIONS, REGULATORY REQUIREMENTS AND GUIDANCE

Statutory provisions

- 3.1. The FSA's statutory objectives, set out in section 2(2) of the Act are: market confidence; public awareness; the protection of consumers; and the reduction of financial crime.

Regulatory requirements

- 3.2. Under Principle 2 (Skill, care and diligence), a firm must conduct its business with due skill, care and diligence.
- 3.3. Under Principle 3 (Management and control), a firm must take reasonable care to organise and control its affairs responsibly and effectively, with adequate risk management systems.
- 3.4. The following rules and guidance are also relevant to the conduct in issue:
- (1) ICOB 5.5.14R (Statement of price)
 - (2) ICOB 8.3.1R (Disclosure requirements)
 - (3) MCOB 4.7.2R (Suitability and affordability)
 - (4) DISP 1.2.1R (Internal complaints handling procedures)
 - (5) DISP 1.2.16R (Investigation of complaints)
 - (6) SYSC 3.1.1R (Adequate risk management systems)

4. FACTS AND MATTERS RELIED ON

Background

- 4.1. HCML is a retail mortgage intermediary based in Northwich, Cheshire. It advises on regulated mortgage contracts solely for local authority tenants in relation to the purchase of council houses at a discounted market rate under the right to buy scheme. It advised approximately 660 customers in the period in issue.
- 4.2. The majority of HCML's customers are likely to have limited financial resources in addition some may already have significant levels of unsecured debt. It is particularly important that such clients are recommended mortgage contracts that are demonstrably affordable at the time of purchase and in the longer term because of the risk of repossession and of leaving the customers in a worse position. The consequences for right to buy mortgagees whose properties are repossessed as a result of failing to meet mortgage repayments are extremely serious. The local authority may class them as 'intentionally homeless' and would therefore not be under any obligation to re-house them. Under the right to buy scheme, council tenants are

entitled to a discount on the market value of their homes. If they need to sell the property, for example because of a change in financial circumstances, they would usually be required to repay some or all of the discount (“discount repayment”). Under The Housing Act 2004, the discount repayment period was extended from three to five years, and the discount repayment if the property is resold within the relevant period is now a percentage of the market value of the property when it is sold. Mortgage payment protection insurance is therefore a consideration for council tenants who decide to buy their home.

- 4.3. HCML became authorised by the FSA on 31 October 2004 to carry on the following regulated activities in relation to regulated mortgage contracts:
 - (1) advising on regulated mortgage contracts;
 - (2) agreeing to carry on a regulated activity;
 - (3) arranging (bringing about) regulated mortgage contracts; and
 - (4) making arrangements with a view to regulated mortgage contracts.
- 4.4. On 14 January 2005, HCML was granted permission to carry on the following additional regulated activities in relation to non-investment insurance contracts:
 - (1) advising on investments (except on Pension Transfers and Pension Opt Outs);
 - (2) arranging (bringing about) deals in investments; and
 - (3) making arrangements with a view to transactions in investments.
- 4.5. According to HCML, it currently employs nine advisers.
- 4.6. Mr Bowers is the sole director and owner of HCML. With effect from 31 October 2004, he was approved by the FSA to perform the significant influence functions of Director (CF1) and Apportionment and Oversight (CF8) in relation to regulated activities which HCML has permission to carry on.

Background to the investigation

- 4.7. The FSA’s Small Firms Division (“SFD”) visited HCML in November 2005 as a result of concerns relating to the management and control of its regulated activities and, more specifically, its selling practices and activities and in particular one of its advisers, Adviser A. Subsequently HCML agreed to conduct a past business review of a sample of its business. It produced a report of the review, a revised Initial Disclosure Document that it proposed to use in future, and details of its complaints procedures.
- 4.8. HCML’s internal review of Adviser A’s cases concluded that in some cases the quality of the advice given was poor, and in some cases there was evidence of falsification or inflation of income, where Adviser A had sought to explain his action

on the basis that it enabled customers to get a more affordable mortgage. Four cases of financial hardship were identified by HCML.

- 4.9. SFD decided that a skilled person should be appointed to conduct an independent review of a sample of client files (focussing in particular on Adviser A). It also referred HCML to the FSA's Enforcement Division and investigators were appointed on 16 March 2006.
- 4.10. Enforcement reviewed a sample of 20 client files from HCML and interviewed HCML staff. Enforcement reviewed a further 20 client files where the mortgages had been obtained through a lenders' online application facility, to compare the information contained on HCML's client files with that which had been entered by HCML onto the lender's online system. Enforcement also reviewed evidence of the action taken by HCML in response to Adviser A's misconduct.

Conduct in issue

Adviser A

- 4.11. HCML became aware of the allegations of income inflation and inappropriate sales practices that were being carried out by Adviser A, who advised on 83 cases. In March 2005 a disciplinary meeting was held, which resulted in a final written warning being given to Adviser A for having "wilfully and negligently failed in a large number of compliance aspects". HCML purported to limit Adviser A's role but the misconduct continued until Adviser A left HCML in October 2005.
- 4.12. Between March and October 2005, HCML became aware of two further instances in which Adviser A had falsified employment details of customers and inflated their incomes on mortgage applications. HCML discovered the first instance in March 2005, shortly after the disciplinary meeting, and the second instance in July 2005. Both of these cases appear on HCML's "serious complaints" register, despite which no decisive action was taken against Adviser A until 14 October 2005. In the opinion of the FSA, HCML failed to take appropriate action to prevent Adviser A from placing customers at risk (**Principle 2**).
- 4.13. HCML accepted that Adviser A, and in some specific instances other advisers, had inflated customers' incomes, and that its failure to ensure that systems and controls were in place to prevent this practice in the first place amounts to a breach of **Principle 3**. Furthermore it failed to address the matter in period up to the FSA's visit in November 2005.

Suitability of advice and record keeping

- 4.14. Enforcement considered whether the information retained on HCML's client files was sufficient to demonstrate that the mortgage contracts recommended were affordable. Evidence that a firm has taken reasonable steps to comply with the relevant regulatory requirements might include an affordability assessment and explanation as to why the mortgage contract recommended was considered to be suitable.

- 4.15. From an initial review of 23 client files the investigators found evidence of income verification on only four which would suggest that the adviser may not have satisfied himself of the customer's income. A review of a further 20 on-line applications confirmed such failures on nine applications. It appeared that even where customers had provided evidence of income it was not retained by HCML.
- 4.16. Enforcement considered whether there was evidence of inflation of customers' earnings on mortgage applications at HCML, and not just limited to Adviser A's cases. It found eight instances out of the sample of 20 online applications in which the customers' earnings as stated on the online mortgage applications were higher than that shown on the evidence provided by the customers.
- 4.17. There were files where there was a lack of documentary evidence of customers' incomes and other instances where income verification documents were not retained on the file. There were also cases where customers had not been provided with adequate and timely illustrations of the products. These issues are all regarded as evidence of HCML's failures in respect of management and control functions, which should include ensuring compliance with its documented sales processes, and represent a breach of **Principle 2**.
- 4.18. HCML accepted that it had failed to take reasonable care to ensure that its advisers made and retained adequate records of customers' personal and financial information, in breach of **Principle 2**.
- 4.19. Further failures in respect of management and control were noted in relation to the functions being carried out by HCML's data entry staff. HCML failed to ensure that customers' income details were being accurately recorded by data entry during the online application process and there were instances where basic income details were being inflated to include additional income too. This is further evidence of a breach of **Principle 2**.
- 4.20. Enforcement established that in two cases customers were sold mortgage products with an unauthorised lender. The unauthorised lender was referred to as Michael Bowers or M Bowers Homeloans, who is the director and proprietor of HCML although he was acting in his personal capacity. According to HCML, its staff made clear to the customers the fact that Mr Bowers was acting in his personal capacity. The FSA's conclusion is that, nevertheless, HCML failed to exercise the required degree of skill care and diligence by recommending mortgage contracts with a third party who was not authorised by the FSA to act as a lender and therefore acted in breach of **Principle 2**.

ASU policies

- 4.21. Since 14 January 2005, HCML sold approximately 500 ASU policies, of which approximately 300 were single premium policies. According to HCML, the majority of these policies were sold at the time of the purchase of the properties by the customers from the council and provided cover for three or five years corresponding with the discount repayment period. HCML's advisers would receive a completion fee of £100 for the sale of single premium ASU policies compared to £10 for the sale

of a regular premium ASU policy. HCML failed to ensure that its advisers discussed with customers and disclosed to them the total cost of the payment protection insurance policies, including interest payable on the premium (as appropriate).

- 4.22. HCML accepted that it had not taken sufficient care when giving advice in relation to payment protection insurance policies, in breach of **Principle 2** and, accordingly, it has made significant changes to its sales process to help ensure that it treats its customers fairly, which include a flat commission payment to advisers and an explanation of the total cost of the policies recommended.
- 4.23. Enforcement also found other matters of concern, albeit limited to smaller numbers of client files or individual clients from the sample reviewed, some of which are summarised below:
- (1) the Key Facts Illustrations on eight client files were dated after the mortgage offers had been made which suggests that the customers were not in possession of all the relevant information about the contract before completing their applications;
 - (2) the Key Facts Illustrations on a further five client files were dated after the mortgage offer from the lender;
 - (3) fact finds on three client files did not include adequate assessments of affordability into retirement;
 - (4) in one case, the customers had told HCML about two existing loans which were recorded accurately on the first fact find but only one was recorded on a subsequent fact find on the same file; and
 - (5) in another case the fact find incorrectly stated that the customer's current mortgage contract had no early redemption charge.

5. ANALYSIS OF SANCTION

- 5.1. The FSA's policy on the imposition of financial penalties is set out in Chapter 13 of the Enforcement Manual ("ENF"), which is part of the FSA's Handbook of rules and guidance. The principal purpose of a financial penalty is to promote high standards of regulatory conduct by deterring firms who have breached regulatory requirements from committing further contraventions, helping to deter other firms from committing contraventions and demonstrating generally to firms the benefits of compliant behaviour.
- 5.2. In determining whether a financial penalty is appropriate, and if so its level, the FSA is required to consider all the relevant circumstances of the case. ENF 13.3.3 sets out the factors that may be of particular relevance in determining the level of a financial penalty. The factors set out are not exhaustive (ENF 13.3.4). For the avoidance of doubt, this analysis of the level of penalty was undertaken before applying the 30% (stage 1) discount (ENF 13.7.3).

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

- 5.3. The FSA 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 customers affected and/or put at risk.
- 5.4. HCML failed to organise and control its affairs responsibly and effectively. The deficiencies in respect of systems and controls are highlighted by the misconduct of Adviser A and the failure to prevent further consumer detriment in the knowledge that he presented a risk to customers, and by HCML's failure, for example, to detect the discrepancies with income data on mortgage applications that resulted from the action of employees carrying out data entry tasks.
- 5.5. The FSA found that HCML had failed to ensure that there was documentary evidence on its customer files that advice given was suitable and that products recommended were affordable and appropriate to the needs of its customers. These failures are viewed as serious given the potential vulnerability of HCML's customers.

ENF 13.3.3(2): The extent to which the contraventions were deliberate or reckless

- 5.6. The FSA has concluded that HCML was reckless in recommending Mr Bowers as an unauthorised lender.

ENF 13.3.3(3): The size, financial resources and other circumstances of the firm and the amount of profit accrued or loss avoided

- 5.7. The FSA is satisfied that HCML has the means to pay the proposed financial penalty.

ENF 13.3.3(5): Conduct following the contravention

- 5.8. The FSA has taken into account HCML's decision to conduct a past business review and, subsequently to co-operate fully with the FSA, as well as the cost of the appointment of a skilled person, on the ability of HCML to pay a significant financial penalty. Also, HCML has agreed to take full remedial action to the satisfaction of the FSA, including in respect of the two customers who were sold products with an unauthorised lender named as "Mike Bowers" and "M Bowers Homeloans" respectively, and is arranging for alternative suitable mortgages.
- 5.9. Notwithstanding the fact that it was wrong of Mr Bowers to provide loans to the customers in the manner referred to in paragraph 5.8 above, Mr Bowers' explanation for providing the loans to the two customers is that the mortgages were in respect of non-traditional build properties where, at the time in question, only one authorised lender was able to offer mortgage finance, and the transactions were undertaken to enable the customers to complete right to buy contracts before the offers on their properties expired.
- 5.10. Some credit is also given for the fact that HCML eventually took action against Adviser A to address the risk posed to customers.

ENF 13.3.3(6): Disciplinary record and compliance history

- 5.11. HCML has no disciplinary record.

ENF 13.3.3(7): Previous action taken by the FSA in relation to similar behaviour

- 5.12. The FSA has taken into account disciplinary action taken against other authorised firms for similar misconduct.

6. RELEVANT STATUTORY PROVISIONS

- 6.1. The FSA's statutory regulatory objectives are set out in section 2(2) of the Act and may be summarised as follows: market confidence; public awareness; the protection of consumers; and the reduction of financial crime.
- 6.2. The FSA has the power pursuant to section 206 the Act to impose a penalty on an authorised person if it considers that he has contravened a requirement imposed on him by or under the Act.

7. DECISION MAKERS

- 7.1. 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.

8. IMPORTANT

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

Manner of and time for Payment

- 8.2. The financial penalty must be paid in full by HCML to the FSA by no later than 20 December 2006, 14 days from the date of this Final Notice.

If the financial penalty is not paid

- 8.3. If all or any of the financial penalty is outstanding on 20 December 2006, the FSA may recover the outstanding amount as a debt owed by HCML and due to the FSA.

Publicity

- 8.4. 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.
- 8.5. The FSA intends to publish such information about the matter to which this Final Notice relates as it considers appropriate.

FSA contacts

- 8.6. For more information concerning this matter generally, you should contact Chris Walmsley (direct line: 020 7066 5894) of the Enforcement Division of the FSA.

Jonathan Phelan

Head of Department

FSA Enforcement Division