
FINAL NOTICE

To: **Kensington Mortgage Company Limited**

Of: **2 Gresham Street
London
EC2V 7QP**

Date: **12 April 2010**

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 Kensington Mortgage Company Limited ("Kensington"/"the Firm") a Decision Notice on 9 April 2010 which notified the Firm that pursuant to section 206 of the Financial Services and Markets Act 2000 ("the Act"), the FSA had decided to impose a financial penalty of £1.225 million on the Firm in respect of breaches of Principle 3 (Management and control) and Principle 6 (Customers' interests) of the Principles for Businesses ("the Principles") and Rules 12.3.1 R, 12.5.1 R and 13.3.1 R in the Mortgages and Home Finance: Conduct of Business sourcebook ("MCOB") in the period between 1 January 2007 and 31 October 2008 ("the Relevant Period").

- 1.2. The Firm confirmed on 6 April 2010 that it will not be referring the matter to the Financial Services and Markets Tribunal. Kensington qualified for a 30% (stage 1) reduction in penalty, pursuant to the FSA's executive settlement procedures. Were it not for this discount, the FSA would have sought to impose a financial penalty of £1.75 million on the Firm.
- 1.3. Kensington will carry out a customer redress programme with a view to providing redress to all customers with regulated first charge mortgages that were in arrears and who were charged specific unfair and/or excessive charges in respect of their mortgage account. The estimated cost of redress is up to £1.066 million, including interest.

2. REASONS FOR THE ACTION

- 2.1. The breaches of the Principles and MCOB Rules, which are described in more detail in section 4 below, relate to a number of serious failings by Kensington in relation to customers with a mortgage with the Firm who were in arrears.
- 2.2. The Firm breached Principle 3 during the Relevant Period in that it failed to take reasonable care to organise and control its affairs responsibly and effectively, with adequate risk management systems. In particular, during the Relevant Period, Kensington failed to take reasonable care to establish and maintain adequate arrangements to oversee compliance with regulatory requirements. In particular, in relation to its mortgage arrears handling, the Firm:
 - (1) failed to establish and maintain a clear and appropriate apportionment of significant influence responsibilities among its directors and senior managers so that it was clear which individual held each of those responsibilities and so that the business and affairs of the Firm could be adequately monitored and controlled by the directors, senior managers and governing body of the Firm; and
 - (2) failed to establish and maintain sufficient oversight of its processes and procedures, including by failing to conduct adequate compliance checks and

failing to obtain and/or review sufficient management information to assess the handling of mortgage arrears and repossessions to ensure the fair treatment of customers.

2.3. Kensington breached Principle 6 during the Relevant Period in that it failed to pay due regard to the interests of certain of its customers and treat them fairly. In particular, the following failings were identified in that the Firm:

- (1) failed to take reasonable steps to ensure that the mortgage servicing staff acting on its behalf had an adequate understanding of and implemented the requirement to treat customers fairly in handling its mortgage arrears and repossessions activities;
- (2) focused on the collection of payment of arrears over a short period of time within fixed mandates, rather than establishing a suitable arrangement to pay based on the customer's individual circumstances; and
- (3) did not have an appropriate cost-based approach to the calculation of certain charges and applied three charges to customers' accounts that were unfair and/or excessive.

2.4. Kensington also breached MCOB 12.3.1 R, 12.5.1 R and 13.3.1 R in relation to the facts described at paragraph 2.3 above.

2.5. As a result of the breaches of Principles 3 and 6, Kensington failed to treat some of its customers fairly.

2.6. Accordingly, the failings merit the imposition of a substantial financial penalty. In deciding upon the appropriate disciplinary sanction, the FSA recognises the following factors which to a considerable extent, mitigate the seriousness of the findings:

- (1) Kensington substantially reviewed and revised its TCF processes, procedures and management information since the early part of 2008 and strengthened its corporate governance structure;
- (2) Since October 2009 Kensington changed its Terms of Business such that all new customers are not charged the early repayment charge ("ERC") on

mortgage balances including arrears fees and charges and the Firm was proactive in suggesting a customer contact and redress package in relation to certain charges imposed on customers by the Firm in connection with arrears handling and repossession activities;

- (3) Since the early part of 2008, Kensington has significantly enhanced its oversight of the mortgage servicing activities conducted on its behalf; and
- (4) Kensington's senior management have worked in an open and co-operative way with the FSA during the investigation and agreed to the facts quickly, ensuring early resolution of the matter and timely redress for customers.

3. RELEVANT STATUTORY PROVISIONS

3.1. The FSA's statutory objectives are set out in section 2(2) of the Act. The relevant objectives for the purpose of this case are maintaining market confidence and the protection of consumers.

3.2. Section 206 of the Act provides:

- (1) 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.

3.3. Kensington is an authorised person for the purposes of section 206 of the Act. A requirement imposed on a firm includes the Principles and Rules made under section 138 of the Act, which provides that the FSA may make such rules applying to authorised persons as appear to be necessary or expedient for the purposes of protecting the interests of consumers.

3.4. Principle 3 provides that:

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 that:

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

3.6. MCOB 12.3.1 R provides:

A firm must ensure that any regulated mortgage contract that it enters into does not impose, and cannot be used to impose, an early repayment charge other than one that is:

- (1) able to be expressed as a cash value; and
- (2) a reasonable pre-estimate of the costs as a result of the customer repaying the amount due under the regulated mortgage contract before the contract has terminated.

3.7. MCOB 12.5.1 R provides:

A firm must ensure that any regulated mortgage contract , home reversion plan or regulated sale and rent back agreement that it enters into does not impose, and cannot be used to impose, excessive charges upon a customer.

3.8. MCOB 13.3.1 R provides:

- (1) A firm must deal fairly with any customer who:
 - (a) is in arrears on a regulated mortgage contract or home purchase plan;
 - (b) has a sale shortfall; or
 - (c) is otherwise in breach of a home purchase plan.
- (2) A firm must put in place, and operate in accordance with, a written policy (agreed by its respective governing body) and procedures for complying with (1).

4. FACTS AND MATTERS RELIED ON

- 4.1. Since October 2004, Kensington has been authorised by the FSA with permission to arrange, administer and enter into regulated mortgage contracts. During the Relevant Period, the Firm operated as a non-bank specialist lender in mortgage products

primarily for self-employed and credit-impaired borrowers. Credit-impaired borrowers are perceived to have a high credit risk, often because of a poor credit history, or due to other characteristics that are associated with a high potential risk of defaulting on the mortgage. As at October 2008, Kensington had approximately £1.1bn of loans on its balance sheet and securitised assets in the region of £2.1bn. During the Relevant Period, Kensington administered on average 39,042 regulated mortgage contracts a month with a total balance of approximately £4.6bn.

- 4.2. Kensington was one of the firms that took part in the FSA's thematic work in connection with the Mortgage Effectiveness Review which started in 2008.

Management and Control: Apportionment and Oversight

- 4.3. In relation to its mortgage arrears and repossessions activities, Kensington failed properly to apportion significant responsibilities among its directors and senior managers so that it was clear which individual held each of those responsibilities such that the business and affairs of the Firm could be adequately monitored and controlled by the directors, senior managers and governing body of the Firm.
- 4.4. An internal audit report dated November 2007 reviewed the adequacy of Kensington's control framework for monitoring mortgage servicing staff acting on its behalf. The report assessed the inherent risk of the Firm's arrears handling activities as "*Extreme*" and identified weaknesses, including in relation to:
- (1) its apportionment of significant influence responsibilities;
 - (2) its process for escalating operational issues; and
 - (3) its compliance governance arrangements, including no evidence of a risk assessment having been conducted by the Firm's compliance function to prioritise regulatory risks associated with its arrears handling activities. For example, the 2007 monitoring programme made little provision for reviewing its arrears handling activities.
- 4.5. Amongst other things, the report recommended that the Firm's compliance department should develop a risk based monitoring programme. This recommendation

was accepted by management.

Management and Control: Compliance Monitoring, Processes and Procedures

- 4.6. During the Relevant Period, mortgage servicing staff acting on behalf of Kensington dealt with incoming and outgoing calls to, and correspondence with, customers in arrears. Mortgage servicing staff had prescribed mandates for approving the time period within which customers were required to clear any outstanding arrears or agree concessions such as a reduced Current Monthly Mortgage Payment, although they also had discretion to refer cases to Kensington's Customer Management Team to agree arrangements outside the prescribed mandates where appropriate.
- 4.7. Kensington engaged field counsellors to visit customers at home to discuss their mortgage arrears and obtain information on their personal and financial circumstances.
- 4.8. As set out below, Kensington failed to implement and maintain adequate compliance monitoring processes and procedures during the Relevant Period in relation to its mortgage arrears and repossessions activities, including by conducting inadequate monitoring of the mortgage servicing staff acting on its behalf.
- 4.9. The Firm was aware that its compliance department was inadequately resourced between October 2007 and March 2008 and that insufficient routine compliance monitoring was undertaken during this period.
- 4.10. Weaknesses relating to the Firm's compliance monitoring of its arrears and repossessions activities were set out in the findings of two reviews conducted for the Firm in April and June 2008, the findings of which are referred to below.

Compliance Monitoring Review Dated April 2008

- 4.11. A compliance monitoring review dated April 2008 assessed, amongst other things, the monitoring of the Firm's arrears procedures, practices and telephone calls from a TCF perspective. The review noted that:

“During the past six months the Kensington Compliance team has reduced from an overall resource of 7 full time staff to 1.5 full time staff and 0.5 administrators... Over the past 6-12 months the level of compliance monitoring has steadily reduced, as have documented client file reviews, arrears monitoring, complaint root cause analysis and telephone monitoring.”

- 4.12. The review also stated that as at January 2008, no regular on site or off site monitoring of the arrears handling function was being undertaken by the Firm’s compliance department.
- 4.13. Amongst other things, the review recommended regular monitoring of arrears handling calls by the Firm’s compliance department, to be incorporated into the 2008 Compliance Monitoring programme.

Compliance Monitoring Report Dated 3 June 2008

- 4.14. A compliance monitoring report dated 3 June 2008 found that *“the majority of calls were handled appropriately”*. However, it also noted that *“in some cases the customer’s circumstances should have led to a referral to management for further consideration”*. The report identified certain weaknesses in the Firm’s management of its arrears and reposessions activities, including in relation to its policy, oversight of arrears handlers, call monitoring and TCF.
- 4.15. Its findings included that:
- (1) the Firm was not implementing a *“robust oversight”* of the arrears management operation; and
 - (2) a low level of compliance monitoring activity was conducted during 2007 and early 2008.
- 4.16. In relation to Kensington’s Collection Policy Manual, the report concluded that there were some areas of the manual that did not fully comply with the requirements of MCOB:
- (1) it did not contain a reference to liaising with a third party source of advice where the customer makes arrangements for this;

- (2) it did not contain adequate reference to Kensington adopting a reasonable approach to the time over which a payment or sale shortfall should be repaid with particular regard to the need to establish where feasible, a payment plan which is practical in terms of the circumstances of the customer;
- (3) it did not contain reference to whether Kensington will grant a request from the customer to change the date or method of payment;
- (4) it did not contain reference to Kensington giving consideration, where no reasonable payment can be made, to the customer being allowed to remain in possession to effect a sale;
- (5) it did not contain reference to giving the customer a reasonable period of time to consider any proposals for arrangements to pay the payment or sale shortfall; and
- (6) the policy did not contain explicit references to how it ensured that customers in arrears or possession were treated fairly in practice, specifically that customers should be treated on an individual basis.

4.17. The report contained the following section on TCF:

“Everyone interviewed had an awareness of TCF. However, the call handlers’ ability to articulate what this meant within an arrears or repossessions environment was weak. Whilst it is acknowledged that call handlers operate within set mandates and procedures within which the fair treatment of customers is considered, a more detailed knowledge and understanding of how to apply TCF would be beneficial. This will enable call handlers to recognise when to refer customers whose circumstances may have TCF implications and fall outside of the established process.”

4.18. During the Relevant Period, Kensington’s own audits and reviews alerted it to failings relating to its arrears and repossessions activities, including deficiencies in the contents of its collections policy, its compliance monitoring and its implementation of TCF. The Firm failed to take adequate steps to act upon and/or remedy any of these failings in a sufficiently timely fashion.

Management Information

- 4.19. Kensington regularly reviewed the servicing of its mortgage accounts, but its reviews included few, if any, TCF and customer outcome measures. Instead, the Firm's management information focused on the performance of the Firm's mortgage book and the profitability of the business. Insufficient management information was produced to enable senior management of the Firm to monitor TCF outcomes at the Firm. For example, no management information was produced in relation to the uphold rates on "Arrangements to Pay"¹ ("ATPs") or the reasons for failed ATPs. Similarly, no management information was produced on the average success rates of the Firm's applications in repossession proceedings, nor the reasons for any such applications failing.
- 4.20. As a result of these failings, the Firm had insufficient management information properly to monitor its arrears and repossessions activities and to ensure that all customers were being treated fairly.

Staff Training

- 4.21. Training literature reviewed by the FSA identified that mortgage servicing staff acting on behalf of Kensington were encouraged to focus on obtaining maximum payments from customers rather than TCF issues.

Arrears and repossessions handling - failure to treat customers fairly

- 4.22. In dealing with customers who were in arrears with their mortgage, Kensington focused on establishing the maximum amount the customer could pay each month in addition to their current monthly mortgage payment in order that the customer would pay off their arrears as quickly as possible.
- 4.23. The FSA reviewed 30 customer files relating to customers who were in arrears and in some cases involved in repossession proceedings. The FSA also reviewed related telephone calls between mortgage servicing staff acting on behalf of Kensington and the Firm's customers. The FSA's findings in relation to those file reviews are set out

¹ An arrangement to pay is an agreement with the customer to effect a monthly payment over an agreed term in order to clear the customer's arrears.

below.

- 4.24. In 14 cases (46%) arrears handlers failed actively to try to manage the situation, but to collect the arrears in full in a short period without making allowance for the borrower's positions and/or did not take a reasonable approach to the time over which arrears might be repaid.
- 4.25. In 13 cases (43%) the arrears handlers failed to check the basis of a borrower's offer of regular payment to ascertain whether it was sustainable.
- 4.26. In 8 cases (27%) the Firm's policies and procedures were not followed in that the mortgage servicing staff did not endeavour to update income and expenditure details in the course of contacting the customer by telephone after the second missed mortgage payment.
- 4.27. In 5 cases (17%) the property was repossessed before all other reasonable attempts to resolve the issue had failed.
- 4.28. The above failings demonstrate that some mortgage servicing staff acting on behalf of Kensington had an inadequate understanding of TCF and failed to implement it when undertaking mortgage arrears and repossessions activities. In particular, in some cases the Firm:
 - (1) failed to discuss with customers all options available to them with regard to the method of repaying a payment shortfall, such as a switch in repayment type from repayment to interest only, an extension of the mortgage term, or capitalisation of arrears;
 - (2) failed to adopt a reasonable approach to the time over which the payment shortfall should be repaid taking into account the customer's individual circumstance, such as allowing the customer to arrange repayments over a number of years or indeed the remaining term;
 - (3) failed to assess whether the customer's offer of a regular payment was sustainable; and
 - (4) repossessed properties without first exhausting all attempts to resolve the

arrears.

- 4.29. The Firm focused on collecting additional payments from customers over a short period of time and within fixed mandates. In some cases, the FSA found that ATPs were agreed with customers without a proper assessment of the affordability for the customer of the ATP or whether there was a better alternative for resolving the customer's arrears situation based on their individual circumstances.
- 4.30. As a result of these failings, the Firm failed to treat certain of its customers fairly.

Arrears charges

- 4.31. During the Relevant Period, Kensington imposed a number of excessive or unfair charges on customers in arrears.
- 4.32. The excessive or unfair charges imposed by Kensington were:
- (1) a fee for a returned direct debit which was charged on each re-presentation of the direct debit by the Firm regardless of the number of times it had already been returned unpaid;
 - (2) a fee for a cancelled direct debit, which was excessive in light of the associated administration costs; and
 - (3) the calculation and imposition of an early repayment charge on mortgage balances which included arrears fees and charges within that balance.
- 4.33. The above charges were excessive or and/or unfair because they did not accurately reflect the actual administrative costs incurred by the Firm or were otherwise unfairly applied to the customer.

5. ANALYSIS OF BREACHES AND PROPOSED SANCTION

- 5.1. Principle 3 requires that a firm takes reasonable care to organise and control its affairs responsibly and effectively, with adequate risk management systems. In failing properly to apportion certain regulatory functions relating to its mortgage arrears and repossessions handling and failing to obtain and use sufficient management

information, Kensington failed to put in place adequate risk management systems relating to its arrears and repossessions management function.

- 5.2. As a result, Kensington's systems and controls were insufficient in relation to the handling and oversight of mortgage arrears and repossession activities and accordingly the Firm was in breach of Principle 3.
- 5.3. Principle 6 requires that a firm must pay due regard to the interests of its customers and treat them fairly. In doing so, firms should ensure that customers are treated fairly if they are in arrears with their mortgage by being flexible in considering a customer's individual circumstances and ensuring that the firm uses repossession of a customer's home only as a last resort.
- 5.4. In focusing on the collection of payment of arrears in a short period of time, rather than considering what might be a more suitable arrangement based on the customer's circumstances, Kensington failed to pay due regard to the interests of certain of its customers and treat them fairly.
- 5.5. In addition, Kensington did not treat certain of its customers fairly as a result of applying charges and fees to a customer's account that were excessive and/or unfair in that they did not accurately reflect the additional cost of administering an account in arrears in breach of MCOB 12.3.1 R, 12.5.1 R and 13.3.1 R.
- 5.6. The Firm's failings resulted in some customers incurring excessive or unfair costs and accruing arrears that could have been avoided had Kensington adopted a more flexible and fair approach to arrears management that properly took into account the customer's individual personal and financial circumstances.
- 5.7. As a result of the above, Kensington failed to pay due regard to the interests of certain of its customers and treat them fairly, in breach of Principle 6.
- 5.8. When exercising its powers the FSA seeks to act in a way which it considers most appropriate for the purpose of meeting its regulatory objectives as set out in section 2(2) of the Act. The FSA considers that imposing a financial penalty in respect of the Firm meets the regulatory objectives of market confidence and protection of consumers.

- 5.9. In deciding to take this action, the FSA has had regard to the guidance published in the FSA handbook, in particular as set out in Chapter 12 of the Enforcement Guide (“EG”) and Chapter 6 of the Decision Procedure and Penalties Manual (“DEPP”), which form part of the FSA Handbook of Rules and Guidance. Prior to 28 August 2007 it was set out in Chapter 13 of the Enforcement Manual (“ENF”). The FSA has had regard to both DEPP and ENF as both manuals applied at separate times during the Relevant Period. The Manuals set out a non-exhaustive list of criteria that may be of particular relevance in determining the appropriate level of financial penalty for an authorised person.

Deterrence

- 5.10. The principal purpose of imposing a financial penalty is to promote high standards of regulatory conduct by deterring persons who have committed breaches from committing further breaches, helping to deter other persons from committing similar breaches, and demonstrating generally the benefits of compliant behaviour.

The nature, seriousness and impact of the breach

- 5.11. In determining the appropriate sanction, 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 who suffered financial loss.
- 5.12. The FSA considers Kensington’s failings to be serious because:
- (1) the failings persisted over a significant period of time and impacted a number of customers;
 - (2) during the Relevant Period Kensington was aware of failings in relation to its monitoring of its mortgage arrears and repossessions activities, but failed to take adequate appropriate steps to act upon and/or remedy the failings in a sufficiently timely fashion;
 - (3) arrears rates in the sub-prime sector are higher than those in the rest of the mortgage market, and as Kensington specialised in the sub-prime sector, a number of its customers have suffered charges which were excessive or unfair; and

- (4) a number of customers who already had an adverse credit status were put at risk of further financial detriment.

The extent to which the breach was deliberate or reckless

- 5.13. The FSA has not determined that Kensington deliberately or recklessly contravened regulatory requirements.

The size, financial resources and other circumstances of the firm

- 5.14. There is no evidence to suggest that Kensington is unable to pay the financial penalty.

The amount of benefit gained or loss avoided as a result of the breaches

- 5.15. The FSA has not determined that Kensington deliberately set out to accrue additional profits or avoid a loss through the way in which it operated its systems and controls and processes.

Conduct following the breaches

- 5.16. In deciding on the appropriate disciplinary sanction, the FSA recognises the following factors which mitigate the seriousness of the failings identified in this case:

- (1) Kensington substantially reviewed and revised its TCF processes, procedures and management information since the early part of 2008, strengthened its corporate governance structure and undertook a “front-to-back” Customer Experience Review which reviewed all aspects of customers’ dealings with the Firm to ensure that every customer was being treated fairly at every stage of the arrears process;
- (2) From October 2009 Kensington changed its terms of business such that all new customers are not charged the ERC on mortgage balances including arrears fees and charges and the Firm was proactive in suggesting a customer contact and redress package in relation to certain charges imposed on customers by the Firm in connection with arrears handling and repossession activities;
- (3) Since the early part of 2008, Kensington has significantly enhanced its oversight of the mortgage servicing activities conducted on its behalf, for

example by elevating governance meetings from operational management to board level and by increased involvement in the training and monitoring of mortgage servicing staff;

- (4) In January 2009, Kensington set up its own Special Servicing team and Customer Liaison team to deal with specific areas in the collections cycle to provide a more in-depth and relationship focused approach to customers; and
- (5) Kensington's senior management have worked in an open and co-operative way with the FSA during the investigation and agreed to the facts quickly, ensuring early resolution of the matter and timely redress for customers.

Disciplinary record and compliance history of the Firm

- 5.17. Kensington has not been the subject of previous disciplinary action.

6. CONCLUSION

- 6.1. Taking into account the seriousness of the breaches and the risks they posed to the FSA's statutory objectives of market confidence and the protection of consumers, the FSA has imposed a financial penalty of £1.225 million on the Firm.

7. DECISION MAKERS

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

8. IMPORTANT

- 8.1. This Final Notice is given to the Firm 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 the Firm to the FSA by no later than 26 April 2010, 14 days from the date of the Final Notice.

If the financial penalty is not paid

- 8.3. If all or any of the financial penalty is outstanding on 27 April 2010, the FSA may recover the outstanding amount as a debt owed by the Firm 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 Jeremy La Niece (Tel: 020 7066 1346) of the Enforcement and Financial Crime Division of the FSA.

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Georgina Philippou
FSA Enforcement and Financial Crime Division