
FINAL NOTICE

To: **Lloyds TSB Bank Plc, Lloyds TSB Scotland Plc and Bank of Scotland plc
(together Lloyds Banking Group, "LBG")**

FSA
Reference
Numbers: **119278, 191240 and 169628**

Address: **25 Gresham Street London EC2V 7HN**

Date: **15 February 2013**

1. ACTION

- 1.1. For the reasons given in this notice, the FSA hereby imposes on LBG a financial penalty of £4,315,000.
- 1.2. LBG 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. Were it not for this discount, the FSA would have imposed a financial penalty of £6,164,327 on LBG.

2. SUMMARY OF REASONS

- 2.1. The penalty relates to LBG's failure to pay redress promptly to PPI complainants between 5 May 2011 and 9 March 2012 (the "Relevant Period").
- 2.2. During the Relevant Period, LBG sent 582,206 decision letters to PPI complainants, agreeing to pay redress to them. In order to comply with its regulatory obligation to pay redress promptly, LBG aimed to make payment within 28 days of these decision letters. However, LBG failed to do so in up to 140,209 (24%) cases. 24,589 (4%)

cases inadvertently dropped out of LBG's PPI redress payments process, and remedial action had to be taken subsequently to ensure those payments were made. These payments were identified as a result of customers telephoning LBG to chase payments and media attention. Following this, LBG carried out an investigation.

2.3. LBG breached the FSA's Principles and rules by failing to:

- 1) take reasonable care to organise and control its affairs responsibly and effectively, with adequate risk management systems (Principle 3); and
- 2) comply promptly with offers of redress which LBG had made and which had been accepted by PPI complainants (DISP 1.4.1R(5)).

2.4. In particular:

- 1) LBG failed to establish an adequate process for preparing redress payments to send to PPI complainants. In addition to a lack of initial planning by LBG, LBG's staff engaged on the redress process did not have the collective knowledge and experience to ensure that the process worked properly;
- 2) As a result, there were a number of serious deficiencies in LBG's PPI payment preparation framework. These deficiencies related to the way LBG processed data relating to customers' PPI redress payments before this data was sent to the separate payments area. LBG's system was heavily reliant on manual processes and data transfers which could not cope with high volumes of PPI payments of varying complexity. There was ineffective tracking of cases through the process and a lack of co-ordination between multiple redress sites. Customers' payment details were subjected to poor data governance and there was a lack of controls, including no control at all for the reconciliation of PPI payments. In addition, parts of the process were under resourced;
- 3) LBG failed to monitor effectively whether it was making all payments of PPI redress promptly. Nor did it gather sufficient management information to enable it to identify, in a timely manner, the full nature and extent of the payment failings; and
- 4) LBG's risk governance framework in respect of its process for preparing redress payments to send to PPI complainants was ineffective. An effective risk function would have assisted LBG to identify and address, in a timely way, the systems and controls deficiencies in its process.

2.5. As a result of these failings, up to 140,209 (24%) customers whose complaints were upheld in full or in part were not paid redress within 28 days of LBG's decision letters to customers. Approximately 87,000 (15%) of these customers had to wait over 45 days, 56,000 (9.7%) over 60 days, 29,000 (5%) over 90 days and some 8,800 (1%) over 6 months (these have subsequently been paid, other than where they involve exceptional customer circumstances and are still being addressed). Although LBG has taken steps to ensure that these customers have not been financially disadvantaged by the delays by paying interest at 8% per annum on the outstanding redress figure where appropriate, the average redress due to each customer was £2,733 and customers were inconvenienced by the delay. When customers telephoned LBG to

enquire about the non-receipt of the payments they had been expecting, the deficiencies in its processes meant that LBG was unable to fast-track the payment to the customer, inform them when payment would be made, or explain why it had been delayed.

- 2.6. LBG has since completed a comprehensive reconciliation of its PPI redress payments to ensure that all customers due PPI redress have been correctly paid and compensated for any delay in receiving their payment. Once the deficiencies in its process had been identified, LBG quickly conducted the reconciliation review and improved its processes to address the failings identified in this notice, including the rapid implementation of a PPI payment validation tool intended to ensure that any future issues regarding delayed payments are immediately identified and corrected.

3. DEFINITIONS

- 3.1. The definitions below are used in this Final Notice:

“the Act” means the Financial Services and Markets Act 2000;

“BBA” means the British Bankers’ Association;

“Bank of Scotland” means BOS’s Bank of Scotland brand;

“BOS” means Bank of Scotland plc;

“DEPP” means the FSA’s Decision Procedure & Penalties Manual as set out in the FSA Handbook;

“DISP” means the Dispute Resolution: Complaints Sourcebook which is part of the FSA Handbook;

“the FSA” means the Financial Services Authority;

“HBOS” means HBOS plc;

“Halifax” means the BOS’s Halifax brand;

“the Judicial Review” means the Judicial Review proceedings challenging the FSA’s decision to introduce measures set out in PS 10/12;

“LBG” means, together, Lloyds TSB Bank Plc, Lloyds TSB Scotland Plc and Bank of Scotland plc;

“LTSB” means Lloyds TSB Bank Plc and Lloyds TSB Scotland Plc;

“PPI” means payment protection insurance;

“the Principles” means the FSA’s Principles for Businesses as set out in the FSA Handbook;

“PS 10/12” means “Policy Statement 10/12, The assessment and redress of Payment Protection Insurance complaints; feedback on the further consultation in CP10/6 and final Handbook text”; and

“the Relevant Period” means the period between 5 May 2011 and 9 March 2012.

4. FACTS AND MATTERS

Background

- 4.1. LTSB and BOS are wholly owned subsidiaries of Lloyds Banking Group plc, which was formed following the acquisition of HBOS by Lloyds TSB Bank Plc in January 2009. They provide a wide range of banking and financial services and have been authorised by the FSA since 1 December 2001. BOS operates the Bank of Scotland and Halifax brands in the UK.

Payment protection insurance (PPI)

- 4.2. PPI is an insurance product which has often been sold to customers in connection with personal loans, credit cards, mortgages or other forms of debt. It is designed to help meet repayments in certain circumstances where the customer is unable to make repayments, such as in the event of an accident, sickness or unemployment and may also include life cover. The insurance can be offered in return for a single up front premium or regular monthly premiums for the duration of the cover. It can be sold on an advised or execution only basis.
- 4.3. LBG sold very significant volumes of PPI policies to customers, which represented a significant source of revenue for the group. LBG stopped selling single premium PPI in January 2009. In July 2010 LBG also ceased writing new regular premium PPI business.
- 4.4. There have been widespread and serious failings in relation to the sale of PPI across the financial services industry and very high numbers of complaints about PPI in recent years.
- 4.5. LBG has also received, and handled, a very high and unprecedented volume of PPI complaints. In 2011 LBG made a provision of £3.2 billion (which it has since increased to £5.3 billion as of autumn 2012) in respect of the cost of PPI mis-selling. By the end of September 2012, LBG had incurred total costs of £3.7 billion in respect of compensating mis-sold PPI customers.
- 4.6. The average amount of redress paid by LBG in respect of each PPI complaint it received during the Relevant Period was £2,733. In many cases LBG paid interest on the redress payments from the date of the sales failing to the date of payment at 8% per annum, where the redress payment took the form of a cash payment from LBG to the customer. In other cases, such as when a customer had an outstanding loan with LBG in relation to a PPI policy which had been mis-sold, the loan was restructured to take account of the redress owed by LBG to the customer with effect from the date of sale of the PPI. Following the Judicial Review referred to below, it made many payments of redress to PPI complainants on an ex gratia basis to help deal with the backlog of complaints.

The judicial review of PS10/12

- 4.7. On 8 October 2010 LBG and the other main UK banks, through the BBA, commenced judicial review proceedings in relation to the FSA's decision to introduce a package of measures outlined in the FSA's Policy Statement PS10/12 ("the Judicial Review"). These measures were intended by the FSA to ensure that firms handled PPI complaints more fairly and consistently and delivered fairer outcomes to customers who had been mis-sold PPI, but had not complained. Pending the outcome of the Judicial Review, in common with other firms and with the FSA's consent, LBG put on hold its assessment of approximately 135,000 PPI complaints which were affected by the issues considered by the Judicial Review.
- 4.8. On 20 April 2011 the High Court ruled in favour of the FSA and upheld PS 10/12 in all respects.
- 4.9. On 5 May 2011 LBG announced that it would accept the Court's decision and would not be participating in any appeal that the BBA might seek to bring. The BBA subsequently confirmed that it would not seek to appeal the decision that the FSA's measures should be upheld in full, bringing the Judicial Review to an end.
- 4.10. LBG had undertaken limited contingency planning in relation to future PPI complaints handling pending the outcome of the Judicial Review, since it had expected to appeal any unfavourable decision. When it took a different approach and decided not to appeal, it was then obliged to process rapidly its backlog of approximately 135,000 PPI complaints as well as handle new PPI complaints.

LBG's redress payment sites

- 4.11. During the Relevant Period, LTSB used one main site to prepare customer payment data for redress due in respect of PPI policies it had sold with LTSB products. Other smaller sites were also used.
- 4.12. Halifax and Bank of Scotland did not have dedicated sites for preparing customer payment data. Four different sites were used for processing PPI redress due in respect of PPI policies sold with their products.

Failings

1) Failure to establish an adequate redress payments process

- 4.13. LBG failed to undertake effective planning activity at the outset to ensure it established a robust redress process that was able to process promptly a significant number of PPI redress payments, some of which were complex in nature.
- 4.14. LBG adapted an existing PPI procedure to enable it to prepare PPI redress payments following the Judicial Review.
- 4.15. LBG assumed that because its PPI redress processes had been adapted from an existing PPI procedure, there was a low risk that they would fail to operate as intended. However, this was not an appropriate assumption to make because the existing PPI procedure was not designed to process large volumes of complex PPI redress payment cases on an ongoing basis.

- 4.16. The end to end PPI payment preparation process was complex and not fully understood by the staff involved, who did not have the collective knowledge and experience required to establish and manage operational processes of this scale and complexity. They included variable manual data transfers across multiple sites, which were determined by platform, brand and product. Despite this, LBG did not have documented process maps in place throughout 2011.
- 4.17. Following the Judicial Review, LBG did not adequately assess the capacity restraints of its new PPI payment preparation process. Only limited scenario planning and stress testing had taken place and this failed to highlight whether the process could cope with forecasted numbers of PPI redress payments. In the event, LBG did not establish a process which was capable of handling payments of such volumes of PPI payments which materialised, leading to delayed redress payments and some payments inadvertently dropping out of the dedicated process until they were remedied some time later.

2) Deficiencies in LBG's operational framework for making PPI redress payments

- 4.18. As a result of LBG's failure to plan effectively and establish a robust process for preparing PPI redress payments at the outset, there were a number of deficiencies in LBG's PPI redress framework as set out below.

Reliance on manual processes in respect of which there were insufficient controls

- 4.19. LBG's process for preparing PPI redress payments relied heavily on customer payment information being accurately transferred manually from one area of LBG's process to another, including through the use of Excel spreadsheets containing customer payment data. There were multiple redress sites and contractors were used to perform some of the work, which increased the number of manual data transfers between different parts of the process. These data transfers were only subject to limited checks which meant that there was a risk that errors would go undetected. Until LBG subsequently recognised the deficiencies in January 2012 and took remedial action to address them, payments did not always progress through the process as intended.
- 4.20. Other aspects of LBG's PPI payment preparation process were also manual in nature and gave rise to a risk of payment problems occurring which would not be mitigated by the existence of appropriate controls. For example:
- 1) Numerous Excel spreadsheets containing customer payment data were subject to copy and paste errors. One particularly serious copy and paste error occurred in September 2011 which resulted in a considerable number of PPI complainants being paid the wrong amounts of redress. Remedial action had to be taken to ensure customers ultimately received the correct payments;
 - 2) A manual ticketing process was used to manage the work flow through the main LTSB site. This process relied on paper tickets being moved between whiteboards. Tickets were at risk of being lost or moved incorrectly. Other paper based systems were also used at a HBOS site which gave rise to an unacceptable risk of documentation being lost or misplaced;

- 3) At the main LTSB site, staff inadvertently failed to process all of the payments set out on spreadsheets or processed batches of payments twice; and
 - 4) At a HBOS site there were instances of cheques being stored inappropriately and there were inadequate controls in place for showing a clear audit trail should a cheque go missing.
- 4.21. At sites where lower volumes of payments were processed, reliance was placed upon informal communications to facilitate the progression of payment cases through the process. However, these informal communications were insufficiently structured and proved ineffective as the volume of redress payments to be made increased.

Ineffective tracking of work-flow

- 4.22. A significant failing was LBG's inability to track redress payments through the process. LBG was therefore unable to detect whether payments had not progressed through the process as intended, or identify without manual intervention which payments had not been made. This made timely remedial action impossible.
- 4.23. PPI redress payments were not logged as they entered the PPI payment preparation process and some payments entered the process having missed the new submissions process altogether. Batches of cases were not sequentially numbered and there was ineffective work flow tracking through pre-payments activities. Proper records were not used to confirm that batches were allocated to the appropriate areas.
- 4.24. At the main LTSB site data was received from three redress sites and broken down into smaller batches of up to 60 payment cases for manual processing. Batches saved onto a shared computer drive were not reconciled to ensure work on all redress payments was completed.

Lack of co-ordination between payment sites

- 4.25. There was poor communication between various Halifax and Bank of Scotland redress payment sites and an overall lack of coordination. These redress sites were often working in isolation.
- 4.26. When issues were identified which affected more than one site, lessons learned and best practice were not shared with other sites despite similarities in how these redress sites operated and the obvious benefits of sharing this information.

Poor data governance

- 4.27. At the main LTSB site the process for preparing PPI redress payments was managed through unprotected spreadsheets to which all processing staff had access. There were numerous points in the process at which spreadsheets and documents containing payment information could have been amended inadvertently.

Lack of quality controls

- 4.28. There were insufficient quality controls in place across LBG's entire process for preparing PPI redress payments to send to customers. Through its own investigations LBG's audit department identified in a report dated March 2012 that the degree of

control over the LTSB Cards and Loans PPI payment preparation process was inadequate between May 2011 and January 2012. Appropriate controls would have enabled LBG to identify promptly under or over payments of redress, or duplicate payments, all of which were subsequently uncovered when LBG took remedial action.

4.29. Particularly significant examples of control failings include:

- 1) in autumn 2011 6,178 LTSB loans were not restructured as required in order to take into account the redress due to PPI complainants. A historical control failure meant that these loans were not included in the restructure information passed from the PPI complaint teams to the centre responsible for carrying out the restructuring; and
- 2) at the main LTSB site there were no checks performed in relation to the accuracy of batches of redress payments processed through payment preparation stages.

Inadequate resourcing

4.30. Parts of LBG's PPI redress process were under resourced and capacity constraints were exceeded. As a result, backlogs of payments occurred and this in turn impacted adversely upon LBG's ability to make timely payments of redress to other complainants.

4.31. In addition, there were no formal training plans or competency schemes in place in a number of LBG's PPI redress sites, including at LTSB's largest site. At another LTSB site, training and competency schemes were only communicated to staff orally and there were indications that staff were not complying with the training. At a HBOS site, it was identified that some temporary contractors had not completed core training requirements and were unaware of their responsibilities.

4.32. Where external contractors were used by LBG to perform work in connection with its PPI payment preparations, the precise nature and the standard of the work required to be completed by those contractors was not adequately outlined within existing contractual documentation. Nor was the quality of the work performed by contractors robustly measured through the use of appropriate metrics. Inadequate oversight of contractors also allowed poor performance on occasion to pass unchecked.

3) Failure to monitor the PPI redress payments operation appropriately

4.33. LBG did not have adequate management information available to indicate whether it was making payments of redress to PPI complainants promptly, or whether those payments were accurate. Initially, LBG did not know how many payments were being processed at each of its PPI redress sites. LBG's management could not readily ascertain when backlogs of payments had developed in parts of the process which needed to be addressed. They were accordingly unaware of the underlying problems that were developing and unable to take prompt and effective action to address them.

4.34. Through its own subsequent investigation work, LBG identified that additional monitoring, data validation and reporting was required for LTSB Cards and Loans to prevent dropped batches or identify bottlenecks in the process.

- 4.35. As mentioned in paragraph 4.20(1) above, the first indication of a problem occurred in September 2011 due to a copy and paste error in a payment spreadsheet. Postings on customer forums, media coverage, and a significant rise in calls from customers chasing payments flagged the payment problems in autumn 2011. LBG's management, through customer call listening, identified that a significant proportion of calls were from customers chasing expected redress payments. Initially, LBG was unable to handle the unexpected increase in call volumes and many attempted telephone calls to LBG were abandoned by customers before they were answered.
- 4.36. When at the same time the FSA raised queries with LBG relating to its PPI redress payments, LBG did not have sufficient information to be able to confirm to the FSA that all redress payments had been processed and accurate payments made.
- 4.37. In the absence of meaningful management information, LBG sought to rectify issues on an ad hoc basis. For example, in October 2011, LBG identified 42,000 cases where it had failed to make payments to customers. LBG's management believed that this was an isolated issue and did not fully investigate it. As a result LBG failed to identify and correct the root causes of the problems at an early juncture. Reviews conducted of payments agreed to be made in September 2011, December 2011 and January 2012 highlighted the need for a full investigation. Further investigation subsequently took place and revealed that the 42,000 payments referred to above were delayed due to a backlog in LBG's payment preparation process.
- 4.38. In the meantime LBG was unable to give customers an adequate response when they called to query a late or missing payment. The deficiencies in LBG's systems left staff unable to provide customers who chased payments with a definitive timescale for when their redress payment would be made or an explanation for the cause of the delay. Initially, there was no way in which missed or merely late payments could be identified and swift payment made.
- 4.39. The issue of missing or delayed payments was first flagged to a senior management committee in November 2011 when it was reported that the 42,000 cases had not at that point been paid. Further PPI payment problems were reported to management in late November 2011 when it was discovered that no payment record had been created for 32,000 cases.
- 4.40. In January 2012 a batch of 18,814 payments (comprising a portion of the 24,589 referred to at paragraph 2.1 above) was identified as having dropped out of the payments process following telephone calls from affected customers querying why they had not received payment.

4) Inadequate risk governance

- 4.41. Until November 2011, LBG failed to have an effective risk governance framework in place in respect of its processes for preparing PPI redress payments to send to customers. An effective risk framework would have enabled LBG to identify and assess the key operational risks associated with its PPI payments systems and controls and to remediate the deficiencies.
- 4.42. Prior to November 2011 LBG's various risk committees failed to address LBG's PPI redress payments processes. Whilst some very limited risk monitoring did take place

at certain redress sites, at other sites no formal record was kept of discussions about performance and operational challenges. It is accordingly unclear what action, if any, was taken to address issues as they were identified.

- 4.43. A limited risk review was conducted in September 2011. This review recognised that there was no robust risk management framework in place at that time. It also identified a number of deficiencies in LBG's PPI payment preparation processes. However, the specific nature and seriousness of the issues affecting these processes were not sufficiently highlighted in the review.
- 4.44. A more detailed risk review took place in November 2011. It flagged a number of risk and control gaps and noted that various ongoing initiatives would assist LBG to address these, such as some risk workshops which had taken place. However, the review reinforced the conclusions made in the September 2011 review that LBG needed a much more formal approach to operational risk governance and risk management. It identified the need for the establishment of an integrated risk governance framework, development of proper risk profiles, formal control test plans to be put in place and for risk event management when risks materialised. These initiatives were progressively implemented throughout 2012, including through the establishment of additional risk forums.

Full reconciliation review

- 4.45. LBG commenced a full reconciliation of PPI redress payments on 9 March 2012. The results of the reconciliation and other investigatory work subsequently conducted by LBG show that during the Relevant Period:
- 1) LBG sent 582,206 letters to PPI complainants agreeing to pay redress to them;
 - 2) LBG failed to pay redress within 28 days of its decision letters to customers in up to 140,209 (24%) cases. Approximately 85% of payments were made within 45 days, 90% within 60 days, 95% were made within 90 days and 99% were made within 6 months. All payments outstanding at 6 months have been paid other than where they involve exceptional customer circumstances and are still being addressed;
 - 3) 24,589 (4%) cases inadvertently dropped out of LBG's PPI redress payments process and remedial action had to be taken to ensure the payments were made; and
 - 4) The majority of the interest payments LBG made to customers (at the rate of 8% per annum) on account of delayed redress were of £5 or under in value. LBG paid a total amount of £1,867,978 in interest to delayed complainants, with an average value of these interest payments of £13.32 per affected customer.

5. FAILINGS

- 5.1. Annex A sets out extracts from statutory and regulatory provisions relevant to this Notice.

- 5.2. During the Relevant Period LBG breached Principle 3 because, in respect of its PPI redress processes, it failed to take reasonable care to organise and control its affairs responsibly and effectively, with adequate risk management systems. Specifically, on the basis of the facts and matters set out in paragraphs 4.1 to 4.45 (inclusive) above, LBG failed to:
- 1) adequately plan for, establish and maintain an effective process for preparing redress payments to send to PPI complainants, which would ensure such payments were made promptly and accurately;
 - 2) undertake effective monitoring and management oversight of its redress process; and
 - 3) until approximately November 2011, have an effective risk governance framework in place.
- 5.3. LBG also breached DISP 1.4.1R(5) by failing to make PPI redress payments promptly to PPI complainants to whom it had agreed to pay redress.

6. SANCTION

- 6.1. The FSA's policy on the imposition of financial penalties and public censures is set out in the FSA's Decision Procedure and Penalties Manual (DEPP) and the Enforcement Guide. In determining the appropriate outcome in this case, the FSA has had regard to this guidance. The FSA considers that the seriousness of this matter merits the imposition of a financial penalty.
- 6.2. DEPP 6.1.2G provides that the principal purpose of a financial penalty is to promote high standards of regulatory conduct. It seeks to do this by deterring firms who have breached regulatory requirements from committing further contraventions, helping to deter other firms from committing contraventions and demonstrating generally to firms the benefit of compliant behaviour.
- 6.3. The FSA introduced a new policy for imposing a financial penalty in March 2010, which requires the FSA to apply a five-step framework to determine the appropriate level of financial penalty. This policy is set out in Chapter 6 of DEPP. As the Relevant Period is 5 May 2011 to 9 March 2012, the FSA has applied the new policy to calculate the appropriate penalty for LBG's breach.

Step 1: disgorgement

- 6.4. Pursuant to DEPP 6.5A.1G, at Step 1 the FSA seeks to deprive a firm of the financial benefit derived directly from the breach where it is practicable to quantify this.
- 6.5. The FSA has not identified any financial benefit that LBG derived directly from its breach.
- 6.6. Step 1 is therefore £0.

Step 2: the seriousness of the breach

- 6.7. Pursuant to DEPP 6.5A.2G, at Step 2 the FSA determines a figure that reflects the seriousness of the breach. Where the amount of revenue generated by a firm from a particular product line or business area is indicative of the harm or potential harm that its breach may cause, that figure will be based on a percentage of the firm's revenue from the relevant products or business area.
- 6.8. The FSA considers that the revenue generated by LBG is not an appropriate indicator of the harm or potential harm caused by its breach in this case. The FSA considers that a figure based on the relevant interest paid by LBG to affected customers is an appropriate indicator of the harm or potential harm caused by its breach in this case. LBG's relevant interest is the total interest paid or due to be paid by LBG to complainants in respect of delayed PPI redress payments during the Relevant Period. The FSA has used the figure provided by LBG as the basis of relevant interest for this period which is £1,867,978.
- 6.9. Having determined the relevant interest, the FSA has considered the seriousness of LBG's breach by taking into account those factors which are relevant to an assessment of the level of seriousness of the breach.
- 6.10. The factors the FSA has taken into account in assessing the seriousness level reflect the impact and nature of the breach, and whether it was committed deliberately or recklessly. The FSA assesses the level of seriousness on a sliding scale between level 1 and 5, with level 5 representing the most serious breaches and level 1 representing the least serious. DEPP 6.5A.2(11) lists factors likely to be considered "level 4 or 5 factors". The FSA does not consider that any of these factors apply.
- 6.11. DEPP 6.5A.2(12) lists factors likely to be considered "level 1, 2 or 3 factors". Of these, the FSA considers the following factors to be relevant:
- 1) LBG did not make any profit or avoid any loss directly as a result of the breach;
 - 2) No significant loss was caused to customers as a whole. In particular:
 - (a) LBG has confirmed that interest has been paid at the rate of 8% per annum on delayed redress payments (totalling £1,867,978). The majority of interest payments were £5 or under in value and £13.32 was paid to each affected customer on average. Approximately 85% of customers were paid within 45 days, 90% within 60 days, 95% within 90 days and 99% within 6 months. All payments outstanding at 6 months have subsequently been paid other than where they involve exceptional customer circumstances and are still being addressed;
 - (b) The FSA considers that the risk of the 24,589 payments which inadvertently dropped out of LBG's PPI redress payments process being permanently missed by LBG was low. Although LBG's systems did not proactively identify the issues with these payments, LBG had notified customers of its offers of redress in writing in response to their complaints about PPI. Customers were expecting to receive redress

payments and, when they did not, they chased LBG for them. Multiple calls from customers prompted LBG to investigate these payments. On 9 March 2012, LBG commenced a full reconciliation of all PPI redress payments. In such circumstances it is unlikely that any appreciable number of payments would have ultimately gone unpaid or unnoticed;

- 3) Although the breach was widespread across the redress part of LBG's PPI complaints operation, there is no evidence that the breach indicates a widespread problem or weakness in other parts of LBG's business which do not involve PPI complaints handling; and
 - 4) The FSA has not found that the breach was committed deliberately.
- 6.12. DEPP 6.5A.2(6) lists non-exhaustive factors relating to the impact of the breach and DEPP 6.5A.2(7) lists non-exhaustive factors relating to the nature of the breach. Under the circumstances of this case, the FSA considers that the inconvenience and distress caused to a significant number of customers (up to 140,209) on account of LBG's delayed PPI redress payments is a factor relevant to the impact and nature of the breach.
- 6.13. The FSA also considers that the following factors are relevant:
- 1) LBG's breach did not, and did not have the potential to, impact upon LBG's decisions to uphold or reject complaints;
 - 2) The fact that 24,589 payments inadvertently dropped out of LBG's PPI redress payment process means that the breaches are more serious than those in cases involving delayed payments alone;
 - 3) The known and expected volume of PPI complaints and seriousness of the PPI issues meant that LBG should have planned and tested its PPI payments systems better and more carefully monitored results to check for any potential deficiencies, especially in circumstances where it was aware that it had had to put in place its new payment process quickly following the Judicial Review.
- 6.14. Taking all these factors into account, the FSA considers the seriousness of the breach to be level 2.
- 6.15. For the purposes of this case the FSA has applied the following multiples to the seriousness factors considered at DEPP 6.5A.2(3):
- 1) level 1 – 0
 - 2) level 2 – x 3
 - 3) level 3 – x 6
 - 4) level 4 – x 9
 - 5) level 5 – x 12

6.16. The penalty calculation, having taken into account the factors above is 3 x £1,867,978.

6.17. Step 2 is therefore £5,603,934.

Step 3: mitigating and aggravating factors

6.18. Pursuant to DEPP 6.5A.3G, at Step 3 the FSA may increase or decrease the amount of the financial penalty arrived at after Step 2, but not including any amount to be disgorged as set out in Step 1, to take into account factors which aggravate or mitigate the breach.

6.19. The FSA considers that LBG's previous disciplinary record and general compliance history aggravate the breach. In particular:

1) in September 2003, the FSA fined Lloyds TSB Bank Plc £1.9 million for its conduct in selling high income bonds;

2) Bank of Scotland plc has recently been the subject of disciplinary action by the FSA on a number of occasions. In particular, in:

(i) May 2011, the FSA fined the firm £3.5 million in relation to its handling of complaints relating to retail investments;

(ii) March 2012, the FSA imposed a public censure on the firm in relation to the management and control of its corporate lending; and

(iii) October 2012, the FSA fined the firm £4.2 million in relation to incorrect mortgage terms and conditions that it gave to standard variable rate customers; and

3) Lloyds Banking Group plc made a provision in its accounts of £5.3 billion in respect of compensating mis-sold PPI customers.

6.20. Having taken into account these aggravating factors, the FSA considers that the Step 2 figure should be increased by 10%.

6.21. Step 3 is therefore £6,164,327.

Step 4: adjustment for deterrence

6.22. Pursuant to DEPP 6.5A.4G, if the FSA considers the figure arrived at after Step 3 is insufficient to deter the firm who committed the breach, or others, from committing further or similar breaches, then the FSA may increase the penalty.

6.23. The FSA considers that the Step 3 figure of £6,164,327 represents a sufficient deterrent to LBG and others, and so has not increased the penalty at Step 4.

6.24. Step 4 is therefore £6,164,327.

Step 5: settlement discount

- 6.25. Pursuant to DEPP 6.5A.5G, if the FSA and the firm on whom a penalty is to be imposed agree the amount of the financial penalty and other terms, DEPP 6.7 provides that the amount of the financial penalty which might otherwise have been payable will be reduced to reflect the stage at which the FSA and the firm reached agreement. The settlement discount does not apply to the disgorgement of any benefit calculated at Step 1.
- 6.26. The FSA and LBG reached agreement at Stage 1 and so a 30% discount applies to the Step 4 figure.
- 6.27. Step 5 is therefore £4,315,029, which we have rounded to £4,315,000.

Proposed penalty

- 6.28. The FSA therefore proposes to impose a financial penalty of £4,315,000 on LBG for breaching Principle 3 and DISP 1.4.1R(5).

7. PROCEDURAL MATTERS

Decision makers

- 7.1. The decision which gave rise to the obligation to give this Final Notice was made by the Settlement Decision Makers.
- 7.2. This Final Notice is given under, and in accordance with, section 390 of the Act.

Manner of and time for payment

- 7.3. The final penalty must be paid in full by LBG to the FSA by no later than 14 days from the date of this Final Notice.

If the financial penalty is not paid

- 7.4. If all or any of the financial penalty is outstanding after 14 days from the date of this Final Notice, the FSA may recover the outstanding amount as a debt owed by LBG and due to the FSA.

Publicity

- 7.5. 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 LBG or prejudicial to the interests of consumers.
- 7.6. The FSA intends to publish such information about the matter to which this Final Notice relates as it considers appropriate.

FSA contacts

7.7. For more information concerning this matter generally, contact Lance Ellison (direct line: 020 7066 2422) of the Enforcement and Financial Crime Division of the FSA.

Signed:

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Tom Spender

FSA Enforcement and Financial Crime Division

ANNEX A

RELEVANT STATUTORY AND REGULATORY PROVISIONS

1. STATUTORY PROVISIONS

1.1. The FSA's statutory objectives, set out in section 2(2) of the Act, are market confidence, financial stability, customer protection and the reduction of financial crime.

1.2. Section 206 of the Act 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".

1.3. LBG is an authorised person for the purposes of section 206 of the Act. The requirements imposed on authorised persons include those set out in the FSA's rules made under section 138 of the Act.

2. REGULATORY PROVISIONS

Principles for Businesses (PRIN)

2.1. The Principles are a general statement of the fundamental obligations of firms under the regulatory system and are set out in the FSA Handbook. They derive their authority from the FSA's rule-making powers as set out in the Act and reflect the FSA's regulatory objectives. The Principles relevant to this case are as follows:

2.2. Principle 3 states:

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

Dispute Resolution: Complaints Sourcebook (DISP)

2.3. The Dispute Resolution: Complaints Sourcebook contains rules and guidance on how firms should deal with complaints promptly and fairly.

2.4. DISP 1.4.1R(5) states that:

"Once a complaint has been received by a respondent, it must...taking into account all relevant factors...comply promptly with any offer of remedial action or redress accepted by the complainant."