



Financial Services Authority

FINAL NOTICE

To: **Newcastle Home Loans Limited**

Of: 1st Floor Endeavour House
Colmet Court
Team Valley Trading Estate
Gateshead
NE11 0EF

Dated: 26 February 2009

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

1. THE PENALTY

- 1.1. The FSA gave Newcastle Home Loans Limited ("NHL"/ the "Firm") a Decision Notice on 16 January 2009 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 £170,000 on NHL in respect of a breach of Principle 1 of the FSA's Principles for Businesses (the "Principles") and in respect of a contravention of section 59 of the Act.
- 1.2. NHL was informed of its statutory right to make a reference to the Financial Services and Markets Tribunal, but it has not referred the Decision Notice to the Tribunal within 28 days of the date on which the Decision Notice was given to the Firm.
- 1.3. Accordingly, for the reasons set out below and pursuant to section 206 of the Act, the FSA hereby imposes a financial penalty of £170,000 on NHL.

2. REASONS FOR THE PENALTY

- 2.1. NHL has breached Principle 1 and has failed to conduct its business with integrity by arranging (bringing about) regulated mortgage contracts based on applications which contained false information. This resulted in the mortgage lender, to which NHL was tied (the “Lender”), unknowingly advancing sums significantly in excess of its lending policy. In some cases, the advance exceeded the purchase price of the property.
- 2.2. Further, NHL has contravened section 59 of the Act by failing to take reasonable care to ensure that no person performs a controlled function in relation to its regulated activities without FSA approval. In particular, it permitted David Purdie, one of the founders of the Firm, to perform the role of Director and Chief Executive Officer without seeking FSA approval for him to perform this role.
- 2.3. These failings are sufficiently serious to warrant the imposition of a significant financial penalty.

Relevant Statutory and Regulatory Provisions

- 2.4. Under section 2(2) of the Act the reduction of financial crime is a regulatory objective for the FSA.
- 2.5. Under section 206(1) of the Act, if the FSA considers that an authorised person has contravened a requirement imposed by or under the Act, it may impose on him a penalty, in respect of the contravention, of such amount as it considers appropriate. Section 206(2) provides that the FSA may not in respect of any contravention both require a person to pay a penalty under this section and withdraw his authorisation under section 33.
- 2.6. Section 59(1) states that:

“An authorised person (“A”) must take reasonable care to ensure that no person performs a controlled function under an arrangement entered into by A in relation to the carrying on by A of a regulated activity, unless the Authority approves the performance by that person of the controlled function to which the arrangement relates.”
- 2.7. Under section 59(3) “Controlled function” means a function of a description specified in rules set out by the FSA. Section 59(4) provides that the FSA may specify a description of function under subsection (3) only if, in relation to the carrying on of a regulated activity by an authorised person, it is satisfied that the first, second or third condition is met. Section 59(5) provides that the first condition is one which is likely to enable the person responsible for its performance to exercise a significant influence on the conduct of the authorised person’s affairs, so far as relating to the regulated activity.
- 2.8. The list of controlled functions is set out in the FSA’s Supervision Manual (“SUP”) at SUP 10.4. Rule 10.4.1R provides that each of the functions set out in the table at rule 10.4.5R is a controlled function of which the functions of 1 (Director) and 3 (CEO) are functions having significant influence.

The FSA's Principles for Businesses

2.9. The FSA's Principles for Businesses constitute requirements imposed on authorised persons under the Act.

2.10. Principle 1 states that:

"A firm must conduct its business with integrity".

Facts and matters relied upon

Background

2.11. NHL was incorporated on 29 April 2003, and was set up and run by David Purdie, together with a relative. The Firm originally operated as a "branded lender", and as such, it could only arrange mortgage applications exclusively for the Lender.

2.12. Mr Purdie managed the relationship between NHL and the Lender. He liaised with mortgage introducers on behalf of NHL, promoted the Firm, and made decisions relating to what business NHL could accept. He was also routinely involved in the arrangement of regulated mortgage applications, he would often write out parts of the application forms by hand, conduct "Know Your Customer" checks and complete transaction summaries and was also involved in submitting unregulated mortgage applications containing false information through NHL.

2.13. On 31 October 2004, the FSA took regulatory responsibility for certain mortgage activities. NHL applied for authorisation on 31 May 2005 to conduct regulated mortgage activities. It became authorised on 7 October 2005 to conduct the following activities:

- (1) advising non-investment insurance contracts (except pension transfers/opt outs);
- (2) advising on regulated mortgage contracts;
- (3) agreeing to carry on a regulated activity;
- (4) arranging (bringing about) deals in non-investment insurance contracts;
- (5) arranging (bringing about) regulated mortgage contracts;
- (6) making arrangements for regulated mortgage contracts; and
- (7) making arrangements for non-investment insurance contracts.

2.14. On 23 November 2005, Grace Purdie, the wife of David Purdie, became a director of NHL. She subsequently became an approved person on 16 December 2005, holding CF1 (Director). On 21 March 2006 Linda Patterson became approved to perform CF1 (Director) and CF8 (Apportionment and Oversight) on behalf of NHL. Mrs Patterson had worked for the Lender as an underwriter between December 2003 and December 2005. During this time, she worked on-site at NHL's offices.

Submission of mortgage applications containing false information

- 2.15. NHL arranged both regulated and unregulated mortgage contracts. Prior to November 2005, the mix of business submitted through NHL was approximately 60% regulated and 40% unregulated. During the year up to October 2007, the amount of regulated business dropped to 5%.
- 2.16. Misconduct by the Firm in relation to regulated mortgage contracts is governed by the FSA's rules. Its conduct in relation to unregulated mortgage contracts is relevant in assessing the Firm's ability to satisfy threshold conditions.
- 2.17. In December 2005, the Lender began to review a number of applications for both regulated and unregulated mortgage contracts submitted by NHL. By this date, a total of 1,700 applications had originated from NHL since December 2003. Its initial findings raised concerns over the accuracy of property valuations. It also established differences between statements made on mortgage application forms and information held at the Land Registry. Its subsequent wider review found that mortgage applications were being presented as remortgages when they were actually purchases. The actual purchase price paid for some properties had been concealed from the Lender, and in some cases, the actual purchase price paid was significantly lower than the valuation that had been provided. On 17 May 2006, the Lender removed NHL from its panel of firms.
- 2.18. The Lender referred 157 cases to the FSA. 20 of these were regulated mortgage applications and the remainder were unregulated applications. Of the 157 cases referred, the FSA identified eight applications for regulated mortgage contracts that contained false information.
- 2.19. The Lender's policy was to lend the lower of 85% of the *valuation* or the *purchase price* of a property. Section B of the Lender's mortgage application form required the applicant to identify whether the application was for funds to purchase a property, or funds to remortgage a property he/she already owned. The purpose of the mortgage dictated which part of Section B the applicant should complete.
- 2.20. For funds to purchase a property, the applicant was required to state the purchase price to be paid for the property, how much the property was worth and the amount and source of any deposit being paid. For funds to remortgage, the applicant needed to state the estimated value of the property, any existing mortgage that would be paid off and the name of the existing mortgage lender. The application form also contained an "Additional information sheet" providing space for any other comments relating to the circumstances of the transaction.
- 2.21. In section K the borrower had to answer the question "*Will the property be used solely as private living accommodation for you and your family and not for any business purposes?*" Where the applicant ticked "Yes", the application was for a regulated mortgage contract.

Breach of Principle 1

- 2.22. Between 30 September 2005 and 28 October 2005, NHL arranged four regulated mortgage contracts for borrowers to purchase a property on the basis of applications containing false information as follows:
- (1) the application form mis-stated the purchase price of the property. The amount stated on the form was greater than the purchase price to be paid by the buyer; and
 - (2) the application stated that the applicant was paying the property deposit from their own resources, or was receiving family assistance towards the deposit, when actually the advance from the Lender covered the deposit and all the costs of the purchase too.
- 2.23. The Lender therefore advanced what it believed to be 85% of the stated purchase price for one property and 90% of the stated purchase price for the other three properties. However, as a result of the false information, the Lender unknowingly advanced from 100% up to 108% of the purchase price paid by the borrowers.
- 2.24. Between 28 October 2005 and 22 December 2005, NHL arranged a further four regulated mortgage contracts on the basis of applications which mis-described the transaction as a remortgage. These applications contained false information as follows:
- (1) in all cases the applications falsely stated that the borrowers already owned the properties when they did not; and
 - (2) in three cases a false original purchase price was provided;
 - (3) in two cases a false original purchase date was provided;
 - (4) in one case false details were provided about an existing mortgage.
- 2.25. By falsely presenting these transactions as remortgages, NHL caused the Lender to advance 85% of the *valuation* in each case, rather than 85% of the actual *purchase price*. As a result, the Lender advanced from 103% up to 126% of the actual purchase price paid. If these transactions had been presented as purchases, the Lender would have advanced 85% of the actual purchase price. In fact, these properties were purchased at a significant discount to the valuation.
- 2.26. NHL knowingly submitted these false applications. The practice of providing false information was routine at the Firm and was not limited to the eight applications reviewed in the course of the FSA's investigation.

Contravention of section 59 of the Act

- 2.27. David Purdie is not a director of NHL. Despite not being formally appointed as a director, in practice David Purdie has always carried out this role and is, in effect, the Chief Executive Officer (“CEO”) of the Firm. Since the inception of the company in 2003, and continuing throughout the period in which the Firm was authorised by the FSA, David Purdie exercised a significant influence over the affairs of NHL and made the key business decisions within the Firm.
- 2.28. David Purdie was not formally made a director of NHL because, at the time NHL was set up, he was still bound by the terms of an agreement entered into with a former employer by which he agreed not to act as the Director of a competing business, that of mortgage arrangement and packaging.

Analysis of sanction

- 2.29. The FSA's policy in relation to the imposition of financial penalties is set out in Chapter 6 of the Decision Procedure and Penalties Manual (“DEPP”) which forms part of the FSA Handbook and which came into effect on 28 August 2007. It was previously set out in Chapter 13 of the Enforcement Manual (ENF). Owing to the period during which NHL’s breach of Principle 1 occurred and the duration of its contravention of section 59, the FSA has had regard to both these Manuals. The factors set out in these Manuals may be of particular relevance in determining the appropriate level of financial penalty for a firm or approved person, are not exhaustive and all relevant circumstances of the case will be taken into consideration.

Deterrence

- 2.30. The FSA has highlighted mortgage fraud and misconduct by mortgage intermediaries as an area of particular concern. A significant financial penalty is necessary to strengthen the message that the FSA will not tolerate mortgage fraud or contraventions of its rules, particularly where such contraventions are to the Firm’s pecuniary advantage.

The nature, seriousness and impact of the breaches

- 2.31. Principle 1 is of key importance to the FSA and the conduct of regulated activities. NHL routinely completed mortgage application forms with false information and breached Principle 1 by submitting eight false mortgage forms. The breach is both systemic and deliberate. Firms must seek approval for those persons performing controlled functions. David Purdie was the controlling mind of the Firm. NHL did not appoint David Purdie as Director because he sought to avoid a formal appointment that might place him in contravention of his agreement with his former employer. The FSA has therefore concluded that NHL deliberately contravened section 59. These breaches are serious.

The impact of the breaches

- 2.32. The ambit of the mortgage misconduct of which NHL was the epicentre appears to have involved non-authorised firms and individuals. Mortgage fraud disrupts the orderliness of the market and undermines public confidence and the issuing of a significant financial penalty will send a strong message to the market, commensurate with the FSA’s wider work on mortgage fraud.

Financial resources and other circumstances of the Firm

- 2.33. In considering the level of financial penalty we have taken account of NHL's published (net), post-dividend profits for the last three years.

Representations

- 2.34. No representations were made in respect of the Warning Notice.

Conclusion

- 2.35. In the period from 30 September 2005 to 22 December 2005 NHL knowingly submitted eight applications for regulated mortgage contracts to the Lender which contained false information. This practice of providing false information was routine. The FSA has concluded that NHL has failed to conduct its business with integrity and has breached Principle 1.
- 2.36. NHL has permitted David Purdie to perform significant influence controlled functions since the date on which NHL was first authorised and failed to seek FSA approval for him to perform this role. In doing so, the Firm has contravened section 59 of the Act.
- 2.37. These are serious contraventions in respect of which the FSA has imposed a financial penalty under section 206(1) of the Act.

3. DECISION MAKER

- 3.1. The decision which gave rise to the obligation to give this notice was made by the Regulatory Decisions Committee.

4. IMPORTANT

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

Manner of and time for Payment

- 4.2. The financial penalty must be paid in full by NHL to the FSA by no later than 12 March 2009, 14 days from the date of the Final Notice.

If the financial penalty is not paid

- 4.3. If all or any of the financial penalty is outstanding on 13 March 2009, the FSA may recover the outstanding amount as a debt owed by NHL and due to the FSA.

Publicity

- 4.4. 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 in such

publication would, in the opinion of the FSA, be unfair to you or prejudicial to the interests of consumers.

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

FSA contacts

- 4.6. For more information concerning this matter generally, you should contact Bill Sillett (direct line: 020 7066 5880) of the Enforcement Division of the FSA.

William Amos
Head of Department
Enforcement Division