
FINAL NOTICE

To: **Next Generation Mortgages Limited**

Of: **11/12 Jellicoe Court
Admirals Landing
Cardiff
CF10 4AJ**

Date: **19 November 2007**

TAKE NOTICE: The Financial Services Authority of 25 The North Colonnade, Canary Wharf, London, E14 5HS ("the FSA") gives final notice about a decision to impose a financial penalty on Next Generation Mortgages Limited.

1. ACTION

- 1.1. The FSA gave Next Generation Mortgages Limited ("NGM") a Decision Notice on 19 November 2007 which notified NGM that pursuant to section 206 of the Financial Services and Markets Act 2000 ("the Act"), and on the basis that NGM has agreed to undertake a past business review and to vary its Part IV permission by agreeing not to advise on and arrange self certified mortgage contracts, the FSA had decided to impose a financial penalty of £10,500 on NGM in respect of breaches of Principle 7 (communication with clients) and Principle 9 (suitability of advice) of the FSA's Principles for Businesses and FSA Rules between 1 June 2005 and 19 January 2007 ("the relevant period").

- 1.2. The penalty also takes into account the fact that NGM has breached the following FSA Rules:
 - (1) FSA Rules 4.7.2R, 4.7.4R(1) and 4.7.17R(1) in the part of the FSA Handbook entitled Mortgages: Conduct of Business ("MCOB"); and
 - (2) FSA Rule 1.4.12R in the part of the FSA Handbook entitled Dispute Resolution: Complaints ("DISP").
- 1.3. NGM 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 FSA would otherwise have imposed a financial penalty of £15,000 on NGM.
- 1.4. NGM agreed that it would not be referring the matter to the Financial Services and Markets Tribunal.
- 1.5. Accordingly, for the reasons set out below and having agreed with NGM the facts and matters relied on, the FSA imposes a financial penalty of £10,500.

2. REASONS FOR THE PROPOSED ACTION

- 2.1. The FSA has imposed a financial penalty on NGM in respect of **breaches of Principles 7 and 9** that occurred in the relevant period. These breaches relate to NGM's deficiencies in connection with the operation of its mortgage sales process. These failings are set out in more detail in paragraphs 4.2 to 4.20 below.
- 2.2. In summary, the FSA has made the following findings:
 - (1) NGM failed to communicate with its customers in an appropriate manner. Its suitability letters contained standard generic phrases and were not tailored to the customers' circumstances. NGM also failed to notify complainants adequately in final responses of their right to refer a complaint to the Financial Ombudsman Service ("the FOS"). NGM therefore failed to communicate with its customers in a clear, fair and not misleading way (in breach of **Principle 7**); and
 - (2) NGM failed to ensure that its advisers gathered and recorded sufficient information about its customers or make sufficient records demonstrating the suitability of, and the reasons for, its recommendations. NGM also failed to put in place adequate compliance arrangements and controls in respect of its mortgage advisory process. NGM therefore failed to demonstrate that it had taken reasonable care to ensure the suitability of its advice (in breach of **Principle 9**).

3. RELEVANT STATUTORY PROVISIONS AND REGULATORY REQUIREMENTS

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 public awareness and the protection of consumers.

3.2. Section 138 of the Act provides that the FSA may make such rules applying to authorised persons as appear to be necessary or expedient for the purpose of protecting the interests of consumers.

3.3. 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 an amount as it considers appropriate".

3.4. Under the FSA's rule-making powers, the FSA has published in the FSA Handbook the "Principles for Businesses" which apply either in whole, or in part, to all authorised persons. These Principles are a general statement of the fundamental obligations of firms under the regulatory system and reflect the FSA's regulatory objectives. Breaching a Principle makes a firm liable to disciplinary action.

3.5. The Principles and Rules which are relevant to this matter are set out below.

FSA's Principles for Businesses

3.6. **Principle 7** (communications with clients) provides that:

"A firm must pay due regard to the information needs of its clients, and communicate information to them in a way which is clear, fair and not misleading".

3.7. **Principle 9** (suitability of advice) provides that:

"A firm must take reasonable care to ensure the suitability of its advice and discretionary decisions for any customer who is entitled to rely on its judgement".

MCOB

3.8. MCOB 4.7.2R provides that a firm must take reasonable steps to ensure that it does not make a personal recommendation to a customer to enter into a regulated mortgage contract, or to vary an existing regulated mortgage contract, unless the regulated mortgage contract is, or after the variation will be, suitable for that customer.

3.9. MCOB 4.7.4R(1) provides that, for the purposes of MCOB 4.7.2R, a regulated mortgage contract will be suitable if, having regard to the facts disclosed by the customer and other relevant facts about the customer of which the firm is or should reasonably be aware, the firm has reasonable grounds to conclude that:

- (a) the customer can afford to enter into the regulated mortgage contract;
- (b) the regulated mortgage contract is appropriate to the needs and circumstances of the customer; and
- (c) the regulated mortgage contract is the most suitable of those that the firm has available to it within the scope of the service provided to the customer.

3.10. MCOB 4.7.17R(1) provides that a firm must make and retain a record:

- (a) of the customer information, including that relating to the customer's needs and circumstances, that it has obtained for the purposes of MCOB 4.7; and
- (b) that explains why the firm has concluded that any personal recommendation given in accordance with MCOB 4.7.2R satisfies the suitability requirements in MCOB 4.7.4R(1).

DISP

3.11. DISP 1.4.12R provides that when a firm sends a complainant its final response, the final response must:

- (1) inform the complainant that he may refer the complaint to the FOS if he is dissatisfied with the final response and that he must do so within six months; and
- (2) enclose a copy of the FOS explanatory leaflet.

4. FACTS AND MATTERS RELIED UPON

4.1. NGM is a small mortgage broker, its main business being sub prime mortgages. NGM has been regulated by the FSA since 31 October 2004. Its authorised business also includes advising on and arranging insurance contracts.

Thematic Work

4.2. The FSA's Supervision Division ("Supervision") visited NGM on 25 June 2005 and 18-19 January 2007 as part of a thematic project looking at the sale of sub-prime mortgage products.

4.3. During the first visit on 25 June 2005, Supervision reviewed nine customer files and found that NGM was gathering insufficient information about customers' personal and financial circumstances.

4.4. In relation to mortgage applications made on a self certification basis, Supervision found that figures entered on lender application forms were higher than the evidence of actual income provided by customers to NGM. There was no evidence on the files to indicate that higher self certified income figures had been verified adequately by NGM.

- 4.5. At the end of the visit Supervision debriefed NGM, summarising the general findings drawn from the visit. The debrief was followed by a letter setting out Supervision's detailed findings which was sent to NGM on 7 September 2005. NGM was informed that its standard of compliance was considered to be below acceptable levels, but Supervision noted that NGM was taking steps to make necessary improvements to its processes and procedures.
- 4.6. Supervision revisited NGM on 18-19 January 2007 and reviewed a total of 20 customer files. Supervision found no improvement in NGM's sales process since the visit on 25 June 2005, and also identified the following additional failings:
- (1) Weaknesses remained in NGM's fact find process. In all cases reviewed, NGM had continued to fail to gather and record key information about its customers relevant for establishing the affordability and suitability of recommendations;
 - (2) Concerns continued in relation to the sale of self certification mortgages. There was little evidence of income verification on the files. In cases where proof of income was available from customers, the files failed to explain adequately why NGM had recommended those mortgages on a self certification basis;
 - (3) NGM failed to show clearly that customers were made aware of the risks and consequences of what they were entering into. There was no evidence on the files that the additional cost implications of applying for a mortgage on a self certification basis, or the capital repayment implications of taking an interest only mortgage, were adequately explained to customers;
 - (4) The advisory process was unclear. Information recorded on the files failed to explain why a particular lender and product was recommended or evidence that the most suitable product had been recommended. Suitability letters were also poor, consisting mainly of standard generic phrases. The letters were not sufficiently personalised to demonstrate that the lender and product recommended was suitable;
 - (5) NGM's compliance checking of customer files was performed at random. There was no additional compliance checking for those customers who were sold products considered to be higher risk. Its files also failed to evidence that the results of reviews were recorded in advisers' learning and development plans;
 - (6) NGM's control systems did not provide it with any management information for monitoring the quality and suitability of advice given by its advisers and/or whether customers were being treated fairly; and
 - (7) There were deficiencies with NGM's communications with customers on complaints; NGM failed to notify complainants appropriately of their right to refer a complaint to the FOS.

- 4.7. The findings were detailed in a letter to NGM on 12 March 2007 and the matter was referred to the FSA's Enforcement Division ("Enforcement") for investigation on 12 March 2007.

Enforcement Investigation

- 4.8. As part of its investigation, Enforcement reviewed a sample of six customer files, which were selected at random from NGM's business register, and interviewed staff at NGM.
- 4.9. The investigation covered NGM's sales process, and focussed on the main consumer risk issues:
- (1) Establishing the adequacy of the information obtained from the customers;
 - (2) Assessing whether a suitable recommendation could have been made from the information on file; and
 - (3) Assessing NGM's systems and controls for ensuring the suitability of advice.
- 4.10. Enforcement found evidence of failures in information gathering, record keeping and compliance to support the concerns identified by Supervision.

Ensuring suitability of advice

- 4.11. Based on the file reviews and interview, Enforcement concluded that NGM did not take reasonable steps to ensure suitable advice was given to customers.

Sales process

- 4.12. Insufficient information had been recorded on NGM's customer files, contrary to MCOB 4.7.17R(1). In particular, NGM failed to ensure that its advisers obtained and recorded sufficient information about its customers' personal and financial circumstances to establish the customers' needs and objectives, even when such information was required in its "fact find" template. It also failed to demonstrate the suitability of mortgage contracts for its customers to satisfy the requirements of MCOB 4.7.2R and MCOB 4.7.4R(1). Specifically:
- (1) Customer information was held on a separate mortgage database and not consolidated on customer files. NGM could not demonstrate that it had considered all relevant information in determining the suitability of its recommendations;
 - (2) NGM did not investigate adequately its customers' financial position. NGM failed to enquire fully about customers' income, expenditure, credit history and debt position, so it could not consider fully all matters relating to income and expenditure in assessing the affordability of its recommendations. There was little or no evidence of income verification in relation to mortgages on a self

certification basis, and NGM gave no consideration to customers' ability to repay where the mortgage term extended beyond the customers' stated retirement age; and

- (3) NGM retained little or no evidence of product research to support its recommendations. NGM also recorded insufficient details of advice given to customers and the reasons for its recommendations.

4.13. By failing to ensure that its advisers gathered and recorded sufficient personal and financial information about customers, NGM breached MCOB 4.7.2R, 4.7.4R(1) and 4.7.17R(1). These failures are serious in that they hindered the ability of NGM's management to check the suitability of recommendations to enter into mortgage contracts. It also meant that lenders may have entered into mortgage contracts where all relevant information about the customers' financial position may not have been made available. Furthermore, it had the potential of hindering any independent assessments carried out by third parties such as the FSA.

Compliance arrangements

4.14. NGM did not have adequate compliance monitoring arrangements in place for controlling its mortgage advisory process. In particular the following failings were identified:

- (1) Weaknesses remained in NGM's monitoring of advice. NGM could not demonstrate how it monitored and reviewed the quality and suitability of its advice. There was no evidence that corrective action had been pursued, followed up or reviewed in relation to issues identified following file reviews; and
- (2) Whilst NGM held regular management meetings, during which new business, training needs and sales procedures were discussed, such meetings were informal in nature and compliance issues were not effectively recorded to ensure follow up action or review.

4.15. NGM's failure to put in place adequate compliance monitoring arrangements resulted in persistent information gathering and record keeping deficiencies, with the consequence that customers were exposed to the risk of being given unsuitable advice.

4.16. Due to NGM's failure to gather and recording sufficient customer information, NGM could not demonstrate that its recommendations were made on the basis of an adequate assessment of customers' needs and circumstances. NGM also failed to monitor and review adequately the quality of advice given by its advisers to customers, and to follow up compliance issues. Taking these deficiencies together, NGM failed to take reasonable care to ensure the suitability of its advice (Principle 9).

Communication with customers

- 4.17. Based on the file reviews, Enforcement found that NGM had not communicated its recommendations to customers in an appropriate manner. Although mortgage intermediaries do not have to issue suitability letters, firms that issue such letters are required to ensure that their communications with customers are clear, fair and not misleading.
- 4.18. The majority of NGM's suitability letters did not explain adequately the reason for, or the suitability of, recommendations for its customers. Specifically, a number of suitability letters produced by NGM did not properly:
- (1) Explain why NGM had concluded that the relevant transaction was suitable for the customer in question, having regard to the customer's personal and financial circumstances; and/or
 - (2) Contain a summary of the main consequences and possible disadvantages of the transaction.

Instead the letters relied on a number of standard generic phrases from NGM's "Reason Why Template".

- 4.19. Based on the file reviews, Enforcement found that NGM was not communicating with customers on complaints in accordance with DISP 1.4.12R. NGM's final responses to complaints did not refer to a six month time limit (from the completion of its investigation into a complaint) for complainants to refer the complaint to the FOS, and no reference was made to the FOS leaflet. NGM was including a complainant's referral right to the FOS in its acknowledgement letter rather than in its final response.
- 4.20. Due to the fact that suitability letters were not sufficiently tailored to the customers' circumstances, and that communications on complaints did not follow DISP rules, NGM failed to communicate with its customers in a clear, fair and not misleading way (Principle 7).

5 ANALYSIS OF THE PROPOSED SANCTION

- 5.1. The FSA's policy on the imposition of financial penalties is set out in Chapter 6 of the Decision Procedures and Penalties Manual ("DEPP"), which forms part of the FSA Handbook. The principal purpose of a financial penalty is to promote high standards of regulatory conduct by deterring firms who have committed breaches from committing further breaches and helping to deter other firms from committing similar breaches, as well as demonstrating generally the benefits of compliant business.
- 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 a case. DEPP 6.5.2 sets out a non-exhaustive list of factors that may be of relevance in determining the level of a financial penalty.
- 5.3. The FSA considers that the following factors are particularly relevant in this case.

DEPP 6.5.2(1): Deterrence

- 5.4. A financial penalty would deter NGM from further breaches of regulatory rules and Principles. Equally, other firms will be deterred from following NGM's practices and this will promote the message to the industry that the FSA expects firms to maintain high standards of regulatory conduct. In this case we expect firms to maintain appropriately detailed customer files and to have effective systems for monitoring advice.

DEPP 6.5.2(2): The nature, seriousness and impact of the breach in question

- 5.5. In determining the appropriate sanction, the FSA has had regard to the seriousness of the breaches, including the nature of the requirements breached, the duration and frequency of the breaches, whether the breaches revealed serious or systemic failings in the firm's systems and controls and the number of customers who were affected and/or placed at risk of loss. For the reasons set out below the FSA considers that the breaches in this case are of a serious nature.
- 5.6. NGM's failings are viewed as being serious because:
- (1) NGM operates mainly in the sub prime mortgage sector and many of its customers may be financially vulnerable;
 - (2) Failures in information gathering and record keeping were widespread and systemic in nature;
 - (3) Due to insufficient fact finding, recording of customers' personal and financial information (including evidence and reasons for recommendations) and verification of self certified income, it was not possible for NGM to demonstrate that it had considered the interests of its customers (128 contracts arranged in the relevant period) or that its customers had been treated fairly in terms of the affordability and suitability of recommendations;
 - (4) Inadequate suitability letters meant that customers did not receive an appropriate explanation of how the recommended product met their objectives and needs, or of the associated risks of those products; and
 - (5) The FSA drew attention to the information gathering failings by a letter to NGM dated 7 September 2005, after the first visit by the FSA's Small Firms Division ("Supervision"), but NGM failed to address these deficiencies. The failure is therefore viewed by the FSA as being particularly serious.

5.7. The FSA has taken into account the following steps taken by NGM which have served to mitigate the seriousness of its failings:

- (1) NGM accepts that there were management and control failures in relation to its monitoring of sales. To address the risk of unsuitable recommendations having been made to customers, NGM will appoint an external compliance consultant to undertake a past business review of its business during the relevant period with a view to:
 - (a) identifying any unsuitable recommendations;
 - (b) assessing any loss to customers; and
 - (c) paying any redress where unsuitable advice has led to loss.
- (2) NGM has agreed to vary its Part IV permission formally to cease advising on and arranging self certification mortgages to avoid any further risk of consumer detriment;
- (3) NGM has now employed a full time compliance officer and retained the services of an external compliance consultant to review and update its procedures and processes to ensure that it has the robust systems required going forward and to improve compliance; and
- (4) NGM has co-operated fully with the FSA investigation.

DEPP 6.5.2(3): The extent to which the breach was deliberate or reckless

5.8. The FSA has found no evidence to show that NGM acted in a deliberate or reckless manner.

DEPP 6.5.2(5): The size, financial resources and other circumstances of the firm

5.9. In determining the level of penalty, the FSA has been mindful of the need to ensure that the interests of customers are protected and has sought to ensure that the level of the financial penalty is not set at a level that would effectively prevent NGM from carrying out a past business review and/or providing the redress where appropriate. Taking account of these factors, and having considered NGM's latest financial statement, the FSA considers that a penalty of £15,000 (including a discount of 30% to £10,500 for early settlement) is appropriate.

DEPP 6.5.2(6): The amount of benefit gained or loss avoided

5.10. It is difficult to ascertain the amount of benefit gained or loss avoided by NGM prior to the findings of the past business review. The FSA would not impose a penalty which would inhibit NGM's ability to pay compensation, if any is due to be paid, to customers who were mis-sold products as a result of NGM's failings. However, in setting the level of penalty the FSA has had regard to the need for the penalty to be an incentive for NGM (and other firms) to comply with regulatory standards.

DEPP 6.5.2(8): Conduct following the breach

- 5.11. The FSA has taken into account NGM's co-operation with the FSA's investigation and its stated commitment to ensuring that it will comply with FSA's requirements on an ongoing basis. NGM has agreed to a review of past business and to take any further remedial steps considered to be appropriate.
- 5.12. NGM has decided to stop selling, advising on and arranging self certification mortgages and has taken on additional compliance resource to remodel its compliance procedures in order to have the robust systems and controls to comply with regulatory requirements going forward.

DEPP 6.5.2(9): Disciplinary record and compliance history

- 5.13. NGM has not been the subject of previous disciplinary action.

DEPP 6.5.2(10): Other action taken by the FSA

- 5.14. In determining the level of financial penalty, the FSA has taken into account penalties imposed by the FSA on other authorised persons for similar behaviour.

6 DECISION MAKERS

- 6.1. The decision which gave rise to the obligation to give this Warning Notice was made by Margaret Cole, Director of Enforcement, and Michael Folger, Director of Wholesale and Prudential Policy, as Settlement Decision Makers on behalf of the FSA.

7. IMPORTANT

- 7.1. This Final Notice is given to NGM under section 390 of the Act. The following statutory rights are important.

Manner of and timing for payment

- 7.2. The financial penalty must be paid in full by NGM to the FSA by no later than 3 December 2007, 14 days from the date of this Final Notice.

If the financial penalty is not paid

- 7.3. If all or any of the financial penalty is outstanding on 3 December 2007, the FSA may recover the outstanding amount as a debt owed by NGM and due to the FSA.

Publicity

- 7.4. Sections 391(4), 391(6) and 391(7) of the Act apply to the publication of information about the matter to which this Final Notice relates. Under those provisions, the FSA must publish such information about the matter to which this Final 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 the publication would, in the opinion of the FSA, be unfair to NGM or prejudicial to the interests of consumers.

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

FSA contacts

- 7.6. For more information concerning this matter generally, please contact Russell Clifton at the FSA (direct line: 020 7066 5304 / fax: 020 7066 5305).

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Jonathan Phelan
Head of Department
FSA Enforcement Division