
FINAL NOTICE

To: Orchid Financial Limited

Of: Top Floor, Wright Business Park, Carr Hill, Doncaster, DN4 8DE

Date: 14 October 2008

TAKE NOTICE: The Financial Services Authority of 25 The North Colonnade, Canary Wharf, London E14 5HS (“the FSA”) has decided to take the following action:

1 ACTION

- 1.1. The FSA gave Orchid Financial Limited (“Orchid”) a Decision Notice on 14 October 2008 which notified Orchid 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 £34,500 on Orchid. This financial penalty is in respect of breaches of Principle 9 of the FSA's Principles for Businesses (the “Principles”) between 25 October 2005 and 13 March 2008 (the “Relevant Period”) in relation to advised sales of regulated mortgages.
- 1.2. Orchid confirmed on 9 October 2008 that it will not be referring the matter to the Financial Services and Markets Tribunal.
- 1.3. Accordingly, for the reasons set out below and having agreed with Orchid the facts and matters relied on, the FSA imposes a financial penalty of £34,500 on Orchid.

- 1.4. Orchid agreed to settle at an early stage of the FSA's investigation. It therefore 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 imposed a financial penalty of £49,285 on Orchid.

2 REASONS FOR THE ACTION

- 2.1. The FSA has decided to impose a financial penalty of £34,500 on Orchid for breaches of Principle 9 in relation to its sale of regulated mortgages.
- 2.2. These breaches, which are described in more detail at sections 4 and 5 below, relate to Orchid's failure during the Relevant Period to organise itself to ensure it took reasonable care to ensure the suitability of its advice (Principle 9).
- 2.3. Orchid breached Principle 9 by failing to:
- (1) obtain and record from customers all information likely to be relevant to the suitability of its advice, including financial information;
 - (2) record how or why recommended mortgage contracts were suitable. This included a failure to record adequate evidence of product research, and record adequately why a recommended product was suitable;
 - (3) implement appropriate arrangements for the supervision and ongoing monitoring of its advisers; and
 - (4) make and retain appropriate records to demonstrate how it was carrying out training, supervision and monitoring of its advisers.
- 2.4. The FSA regards Orchid's failings as serious because they exposed over 900 customers to an unacceptable risk of buying mortgage products that were not suitable for them during the Relevant Period. As a result Orchid failed to treat its customers fairly.
- 2.5. The FSA has taken into account the following points which are regarded as mitigating factors:
- (1) Orchid has been open and has cooperated fully with the FSA's investigation;
 - (2) Orchid accepted that there were management and control failures during the Relevant Period. Accordingly it implemented a series of changes to its practices

and procedures after the FSA highlighted the failures during a visit to Orchid in March 2008;

- (3) the FSA has not found any evidence of actual consumer detriment; and
- (4) Orchid has conducted, and is in the process of completing, a file review and customer contact exercise.

3 RELEVANT STATUTORY AND REGULATORY PROVISION

- 3.1. The FSA's statutory objectives, set out in section 2(2) of the Act, are market confidence, public awareness, the protection of consumers and the reduction of financial crime.
- 3.2. 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 an amount as it considers appropriate."

Principles for Businesses

- 3.3. The Principles are a general statement of the fundamental obligations of firms under the regulatory system. They derive their authority from the FSA's rule-making powers as set out in the Act and reflect the FSA's regulatory objectives.
- 3.4. Principle 9 (customers: relationships of trust) states 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 upon its judgement."

Rules and guidance

- 3.5. Details of the FSA's policy on imposing financial penalties are set out in Annex A to this notice.

4 FACTS AND MATTERS RELIED UPON

Background

- 4.1. Orchid has been authorised by the FSA to sell regulated mortgage contracts since 25 October 2005.

- 4.2. Orchid is a limited company with three directors. During the Relevant Period, Orchid employed 11 advisers who between them advised on over 900 mortgage contracts.
- 4.3. Orchid was one of 50 mortgage brokers visited by the FSA in 2008 as part of a thematic project looking into the 'quality of advice processes' in mortgage brokers.
- 4.4. Unless otherwise stated, the facts and matters set out in paragraphs 4.5 to 4.24 below relate to the Relevant Period.

Reasonable care to ensure suitability of advice

Training and competence of advisers

- 4.5. Orchid's advisers should have an appropriate qualification before they can start to advise customers. The FSA identified that one of Orchid's "trainee" advisers had been advising for six months without any relevant qualifications.
- 4.6. All advisers have to pass a series of qualifications before they are allowed to be deemed a "competent" adviser. The level of monitoring and supervision of an adviser varies, depending on whether they are a trainee adviser or a competent adviser. Orchid would check 100% of a trainee adviser's files, and between 25-50% of a competent adviser's files. In error, Orchid assessed one trainee adviser as competent without that adviser having passed all the appropriate qualifications. This adviser therefore received reduced supervision and monitoring, when all of his files should have been checked.
- 4.7. One trainee adviser had recommended interest only mortgages to at least seven customers who seemingly had a cautious attitude to risk. Orchid has since identified that this adviser had been ticking the incorrect box in the attitude to risk section on the fact find rather than ascertaining the customer's true risk appetite. Orchid stated that the affected customers did not actually have a cautious attitude to risk. As a trainee adviser, all of his files should have been checked, however Orchid failed to identify the adviser's errors promptly.
- 4.8. Advisers were expected to undertake 50 hours of training per year. Orchid failed to document and evidence all training that was undertaken.
- 4.9. Orchid's senior management used Key Performance Indicators (KPIs) to monitor adviser activity. These KPIs included, for example, the volume of cases advised on, and the

volume of cases that went to the mortgage offer stage. These KPIs focussed on business production, however they did not consider the quality of that business.

Compliance function

- 4.10. The compliance function monitored the advisers sales by listening in to live calls and monitoring client files. Orchid failed to document all monitoring that took place.
- 4.11. Orchid's senior management delegated compliance responsibilities to other staff, but failed to conduct an independent review of the quality of this compliance monitoring.
- 4.12. Orchid therefore is not able to:
 - (1) evidence that monitoring took place; and
 - (2) ascertain the quality of its compliance monitoring.

Conclusion

- 4.13. Orchid failed to:
 - (1) implement appropriate arrangements for the supervision and ongoing monitoring of its advisers; and
 - (2) make and retain appropriate records to demonstrate how Orchid carried out training, supervision and monitoring of its advisers.

Gathering customer information

- 4.14. Orchid completed 'fact finds' during telephone conversations or face to face meetings between sales advisers and customers. These fact finds contained a tick box section, which would require an adviser to confirm that they had obtained certain information from a customer. The fact finds did not require the adviser to actually document the details of the information that had been obtained.
- 4.15. Orchid did not always keep information provided by a customer in support of their application. For example, bank statements which demonstrated income and expenditure were shredded rather than kept on file. In other cases, calculations which enabled Orchid to carry out affordability assessments, and therefore determine the customer's ability to afford a particular product, were not kept.

Evidencing suitability of advice

- 4.16. Once an adviser obtained the information they required during the fact find process, they used a computer generated research tool to ascertain the most suitable product for a customer. Orchid did not always keep copies of the results of this research. Orchid therefore failed to keep the evidence to support and demonstrate why that particular product had been selected amongst all the other options available.
- 4.17. The adviser recorded the reasons for recommending a particular product on the fact find document. Orchid acknowledged that the reasons for recommending a particular product were not always documented in sufficient detail to ascertain the reasons for that recommendation.
- 4.18. Once an adviser selected the most suitable product, they would then contact the customer, and give them a verbal explanation as to why that product had been recommended. Orchid did not send the customer a copy of the fact find or any other documentation explaining the reasons for the advice it gave. Orchid had no requirement for the adviser to document the verbal explanation given to the customer. Orchid therefore failed to keep an accurate record of the recommendation given to the customer.
- 4.19. Sometimes the original product that Orchid recommended would not be the one that was ultimately offered by the lender. For example, the lender might withdraw a product. In these cases, the adviser recommended an alternative product. Orchid sometimes failed, however, to document why another product had subsequently been recommended and explain how it deemed the alternative product to be suitable for the customer.
- 4.20. In other cases, sometimes the customer would contact the adviser to inform them that their circumstances had changed. Again, the adviser might recommend another product. Orchid sometimes failed to document these conversations with the customer.
- 4.21. When an adviser recommended another product to the customer, Orchid sometimes failed to send out a revised Key Facts Illustration (KFI), or failed to keep a copy of the revised KFI if one was sent out. In addition, Orchid sometimes failed to ensure that the KFI contained accurate and up-to-date information about the fees that the customer would incur.
- 4.22. In some cases, customers had an existing repayment mortgage, and were looking to remortgage their property. Orchid's advisers recommended interest only remortgages

because this would often be cheaper than a repayment remortgage. Orchid's advisers failed, however, to obtain details of, and therefore assess, the customer's attitude to risk when making their recommendation.

- 4.23. Orchid would normally receive a fee for advising a particular product to a customer. Orchid failed to provide all customers with accurate information relating to the fee that they would receive.

Conclusion

- 4.24. Orchid failed to ensure that it:
- (1) obtained, and retained, adequate records of its customers' personal and financial information; and
 - (2) recorded how or why it had concluded that recommended mortgage contracts were suitable.

5 ANALYSIS OF BREACHES

Principle 9

- 5.1. By reason of the facts and matters referred to in paragraphs 4.5 to 4.24 above, the FSA considers that Orchid has failed to demonstrate the suitability of advice, and that Orchid has therefore breached Principle 9.
- 5.2. Orchid's failures have exposed customers to the risk that:
- (1) they may have received unsuitable advice;
 - (2) they may not have received a clear or accurate message as to why a recommended product was considered to be suitable for them; and
 - (3) they may not have received sufficient information prior to making a mortgage application.
- 5.3. Orchid is unable to:
- (1) demonstrate that compliance monitoring took place;
 - (2) ascertain the quality of its compliance monitoring; and

(3) identify potential problems and take any necessary remedial action.

5.4. Further, Orchid's failures exposed customers to the risk of receiving unsuitable advice:

(1) from an unqualified adviser; and/ or

(2) from advisers who were not appropriately supervised.

6 ANALYSIS OF THE SANCTION

Determining the level of the financial penalty

6.1. 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. The FSA has also had regard to the Enforcement Manual ("ENF") which was in force for part of the relevant period. DEPP sets out the factors that may be of particular relevance in determining the appropriate level of financial penalty for a firm or approved person. The criteria are not exhaustive and all relevant circumstances of the case will be taken into consideration. Relevant extracts from DEPP are set out in Annex A.

Deterrence

6.2. 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 seriousness of Orchid's breaches

6.3. The FSA has had regard to the seriousness of the breaches, including the nature of the requirement breached, the number and duration of the breaches, the extent to which the breaches revealed serious or systemic weakness of the management systems or internal controls, the number of customers who were exposed to risk of loss and the number of customers likely actually to suffer financial detriment.

6.4. Furthermore, the FSA has had regard to the findings of an external compliance report which was provided to the Orchid's senior management in May 2007. Orchid's senior

management failed to take any action as a result of this report. Many of the failings identified in this report were also identified by the FSA.

- 6.5. For the reasons set out above and having regard to the impact on Orchid's customers, the FSA considers that the breaches are of a serious nature.

The extent to which the breaches were deliberate or reckless

- 6.6. The FSA does not consider that Orchid acted in a deliberate or reckless manner.

The amount of profits accrued

- 6.7. During the period between 25 October 2005 to 5 April 2008, Orchid's net commission and fees from regulated mortgage contracts totalled £1,467,998.
- 6.8. The FSA has taken into account the profits Orchid made from sales of regulated mortgages during the Relevant Period.

The size, financial resources and other circumstances of the firm

- 6.9. There is no evidence to suggest that Orchid is unable to pay the proposed penalty or exceptional circumstances to warrant a lower level of penalty.

Conduct following the breach

- 6.10. Orchid has been open and has cooperated fully with the FSA's investigation.
- 6.11. Orchid has accepted that there were management and control failures during the Relevant Period. Accordingly it implemented a series of changes to its practices and procedures after the FSA highlighted the failures during a visit to Orchid in March 2008.
- 6.12. Orchid has conducted, and is in the process of completing, a file review and customer contact exercise.
- 6.13. Without these positive steps, the financial penalty would have been higher.

Previous action taken in relation to similar failings

- 6.14. In determining the appropriate sanction, the FSA has taken into account sanctions imposed by the FSA on other authorised persons for similar behaviour. This was considered alongside the principal purpose for which the FSA imposes sanctions, namely

to promote high standards of regulatory conduct by deterring persons who have committed breaches from committing further breaches and helping to deter other persons from committing similar breaches, as well as demonstrating generally the benefits of compliant business.

7 CONCLUSIONS

- 7.1. Having regard to the seriousness of the breaches and the risk they posed to the FSA's statutory objectives of maintaining confidence in the financial system and securing the appropriate degree of protection for consumers, the FSA has decided to impose a financial penalty of £34,500 on Orchid.

8 DECISION MAKER

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

9 IMPORTANT

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

Manner of and time for Payment

- 9.2. The financial penalty of £34,500 must be paid in full by Orchid in instalments as agreed with the FSA. Payment in full is to be received by 4 May 2009.

If the financial penalty is not paid

- 9.3. If all or any of the financial penalty is outstanding on the due dates, the FSA may recover the outstanding amount as a debt owed by Orchid and due to the FSA.

Publicity

- 9.4. 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

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

FSA contacts

9.6. For more information concerning this matter generally, you should contact Catherine Harris (direct line: 020 7066 4872 /fax: 020 7066 4873) of the Enforcement Division of the FSA.

Signed:

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Jonathan Phelan
Project Sponsor
FSA Enforcement Division

Annex A: Rules and guidance

1. The FSA's policy on the imposition of financial penalties

1.1 The FSA's policy in relation to the issue of public censures is set out in Chapter 6 of the Decision Procedure and Penalties Manual (DEPP) which forms part of the FSA Handbook. It was previously set out in Chapter 12 of the Enforcement Manual (ENF), to which the FSA has also had regard. The principal purpose of issuing a public censure 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.

1.2 The FSA will consider the full circumstances of each case when determining whether or not to issue a public censure. DEPP6.4.2G sets out guidance on a non-exhaustive list of factors that may be of relevance in determining whether it is appropriate to issue a public censure rather than impose a financial penalty, which include the following.

- (1) DEPP6.4.2 G(1): deterrence;
- (2) DEPP6.4.2G(2): the degree of profit made or loss avoided as a result of the breach;
- (3) DEPP6.4.2G(3): the seriousness of the breach;
- (4) DEPP6.4.2G(4): conduct after the breach;
- (5) DEPP6.4.2G(5): co-operation and compensation;
- (6) DEPP6.4.2G(6): The previous disciplinary record and compliance history of the person;
- (7) DEPP6.4.2G(7): Action taken by the FSA in previous similar cases; and
- (8) DEPP6.4.2G(8): the impact on the person concerned.

2. Determining the level of the financial penalty

2.1 The FSA will consider all the relevant circumstances of a case when it determines the level of financial penalty. DEPP6.5.2G, and previously ENF 13.3.3 G, sets out guidance on a

non exhaustive list of factors that may be of relevance when determining the amount of a financial penalty.

2.2 Factors that may be relevant to determining the appropriate level of financial penalty include:

- (1) whether the breach revealed serious or systematic weaknesses in the person's procedures or of the management systems or internal controls relating to all or part of a person's business (DEPP 6.5.2 G (2) (b)); and
- (2) the general compliance history of the person, including whether the FSA has previously brought to the person's attention, issues similar or related to the conduct that constitutes the breach in respect of which the penalty is imposed (DEPP 6.5.2 (9) (d)).

2.3 Corresponding provisions are set out in ENF 12.3 which sets out factors that may be relevant when determining whether it is appropriate to issue a public censure rather than impose a financial penalty.