
FINAL NOTICE

To: **Redstone Mortgages Limited**
Of: 2 Royal Exchange Buildings, London EC3V 3LF
Date: **12 July 2010**

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

1. THE PENALTY

- 1.1. The FSA gave Redstone Mortgages Limited ("Redstone"/"the Firm") a Decision Notice on 8 July 2010 which notified the Firm that pursuant to section 206 of the Financial Services and Markets Act 2000 ("the Act"), the FSA had decided to impose a financial penalty of £630,000 on the Firm in respect of breaches of Principle 3 (Management and control) and Principle 6 (Customers' interests) of the Principles for Businesses ("the Principles") and Rules 12.3.1 R, 12.5.2 R and 13.3.1 R in the Mortgages and Home Finance: Conduct of Business sourcebook ("MCOB") in the period between 1 January 2007 and 5 August 2009 ("the Relevant Period").
- 1.2. The Firm confirmed on 8 July 2010 that it will not be referring the matter to the Upper Tribunal (Tax and Chancery Chamber). Redstone qualified for a 30% (stage 1) reduction in penalty, pursuant to the FSA's executive settlement procedures. Were it not for this discount, the FSA would have sought to impose a financial penalty of £900,000 on the Firm.
- 1.3. Redstone will carry out a customer redress programme with a view to providing redress to all customers with regulated first charge mortgages ("mortgages") that were in arrears and who were charged specific unfair and/or excessive charges in respect of

their mortgage account. The estimated cost of redress is up to £500,000, excluding interest.

- 1.4. Accordingly, for the reasons set out below, the FSA imposes a financial penalty on Redstone in the amount of £630,000.

2. REASONS FOR THE ACTION

- 2.1. The breaches of the Principles and MCOB Rules, which are described in more detail in section 4 below, relate to a number of serious failings by Redstone in relation to customers with a mortgage with the Firm who were in arrears.

- 2.2. The Firm breached Principle 3 during the Relevant Period in that it failed to take reasonable care to organise and control its affairs responsibly and effectively, with adequate risk management systems. In particular, during the Relevant Period, Redstone:

- (1) failed to take reasonable care to establish and maintain adequate arrangements to oversee compliance with regulatory requirements in relation to its mortgage arrears and mortgage litigation¹ activities. Specifically, the Firm failed to obtain and/or review sufficient treating customers fairly (“TCF”) management information to assess the handling of mortgage arrears and mortgage litigation activities to ensure the fair treatment of customers; and
- (2) failed to take reasonable steps to ensure that the mortgage arrears servicing staff acting on its behalf (“the mortgage servicing staff”) had an adequate understanding of and implemented the requirement to treat customers fairly in handling its mortgage arrears and mortgage litigation activities. Specifically, the Firm failed to maintain sufficient oversight of training and incentive structures in respect of the mortgage servicing staff.

¹ Mortgage litigation refers to and includes litigation activities from instructing solicitors, sending a letter before action, applying for a possession order and enforcing that order.

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

- (1) prior to April 2009, did not properly assess whether a proposed “arrangement to pay” (“ATP”²) was sustainable or whether there were alternatives for resolving a customer’s arrears other than an ATP based on the customer’s personal and financial circumstances;
- (2) had a written policy of initiating mortgage litigation if the customer’s account was two months or more in arrears regardless of the customer’s personal and financial circumstances. The mortgage servicing staff therefore focussed on reducing arrears to less than two months as part of the negotiation to enter into an ATP and in some cases this resulted in unnecessary litigation costs being incurred by the customer;
- (3) had a written policy of applying for a Suspended Possession Order (“SPO”) to secure an ATP if the customer could not bring their arrears under two months. In some cases, this resulted in unnecessary litigation costs being incurred by the customer, even where the customer had proposed an ATP that was reasonable in light of their personal and financial circumstances;
- (4) issued repetitive, excessive and sometimes confusing correspondence;
- (5) failed to inform customers:
 - (a) of their right to refuse a field counsellor; and/or
 - (b) that a field counsellor had been instructed and/or to notify them of the date and time of a proposed field counsellor visit,

² An arrangement to pay is an agreement with the customer to effect a monthly payment over an agreed term in order to clear the customer’s arrears.

thereby depriving customers of the opportunity to refuse or cancel the visit without charge; and

(6) applied certain charges that were unfair and/or excessive.

2.4. Redstone also breached MCOB 12.3.1 R, 12.5.2 R and 13.3.1 R in relation to the facts described at paragraph 2.3 above.

2.5. Accordingly, the failings merit the imposition of a substantial financial penalty.

3. RELEVANT STATUTORY PROVISIONS

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

3.2. Section 206 of the Act provides:

(1) If the Authority considers that an authorised person has contravened a requirement imposed on him by or under this Act, it may impose on him a penalty, in respect of the contravention, of such amount as it considers appropriate.

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

3.4. Principle 3 provides that:

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

3.5. Principle 6 provides that:

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

3.6. MCOB 12.3.1 R provides that:

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

(1) able to be expressed as a cash value; and

(2) a reasonable pre-estimate of the costs as a result of the customer repaying the amount due under the regulated mortgage contract before the contract has terminated.

3.7. MCOB 12.5.2 R provides that:

A firm must ensure that its charges to a customer in connection with the firm entering into, making a further advance or further release on, administering, arranging or advising on a regulated mortgage contract, home reversion plan or regulated sale and rent back agreement, or arranging or advising on a variation to the terms of a regulated mortgage contract, home reversion plan or regulated sale and rent back agreement are not excessive.

3.8. MCOB 13.3.1 R provides that:

(1) A firm must deal fairly with any customer who:

(a) is in arrears on a regulated mortgage contract or home purchase plan;

(b) has a sale shortfall; or

(c) is otherwise in breach of a home purchase plan.

(2) A firm must put in place, and operate in accordance with, a written policy (agreed by its respective governing body) and procedures for complying with (1).

4. FACTS AND MATTERS RELIED ON

Background

- 4.1. Since April 2005, Redstone has been authorised by the FSA with permission to administer and enter into regulated mortgage contracts. During the Relevant Period, Redstone did not originate mortgages itself, but purchased loans from non-bank specialist mortgage lenders that primarily provided loans to self-employed and credit-impaired borrowers. Credit-impaired borrowers are perceived to have a high credit risk, often because of a poor credit history, or due to other characteristics that are associated with a high potential risk of defaulting on the mortgage.
- 4.2. As at January 2010, Redstone had approximately £1.38 billion of loans on its balance sheet and at April 2010 it had securitised assets in the region of £480 million. During the Relevant Period, Redstone administered on average 9,817 regulated mortgage contracts a month with an average total balance of approximately £1.25 billion.
- 4.3. Redstone was one of the firms that took part in the FSA's thematic work in connection with the Mortgage Effectiveness Review which started in 2008.

Management and Control

- 4.4. During the Relevant Period, the mortgage servicing staff dealt with incoming and outgoing calls to, and correspondence with, customers in arrears.
- 4.5. Redstone failed to implement and maintain adequate oversight of the mortgage servicing staff, and failed to ensure that the mortgage servicing staff had an adequate understanding of, and implemented, TCF.
- 4.6. Prior to April 2009, Redstone had insufficient oversight of training for the mortgage servicing staff and conducted insufficient compliance monitoring to ensure that this training resulted in appropriate TCF outcomes for customers. As a result, prior to April 2009, the mortgage servicing staff failed properly to consider and/or implement TCF requirements in relation to customers in arrears.

- 4.7. Redstone also failed to maintain sufficient oversight of the incentive structures in place in respect of the mortgage servicing staff. The mortgage servicing staff had call duration targets that impacted on their remuneration. These call duration targets were too short to enable staff both to meet their targets and to obtain enough information about customers' personal and financial circumstances to discuss the options available to them in repaying their arrears. As a result, Redstone failed to treat its customers fairly as set out below.
- 4.8. The Firm received insufficient TCF management information to ensure its customers were being treated fairly in its handling of its mortgage arrears and mortgage litigation activities. In particular, the Firm did not obtain sufficient management information on the performance of ATPs, such as the uphold rate, or other qualitative performance indicators, to enable it to assess whether the outcomes of its procedures and processes resulted in the fair treatment of customers.
- 4.9. In the Relevant Period, Redstone's arrears and mortgage litigation management information, in relation to TCF, consisted solely of complaints data and this was not sufficient for the Firm to identify potential and/or existing failings in its mortgage litigation handling and remedy any such failings.

Arrears and mortgage litigation handling – failure to treat customers fairly

Arrears handling by mortgage servicing staff

- 4.10. The mortgage servicing staff had prescribed mandates for approving the time period within which customers were required to clear any outstanding arrears, although they also had discretion to refer cases to Redstone management to agree arrangements outside the prescribed mandates where appropriate.
- 4.11. As a result of Redstone's policy of initiating litigation when the customer was two months in arrears, the mortgage servicing staff failed to adopt a reasonable approach to the time over which payment shortfalls could be paid and/or to take into account the customer's personal and financial circumstances. Instead they focussed on reducing arrears to less than two months as part of the negotiation to enter into an ATP.

- 4.12. Before April 2009 the mortgage servicing staff were not required to, and did not, properly assess whether the customer's offer of an ATP was sustainable. For example, the mortgage servicing staff did not ask customers to provide them with their income and expenditure details over the telephone.
- 4.13. Before April 2009, Redstone failed properly to assess whether, based on the customer's personal and financial circumstances, there was a better alternative to an ATP for resolving their arrears. Redstone's arrears handling policy permitted concessions such as allowing customers to pay less than the monthly payment or to switch their repayment type from repayment to interest only. However, these options were only available at the customer's request and were not proactively offered by the mortgage servicing staff.

Arrears handling – use of field counsellors

- 4.14. Redstone engaged field counsellors to visit customers at home to discuss their mortgage arrears and obtain information on their personal and financial circumstances. Field counsellors were instructed as a matter of course if a borrower fell into arrears without agreeing an ATP with the Firm.
- 4.15. Customers were not always informed by Redstone when a field counsellor had been instructed. Customers were regularly sent standard letters stating 'we may' or 'we will' instruct a field counsellor, but often were not told that a counsellor had actually been instructed to attend their property or notified of the date and time of the appointment. These customers were therefore unaware of any right to refuse or cancel an inconvenient and/or unwanted visit and may have incurred charges that could have been avoided had they been properly informed of the scheduled visit.
- 4.16. Customers were not proactively informed of their right to refuse a field counsellor by the mortgage servicing staff and this option was not mentioned in Redstone's standard letters. The wording of the standard letters informed customers that a counsellor's visit could be cancelled at a charge of £50 but did not inform them of their right to refuse a counsellor and avoid incurring field counsellors' charges.

Mortgage Litigation

- 4.17. The Firm had a written policy of initiating mortgage litigation if the customer's account was two months or more in arrears regardless of the customer's personal and financial circumstances. This policy led, in certain cases, to the Firm commencing mortgage litigation without giving adequate consideration to the most appropriate options for those customers and/or taking into account their personal and financial circumstances.
- 4.18. Further, Redstone's written policy was to apply for an SPO to secure an ATP in all cases where the mortgage account was two months or more in arrears. In some cases this resulted in unnecessary litigation rather than trying to avoid mortgage litigation and its related costs altogether and reach a direct agreement with the customer for an ATP without an SPO.

Arrears charges

- 4.19. During the Relevant Period, Redstone imposed a number of excessive or unfair charges on customers in arrears.
- 4.20. The excessive or unfair charges imposed by Redstone were:
- (1) a fee for a returned direct debit which was charged on each re-presentation of the direct debit by the Firm regardless of the number of times it had already been returned unpaid;
 - (2) the inclusion of arrears fees and charges in the balance which formed the basis of the calculation of the early repayment charge;
 - (3) field counsellor fees charged to customers who had not been properly informed of the timing of the scheduled counsellor visit and/or their right to refuse or cancel the visit and who either refused the visit or were not available when the counsellor visited;
 - (4) field counsellor fees charged in full to the customer due to an administrative error when the reduced rate cancellation fee should have been charged; and

- (5) fees associated with litigation activities when Redstone unnecessarily secured an ATP by way of an SPO.

Communication with customers

- 4.21. The FSA reviewed 22 customer files relating to customers who were in arrears and, in some cases, involved in mortgage litigation.
- 4.22. In the Relevant Period, correspondence issued to borrowers in arrears by the Firm was often excessively long and repetitive, as demonstrated in 18 of the 22 files reviewed. Duplicate or near duplicate correspondence was often sent to customers. Further, 13 out of the 22 files reviewed contained evidence of confusing and/or conflicting information being provided to customers.
- 4.23. As described above, Redstone also failed properly to inform customers of scheduled field counsellor visits and their right to refuse or cancel the visit.

5. ANALYSIS OF BREACHES AND PROPOSED SANCTION

- 5.1. Principle 3 requires that a firm take reasonable care to organise and control its affairs responsibly and effectively, with adequate risk management systems. Redstone failed to obtain and use sufficient TCF management information and failed to implement and maintain adequate oversight of the mortgage servicing staff. Accordingly, Redstone's systems and controls were insufficient in relation to the handling and oversight of mortgage arrears and mortgage litigation activities and the Firm was in breach of Principle 3.
- 5.2. Principle 6 requires that a firm must pay due regard to the interests of its customers and treat them fairly. In doing so, firms should ensure that customers are treated fairly if they are in arrears with their mortgage by:
 - (1) being flexible in considering a customer's personal and financial circumstances; and
 - (2) ensuring that court action for repossession is only used after all other reasonable attempts have been made to resolve the arrears situation.

- 5.3. In failing to assess whether, based on the customer's personal and financial circumstances, a proposed ATP was sustainable or there were better alternatives for resolving a customer's arrears than an ATP, Redstone failed to pay due regard to the interests of its customers and treat them fairly. The failure by Redstone to inform customers of their right to refuse a field counsellor visit and/or to inform customers that a field counsellor had been instructed (or of the date and time of the visit) demonstrated a similar failure to pay due regard to customers' interests and to treat them fairly because it deprived customers of the opportunity to cancel or refuse the visit without cost.
- 5.4. In addition, Redstone did not treat its customers fairly as a result of applying charges and fees to a customer's account that were excessive and/or unfair.
- 5.5. The Firm's failings resulted in some customers incurring excessive or unfair costs and accruing arrears that could have been avoided had Redstone adopted a more flexible and fair approach to arrears management that properly took into account a customer's personal and financial circumstances.
- 5.6. Furthermore, by sending repetitive, excessive and sometimes confusing correspondence, Redstone failed to have due regard to customers' interests and treat them fairly.
- 5.7. As a result of the above, Redstone failed to pay due regard to the interests of its customers and treat them fairly, in breach of Principle 6.
- 5.8. When exercising its powers the FSA seeks to act in a way which it considers most appropriate for the purpose of meeting its regulatory objectives as set out in section 2(2) of the Act. The FSA considers that imposing a financial penalty in respect of Redstone meets the regulatory objectives of maintaining market confidence and protection of consumers.
- 5.9. In deciding to take this action, the FSA has had regard to the guidance published in the FSA handbook, in particular as set out in Chapter 12 of the Enforcement Guide ("EG") and Chapter 6 of the Decision Procedure and Penalties Manual ("DEPP") which form part of the FSA Handbook of Rules and Guidance. Prior to 28 August

2007 the relevant guidance was set out in Chapter 13 of the Enforcement Manual (“ENF”). The FSA has had regard to both DEPP and ENF as both manuals applied at separate times during the Relevant Period. The Manuals set out a non-exhaustive list of criteria that may be of particular relevance in determining the appropriate level of financial penalty for an authorised person.

Deterrence

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

The nature, seriousness and impact of the breach

- 5.11. In determining the appropriate sanction, the FSA had regard to the seriousness of the contraventions, including the nature of the requirements breached, the number and duration of the breaches and the number of customers who suffered a financial loss.
- 5.12. The FSA considers Redstone’s failings to be serious because:
- (1) the failings persisted over a significant period of time and impacted a substantial number of customers; and
 - (2) arrears rates in the sub-prime sector are higher than those in the rest of the mortgage market and, as Redstone specialised in the sub-prime sector, a number of customers who already had an adverse credit status were put at further risk of financial detriment.

The extent to which the breach was deliberate or reckless

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

The size, financial resources and other circumstances of the Firm

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

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

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

Conduct following the breaches

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

- 5.17. Redstone made significant improvements to its arrears handling and mortgage litigation procedures in the latter part of the Relevant Period. In particular;

- (1) since April 2009, the mortgage servicing staff have focussed more on the customer's personal and financial circumstances and on proactively suggesting alternative options to an ATP;
- (2) since November 2008, the mortgage servicing staff have increasingly undertaken income and expenditure assessments with customers to ascertain the sustainability of any proposed ATP. From May 2009 income and expenditure assessments have routinely been undertaken by the mortgage servicing staff;
- (3) since November 2008, if Redstone agrees an ATP with a customer, the Firm will often cancel a repossession hearing even if the customer's arrears total more than two monthly mortgage payments;
- (4) since January 2009, targets for the mortgage servicing staff have become more focused on call quality, and less on call duration;
- (5) since April 2009, Redstone has enhanced its oversight of its mortgage servicing activities, including by placing a greater focus on the training and monitoring of the mortgage servicing staff and on TCF management information; and

- (6) Redstone's senior management have worked in an open and co-operative way with the FSA during the course of the investigation and have worked with the FSA to ensure early resolution of the matter and timely redress for customers.

Disciplinary record and compliance

- 5.18. Redstone has not been the subject of previous disciplinary action.

6. CONCLUSION

- 6.1. Taking into account the seriousness of the breaches and the risks they posed to the FSA's statutory objectives of market confidence and the protection of consumers, the FSA has imposed a financial penalty of £630,000 on the Firm.

7. DECISION MAKERS

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

8. IMPORTANT

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

Manner of and time for payment

- 8.2. The financial penalty must be paid in full by the Firm to the FSA by no later than 26 July 2010, 14 days from the date of the Final Notice.

If the financial penalty is not paid

- 8.3. If all or any of the financial penalty is outstanding on 27 July 2010, the FSA may recover the outstanding amount as a debt owed by the Firm and due to the FSA.

Publicity

- 8.4. Section 391(4), 391(6) and 391(7) of the Act apply to the publication of information about the matter to which this notice relates. Under those provisions, the FSA must publish such information about the matter to which this notice relates as the FSA

considers appropriate. The information may be published in such manner as the FSA considers appropriate. However, the FSA may not publish information if such publication would, in the opinion of the FSA, be unfair to you or prejudicial to the interests of consumers.

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

FSA contact

- 8.6. For more information concerning this matter generally, you should contact Liz Ludlow at the FSA (Tel: 020 7066 1474) of the Enforcement and Financial Crime Division of the FSA.

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Tracey McDermott

FSA Enforcement and Financial Crime Division