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## FINAL NOTICE

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To: **Stonebridge International Insurance Limited**

Firm

Reference

Number: **203188**

Address: **Braywick Gate  
Braywick Road  
Maidenhead  
Berkshire  
SL6 1DA**

Date: **7 August 2014**

### **1. ACTION**

- 1.1. For the reasons given in this notice, the Authority hereby imposes on Stonebridge a financial penalty of £8,373,600.
- 1.2. Stonebridge agreed to settle at an early stage of the Authority's investigation. Stonebridge therefore qualified for a 30% (stage 1) discount under the Authority's executive settlement procedures. Were it not for this discount, the Authority would have imposed a financial penalty of £11,962,317 on Stonebridge.

### **2. SUMMARY OF REASONS**

- 2.1. On the basis of the facts and matters described below, Stonebridge breached Principle 3 (Management and control) and Principle 6 (Customers' interests) of the Authority's Principles for Businesses between 1 April 2011 and 31 December 2012 in relation to telephone sales of Personal Accident, Accidental Death and Accidental Cash Plan insurance products. These products were underwritten by Stonebridge and sold to customers on its behalf by various authorised intermediary firms to whom Stonebridge had outsourced its sales and customer services operations.
- 2.2. Stonebridge failed to take reasonable steps to ensure that its customers were treated fairly. It identified its target market as being persons who typically were in

the middle-to-low income bracket and did not have a college degree or professional qualification; yet the sales process it designed provided insufficient information and channelled customers who had families towards the broader, costlier family cover. Stonebridge designed sales scripts and call flows that emphasised the availability of cancellation rights during the sales calls. However, when customers tried to cancel their policies, the post-sales cancellation process designed by Stonebridge presented customers with barriers to cancellation. All of these factors resulted in customers taking out policies that they did not fully understand.

- 2.3. These failings were made possible by Stonebridge's poor systems and controls, and inadequate oversight of the Outsourcing companies. There were deficiencies in the training material designed by Stonebridge. Stonebridge failed to ensure that sales calls and post-sales cancellation calls by the Sales outsourcing company and the Customer service outsourcing company were subject to adequate quality assurance procedures. It also failed to obtain adequate management information to oversee whether customers were being treated fairly by the Outsourcing companies. Furthermore, Stonebridge was unable properly to monitor its systems and controls in the European Offices because its Compliance department was inadequately resourced.
- 2.4. Stonebridge breached Principle 6 during the Relevant Period by failing to pay due regard to the interests of its customers in the UK and treat them fairly. Its business strategy of maximising sales of the Products was implemented at the cost of the fair treatment of its customers. In particular:
  - a) There were deficiencies in the sales process guides designed by Stonebridge to facilitate the sales calls, known as call flows, which were designed in a manner that channelled customers who had families automatically towards the broader and costlier family cover;
  - b) The sales process encouraged sales personnel to make use of cancellation rights to secure sales. Customers were encouraged to purchase the Products by being informed that they could cancel their policies within 30 days and not incur any fees if they did not consider the Products suitable for their needs; and
  - c) When customers wanted to cancel their policies, the customer services personnel presented barriers to cancellation. Stonebridge's training process encouraged these personnel to overcome customers' objections which resulted in customers not succeeding in cancelling policies despite several attempts.
- 2.5. Stonebridge breached Principle 3 in the UK during the Relevant Period by failing to provide adequate oversight in relation to the sales and post-sales cancellation processes at the Sales outsourcing company and the Customer services outsourcing company. Stonebridge failed to identify and address the following weaknesses in the implementation of these processes:
  - a) The Sales outsourcing company failed to provide information in a clear, fair and balanced manner. The sales personnel failed to disclose adequate information at the point of sale, including the exclusions and limitations of the Products. In addition, the pace of the sales calls conducted by the Sales outsourcing company was too fast to be adequately comprehensible;
  - b) The sales personnel at the Sales outsourcing company failed to inform customers of Stonebridge's identity at the beginning of the sales calls;
  - c) The sales personnel at the Sales outsourcing company failed to inform customers of the implications of some payment options at the point of sale;

- d) If a customer bought a policy providing a narrower scope of coverage following cancellation of a policy, in some cases personnel at the Customer services outsourcing company did not provide adequate and comprehensible information about the replacement policy which included information on exclusions and limitations; and
  - e) Stonebridge failed to take reasonable steps to ensure that sales calls and post-sales cancellation calls were subject to adequate quality assurance procedures.
- 2.6. Stonebridge breached Principle 3 during the Relevant Period by failing to take reasonable care to implement adequate systems and controls in relation to the outsourcing of its sales and customer services operations to the Outsourcing companies responsibly and effectively, with adequate risk management systems. These weaknesses in systems and controls led to customers being placed at an unacceptable risk of being mis-sold the Products. Specifically, during the Relevant Period:
- a) Stonebridge's governance structure during the Relevant Period was inadequate in that it did not ensure that the Outsourcing companies had effective controls to ensure that customers would be treated fairly. For instance:
    - i) Various Board and Executive Committees within Stonebridge during the Relevant Period did not effectively oversee whether the Outsourcing companies were adequately addressing the risks affecting customers and failed to ensure that issues brought to their attention were rectified on a timely basis; and
    - ii) The Committee responsible for setting remuneration was not instructed to consider 'Treating Customers Fairly' objectives when determining the incentive schemes for its own staff and the staff at the Outsourcing companies. In addition, there was inadequate focus on considering customer-specific risks and regulatory obligations when setting remuneration guidelines. Consequently, Stonebridge did not give sufficient weight to addressing the risk of customer detriment when setting up incentive schemes for staff;
  - b) Stonebridge did not obtain adequate management information from the Outsourcing companies to enable it to identify, measure and manage risks to the fair treatment of customers. The management information that Stonebridge obtained was unclear and incomplete, which meant that there was lack of effective monitoring of the Outsourcing companies;
  - c) Stonebridge pursued an aggressive timetable to outsource its customer services function to the Customer services outsourcing company without putting in place adequate systems and controls to enable it to oversee whether the Customer services outsourcing company was treating its customers fairly; and
  - d) Stonebridge had an inadequately resourced Compliance department to enable it to monitor the systems and controls in its European Offices to an appropriate standard and did not take reasonable steps to address this. Stonebridge's processes failed to identify subsequent changes to call scripts made by one of the Outsourcing companies after the Compliance department had approved them.
- 2.7. The Authority considers these failings to be particularly serious because a significant number of customers were placed at risk of mis-selling by Stonebridge's failings. At the end of 2012, Stonebridge had 558,000 customers of which

approximately 40% were based in the UK and the remainder were based in Europe. During the Relevant Period, 486,644 customers were sold policies on Stonebridge's behalf by the Outsourcing companies in the UK and the European Countries.

- 2.8. Stonebridge has carried out a past business review of all of the sales conducted in the UK by the Outsourcing companies during the Relevant Period and has proactively commenced a similar exercise in relation to the Products sold in the UK and the European Countries. Further, it will compensate any customers who have suffered losses as a result of the failings identified in this Notice. The scope of this past business review is significantly wider than that of the Skilled Person's review and includes all current policy holders.
- 2.9. Further, in response to the Authority's concerns, Stonebridge has taken a number of proactive steps. It has voluntarily ceased distribution of the Products in the UK and the European Countries, replaced its executive management team who were in charge during the Relevant Period and comprehensively revised its governance structure and Operating Board membership, and improved the design of its products and policy documentation. It has also revised its contractual arrangements with the Customer services outsourcing company in order to strengthen the level of oversight to be provided in future and implemented new company policies and procedure for managing its prudential and conduct risk.
- 2.10. This action supports the Authority's consumer protection objective.

### **3. DEFINITIONS**

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

"the Act" means the Financial Services and Markets Act 2000

"the ARC" means Stonebridge's Audit and Risk Committee

"the Authority" means the body corporate previously known as the Financial Services Authority and renamed on 1 April 2013 as the Financial Conduct Authority

"Business Partners" means various catalogue sales firms, online retailers and credit card companies that provide customer lists to Stonebridge to enable it to market its insurance products to the Business Partner's customer base

"Call flows" means the less prescriptive sales process guides used in the UK to facilitate the sales calls. The guides set out a sequence of steps which sales personnel had to carry out during the calls. These guides were not as rigid as the detailed call scripts used in the European Countries

"Customer services outsourcing company" means the authorised intermediary firm engaged by Stonebridge from November 2011 until the end of the Relevant Period to carry out its customer services operations in the UK and the European Countries which included dealing with post-sales cancellation calls

"DEPP" means the Authority's Decision Procedures and Penalties Manual

"European Countries" means Germany, France, Italy and Spain where the Products were marketed during the Relevant Period

“European Offices” means Stonebridge’s offices in Germany and France, and its branches in Italy and Spain, comprising Stonebridge’s staff members who set up and managed Stonebridge’s relationship with the Outsourcing companies in the European Countries

“the Outsourcing companies” means, together, the various intermediaries contracted by Stonebridge to carry out sales and customer services in the UK and the European Countries during the Relevant Period including the Sales outsourcing company and the Customer services outsourcing company. Each of the intermediaries was authorised in the relevant country to conduct insurance mediation activities

“Period 1” means the period from April 2011 to December 2011 in respect of sales and also from December 2011 to May 2012 in respect of cancellations

“Period 2” means the period from August 2012 to October 2012

“Principles” means the Authority’s Principles for Businesses

“the Products” means, together, the Personal Accident, Accidental Death and Accidental Cash Plan insurance products sold to customers on behalf of Stonebridge

“RAG rating” means Red, Amber, Green score used by Stonebridge for performance measures

“the Relevant Period” means 1 April 2011 to 31 December 2012

“Sales Calls” means telephone calls made by the Sales outsourcing company in relation to the sale of one of the Products that were reviewed by the Skilled Person including calls that did not result in a sale

“Sales outsourcing company” means the authorised intermediary firm engaged by Stonebridge to conduct telephone sales of the Products on its behalf in the UK during the Relevant Period. This company also provided customer services operations until November 2011

“the Skilled Person” means the independent third party commissioned by Stonebridge at the Authority’s request to prepare a skilled persons report under section 166 of the Act reviewing the sales and customer services operations

“SRC” means Stonebridge’s Strategic Risk Committee

“STIC” means the Short Term Incentive Compensation scheme in place at Stonebridge that was used to calculate the bonuses payable to the staff

“Stonebridge” means Stonebridge International Insurance Limited

“TCF” means Treating Customers Fairly. TCF focuses on the delivery of the Authority’s statutory consumer protection objective

“TCFC” means Stonebridge’s TCF Committee

“TCF Outcomes” means the six improved consumer outcomes which are the aims of the Authority’s TCF initiative. These outcomes were first outlined in the Authority’s July 2006 publication, “Treating customers fairly – towards fair outcomes for consumers” and remain core to what the Authority expects of firms.

The requirement to implement these outcomes is firmly rooted in the Authority's Principles for Businesses

"the Tribunal" means the Upper Tribunal (Tax and Chancery Chamber)

#### **4. FACTS AND MATTERS**

##### **Background facts**

4.1. Stonebridge is a general insurance firm. It has been authorised since 1 December 2001 by the Authority. During the Relevant Period, it held the following permissions in relation to its insurance activities:

- a) Accepting deposits;
- b) Advising on investments (except pension transfers and opt-outs);
- c) Agreeing to carry on a regulated activity;
- d) Arranging deals in investments;
- e) Carrying out contracts of insurance;
- f) Dealing in investments as principal;
- g) Effecting contracts of insurance; and
- h) Making arrangements with a view to transactions in investments.

4.2. During the Relevant Period, Stonebridge through the Outsourcing companies, sold the Products to customers over the phone on a non-advised basis across the UK, Germany, France, Italy and Spain. Lists of potential customers were obtained through various Business Partners throughout the UK and the European Countries, which included catalogue sales firms, online retailers, banks and credit card companies. In return for the customer information, Stonebridge paid an agreed percentage of the premiums it collected to the Business Partners. The Business Partners were not actively involved with selling the Products to the customers. That role was carried out by the Outsourcing companies.

##### *The Products*

4.3. Stonebridge internally viewed the Products as *'high margin, lower claims risk, supplemental "push" protection products, tailored for distribution through telemarketing'*.

4.4. The Products were available either to cover individuals or to cover an individual and his or her family. The family cover also included a customer's partner and any children.

4.5. The Accidental Death Plan allowed relatives of policy holders to receive a lump sum if the policy holders died as a result of an accident. The payment made to the relatives varied according to the type of accident and the plan customers held, with the standard product typically paying £500,000 for a public transport accident, £50,000 for a road traffic accident and £25,000 for most other accidents. The average monthly premium for the policy during the Relevant Period was £6.19 for single cover and £8.76 for family cover.

- 4.6. The Accident Cash Plan enabled customers to receive a fixed amount of money each day if they were unable to work or look after their family. For example, the standard plan paid £350 per day for each day (for up to 365 days) in hospital in the UK as a result of an accident. The average monthly premium for the policy during the Relevant Period was £7.17 for single cover and £11.12 for family cover.
- 4.7. The Personal Accident Plan provided a range of fixed amounts for death, hospitalisation and accidental injuries. For example, the standard Personal Accident Plan paid from £1,000 for minor accidents to £250,000 for major accidents such as those that cause permanent disabilities. The average monthly premium for the policy during the Relevant Period was £6.35 for single cover and £12.93 for family cover.

#### *The business strategy*

- 4.8. During the Relevant Period, Stonebridge focussed increasingly on developing strategic alliances with its Business Partners. This focus strongly influenced product development and the choice of the products that Stonebridge marketed to its customers.
- 4.9. Stonebridge identified its target market as being persons who typically were in the middle-to-low income bracket and did not have a college degree or professional qualification.
- 4.10. Given these strategies, it was essential for Stonebridge to ensure robust controls were in place to ensure compliance with regulatory rules and in particular that its customers were treated fairly.

#### *Sales of Products*

- 4.11. During the Relevant Period, Stonebridge earned revenues (equivalent to gross written premium) of approximately £41.6m from sales of the Accidental Death Plan, £49.2m from sales of Accident Cash Plan and £3.0m from sales of Personal Accident Plan products in the UK and the European Countries, giving a total of approximately £93.8 million across the Products. The UK sales made up 37% of this revenue, followed by Germany, Spain, France and Italy which contributed 25%, 13%, 14% and 11% respectively to these revenue figures.

#### *The Incentive scheme*

- 4.12. Stonebridge operated an incentive scheme which applied to all permanent employees called the Short Term Incentive Compensation scheme ("STIC"). Senior managers could potentially earn an additional payment of up to 75% of their salaries under this scheme. The level at which STIC payments were made was chiefly based on the performance of the company, and a key measure of the performance of the company was the annual income expected to be generated from policies issued. There was no provision, after expiration of the free period, for claw-back of STIC payments if those policies were cancelled or were assessed as being mis-sold. Although lack of compliance with regulation was listed as a factor that could potentially reduce or prevent a STIC payment and, in particular, a senior manager's STIC payment calculations included a 10% weighting for TCF, in practice insufficient weight was given to this factor.
- 4.13. The STIC rewarded sales without sufficient countervailing measures to take into account the quality of the sales. The effect of this was to increase the risk of non-compliance with regulatory rules and in particular the risk that customers would not be treated fairly.

4.14. In addition, Stonebridge did not have sufficient oversight of, or input into, the incentive schemes in place at the Outsourcing companies. The Skilled Person found that although the incentive schemes at the Sales outsourcing company were largely adequate, they did not link cancellations with sales and therefore potentially led to a focus on volume of sales rather than quality. The Skilled Person found that the incentive scheme at the Customer services outsourcing company was focused on retaining customers who wanted to cancel their policies and potentially led to the use of barriers to cancellation. The incentive schemes in place at these Outsourcing companies increased the risk of mis-selling. Stonebridge did not have effective governance arrangements and controls in place to identify and manage this increased risk to its customers.

*The sales process*

4.15. During the Relevant Period, the sales process for the Products involved sales personnel at various outsourcing companies making unsolicited telephone calls to customers included in the lists provided by the Business Partners, using scripts and call flows designed by Stonebridge. In the UK, sales personnel followed a call flow process which provided guidance to the sales personnel on how to make sales calls, whereas in the European Countries they were instructed to follow a call script verbatim which had been approved by Stonebridge in the UK. Both processes included disclosing the name of the Business Partner who had introduced the customers to Stonebridge. The sales process involved customers being informed about the policies, being offered various payment options, and being informed about the exclusions and limitations of the policies they were purchasing. Customers were also informed that if they cancelled the policies before the end of the first 30 days, they would not have to pay any cancellation fees and all premiums would be refunded. Following the sale of the Products and after quality assurance by the sales outsourcing companies, Stonebridge sent the policy documentation to customers.

4.16. Following the sale, Stonebridge conducted a second level review of the sales calls that had been subjected to quality assurance by the sales outsourcing companies to ensure that the companies were carrying out assessments consistently and according to Stonebridge's standards.

*Background to the Authority's investigation*

4.17. During March and April 2012, the Authority reviewed a sample of sales calls and had concerns that customers were buying products without fully understanding the extent of cover under the policies.

4.18. In May 2012, the Authority communicated its concerns to Stonebridge. Stonebridge did not initially agree with the Authority's findings but commissioned an independent review by a City law firm of the same sales calls that had been analysed by the Authority. The law firm was instructed to identify further areas for improvement. The independent legal review concluded that while improvement was required in certain areas, there were no serious concerns in respect of its sales process. An action plan was developed by Stonebridge, in consultation with the Authority, to remedy the deficiencies identified.

4.19. In July 2012, Stonebridge, on its own initiative, commissioned a review of post-sales cancellation calls. A total of 1,703 calls were assessed during the review, of which 267 calls (16%) were deemed to have resulted in potential customer detriment. Upon verification of the findings in the review of these post-sales cancellation calls, Stonebridge reported the results to the Authority.

4.20. In October 2012, the Authority requested Stonebridge to appoint the Skilled Person to review sales and post-sales cancellation calls in the UK over two distinct periods to identify any customer detriment. The first period reviewed by the Skilled Person covered sales for the period from April 2011 to December 2011 and cancellations from December 2011 to May 2012 (Period 1). The second period covered sales and cancellations from August 2012 to October 2012 (Period 2). The Skilled Person's review found that although there was no indication of wilful mis-selling or pressurised selling, there were deficiencies in the sales process. Further, although the Skilled Person found no evidence of actual customer detriment, it was of the view that there was a risk of potential customer detriment. The review also found weaknesses in the systems and controls around the sales and post-sales cancellation process. As a result, the Authority commenced its investigation, the results of which are set out below.

### **Weaknesses in the sales process**

4.21. There were a number of deficiencies in the sales process designed by Stonebridge.

#### ***Deficiencies in the information provided at the point of sale***

4.22. Stonebridge's sales scripts and call flows, which provided guidance to sales personnel at the Outsourcing companies on how to make sales calls, were poorly designed. This resulted in customers not being provided with adequate information on the range of cover available to them, payment options, and the exclusions and limitations of products they were purchasing.

#### ***Failure to provide the customer with appropriate and comprehensible information about the policy***

4.23. Stonebridge designed the sales scripts and call flows that were subsequently used by the Outsourcing companies. Each script varied to comply with local laws but in essence all of them followed the same format. The sales personnel were directed to establish early in the call whether the customer had a family. These scripts were designed so as to steer customers who had families towards the broader and costlier family cover. If a customer answered "yes" to the question which asked whether they had children and/or a spouse, they were automatically offered the family cover without being informed of the cheaper single cover. The customers were not provided with all the relevant options about the levels of cover available to them.

4.24. The Authority considers that if different levels of cover are available in respect of a particular product, customers must be given that information at the point of sale to enable them to make an informed decision as to which level of cover is appropriate to their needs.

4.25. The Skilled Person found that in 80% of the Sales Calls (24 out of 30 calls) in Period 1 and 70% of the Sales Calls (21 out of 30 calls) in Period 2 (45 out of 60 calls in total), customers were not provided with appropriate and comprehensible information about the policy such as would enable the customer to make an informed decision about the arrangements proposed, and in a way that demonstrated that Stonebridge had had regard to the customer's interests and treating them fairly. In 37 out of these 45 calls, customers were not made aware of the different levels of cover that existed for the relevant product and the different costs associated with each level. In 16 out of these 45 calls (36%), personnel at the Sales outsourcing company failed to provide correct information to customers in relation to their eligibility for the Products and failed to explain comprehensively the cover, benefits, key exclusions and limitations.

4.26. The Authority considers that there was a risk that customers agreed to the sale without fully understanding the range of circumstances that were covered by the policies. In one example, a customer explained to a sales person employed by one of the Outsourcing companies that she was prone to falling over as her legs were weak due to an historic injury. The sales person, departing from the sales script, used this example of customer falling over and being hospitalised to explain that in such an event she would be able to claim on the policy. However, the product literature clearly stated that claims were not paid if the accident occurred due to pre-existing medical conditions. The sales person failed to mention this exclusion during the call. On the basis of the information provided to her, the customer agreed to purchase the Personal Accident Product.

*Not providing information in a clear, fair and balanced manner*

4.27. Stonebridge failed to provide proper oversight over the activities of sales personnel at the Sales outsourcing company who failed to provide information in a clear, fair and balanced manner to customers during sales calls.

4.28. In some cases, customers were given inaccurate or misleading information about policy coverage by sales personnel employed by the Outsourcing companies. For instance, one customer was informed that an Accident Cash Plan policy covered the customer if she cut her finger or if something happened to her in the garden. This was an incomplete illustration because this particular product only paid out in the event that the customer was unable to work or look after their family because they had to stay in the hospital for at least 24 hours due to the accident. In some instances, customers were informed that no payments were taken on the day of the sales call. Although this was factually correct, it was prone to being misunderstood by the customer because payment details were taken from the customers during the call committing them to a payment in a few working days. The Authority's review of the sales cancellation calls showed that a number of customers did not understand the policies they had purchased and were confused as to why Stonebridge had taken direct debit payments without their prior authorisation.

4.29. The Skilled Person found that in 20% of the Sales Calls (6 out of 30 calls) in Period 1 and 50% of the Sales Calls (15 out of 30 calls) in Period 2, the sales personnel at the Sales outsourcing company failed to provide information in a clear, fair and balanced manner.

4.30. The Skilled Person further found that the pace of 17% of these Sales Calls (10 out of 60 calls) was inappropriately fast. The Skilled Person concluded that there was therefore a risk that these customers did not fully understand the information they were given.

*Failure to explain Stonebridge's identity and the purpose of the call*

4.31. Stonebridge's monitoring processes did not pick up that sales personnel at the Sales outsourcing company failed to explain at the beginning of the sales calls that they were calling on behalf of Stonebridge and what the purpose of the call was. Instead, sales personnel initially gave an impression that they were calling on behalf of the Business Partner before explaining that they were in fact representing Stonebridge.

4.32. The Skilled Person found that in 80% of the Sales Calls (24 out of 30 calls) in Period 1 and 43% of the Sales Calls (13 out of 30 calls) in Period 2, the sales personnel failed to identify both Stonebridge and the purpose of the call explicitly at the beginning of the conversation.

*Failure to explain associated charges*

- 4.33. Stonebridge did not provide sufficient oversight over the activities of the sales personnel at the Sales outsourcing company, who failed to provide relevant information about the payment options available to its customers.
- 4.34. The Skilled Person found that in 77% of the Sales Calls (23 out of 30 calls) in Period 1, sales personnel at the Sales outsourcing company did not make the customers aware, at the point when they were deciding on the payment method, of the associated charges to which they might be exposed (namely if the customer chose to pay through their account with the Business Partner, it might have resulted in the customer paying interest on the premium if the outstanding balance on the account was not paid in full each month). Where this information was provided, it was given at the end of the sales call in line with the flawed design of the call flows in use at the time. In addition, the Skilled Person found that in 17 out of the 30 Sales Calls, the sales personnel encouraged customers to pay through the Business Partner's account by stating that payment through the store cards or the catalogue statements was more convenient because this method of payment did not require the customer to give bank details over the telephone.
- 4.35. As a result, the customers were not fully aware of the potential for associated charges. The Authority considers that this information is relevant to the affordability of the Products and customers therefore should have been reminded of this at the point of sale.
- 4.36. In June 2012, Stonebridge made changes to its call flows which resulted in customers being made aware of the range of payment methods and associated charges at the point when they had to decide how to pay for the Products. This resulted in improvements in the quality of the sales calls, as confirmed by the Skilled Person's review, which found only 1 out of 30 calls in Period 2 that did not communicate information on premium payment methods in a balanced manner or make the customer aware of associated charges.

*Use of cancellation rights to secure sales*

- 4.37. The training materials designed by Stonebridge encouraged sales personnel at the Sales outsourcing company to use cancellation rights in order to secure sales of the Products.
- 4.38. The sales scripts and call flows prompted sales personnel to state to the customers that they could cancel the policy at any time, and that if the cancellation was completed before the end of the first 30 days, the customers did not have to pay any cancellation fees and were refunded all the premiums they had paid to date. The sales personnel used phrases like "*it wouldn't have cost you a penny*".
- 4.39. The training material used to provide guidance to sales personnel stated that they could "*make explicit use of the cancellation terms to make the sale*". This material gave sales personnel wide discretion as to when, where and how many times they could use cancellation statements during a phone call to secure the sale.
- 4.40. The Skilled Person found that in 43% of the Sales Calls (13 out of 30 calls) in Period 1 and 43% of the Sales Calls (13 out of 30 calls) in Period 2, sales personnel used cancellation rights to secure or attempt to secure sales.

#### *Free periods of cover*

- 4.41. Stonebridge's sales process in the European Countries varied slightly from that followed in the UK because in most of the sales in these countries, the customers were offered free cover for periods of 30, 60 or 90 days. Providing periods of free cover does not, itself, constitute a breach of any applicable regulatory requirement. However, the Authority considers that this sales strategy, combined with presenting barriers to customers wishing to cancel their policies, suggests that Stonebridge was relying on some individuals either forgetting to cancel the policy at the end of the period of free cover or being successfully discouraged from doing so.
- 4.42. The STIC incentive scheme referred to in paragraph 4.12 potentially encouraged this type of selling, since the key measure of performance effectively counted the issue of a policy, even if it were to be promptly cancelled by the customer after the expiration of the free cover.
- 4.43. Consumer inertia is an important barrier to consumers acting to cancel their policies in situations such as this. The Authority's research is continuing in behavioural economics to establish why this is the case.
- 4.44. In this situation robust controls and processes, including scripts to guide sales personnel through compliant sales processes, were needed to mitigate the risk of consumers paying for policies which they did not wish to keep.

#### *Failure by the Outsourcing companies in the European Countries to follow the sales scripts*

- 4.45. Stonebridge's internal procedures meant that all of the sales scripts used by the Outsourcing companies in the European Countries were required to be signed off by the Compliance department before being implemented by sales personnel in the European Countries. However, there was insufficient monitoring by Stonebridge to detect any subsequent changes to the sales scripts on a timely basis.

#### ***Deficiencies in the information provided at the point of cancellation***

##### *Barriers to cancellation*

- 4.46. As explained in paragraph 4.38 above, sales personnel at the Sales outsourcing company emphasised during the sales process that if customers did not consider the Products suitable for their needs, they could cancel their policies and not incur any fees.
- 4.47. Before November 2011, if customers wanted to cancel their policies, they had to contact the Sales outsourcing company to process their request. Stonebridge designed training materials for the relevant persons so that they could respond to the cancellation requests with a view to retaining the customers. One particular training document which outlined how to retain such customers stated: "*by the end of this session you will demonstrate how to best approach a cancellation request with the intention of retaining the customer... [and] effectively handle objections presented by the customer in the retention process*".
- 4.48. From November 2011, the customer services operations for the UK and the European Countries were handled by the Customer services outsourcing company

based in the UK. This company also presented customers with barriers to cancellation.

4.49. Although the data available to Stonebridge indicated that cancellation rates were high, nevertheless the Authority has identified the following examples of barriers to cancellation in the Relevant Period:

- a) Although the sales cancellation scripts stated that customers should answer three data protection questions before they could discuss their policy, the Authority's review of customer calls identified several instances where the customer services personnel asked six data protection questions before they initiated the cancellation process.
- b) The Authority's review of customer calls also identified some instances where the customer services personnel refuted the customer's concerns five times in order to dissuade the customer from cancelling the policy entirely. They tried to persuade customers to keep their policies or take out new policies with reduced cover at a lower cost. For instance, they suggested that the customers review the policy documents which the customer services personnel sent through the post to help them to "*make a more informed decision*". Alternatively, customer services personnel tried to convince customers that "*different kinds of insurance all complement each other*". If a customer explained that they wanted to cancel the policy because they were unable to afford it, the customer services personnel offered them a reduced cover, often without explaining the implications of the reduced cover.
- c) During one telephone call, it became apparent that the customer had tried to cancel his policy since 2004 but on each occasion the customer services personnel persuaded the customer to retain it. When the customer tried to cancel his policy again the agent asked "*is there any reason why you wanting [sic] to cancel it now?*" In response, the customer stated, "*I don't need it, I just don't need it, I'm sure I don't*". Notwithstanding the customer making this request, the telephone call ended with the customer keeping the policy.

4.50. Customer facing personnel at the Sales outsourcing company and the Customer services outsourcing company were rewarded for successfully retaining customers who wanted to cancel their policies.

4.51. The Skilled Person found that in 40% of the cancellation calls (8 out of 20 calls) in Period 1 and 44% of the cancellation calls (11 out of 24 calls) in Period 2 (19 out of 44 calls in total), the customer services personnel presented customers with barriers to cancellation. Only 4 out of these 19 cancellation calls resulted in the customers successfully cancelling their policies. In 7 out of the 19 calls, customers agreed to retain their policies in full and in 8 out of the 19 calls, customers agreed to retain the policies with a reduced cover.

*Failure to provide the customer with appropriate and comprehensible information about reduced policy coverage*

4.52. As a result of the retention process designed by Stonebridge, which encouraged personnel at the customer services outsourcing companies to present barriers to cancellation, many customers who tried to cancel their policies, instead opted for reduced cover. This in effect meant that they agreed to purchase a new policy. However, in a significant proportion of cases, personnel at the Customer services outsourcing company failed to provide appropriate and comprehensible information about the new policies. Customer services personnel should have explained the

revised benefits, exclusions and limitations to the customers. However, the customer services personnel failed to provide this information during the call.

- 4.53. The Skilled Person found that in 35% of the cancellation calls (7 out of 20 calls) in Period 1 and 56% of the cancellation calls (14 out of 24 calls) in Period 2, customers were not provided with sufficient, appropriate and comprehensible information about the policy to enable the customer to make an informed decision. For instance, the customer services personnel failed to check whether the customer was eligible to receive benefits under the policies or inform them about key exclusions and limitations. In two cases, the Skilled Person found that the customers believed that they were purchasing life insurance policies instead of the Accidental Death policy and were uncertain which family members were covered under the policy. The Skilled Person also found that two customers repeatedly asked for more information because they did not understand the products being offered by Stonebridge. However in response to these requests, the sales personnel failed to provide clear and easily understandable information.

#### **Weaknesses in systems and controls**

- 4.54. There were a number of weaknesses in the systems and controls in place at Stonebridge relating to its oversight of the sales and post-sales cancellation process.

#### ***Inadequate Management Information***

- 4.55. The management information that Stonebridge obtained to seek to ensure it was treating its customers fairly was incomplete and unclear, which meant that Stonebridge was unable effectively to monitor the Outsourcing companies during the Relevant Period.
- 4.56. During the Relevant Period the 'TCF dashboard', Stonebridge's management information tool for monitoring TCF outcomes and ensuring timely delivery of associated activities, was inadequate and ineffective. In particular:
- a) The TCF dashboards were not fully or accurately completed. For example in July 2011, for the UK, Germany, Italy and Spain, the detailed executive summaries were identical to one another; the action plans for each of these countries contained the same two issues first raised more than a year previously; and no trend commentary was completed. The poor quality of input from the European Offices to the TCF dashboard remained an issue throughout the Relevant Period.
  - b) The RAG ratings did not effectively assess the extent of the risk to customers. For example, in November 2011, Stonebridge's office in Spain gave a Green RAG rating score to its quality assurance process on the TCF dashboard. However, the Compliance department had completed a review of the same process and rated it as Red over the couple of months preceding the Green rating.

#### ***Ineffective governance***

- 4.57. Various Board and Executive Committees within Stonebridge did not effectively oversee whether the Outsourcing companies were adequately managing risks affecting its customers during the Relevant Period.

### *Executive Committees*

4.58. The TCF Committee ("TCFC") was tasked with assisting the Audit and Risk Committee ("ARC") in the governance of the TCF policy and providing the first level of challenge to senior management in relation to customer risk. It was intended to ensure that the company met its obligations to treat customers fairly and appropriately manage the risk of failing to do so. However, during the Relevant Period the TCFC did not operate effectively to ensure that customers were treated fairly. In particular, during the Relevant Period:

- a) There was no evidence that the TCFC reviewed TCF internal controls in accordance with its terms of reference.
- b) The TCFC did not provide appropriate challenge to the results in the TCF dashboard and the accuracy of the management information that made up the dashboard. For example, in 2012 the regional dashboard regularly produced a RAG rating that was obviously incorrect. The result was overridden to reflect the correct position. However, the deficiencies in the metrics used in the dashboard were not addressed by the TCFC within a reasonable time.
- c) The TCFC was aware of the deficiencies in TCF reporting, but failed to resolve this issue within a reasonable time.
- d) The TCFC also failed to ensure that issues that were brought to its attention were rectified on a timely basis. For instance, in March 2011, the TCFC became aware that the complaint levels in Spain were high. The TCFC requested an analysis to be carried out to determine why. However, this request remained outstanding in February 2012.

4.59. The Strategic Risk Committee ("SRC") was an executive committee tasked with assisting the ARC in identifying, quantifying and mitigating risk, overseeing the effectiveness of controls and supporting risk management programmes, including TCF-related controls. The SRC was responsible under its terms of reference for ensuring that "*fair treatment of customers is integral to the strategic and operational risk objectives*" of Stonebridge. The Authority considers that the SRC was ineffective in this regard during the Relevant Period. In particular:

- a) The management information presented to the SRC was inadequate. For instance, from the beginning of the Relevant Period the Authority had raised concerns about French complaints, which highlighted Stonebridge's failure to gather sufficient data about customer cancellations. This culminated in the Authority sending a formal letter to Stonebridge on 2 September 2011 setting out its concerns and requesting that Stonebridge review its sales process. Yet the pack provided to the SRC that month contained no management information that detailed progress with resolving this issue and "regulatory risk" was RAG rated as Green throughout this period. Further, Compliance reports were not regularly included in SRC packs prior to June 2012. In addition, the December 2011 SRC minutes noted that the French and Spanish offices were not providing adequate input into the preparation of the risk dashboards.
- b) The SRC minutes show no debate on customer risks and issues. The TCFC was also charged with dealing with TCF issues, but was also ineffective in doing so.

### *Board Committees*

4.60. The ARC was the Board committee which had oversight of the effectiveness of the overall risk framework, of financial reporting and internal control principles and

practices during the Relevant Period. Although the ARC discussed Risk and Compliance issues, the Authority considers that there was an inadequate level of sustained challenge in respect of TCF risks, in particular customer-specific risks in relation to sales through the Outsourcing companies:

- a) In August 2010, Internal Audit informed the ARC of the lack of compliance reviews or outcome testing within the Outsourcing companies in the European Countries. In November 2010, an audit of TCF outcomes noted, among other things, that less than half of the Compliance department's oversight monitoring activities had been completed, and no compliance oversight monitoring had been undertaken at all in the Outsourcing companies in the European Countries. The ARC accepted assurances that this was being addressed without further enquiry as to the adequacy of the Compliance department's resources. In May 2011, Internal Audit again reported to the ARC that the Compliance department's monitoring activities were behind schedule due to lack of resources. Although Internal Audit pointed out that this issue was being addressed, the Compliance department remained under-resourced throughout the Relevant Period, as discussed further in paragraphs 4.74 to 4.75 below; and
- b) Internal Audit informed the ARC in August 2011 of serious defects in respect of processes and procedures involved in sales through the Outsourcing companies. Despite the continuing concerns of Internal Audit and evidence of a substantial increase in complaints, the ARC relied on verbal reassurances and failed to call for management information to establish whether any customer detriment was arising.

4.61. The Board's Nomination and Remuneration Committee ("NRC") approved the structure and objectives for performance related pay operated by Stonebridge in the UK and the European Countries. The terms of reference of the NRC did not require consideration of customer-specific risks and compliance with regulatory obligations when setting remuneration and incentives. Although the NRC increased the TCF measure in the STIC bonus structure for senior management prior to the Relevant Period, the Authority considers that, in practice, Stonebridge did not give sufficient weight to addressing the risk of customer detriment when setting up incentive schemes for its staff. As a result, the incentive schemes in place at Stonebridge throughout the Relevant Period incentivised sales without adequate consideration of the quality of those sales.

#### *The Operating Board*

4.62. Although the Operating Board did provide some degree of challenge and oversight during the Relevant Period, it failed to ensure that the systems and controls weaknesses affecting customers, which were raised at Board level, were remedied on a timely basis and that requested actions were progressed to closure. For example:

- a) In September 2011, the Board called for a paper to confirm that all the actions requested by the Authority in its 2009 review had been completed. This was still outstanding in March 2012; and
- b) In December 2011, the Board received an update on an audit being conducted in Stonebridge's French office in response to concerns raised by the French regulator arising from customer complaints. One Board member enquired whether the Compliance department's oversight was sufficient. There is no evidence that a response was provided and no follow up action points were raised to address this matter.

### ***Deficiencies in managing outsourcing arrangements***

- 4.63. In or around May 2011, Stonebridge began the process of creating a new customer services centre in the UK to handle all customer services calls across Europe. The new customer services centre was intended to operate cross-border, and therefore, it was necessary to conduct a fresh assessment for compliance with regulations. The timetable for the creation of this new centre should have included sufficient time for Stonebridge to understand the implications of this significant change and develop the necessary procedural controls.
- 4.64. The TCF dashboard for August 2011 pointed out that there was “aggression” in the timetable set for the migration which was planned for November 2011. The Legal department was notified of the impending migration in September 2011. Stonebridge established a project team to implement the migration. The scope of the responsibilities of this project team included ensuring procedures, training material and scripts were in place before the operation went live. However, these key documents were not approved by the Compliance department.
- 4.65. In August 2011, Internal Audit reported that Stonebridge’s outsourcing policies and procedures were seriously deficient. Internal Audit noted that the relevant policy did not properly highlight risks and controls. It also noted that procedures for the due diligence process in respect of outsourcing were inadequate, including how the process was signed off and controlled. The customer services approval process did require that all customer communications be approved by Compliance prior to use. Despite Internal Audit’s concerns and written advice from the Compliance department drawing attention to the impossibility of achieving a compliant operation in the time available, Stonebridge proceeded with the migration of the customer services function, which took place on 21 November 2011.
- 4.66. A review of the customer services function by the Compliance department, completed in February 2012, found that Stonebridge had not requested that sufficiently robust procedures be put into place at the Customer services outsourcing company to ensure customers were treated fairly and that customer services activity was properly organised. It found that although the project had ‘gone live’ in November 2011, the procedures, training and scripting used by the Customer services outsourcing company were still not approved as of February 2012, and were either not compliant with regulations or not sufficiently robust. In relation to scripting, the review identified that the scripts for the Outsourcing companies in the European Countries were not approved by the Compliance department; either the English version had never been translated, or those translations had not been provided to the Compliance department for approval.

### ***Weaknesses in the training process***

- 4.67. Stonebridge designed the training material which was used by the Outsourcing companies. It was also directly involved in providing the training.

#### *Training deficiencies at the Sales outsourcing company*

- 4.68. There were a number of weaknesses in the design of the training process at the Sales outsourcing company.
- 4.69. For this company, Stonebridge designed an extensive training programme. However, some of the training encouraged poor selling techniques.
- 4.70. The training encouraged staff to use cancellation rights as a means of securing a sale and encouraged staff not to ask certain questions which would have made the

sales more TCF compliant. For instance, the training material stated, "*we will be working on the assumption that the customer would like to cover all eligible family*".

- 4.71. The Skilled Person found that although the training and competence scheme in place at the Sales outsourcing company had most of the components that it would expect to find, sales personnel were not provided with feedback on the quality of the calls and the results of the call monitoring reviews. The testing on the use of products, regulations and process was set at too basic a level and the training material was not consistent with regulatory requirements and did not consider good and poor customer outcomes.

#### *Training deficiencies at the Customer services outsourcing company*

- 4.72. The Customer services outsourcing company used its own training materials for the first year of its operation. However, Stonebridge also did not adequately oversee what training materials were in use by this outsourcing company. The Authority considers that an insurer in this position is obliged under Principle 6 to review the training materials to be used by its intermediaries and to satisfy itself of their suitability, as well as taking reasonable steps to ensure that the training is being undertaken to a satisfactory standard.
- 4.73. The Skilled Person found that the training procedure which was in place during the Relevant Period for staff at the Customer services outsourcing company was too basic and did not focus on TCF Outcomes. There was also a lack of formal training given to the staff, which meant there were no training records to demonstrate the competence of staff. Further, one-to-one feedback meetings with individual agents put undue emphasis on retaining customers.

#### **Weaknesses in Compliance**

- 4.74. The Compliance department at Stonebridge operated under a governance framework which specified how it would fulfil its duties in relation to monitoring and assessing the adequacy and effectiveness of Stonebridge's policies and controls. The framework formed part of Stonebridge's governance arrangements and aimed to provide a second line of defence. The development of this Compliance framework started before 2011, but was only completed in May 2012.
- 4.75. Throughout the Relevant Period, the Compliance department at Stonebridge was under-resourced. All of its staff members were physically based in the UK and did not visit either the European Offices or the Outsourcing companies in Germany or Italy as part of their Compliance monitoring reviews. As a result, because the European Offices did not have their own Compliance teams, it meant that Germany and Italy were not subject to any Compliance monitoring reviews in the Relevant Period. Instead, the Compliance department focused its efforts on the European Offices and the Outsourcing companies in France and Spain.

#### **Weaknesses in the quality assurance process**

- 4.76. All sales were subject to two levels of quality assurance procedures. During the Relevant Period, the quality assurance process for sales made by the Sales outsourcing company and post-sales cancellations by the Customer outsourcing company comprised the following key steps:

- a) The Sales outsourcing company reviewed each one of the sales calls before the policy documentation was issued to customers. This process was set out in a manual designed by Stonebridge;
- b) From November 2011 to May 2012, the Customer services outsourcing company used its own quality assurance manual. From May 2012, Stonebridge implemented a quality assurance manual for the Customer services outsourcing company to follow. This manual was similar in design to the one that Stonebridge put in place for the quality assurance of sales calls; and
- c) In addition, Stonebridge conducted a second level review of the sales and post sales cancellation calls that had been subjected to a quality assurance process by the Outsourcing companies. This review was known as 'congruence testing'. This was to ensure the Outsourcing companies were carrying out the assessments consistently and accurately to Stonebridge's standards.

*Deficiencies in the quality assurance process*

4.77. The second level quality assurance process at Stonebridge had the following key weaknesses:

- a) The process did not provide for any analysis to determine the reasons why calls at the Sales outsourcing company and the Customer services outsourcing company were failing quality assurance. There was no mechanism in place to feed back the results of the quality assurance process which would have helped improve the sales process;
- b) The staff carrying out quality assurance of the French sales calls did not listen to the entire telephone calls before grading them. Instead, they concluded their assessments after only listening to the first five minutes of the sales calls. This increased the risk of the quality assurance process not identifying all of the unsuitable sales. Further, the Spanish office did not record the results of any of its quality assurance testing. Consequently, the Compliance department in the UK was unable to validate these results; and
- c) Due to lack of oversight provided by Stonebridge over the Customer services outsourcing company, for a large part of the Relevant Period, no quality assurance was carried out in relation to post-sales cancellation calls.

4.78. The first level quality assurance process in place at the Sales outsourcing company and the Customer services outsourcing company in the UK had the following deficiencies:

- a) The process did not require sales calls to be assessed against all areas of the Authority's regulatory requirements. For instance, the process did not take into account whether customers were getting the right products and service when assessing the quality of the calls; and
- b) The new quality assurance process implemented in May 2012 for the post-sales cancellation process stipulated that the customer services personnel were provided feedback on a minimum of one call per week. However, the phone calls on which customer services personnel were given feedback did not necessarily have to be of poor quality. The process did not require feedback on all calls that showed a poor customer outcome.

4.79. Stonebridge failed to identify these deficiencies in the first level quality assurance process either as part of its initial due diligence process prescribed by its

outsourcing policy or through its monitoring of the Sales outsourcing company and the Customer services outsourcing company.

#### *Results of the Skilled Person's review*

- 4.80. The Skilled Person compared the results of Stonebridge's second level quality assurance process to the findings of its own review. It found that in relation to 80% of the Sales Calls (24 out of 30 calls) in Period 1 and 75% of the Sales Calls (18 out of 24 calls) in Period 2, Stonebridge's second level quality assurance review did not identify any of the matters that the Skilled Person found. In the remaining calls, Stonebridge's second level quality assurance process only partially identified the relevant findings.
- 4.81. In relation to post sales cancellation calls, the Skilled Person found that in respect of 100% of the Sales Calls (11 out of 11 calls) in Period 1 and 89% of the Sales Calls (17 out of 19 calls) in Period 2, Stonebridge's second level quality assurance review did not identify any of the relevant findings of the Skilled Person.

#### **Steps taken by Stonebridge to address the Authority's Findings**

- 4.82. Stonebridge has carried out a past business review of all of the sales conducted in the UK by the Outsourcing companies during the Relevant Period and has proactively commenced a similar exercise in relation to the Products sold in the UK and the European Countries. Further, it will compensate any customers who have suffered losses as a result of the failings identified in this Notice. The scope of this past business review is significantly wider than that of the Skilled Person review and includes all current policy holders.
- 4.83. Further, in response to the Authority's concerns, Stonebridge has taken the following proactive steps:
- a) voluntarily ceased distribution of all Products in the UK and the European Countries;
  - b) replaced its executive management team who had been in charge during the Relevant Period;
  - c) comprehensively revised its governance structure, including implementing a new committee structure, terms of reference and risk management framework;
  - d) undertaken a detailed review of all its existing product lines to reflect the Authority's current expectations on product governance, resulting in numerous improvements in both product design and policy documentation;
  - e) revised its contractual arrangements with the Customer services outsourcing company in order to strengthen the level of oversight to be provided in future; and
  - f) implemented new company policies and procedure for the management of both prudential and conduct risk.

## **5. FAILINGS**

- 5.1. The statutory and regulatory provisions referred to in this Final Notice are referred to in **Annex A**.

- 5.2. The Authority considers that Stonebridge has breached Principle 6 (Customers' interests) and Principle 3 (Management and Control).

**Principle 6 - failure to ensure that the sales and post-sales cancellation process considered the customer's needs**

- 5.3. Stonebridge breached Principle 6 in the UK by failing to pay due regard to the interests of its customers and treat them fairly in its design of the sales process and post-sales cancellation process which were implemented at the Sales outsourcing company and the Customer services outsourcing company. In particular:

- a) Stonebridge designed call flows which were based on the assumption that a customer with a family wanted the costlier family cover.
- b) The call flows and scripts encouraged sales personnel at the Sales outsourcing company to use the availability of cancellation rights to persuade customers to purchase the Products. However, if customers later wished to cancel their policies, the Customer services outsourcing company presented barriers to cancellation in a significant proportion of cases by following call scripts and call flows designed by Stonebridge. Stonebridge's training process encouraged customer services personnel to overcome customers' objections and unduly emphasised retaining customers rather than focusing on what was the right outcome for them. As a result, customer services personnel refuted the customers' concerns and persuaded the customers to keep the policy or take out a narrower and therefore less costly cover option. Some customers did not succeed in cancelling policies despite several attempts.

**Principle 3 – failure to implement adequate systems and controls and to provide adequate oversight of the Outsourcing companies in relation to the sales and post-sales cancellation processes**

- 5.4. Stonebridge breached Principle 3 by failing to provide adequate oversight in the UK in relation to the sales and post-sales cancellation processes at the Sales outsourcing company and the Customer services outsourcing company. Stonebridge failed to identify and address the following weaknesses in the implementation of these processes:

- a) The Sales outsourcing company failed to provide information in a clear, fair and balanced manner. The sales personnel failed to disclose adequate information at the point of sale, including the exclusions and limitations of the Products. In addition, the pace of the Sales Calls conducted by the Sales outsourcing company was too fast to be adequately comprehensible;
- b) Customers were not informed by the Sales outsourcing company of Stonebridge's identity at the beginning of the Sales Calls;
- c) Customers were not informed by the Sales outsourcing company of the implications of some payment options at the point of sale; and
- d) If a customer was persuaded to take out a narrower and therefore less costly policy to replace a cancelled product, personnel at the Customer services outsourcing company did not provide adequate and comprehensible information about the replacement policy which included information on exclusions and limitations.

- 5.5. In addition, Stonebridge failed to take reasonable steps to ensure that sales calls and post-sales cancellation calls at the Sales outsourcing company and the Customer services outsourcing company were subject to adequate first level quality assurance procedures. The second level quality assurance process did not analyse the reasons why calls were failing quality assurance testing. Due to lack of oversight provided by Stonebridge over the Customer services outsourcing company, for a large part of the Relevant Period, no quality assurance was carried out in relation to post sales cancellation calls.
- 5.6. Stonebridge breached Principle 3 by failing to take reasonable steps to implement adequate systems and controls in relation to its outsourcing arrangements to ensure that the sales and post-sales cancellations of the Products in the UK and each of the European Countries complied with the relevant regulatory requirements. In particular, Stonebridge failed to:
- a) ensure that its Board and Executive Committees provided effective oversight of the Outsourcing companies. These executive bodies also failed to ensure that issues brought to their attention were rectified on a timely basis. Further, the Committee responsible for setting remuneration did not adequately consider customer-specific risks when determining employee incentive schemes;
  - b) obtain adequate and effective management information from the Outsourcing companies to enable it to address risks affecting its customers. The management information obtained by Stonebridge was incomplete, unclear, and did not effectively assess the extent of risks facing customers;
  - c) implement adequate systems and controls before the customer services function was outsourced to a new provider. Stonebridge pursued an aggressive timetable for outsourcing these services without ensuring that proper procedures and documents were in place at the time the operation went live. Stonebridge failed to ensure a smooth transition of its operations from its existing arrangements to the new Customer services outsourcing company. Stonebridge ignored written advice from the Compliance department which stated that the operation would not be compliant at the time of going live. Stonebridge did not fully analyse and address the implications of its new outsourcing arrangement; and as a result was unable to meet its regulatory obligations. In addition, there was a lack of urgency in rectifying outstanding issues to meet the regulatory requirements; and
  - d) resource adequately its Compliance department to enable it to establish and monitor systems and controls in Stonebridge's European Offices and the Outsourcing companies in the European Countries to an adequate standard and did not take reasonable steps to address this. Stonebridge's systems failed to detect subsequent changes to call scripts by one of the Outsourcing companies in the European Countries after the Compliance department had approved them.

## **6. SANCTION**

- 6.1. The Authority's policy for imposing a financial penalty is set out in Chapter 6 of DEPP. In respect of conduct occurring on or after 6 March 2010, the Authority applies a five-step framework to determine the appropriate level of financial penalty. DEPP 6.5A sets out the details of the five-step framework that applies in respect of financial penalties imposed on firms.

### **Step 1: disgorgement**

- 6.2. Pursuant to DEPP 6.5A.1G, at Step 1 the Authority seeks to deprive a firm of the financial benefit derived directly from the breach where it is practicable to quantify this.
- 6.3. DEPP 6.5A.1G(2) states that where a firm agrees to carry out a redress programme to compensate those who have suffered loss as a result of the breach, or where the Authority decides to impose a redress programme, the Authority will take this into consideration. In such cases the final penalty might not include a disgorgement element, or the disgorgement element might be reduced.
- 6.4. Stonebridge has agreed to carry out a past business review, with the assistance of an independent third party, in relation to its sales of the Products to customers who purchased them during the Relevant Period. Following this review, Stonebridge has agreed that it will compensate customers for any losses they suffered as a result of the failings identified in this Notice. In these circumstances, no disgorgement applies.
- 6.5. Step 1 is therefore £0.

### **Step 2: the seriousness of the breach**

- 6.6. Pursuant to DEPP 6.5A.2G, at Step 2 the Authority 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.
- 6.7. The Authority considers that the revenue generated by Stonebridge from the sales of the Products in the UK and the European Countries during the Relevant Period is indicative of the potential harm caused by its breach. This comprises of the revenue accrued by Stonebridge from the sales of these Products during the period of the breach, as opposed to the total revenue recognised from contracts entered into or influenced by misconduct during the period of the breach. The Authority considers Stonebridge's relevant revenue for this period to be £93,822,092.
- 6.8. In deciding on the percentage of the relevant revenue that forms the basis of the Step 2 figure, the Authority considers the seriousness of the breach and chooses a percentage between 0% and 20%. This range is divided into five fixed levels which represent, on a sliding scale, the seriousness of the breach; the more serious the breach, the higher the level. For penalties imposed on firms there are the following five levels:
  - Level 1 – 0%
  - Level 2 – 5%
  - Level 3 – 10%
  - Level 4 – 15%
  - Level 5 – 20%
- 6.9. In assessing the seriousness level, the Authority takes into account various factors which reflect the impact and nature of the breach, and whether it was committed deliberately or recklessly. DEPP 6.5A.2G(11) lists factors likely to be considered

'level 4 or 5 factors'. Of these, the Authority considers the following factors to be relevant:

- a) The breaches caused a significant risk of loss to Stonebridge's customers. At the end of 2012, Stonebridge had 558,000 customers of which approximately half were based in the UK and the remainder were based in the European Countries. Since a lack of regard for customers' interests was inherent in the business model throughout the Relevant Period, there is a risk that a significant proportion of these sales were unsuitable for the customers, who might have consequently suffered loss; and
- b) The weaknesses in Stonebridge's systems and controls in relation to sales and post-sales cancellation process were serious and systemic. As a result, Stonebridge was unable to monitor and assess whether customers were being treated fairly.

6.10. DEPP 6.5A.2(12) lists factors likely to be considered 'level 1, 2 or 3 factors'. Of these, the Authority considers it relevant that most of Stonebridge's breaches were committed negligently although in relation to the transfer of customer services operation to the Customer services outsourcing company, the Authority considers that the breaches were reckless.

6.11. DEPP 6.5A.2(6) lists factors which relate to the impact of the breach. Of these, the Authority considers relevant the fact that Stonebridge identified its target market as being persons who typically were in the middle-to-low income bracket and did not have college degree or professional qualification.

6.12. Taking all of these factors into account, the Authority considers the seriousness of the breach to be level 4 and so the Step 2 figure is 15% of £93,822,092.

6.13. Step 2 is therefore £14,073,314.

### **Step 3: mitigating and aggravating factors**

6.14. Pursuant to DEPP 6.5A.3G, at Step 3 the Authority 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.

6.15. The Authority considers that there are no factors that aggravate the breach.

6.16. The Authority considers that the following factors mitigate the breach:

- a) Stonebridge has carried out a comprehensive redress programme, with the assistance of an independent third party, in relation to all sales of the Products during the Relevant Period. In addition, Stonebridge, following its own review and assessment, has agreed to implement a past business review to include all current customers and has agreed to compensate customers for any losses they suffered as a result of the failings identified in this Notice. This review will extend beyond the Relevant Period and has now commenced;
- b) Stonebridge voluntarily ceased all new sales of all products in the UK and the European Countries (although it continues to service its existing customers);
- c) Stonebridge replaced the executive management team who had been in charge during the Relevant Period;

- d) Stonebridge comprehensively revised its governance structure and Operating Board membership, including implementing a new committee structure, terms of reference and risk management framework;
- e) Stonebridge undertook a detailed review of all of its existing product lines to reflect the Authority's current expectations on product governance, resulting in numerous improvements in both product design and policy documentation;
- f) Stonebridge has revised its contractual arrangements with the Customer services company in order to strengthen the level of oversight to be provided in future; and
- g) Stonebridge has implemented new company policies and procedures for the management of both prudential and conduct risk.

6.17. Having taken into account these mitigating factors, the Authority considers that the Step 2 figure should be decreased by 15%.

6.18. Step 3 is therefore £11,962,317.

#### **Step 4: adjustment for deterrence**

6.19. Pursuant to DEPP 6.5A.4G, if the Authority 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 Authority may increase the penalty.

6.20. The Authority considers that the Step 3 figure of £11,962,317 represents a sufficient deterrent to Stonebridge and others, and so has not increased the penalty at Step 4.

6.21. Step 4 is therefore £11,962,317.

#### **Step 5: settlement discount**

6.22. Pursuant to DEPP 6.5A.5G, if the Authority 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 Authority and the firm reached agreement. The settlement discount does not apply to the disgorgement of any benefit calculated at Step 1.

6.23. The Authority and Stonebridge reached agreement at Stage 1 and so a 30% discount applies to the Step 4 figure.

6.24. Step 5 is therefore £8,373,600.

#### **Penalty**

6.25. The Authority therefore imposes a total financial penalty of £8,373,600 on Stonebridge for breaching Principles 6 (Customers' interests) and 3 (Management and control).

## **7. PROCEDURAL MATTERS**

### **Decision maker**

- 7.1. The decision which gave rise to the obligation to give this 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 financial penalty must be paid in full by Stonebridge to the Authority by no later than 21 August 2014, 14 days from the date of the Final Notice.

### **If the financial penalty is not paid**

- 7.4. If all or any of the financial penalty is outstanding on 22 August 2014, the Authority may recover the outstanding amount as a debt owed by Stonebridge and due to the Authority.

### **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 Authority must publish such information about the matter to which this notice relates as the Authority considers appropriate. The information may be published in such manner as the Authority considers appropriate. However, the Authority may not publish information if such publication would, in the opinion of the Authority, be unfair to you or prejudicial to the interests of consumers or detrimental to the stability of the UK financial system.
- 7.6. The Authority intends to publish such information about the matter to which this Final Notice relates as it considers appropriate.

### **Authority contacts**

- 7.7. For more information concerning this matter generally, contact Matthew Hendin at the Authority (direct line: 020 7066 0236 /fax: 020 7066 0237).

Bill Sillett

Financial Conduct Authority, Enforcement and Financial Crime Division

## **ANNEX A**

### **RELEVANT STATUTORY AND REGULATORY PROVISIONS**

#### **1. RELEVANT STATUTORY PROVISIONS**

1.1. The Authority's operational objectives, set out in section 1B(3) of the Act, include the consumer protection objective.

1.2. Section 206(1) 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."*

#### **2. RELEVANT REGULATORY PROVISIONS**

##### *Principles for Businesses*

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

2.2. Principle 3 (Management and control) provides:

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

2.3. Principle 6 (Customers' interests) provides:

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

##### *DEPP*

2.4. Chapter 6 of DEPP, which forms part of the Authority's Handbook, sets out the Authority's statement of policy with respect to the imposition and amount of financial penalties under the Act.

##### *The Enforcement Guide*

2.5. The Enforcement Guide sets out the Authority's approach to exercising its main enforcement powers under the Act.

2.6. Chapter 7 of the Enforcement Guide sets out the Authority's approach to exercising its power to impose a financial penalty.