
FINAL NOTICE

To: **The Loan Company t/a Greenhill Finance (“TLC”/ “the Firm”)**
Of: **Saxon House**
Moston Road
Sandbach
Cheshire
CW11 3AP
Date: 29 October 2007

TAKE NOTICE: The Financial Services Authority of 25 The North Colonnade, Canary Wharf, London E14 5HS (“the FSA”) gives you final notice about a decision to impose a financial penalty on TLC.

1 ACTION

1.1 The FSA gave TLC a Decision Notice on 29 October 2007 which notified TLC 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 £31,500 on TLC in respect of breaches of the FSA’s Principles for Businesses (“Principles”) and related FSA Rules between June 2005 and November 2006 (“the relevant period”).

1.2 TLC has breached:

- (1) Principle 3 (management and control);
- (2) Principle 7 (communications with customers); and
- (3) Principle 9 (customers: relationships of trust)

in respect of systems and controls and record keeping failures, all in relation to advised sales of regulated mortgage contracts.

1.3 TLC has also breached the following FSA Rules:

- (1) Rules 3.1.1R, 3.2.6R and 3.2.20R in the part of the FSA's Handbook of Rules and guidance ("the Handbook") entitled Senior Management Arrangements, Systems and Controls ("SYSC");
- (2) Rules and guidance 2.2.6R, 2.2.7G, 2.2.8G, 4.3.1R, 4.3.2R 4.4.7R, 4.7.2R, 4.7.4R, 4.7.6R and 4.7.17R in the part of the Handbook entitled Mortgages and Home Finance: Conduct of Business ("MCOB"); and
- (3) Rules 2.3.1R and 2.8.1R in the part of the Handbook entitled Training and Competence ("T&C").

1.4 TLC agreed to settle at an early stage of the FSA's investigation. It therefore qualified for a 30% (stage 1) discount under the FSA's executive settlement procedures. Were it not for this discount, the FSA would have imposed a financial penalty of £45,000 on TLC.

2 REASONS FOR THE ACTION

Introduction

2.1 The FSA decided to impose a financial penalty on TLC for breaches of the FSA Principles and Rules identified in Section 1 above that occurred during the relevant period. These breaches relate to TLC's failure to establish and maintain effective systems and controls in relation to its sales and advice procedures and its failure to ensure that such mortgage brokerage was conducted in accordance with FSA requirements. These failings are set out in more detail in paragraph 3.4 below.

2.2 In summary the FSA made the following findings:

- (1) TLC failed to adequately identify and meet the training needs of mortgage advisers and to identify problems when they arose, representing a failure to take reasonable care to organise and control its affairs responsibly and effectively in breach of Principle 3 and T&C Rules 2.3.1 and 2.8.1;
- (2) TLC failed to take appropriate steps to monitor and review client files and the suitability of advice in breach of Principle 3;
- (3) At the point of sale, there was often inconsistent disclosure of key features of the new mortgage product such as interest rate and whether the product was interest only or repayment, fixed or variable rate, while discussion of levels of Early Repayment Charges ("ERCs") was poor, meaning that customers were not made aware of the implications of remortgaging in breach of Principle 7 and MCOB 2.2.6R;
- (4) Documentation provided to customers did not explain suitability or contain any form of risk analysis in breach of Principle 7 and MCOB 2.2.6R; and
- (5) TLC failed to gather and record sufficient Know Your Customer ("KYC") information to support assessment of suitability of recommended mortgage contracts in breach of Principle 9 and MCOB 4.7.17R.

Relevant Statutory Provisions

- 2.3 The FSA's statutory regulatory objectives set out in Section 2(2) of the Act include the protection of consumers. The FSA is authorised by the Act to exercise the following powers.
- 2.4 Section 138 of the Act provides that the FSA may make such rules applying to authorised persons as appear to it to be necessary or expedient for the purpose of protecting the interests of consumers.
- 2.5 Section 206 of the Act provides:

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

Relevant Regulatory Requirements

- 2.6 Under the FSA's rule-making powers, the FSA has published in the Handbook the Principles which apply either in whole, or in part, to all authorised persons.
- 2.7 The Principles are a general statement of the fundamental obligations of firms under the regulatory system and reflect the FSA's regulatory objectives.
- 2.8 A firm may be liable to disciplinary sanction where it is in breach of the Principles.
- 2.9 The Principles and Rules, which are relevant to this matter, are set out below.
- 2.10 **Principle 3** (Management and control) provides that:

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

- 2.11 **Principle 7** (Communications with clients) provides that:

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

- 2.12 **Principle 9** (Customers: relationships of trust) provides that:

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

- 2.13 The relevant provisions of SYSC, MCOB and T&C are set out at Annex A attached.

3 FACTS AND MATTERS RELIED ON

3.1 Background

- 3.1.1 TLC is an independent mortgage and loan brokerage firm which was formed in 1990 and has been authorised by the FSA since 31 October 2004. Its authorised business

activities include advising on and arranging deals in investments, and advising on and arranging regulated mortgage contracts. The Firm deals almost entirely in the sub-prime market and most of its advice is conducted over the telephone, although it does not engage in cold calling.

- 3.1.2 TLC's regulated activities of providing mortgage brokerage services and advice (the focus of the investigation) generated around 25% of TLC's income in the year ending March 2007. During the relevant period, TLC completed approximately 1,155 mortgages.

3.2 **Thematic Work**

- 3.2.1 The FSA's Small Firms Division ("SFD") visited TLC in June 2005 as part of the Sub-Prime Sales/Self Certification Sales thematic project and reviewed a sample of 8 client files. The supervision visit report highlighted record keeping issues including a lack of KYC information and a lack of evidence of product research, consideration of affordability or reasons why recommendations were made.

- 3.2.2 SFD visited the Firm again on 15-16 January 2007 as part of the Sub-Prime Mortgages Follow-Up thematic project and reviewed 12 client files. Record keeping issues identified during the June 2005 visit were also apparent on this occasion. In addition, SFD identified potential breaches in management and control, communications with clients and treating customers fairly. In March 2007, the FSA's Enforcement Division appointed investigators.

3.3 **Enforcement's Investigation**

As part of its investigation, Enforcement reviewed:

- (1) Twenty customer files and accompanying audiotapes of the sales process completed during the relevant period;
- (2) TLC's compliance manual and sales procedures;
- (3) The updated training and competence manual and an example of an adviser's training records; and
- (4) A further two customer files completed since the implementation of recent improvements, including an updated Fact Find and a recently introduced suitability letter.

3.4 **Breaches of Principles**

- 3.4.1 Although partners and advisers attended regular training sessions, there was no evidence to show that their training and development needs had been adequately assessed and identified, in breach of Principle 3.

- 3.4.2 In breach of Principle 3, there was no evidence to show that TLC had adequately monitored whether mortgage business had been conducted in a compliant manner as none of the issues identified by the FSA's investigation had been noticed or acted upon. Although some files contained a File Control Sheet, this was nothing more than a "tick box" exercise and there was no evidence that it was subject to any follow-up or review.

3.4.3 TLC failed to communicate key information to customers on the telephone at the point of sale in an appropriate and timely manner. In particular the following issues were identified:

- (a) Although customers were sent an Initial Disclosure Document (“IDD”) setting out TLC’s fee structure in advance of their telephone call with an adviser, during the telephone conversation disclosure of TLC’s and the new lender’s fees occurred only after the recommendation had been made. These fees were often bundled with the monthly repayment cost;
- (b) Disclosure of levels of ERCs on customers’ existing mortgages was poor. Disclosure on the existence of ERCs on the recommended mortgage product was better, although advisers often referred to the ERC as a percentage of the amount borrowed rather than a specific amount. There were cases where clients who had initially requested a loan were advised instead to remortgage, thereby incurring ERCs,¹ but advisers did not discuss the seriousness or possible implications of this. Advisers also suggested to clients that they would be better off remortgaging again in a year’s time to secure more favourable rates and products; and
- (c) Disclosure of key features of the recommended mortgage such as interest rate, whether the product was fixed or variable rate and the method of repayment was inconsistent and generally poor. In several cases, the customer had to prompt the adviser to provide this information and often if the information was given, it was not presented in a clear way; for example, advisers referred to “1% above Barclays base rate”.

These failures to provide customers with key information about the new mortgage product and the consequences of remortgaging are in breach of Principle 7.

3.4.4 TLC exercised inadequate control over its sales process. It failed to gather and record sufficient customer information meaning that customers were placed at risk of being given unsuitable advice in breach of Principle 9. In particular, the following breaches were noted:

- (a) Customers’ attitude to ERCs was not recorded;
- (b) Customers’ attitude to risk was not recorded; and
- (c) Customers’ expected retirement date was not recorded.

3.4.5 TLC did not have an internal formal system in place to assess affordability of recommended mortgage contracts, instead relying on credit searches and lenders applying their lending criteria to ensure that the recommended mortgage contracts were affordable. However, this did not specifically take into account such costs as utilities, food and travel. This is in breach of Principle 9.

3.4.6 The record keeping issues and lack of KYC information make it difficult to assess the suitability of advice. TLC has conceded that, as some of its customers are repeat

¹ In 7 cases, a customer approached TLC requesting a secured loan and was advised to remortgage instead. Of these, 5 were subject to ERCs on their existing mortgage.

business, it may not always have been apparent why an adviser considered a product suitable for a customer as crucial information was not recorded on the current file. However, TLC's Training Manual provides little guidance on what an "inappropriate mortgage" may be and there is a risk that advisers may not always have considered the factors set out in MCOB 4.7.6R in breach of Principle 9.

3.4.7 TLC has also breached the Rules identified below.

3.5 Breaches of SYSC

3.5.1 In breach of SYSC 3.2.20R, TLC did not maintain adequate records of its regulated matters and dealings, making it difficult for third parties such as the FSA to review customer files and the systems and controls in place.

3.6 Breaches of MCOB

3.6.1 Although there was some evidence of product research, TLC recorded insufficient detail on client files to show how and why the mortgage contract had been selected. TLC breached MCOB 4.7.2R, 4.7.4R and 4.7.17R.

3.6.2 It could not be demonstrated that TLC's advisers always considered the factors set out in MCOB 4.7.6R.

3.7 Breaches of T&C

Although TLC had implemented a training and competency regime, the failures of its advisers indicated that there were deficiencies in the system and that TLC failed to determine the needs of its advisers and devise appropriate training in breach of T&C 2.3.1R.

4 ANALYSIS OF SANCTION

4.1 The FSA's policy on the imposition of financial penalties is set out in Chapter 6 of the Decision Procedures and Penalties Manual ("DEPP"), which forms part of the Handbook. The principal purpose of a financial penalty is to promote high standards of regulatory conduct by deterring firms who have committed breaches from committing further breaches and helping to deter other firms from committing similar breaches, as well as demonstrating generally the benefits of compliant business.

4.2 In determining whether a financial penalty is appropriate, and if so, its level, the FSA is required to consider all the relevant circumstances of a case. DEPP 6.5.2 sets out a non-exhaustive list of factors that may be of relevance in determining the level of a financial penalty.

4.3 The FSA considers that the following factors are particularly relevant in this case.

DEPP 6.5.2(1): Deterrence

4.4 A financial penalty strengthens the message to the industry regarding the need to obtain sufficient KYC information to ensure the suitability of advice provided and customers are treated fairly. It also reinforces the message that compliance, training and record keeping are important functions.

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

- 4.5 In determining the appropriate sanction, the FSA has had regard to the seriousness of the breaches, including the nature of the requirements breached, the duration and frequency of the breaches, whether the breaches revealed serious failings in the firm's systems and controls and the number of customers who were affected and/or placed at risk of loss. For the reasons set out below the FSA considers that the breaches in this case are of a serious nature.
- 4.6 TLC's failings are viewed as being particularly serious because:
- (1) The failure to provide any kind of recommendation or 'Reasons Why' document meant that (i) customers did not receive an adequate explanation as to how the recommended product met their mortgage objectives and needs, (ii) customers were not being provided with an appropriate explanation of any risks associated with the recommended product and (iii) the Firm retained no records of suitability;
 - (2) The failure to make and retain appropriate records of customer information were failings that were originally identified at a FSA supervisory visit in June 2005. A follow up supervision visit in January 2007 identified that these failings had not been adequately addressed;
 - (3) TLC concluded 1,155 mortgage contracts during the relevant period;
 - (4) The Firm's principal customer base is sub-prime, and these customers may be particularly vulnerable, often experiencing (or having experienced) acute financial difficulties; and
 - (5) In two cases, an experienced adviser advised customers not to fully disclose their level of indebtedness and arrears, to ensure their acceptance under the lenders' criteria. This behaviour was not identified by TLC's monitoring systems.
- 4.7 The FSA has also taken into account the following steps taken by TLC which have served to mitigate the seriousness of its failings:
- (1) Notwithstanding its failure to take action to rectify problems identified by the FSA supervisory visit in 2005, once subject to Enforcement investigation, TLC co-operated with the FSA's investigation and was proactive in implementing remedial action;
 - (2) TLC has reorganised its compliance arrangements;
 - (3) TLC and an external consultant monitor each of the Firm's advisers live on a monthly basis or weekly if issues are identified with a particular adviser;
 - (4) TLC has issued the adviser whose behaviour is described at 5.6(5) above with a formal written warning and has carried out a risk assessment of other advisers;
 - (5) TLC has accepted that there were issues with its systems and controls and record keeping and has taken appropriate steps to rectify these short-fallings;

- (6) The Firm has introduced a “budget planner” compliant with the FSA’s requirements in MCOB with regard to affordability; and
- (7) In order to address the risk of unsuitable recommendations having been made to customers, TLC is committed to appointing an external compliance consultant to undertake a past business review of sales during the relevant period with a view to:
 - (a) identifying an unsuitable recommendations;
 - (b) assessing any loss to customers; and
 - (c) paying any redress where unsuitable advice has led to loss.

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

- 4.8 The FSA has found no evidence to show that TLC acted in a deliberate or reckless manner.

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

- 4.9 In determining the level of penalty, the FSA has been mindful of the need to ensure that the interests of customers are protected. Having considered TLC’s latest financial statement and the cost of the PBR, the FSA considers that a penalty of £45,000 (subsequently discounted by 30% to £31,500 for early settlement) is appropriate.

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

- 4.10 The FSA found no evidence that TLC sought to increase profit or avoid loss as a result of the identified failings.

DEPP 6.5.2(8): Conduct following the breach

- 4.11 The FSA has taken into account TLC’s pro-active co-operation with the FSA’s investigation, remedial steps taken and its stated commitment to ensuring that it will comply with the FSA’s requirements on an ongoing basis. In addition, TLC has agreed to a review of past business and to take any further remedial steps considered appropriate.

DEPP 6.5.2(9): Disciplinary record and compliance history

- 4.12 TLC has not been the subject of previous disciplinary action.

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

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

5 DECISION MAKERS

The decision which gave rise to the obligation to give this Final Notice was made by the Settlement Decision Makers.

6 IMPORTANT

6.1 This Final Notice is given to TLC under section 390 of the Act.

Manner of and timing for payment

6.2 The financial penalty must be paid in full by TLC to the FSA by no later than 12 November 2007, 14 days from the date of this Final Notice.

If the financial penalty is not paid

6.3 If all or any of the financial penalty is outstanding on 12 November 2007, the FSA may recover the outstanding amount as a debt owed by TLC and due to the FSA.

Publicity

6.4 Sections 391(4), 391(6) and 391(7) of the Act apply to the publication of information about the matter to which this Notice relates. Under those provisions, the FSA must publish such information about the matter to which this Notice relates as the FSA considers appropriate. The information may be published in such manner as the FSA considers appropriate. However, the FSA may not publish information if such publication would, in the opinion of the FSA, be unfair to TLC or prejudicial to the interests of consumers.

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

FSA contacts

6.6 For more information concerning this matter generally, you should contact Angela Stephens of the Enforcement Division of the FSA (direct line: 020 7066 4714).

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Jonathan Phelan
Head of Department
FSA Enforcement Division

Annex A

Relevant FSA Rules

1 SYSC

- 1.1 **SYSC 3.1.1R** provides that a firm must take reasonable care to establish and maintain such systems and controls as are appropriate to its business.
- 1.2 **SYSC Rule 3.2.6R** provides that a firm must take reasonable care to establish and maintain effective systems and controls for compliance with applicable requirements and standards under the regulatory system.
- 1.3 **SYSC Rule 3.2.20R** provides that a firm must take reasonable care to make and retain adequate records of matters and dealings (including accounting records) which are the subject of requirements and standards under the regulatory system.

2 MCOB

- 2.1 **FSA Rule 2.2.6R** in the part of the FSA Handbook (“the Handbook”) entitled Mortgage and Home Finance: Conduct of Business (“MCOB”) requires a firm to take reasonable steps to communicate with its customers in a way which is clear, fair and not misleading.
- 2.2 **MCOB 2.2.7G** states that a firm should have regard to the customer’s knowledge of the home finance transaction to which the information relates.
- 2.3 **MCOB 2.2.8G** states that the rule on clear, fair and not misleading communications covers all communications with customers, for example any oral or written statements, telephone calls and any correspondence which is not a financial promotion.
- 2.4 **MCOB 4.4.7R** requires that where initial contact with a customer is by telephone, that the scope of the service provided by the firm (within the meaning of MCOB 4.3.1R) must be given before proceeding further. The effect of MCOB 4.3.1R and MCOB 4.3.2R is that where a firm offers only the products of a single mortgage provider or limited number of mortgage providers, the customer must be told of the scope of the selection.
- 2.5 **MCOB 4.7.2R** provides that a firm must take reasonable steps to ensure that it does not make a personal recommendation to a customer to enter into a regulated mortgage contract, or to vary an existing mortgage contract, unless the regulated mortgage contract is, or after the variation will be, suitable for that customer.
- 2.6 **MCOB 4.7.4R** provides that, for the purposes of MCOB 4.7.2R, a regulated mortgage contract will be suitable if, having regard to the facts disclosed by the customer and other relevant facts about the customer of which the firm is, or should reasonably be aware, the firm has reasonable grounds to conclude that (a) the customer can afford to enter into the mortgage contract; (b) the regulated mortgage contract is appropriate to the needs and circumstances of the customer; and (c) the regulated mortgage contract is the most suitable of those that the firm has available to it within the scope of the service provided to the customer.

- 2.7 **MCOB 4.7.6R** provides that in relation to MCOB 4.7.4 R(1)(a) and (b), where a firm makes a personal recommendation to a customer to enter into a regulated mortgage contract where a main purpose is to consolidate existing debts it must also take account of the following, where relevant, in assessing whether the regulated mortgage contract is suitable for the customer: (1) the costs associated with increasing the period over which a debt is to be repaid; (2) whether it is appropriate for the customer to secure a previously unsecured loan; and (3) where the customer is known to have payment difficulties, whether it would be more appropriate for the customer to negotiate an arrangement with his creditors than to take out a regulated mortgage contract.
- 2.8 **MCOB 4.7.17R** provides that a firm must make and retain a record of (1) the customer information, including that relating to the customer's needs and circumstances, that is obtained for the purposes of MCOB 4.7, and (2) that explains why the firm has concluded that any personal recommendation given in accordance with MCOB 4.7.2R satisfies the suitability requirements in MCOB 4.7.4R(1).

3 T&C

- 3.1 **T&C 2.3.1R** provides that where a firm's employees engage in or oversee an activity with or for private customers, the firm must:
- (1) At intervals appropriate to the circumstances, determine the training needs of those employees and organise appropriate training to address these needs; and
 - (2) Ensure that training is timely, planned, appropriately structured and evaluated.
- 3.2 **T&C 2.8.1R** provides that a firm must make appropriate records to demonstrate compliance with the T&C rules. Such records must be retained by the firm for at least three years.