Financial Services Authority

FSA®

FINAL NOTICE

To: **Alliance & Leicester plc**

Of: **Carlton Park**
Narborough
Leicester
LE19 0AL

Date **6 October 2008**

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

1. THE PENALTY

1.1 The FSA gave Alliance & Leicester plc (A&L or the firm) a Decision Notice on 6 October 2008 which notified the firm that pursuant to section 206 of the Financial Services and Markets Act 2000 (the Act), the FSA had decided to impose a financial penalty of £7 million on the firm. This penalty is in respect of breaches of Principles 3, 6, 7 and 9 of the FSA's Principles for Businesses (the Principles) between 14 January 2005 and 31 December 2007 (the Relevant Period) in relation to advised telephone sales of payment protection insurance (PPI) offered in connection with unsecured personal loans.

1.2 A&L confirmed on 6 October 2008 that it will not be referring the matter to the Financial Services and Markets Tribunal.

1.3 Accordingly, for the reasons set out below and having agreed with A&L the facts and matters relied on, the FSA imposes a financial penalty on A&L in the amount of £7 million.

1.4 A&L agreed to settle at an early stage of the FSA's investigation. It therefore qualified for a 30% (stage 1) reduction in penalty, pursuant to the FSA's executive settlement procedures. Were it not for this discount, the FSA would have imposed a financial penalty of £10 million on A&L. The FSA has made clear on a number of occasions this year that it will seek to impose higher fines in order to achieve its objective of credible deterrence. The level of this penalty reflects that stated objective.

2. REASONS FOR THE ACTION

Summary of conduct in issue

2.1 The FSA imposes a financial penalty on A&L for breaches of the FSA's Principles in relation to advised sales of single premium PPI it offered in connection with unsecured personal loans and made through telephone channels.

2.2 These breaches, which are described in more detail at section 4 below, relate to A&L's failure to:

(1) take reasonable care to organise and control its affairs responsibly and effectively, with adequate risk management systems (Principle 3);

(2) pay due regard to the interests of its customers and treat them fairly (Principle 6);

(3) 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 (Principle 7); and

(4) take reasonable care to ensure the suitability of its advice and discretionary decisions for any customer who is entitled to rely upon its judgment (Principle 9).

2.3 A&L's PPI telephone sales process was flawed, yet its deficiencies were not appropriately detected and remedied through effective monitoring, compliance review or management information. In part, the problems arose from an "assumptive" approach to sales, i.e. one in which advisers sought to find a reason to recommend and sell PPI whenever customers applied for a personal loan, and as a result failed to pay due regard to the customer's real demands and needs. This resulted in unacceptable levels of non-compliant sales and a high risk of unsuitable sales over a three year period. In particular, the FSA has identified the following failings during the Relevant Period:

(1) A&L did not generally make it sufficiently clear to customers in the telephone sales discussion that PPI was optional. When customers objected to, or questioned, the inclusion of PPI in their quotation or A&L's recommendation that they purchase it, A&L's advisers were trained to use inappropriate sales techniques that put pressure on the customer to accept the recommendation. The risk of an unsuitable sale was further increased by the bonus structure A&L operated for PPI advisers which gave considerable rewards for PPI sales.

(2) A&L failed to ensure that during the telephone call advisers provided customers with adequate disclosure of the policy's significant features, limitations and exclusions. There was a general failure to provide details of the cost of PPI, to explain that it was a single premium added to the loan (with interest) and that, in the event of cancellation outside the statutory 30 day period, the refund could be considerably less than a pro rata repayment of the premium.

(3) A&L provided information to customers during the telephone call which was often inaccurate, unfair or misleading.

(4) A&L's advisers were not required to gather, and properly take into account, sufficient information about customers' personal circumstances and objectives when making recommendations. A&L did not therefore take adequate steps to ensure that its personal recommendations were suitable.

(5) A&L did not have effective systems to train and monitor advisers and ensure the suitability of recommendations. Routine information provided to A&L's senior management was insufficient to enable it to identify, or understand, the extent and seriousness of problems with the sale of PPI. Where the annual Group Compliance inspection reports indicated particular issues, A&L failed to take adequate steps in response.

2.4 The findings above are supported by a review conducted by the FSA as part of the investigation of 100 randomly selected sales calls covering an eleven month period from February to December 2007 (the FSA's 2007 call review), which found that very few calls appeared fully compliant with its requirements. The likelihood is that those findings will have been replicated throughout the Relevant Period.

2.5 These failings presented an unacceptable risk of an unsuitable sale to all customers who purchased PPI on an unsecured loan in an advised sale by telephone[1] over the Relevant Period, as well as resulting in actual non-compliant and, inevitably[2], unsuitable sales. They accordingly comprised a failure by A&L to treat its customers fairly.

2.6 A&L's breaches are viewed as particularly serious because:

(1) A&L is a large retail firm which sold approximately 211,000 PPI policies over the Relevant Period. The failings accordingly exposed a very large number of customers who were entitled to rely on A&L's advice and judgement to a high risk of unsuitable sales;

(2) All of the policies were single premium and the average cost of a policy for a four year term over the Relevant Period was approximately £1,265 (including interest of approximately £210), generating a net PPI income for the firm of approximately £135 million. The financial impact on a customer of an unsuitable sale of PPI was therefore likely to be significant; and

(3) Although A&L had detected some of the problems in its sales process, no effective remedial action was taken until December 2007 and after issues had been found by the FSA as part of its thematic supervisory work. This was despite a series of high profile communications by the FSA throughout the Relevant Period highlighting the need for firms to ensure their PPI sales processes were meeting FSA requirements.

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[1] The findings set out in this Notice relate only to these customers. Unless the context requires otherwise, references to customers in this Notice should be construed accordingly.

[2] The FSA has based its assessment of suitability in its 2007 call review on the customer information gathered by the adviser. In many of the calls reviewed by the FSA the customer information gathered appears to be insufficient for the adviser to make the recommendation.

2.7 A&L's failures therefore merit the imposition of a substantial financial penalty. In deciding upon the level of disciplinary sanction, the FSA recognises the following measures taken by A&L which mitigate the seriousness of its failings:

(1) In October 2007, following the FSA's thematic visit, A&L engaged an independent firm of reporting accountants to review its PPI telephone sales process. The accountants subsequently made various recommendations to revise A&L's sales process as a result of their review. These recommendations were accepted by A&L and the changes were implemented in December 2007 and January 2008;

(2) The accountants also assisted A&L with a customer contact exercise (on the basis of a sample of 4,000 customers) in an attempt to identify potential customer concerns in relation to shortcomings in the firm's sales process identified by the review;

(3) A&L has undertaken improvements and is continuing to review its systems and controls to identify and implement further enhancements to its processes. The firm has also made changes to its training materials for sales advisers and increased training for the telesales monitoring team as well as implementing improved monitoring procedures. In addition, a stronger disciplinary regime has been put in place for staff who do not adhere to A&L's procedures;

(4) A&L has been open and co-operated fully with the Enforcement investigation, which has enabled the investigation to be concluded at an early stage; and

(5) A&L has committed to implement a substantial and comprehensive customer contact programme, overseen by third party accountants, to ensure that its customers are not disadvantaged. As part of this, the firm will be writing to all customers who took out policies by telephone in conjunction with an unsecured loan during the Relevant Period. It will also review any relevant complaints or rejected claims. The firm has committed to pay redress where appropriate. The FSA considers that the substantial remedial changes to which the firm has committed are significant steps in demonstrating the firm's commitment to complying with its regulatory obligations and treating its customers fairly. The customer contact package proposed by the firm has been taken into account by the FSA and has significantly reduced the level of penalty which would otherwise have been imposed.

3. RELEVANT STATUTORY AND REGULATORY PROVISIONS

3.1 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."

FSA Principles

3.2 The FSA's Principles are a general statement of the fundamental obligations of firms under the regulatory system. They derive their authority from the FSA's rule-making powers as set out in the Act and reflect the FSA's regulatory objectives.

3.3 The Principles which are relevant to this matter are:

Principle 3 (Management and control):

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

Principle 6 (Customers' interests):

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

Principle 7 (Communications with clients):

"*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.*"

Principle 9 (Customers: relationships of trust):

"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."

4. FACTS AND MATTERS RELIED ON

Background

The firm

4.1 A&L is a public limited company which has been authorised by the FSA to perform a number of regulated activities since 1 December 2001. In addition, it has been authorised to arrange, assist in the administration of, and deal as agent in, non-investment insurance contracts since 14 January 2005.

4.2 A&L offers loans, mortgages and savings products to customers through its branches, website and telephone call centres. PPI was sold by A&L in conjunction with unsecured loans on a non-advised basis via the internet and on an advised basis by way of face to face meetings at branches (recently changed to a non-advised basis) and by telephone at its call centre. During the Relevant Period A&L made use of its branch network and a third party to take "overflow" calls at peak times. Nevertheless 90-95% of customer calls were dealt with by telephone advisers in the call centre.

4.3 The FSA regulates A&L's sale of PPI (as part of A&L's general insurance business) but not its lending activity, which is outside the scope of the FSA's regulation.

4.4 The FSA's investigation has focused solely upon advised sales of PPI in relation to unsecured loans made by telephone. This Notice accordingly relates to such sales only.

The PPI products sold

4.5 Throughout the Relevant Period A&L offered a single premium PPI policy with two levels of cover:

a. a bundled (full) policy providing cover for life, accident and sickness, and involuntary unemployment; or

b. a policy providing only life cover.

Prior to 16 May 2006, A&L also offered a third policy providing life and critical illness cover.

4.6 A full refund is given if the customer cancels within 30 days of the start of the policy. If the policy is cancelled after the initial 30 day cooling off period (for example if the loan is settled early or refinanced), a sum which could be significantly less than a pro rata amount of the premium is refunded to the customer.

4.7 During the Relevant Period, A&L sold approximately 211,000 PPI policies, representing approximately 41% of customers who took an unsecured personal loan with A&L by telephone (including customers who had initially declined PPI on their internet application). The average cost of a policy over the Relevant Period was approximately £1,265 (including interest of £210). The average cost of a policy with full cover was approximately £1,765 (including interest of £295), and of a life only policy approximately £520 (including interest of £85). 60% of PPI policies sold by A&L were for full cover (i.e. life, accident and sickness, and involuntary unemployment) and 40% were for life alone.

The sales process

4.8 The PPI sales were generated by either the use of advertising and mailshot campaigns which prompted customers to telephone A&L to apply for an unsecured loan or as a follow up to an otherwise non-advised online loan application where the customer had selected not to take PPI cover. During the telephone conversation with customers, advisers introduced the PPI product, sought to obtain selected customer information and made a recommendation to purchase PPI at the same time as the customer's loan product was arranged. Advisers followed a Call Guide, approved by A&L's Group Compliance department, as their principal sales aid. This process was set out on hard copy Call Guides and on the adviser's computer screen, and provided prompts on what advisers should tell customers. Parts of the Call Guide were mandatory, but most of it was permissive, affording advisers discretion on what to say. The sales process was designed so as not to differentiate, from the customer's perspective, between questions relating to the arrangement of the loan and questions relating to the sale of PPI. The telephone recommendation (and customer's verbal agreement to buy PPI) was followed by documents which were sent to the customer by post. These included a statement of the customer's demands and needs for PPI, a PPI policy summary and a credit agreement which the customers ticked, signed and returned to confirm the recommendation agreed in the telephone conversation and conclude the insurance contract.

FSA publications on PPI

4.9 During the Relevant Period the FSA has highlighted to firms the importance of having in place robust systems and controls and treating customers fairly when selling PPI. It has also highlighted various areas where firms are not complying with the FSA's requirements. These concerns have been expressed in reports published by the FSA, individual feedback to firms, a Dear CEO letter and Enforcement actions.

4.10 In November 2005 the FSA published the results of the first phase of its thematic work on PPI and also sent a Dear CEO letter to the industry outlining the findings of the thematic project and highlighting a number of key areas where firms were not treating their customers fairly because of their selling practices and/or their lack of proper compliance controls.

4.11 This letter stressed that if a firm gives advice it should review how the suitability assessment is made to ensure the adviser fully assesses the customer's needs for PPI. In particular, it noted that many customers arranging loans are likely to be cost-sensitive or need flexibility in terms of the PPI contract (or often both), and stressed that these factors must be taken into account when assessing the suitability of a policy. It also addressed the need for the suitability assessment to take into account the relevance of any exclusions and limitations, the need to review the inducements and targets for sales staff, oral and written product disclosure, price disclosure (especially for single premium contracts), training and competence, and compliance monitoring.

4.12 A&L responded to the FSA's Dear CEO letter on 16 December 2005 with assurances that its current systems and controls met FSA requirements.

4.13 On 30 June 2006 the FSA sent an e-mail to the firm, summarising the key messages arising from the FSA's thematic work on PPI at that time. This noted that key areas where there were potentially significant issues to address across a wide cross–section of firms included the need to improve suitability and eligibility assessments (a common theme being that firms appear to make significant assumptions in their approach to judging suitability), product disclosure of limitations and exclusions, price disclosure, ongoing training, and compliance monitoring.

4.14 The FSA reported on a second phase of PPI themed work in October 2006. It highlighted at the beginning of the report three key areas of widespread concern which it stated result in customers being unable to make an informed decision. These included the FSA's concern that many firms were still not giving customers clear information during the sales conversation, in particular that some firms were not making it clear that PPI is optional and customers were not receiving full information about how much the cover cost. It also highlighted the FSA's concern that customers were still not being made fully aware that there may be parts of the policy under which they cannot claim and that some firms were still failing to establish that the PPI policies they recommended were suitable because they were not collecting sufficient information from the customer (including an example of not collecting sufficient information about any existing cover the customer possesses).

4.15 In May 2007 the FSA visited A&L as part of the third phase of the FSA's thematic work on PPI. As a result of this visit the FSA identified a number of concerns relating

to the firm's sale of PPI and A&L was subsequently referred to Enforcement for investigation.

4.16 In September 2007 the FSA published a thematic update on its third phase of thematic work. This outlined its interim findings from a further programme of work to test the industry's progress in ensuring that firms were meeting the FSA's requirements when selling PPI, including regarding the fair treatment of customers. The report also stated that, in the light of the continued failures identified, the FSA had decided to seek to impose higher fines for firms in the PPI market where standards fall below required levels.

4.17 During the Relevant Period, a significant number of disciplinary final notices were also issued by the FSA in relation to PPI.

4.18 These publications highlighted as risks all of the failings which the FSA has found during the Relevant Period in A&L's sales process.

Inappropriate sales techniques

4.19 By reason of the facts and matters detailed below, the FSA considers that A&L has breached Principle 6 of the FSA's Principles for Businesses by not making it clear to customers that the PPI was optional, and by using inappropriate sales techniques that put pressure on the customer to accept the recommendation, allied with inappropriately managed adviser inducements, to encourage customers to buy PPI.

Optionality

4.20 The FSA found from its 2007 call review that A&L failed to make it sufficiently clear to customers on the telephone that the PPI was an optional product which they did not need to buy. A&L trained its telephone advisers to sell PPI "assumptively", i.e. to assume that the customer had a need for PPI and so automatically to include it in quotations given to customers. Subject to the customer meeting certain eligibility requirements, telephone advisers quoted the amount of customers' monthly repayments with PPI included (but did not quote the loan monthly repayments without PPI). If the repayments had been quoted both with and without PPI, it would have helped customers appreciate that the PPI was optional.

4.21 A&L advisers initially offered its more expensive full PPI cover to customers. The much cheaper life cover (on average less than a third of the cost of full cover) was offered as an alternative, only if full cover was persistently turned down by the customer. Typically, on the basis of the cases reviewed by the FSA, the option of no PPI was not offered or explained to the customer.

4.22 This failing was particularly serious because A&L was aware that the FSA had stated in its thematic report published in November 2005 that firms should make it clear that PPI was optional.

Training

4.23 During the period January 2005 to September 2007 A&L induction and adviser workshop trainers' notes addressing the PPI telephone sales process made references

to inappropriate sales techniques that put pressure on the customer to accept the recommendation. This was described as creating a "*pressure cooker effect*".

4.24 In November 2006 A&L launched training for advisers which advocated "assumptive" selling (i.e. including PPI in the quote given to customers on the assumption that they are going to agree, rather than providing customers with information for them to make an informed decision) as the most effective method of closing the sale in circumstances where customers did not raise objections. In February 2007 A&L put in place objection handling training which instructed advisers to offer life cover when faced with repeated objections to full PPI from the customer, rather than to make a recommendation on the basis of the customer's demands and needs and the customer information obtained.

4.25 All training material was submitted to, and approved by, Group Compliance prior to use.

4.26 A&L failed to implement adequate changes to its training for sales advisers until December 2007.

Remuneration

4.27 The risk arising from these inappropriate sales techniques was further increased by the bonus scheme operated by A&L. A&L advisers and team managers were eligible for potentially significant bonuses which were based on the number of PPI policies sold, the value of those sales and the amount by which those sales exceeded target rates. Advisers also received a much larger incentive to sell PPI than on the associated loan. For example, in 2007 advisers receiving inbound calls needed to sell six loans without insurance to achieve the same bonus that they would receive from only one sale with full insurance. The amount an adviser could make from incentives was substantial: although the average bonus over the Relevant Period in each year was approximately 13% of base salary, advisers could earn substantially more than this.

4.28 From 2005 to 2007 the target rates for PPI sales per call were approximately 50% to 55% for non-internet originated-business. Moreover, express provision was made in the 2006 and 2007 bonus schemes that advisers would suffer a 25% penalty to their bonus if they did not achieve these insurance penetration targets.

4.29 Whilst there is nothing wrong in principle with a remuneration policy which recognises and rewards sales of insurance, A&L's remuneration structure increased the risk that advisers might make unsuitable sales of PPI to achieve those bonuses. This increased the importance of having robust systems and controls in place to ensure suitable and compliant PPI sales, including the subsequent claw back of bonus from advisers where the compliance quality of their sales was subsequently found to be unsatisfactory or policies were cancelled at an early stage.

Call review findings

4.30 These risks translated in practice into a situation where customers were not treated fairly by A&L when being sold PPI. The FSA's 2007 call review found that the firm's approach to sales resulted in the majority of customer calls being handled unfairly where, for example, the adviser:

a. provided information in an unfair or unbalanced way;

b. provided information in a misleading way;

c. ignored the customer's reasonable questions (such as whether the PPI was a condition of the loan); or

d. would not take a repeated "no" for an answer.

4.31 These failings were particularly serious because the sales were advised and customers were entitled to rely upon the firm's judgement and advice. A&L should have treated customers fairly and provided objective, balanced advice.

Failure to provide adequate product and price disclosure on the telephone and provide information to customers which was clear, fair and not misleading

4.32 By reason of the facts and matters detailed below, the FSA considers that A&L has breached Principle 7 of the FSA's Principles for Businesses by failing to provide adequate PPI product and price disclosure on the telephone, and by providing information to customers which was unclear, unfair or misleading.

4.33 At the telephone stage of the application process, customers were provided with limited information about the PPI being offered to them. In particular:

(1) *Price:* A&L did not require its advisers to give a full disclosure of the cost of PPI on the telephone until 17 December 2007. The FSA found that in 42 of the calls considered in its 2007 call review the sales person did not give the customer at any point during the call a quote for the loan without PPI. This is important because the cost of the PPI contract is a fundamental consideration and its proper disclosure serves to emphasise the optional nature of the product (especially when it is sold in conjunction with a loan). However, this detail was provided in the documentation subsequently sent to those customers who accepted the recommendation for PPI and before the contract was concluded.

(2) *Nature of single premium:* The firm very rarely made clear the nature of the single premium PPI policy which was being added to the quotation. It did not explain that the premium is added to the loan, and that this incurs additional interest over the life of the policy. In half of the calls covered by the FSA's 2007 review the adviser failed to disclose to the customer that the PPI was payable by a single premium. There was a general failure by advisers to disclose the full cost and details of the cost of the single premium and the added interest. If the nature of the single premium is not made clear, a customer may think that the fact that he is making a monthly payment on the loan means that the policy is paid for by regular premium. A&L did not explain that if the customer settled or cancelled the policy early (such as by taking out a further loan to extend or refinance the existing lending as many customers did) the customer could receive significantly less than a pro rata refund of the PPI premium and interest. For example, if the policy was cancelled after 24 months of a three year policy, a rebate was given of approximately 12% of the premium. Despite this, in calls reviewed by the FSA, the cancellation terms do not appear to have been voluntarily communicated to the

customer on the telephone. Nor were advisers required by the firm's procedures to provide this information on sales calls.

(3) *Policy exclusions:* Advisers did not identify all potentially significant relevant exclusions to the customer on the telephone. Instead, where exclusions were given to the customer, advisers generally referred to only the pre-existing medical condition exclusion. However, in 40 of the calls included in the FSA's 2007 call review the adviser failed either to disclose any exclusion at all to the customer or provided misleading or inaccurate information about exclusions. Moreover, in some calls the adviser failed to draw the attention of the customer orally to the importance of reading the policy summary, and in particular the section of the policy summary on significant or unusual exclusions or limitations in accordance with the FSA's requirements.

4.34 In its 2007 call review the FSA found that in 79 calls A&L failed to communicate information to customers in a way which was clear, fair and not misleading, often in response to specific requests for information from customers. In particular, in some calls inaccurate information was provided about the consequences of not having the policy or extent of the cover (such as by referring to a dependant's liability for the loan in the event of the customer's death). There were also some occasions where the adviser misled the customer about the amount of refund payable in the event of cancellation, in some circumstances wrongly indicating that they would receive a pro rata refund.

4.35 The failings in respect of the oral disclosure were serious and would not necessarily be remedied by the written policy documentation provided by post following the telephone call. This would require a customer to read and understand the written material and recognise (without reviewing the documents with this purpose in mind) that the position differed from his previous understanding. Whilst the customer was given an opportunity to review, for example, the main benefits and exclusions or the written disclosure of price, the statement of demands and needs letter expressly confirmed that the customer had accepted the recommendation for protection. It did not suggest that the customer should consider the product information or any reasoning for the recommendation set out in the statement of demands and needs letter in deciding whether formally to accept the recommendation previously given on the telephone. As indicated above, customers were asked by the adviser at the end of the telephone discussion whether they would accept the recommendation and were often influenced to do so. In such circumstances there was a real risk that a customer would regard the documentation as a formality and simply sign and return the agreements.

Failure to gather sufficient information, and to assess it properly, in advising on suitability

4.36 By reason of the facts and matters detailed below, the FSA considers that A&L has breached Principle 9 of the FSA's Principles for Businesses by failing to take reasonable care to ensure the suitability of its advice.

4.37 Throughout the Relevant Period, A&L did not put in place adequate systems and controls (including the Call Guide for sales advisers, training material and monitoring) to ensure that advisers gathered, and then sufficiently analysed, adequate information on its customers' demands and needs when recommending PPI. As

indicated above, these failings partially stemmed from an assumption that, provided the customer was eligible, PPI was suitable.

4.38 In particular, the process focussed advisers on finding a "need", even if that need was artificial and not one of substance or of real importance to the customer. For example, advisers frequently recommended life cover to customers with no dependants. They sought to justify this by reference to answers given by customers to seemingly unrelated questions raised in a different context earlier in the telephone conversation. These questions concerned whether the customer would want their full estate to go to a family member in the event of their death without making it clear that the adviser was addressing a possible need for PPI and the response would be relied on in that context.

4.39 These failings created an unacceptable risk that advisers would make unsuitable sales, and in 35 of the calls covered by the FSA's 2007 call review the FSA considered from the customer information gathered by the adviser that the policy was highly unlikely to have been suitable.

4.40 A&L failed, in particular, to require advisers to gather and analyse sufficient information about the following matters:

(1) *A customer's future needs and circumstances:* A&L's sales procedures and training did not take into account the customer's expectations regarding the actual time the customer might keep the loan and the PPI policy (notwithstanding its contractual term). In the event of early settlement or cancellation of the policy after the initial 30 day period, the customer would receive a refund which could be substantially less than pro rata. Accordingly, A&L's single premium product is unlikely to have met the need of customers who expected to refinance or repay early the loan from A&L (e.g. to get a lower interest rate or a larger loan). A&L failed to train or require its advisers to question the customer about any intention to repay the loan early until 2008 when a question was added to the Call Guide to cover this.

A&L's failings were particularly serious given that approximately 30% of its PPI policies were cancelled early over the Relevant Period, on average just under half way through a policy's contractual term, with A&L itself refinancing the loans in some of these cases.

A&L's sales procedures and training also failed to take into account whether it was foreseeable that the customer's circumstances in relation to the PPI eligibility criteria would alter. This meant that customers were recommended policies for which they were eligible at the point of sale but would not be able to claim on in respect of all of the benefits, except the life cover, later during the life of the loan (e.g. if the customer was due to retire, move on to a fixed contract or work less than 16 hours a week during the term of the policy).

(2) *Alternative means to protect the loan*: A&L's sales procedures and training failed to obtain sufficient details about, and properly take into account, any existing means the customer may have had to protect some or all of the loan. This might be savings or other assets held by the customer or existing insurance cover provided by another insurer, the customer's employer, or a product previously

sold to the customer by A&L. The FSA's 2007 call review found that in 26 of the calls the adviser recommended full cover to customers who already had existing policies in place which provided full or partial cover.

In addition, A&L failed to ensure that where advisers were aware that the customer might, or did, have existing insurance cover, but did not know the details at the time of the telephone sale, they either held back from making a personal recommendation until details of the insurance cover were available or otherwise made it clear that the recommendation might not be suitable because full details of any existing insurance cover had not been taken into account.

(3) *The type and level of cover required*: A&L's sales procedures and training did not provide guidance to advisers as to the factors (such as individual circumstances, cost and the size of the loan to be covered) to be properly taken into account in assessing whether to recommend the full cover, the life cover on its own, or no cover at all, as suitable. Instead, A&L's sales process assumed that customers required A&L's full cover (the most expensive option), irrespective of a customer's individual circumstances.

Further, in respect of life cover (whether from a life only policy or as part of the full bundled policy), A&L's sales procedures and training did not include any proper assessment of need, including the impact of whether the customer had dependants. The FSA's 2007 call review found that 15 calls were not compliant on this basis.

(4) *Significant limitations and exclusions*: A&L's sales procedures and training failed to advise customers of the significant limitations and exclusions relevant to them. Moreover, whilst A&L required advisers to make customers aware of the exclusion relating to pre-existing medical conditions (which was often represented orally as being the only exclusion), advisers did not have to explain the meaning of that exclusion. A&L should have ensured that the customer knew after discussion with the adviser what a pre-existing medical condition was and where to look for more information in order to make an informed choice about the cover. A pre-existing medical condition was the principal reason for a claim to be rejected by A&L over the Relevant Period. In the last six months of 2007 approximately half of rejected PPI claims were declined by A&L for this reason.

Failings in compliance monitoring, senior management reporting and response, and systems and controls

4.41 By reason of the facts and matters detailed below, the FSA considers that A&L has breached Principle 3 of the FSA's Principles for Businesses, by failing to monitor its advisers responsibly and effectively and by its failings in relation to its senior management reporting and response.

Compliance monitoring

4.42 As set out above, A&L's sales process was flawed. However, these failings were not identified by the monitoring checks that A&L required its sales team leaders, and from June 2005 its business quality function, to perform. The checks A&L required its observers to perform were incomplete and inadequate.

4.43 In particular, the monitoring process and the level of PPI sales monitoring was not sufficiently rigorous or risk-based. For example, it did not take proper account of risk factors such as the proportion of customers to whom PPI was being recommended, complaints, failed claims and cancellation rates in relation to individual advisers in determining the number of calls to monitor for an adviser. Nor were recorded telephone calls effectively monitored to ensure that advisers correctly followed the largely permissive Call Guide and to identify any non-compliant conduct (such as inaccurate and misleading statements or pressure selling).

4.44 The adviser observation aid used by observers to monitor sales calls and score a call "competent", "competent requires development" or "not competent" was insufficient to allow observers to assess the adviser with reference to FSA requirements. A&L's observers were required to assess the adviser on what were in large part sales techniques. However, A&L observers did not assess issues relating to fundamental FSA requirements such as the suitability of the adviser's recommendation during the call, the PPI product disclosure provided to customers and whether the adviser had provided information to the customer in a way which was fair, clear and not misleading.

4.45 These failings in the monitoring process created an unacceptable risk that advisers could breach FSA requirements without failing the observation and consequently allowed observed incidents of non-compliance to go unchecked and failings in the sales process to remain uncorrected.

Senior management reporting and response

4.46 During the Relevant Period routine information provided to A&L's senior management was not sufficient to enable them to identify, and understand the extent and seriousness of, problems with the sale of PPI.

4.47 Where management reports did indicate particular issues, A&L failed to take adequate steps in response. In particular, in October 2005 and August 2006 Group Compliance carried out call monitoring inspections and issued reports to senior management and compliance staff. Each of these reports identified serious failings by advisers when recommending PPI, such as not making it clear that PPI was optional (in some instances despite direct questions from the customer), recommending PPI even where the customer had previously clearly objected, and recommending full cover irrespective of the customer's circumstances.

4.48 Whilst the individual reports set out specific remedial action, such as re-training and changes to the Call Guide, no marked improvement in conduct was evident over the period. In particular, insufficient regard was paid to the largely permissive nature of the Call Guide.

4.49 In addition, in response to the FSA's November 2005 PPI Thematic Report from the FSA, A&L carried out a gap analysis whereby its PPI sales process was assessed against the risks identified by the FSA. The written assessment of loan protection telephone sales dated January 2006 did not correspond with the sales process in place at that time, in that the assessment inaccurately stated that:

a. “*a statement has been added* (to the Call Guide) *to clarify insurance is not compulsory or a condition of the loan*”. However, the statement referred to was included only if the customer objected to full PPI cover and life cover was recommended in its place, rather than universally as a matter of course; and

b. “*the scripts include a balanced summary of the product key features, benefits and exclusions*”. However, the script in place at that time included only limited product information. For example, of the eight policy exclusions it referred to only one, pre-existing medical conditions, and implied that this was the only exclusion under the policy.

4.50 There was also a lack of detailed information provided to management about the reason why a claim or complaint had been rejected and accordingly insufficient root cause reporting. This prevented senior management from being able to identify any trends or remedial action required (for example, further training and monitoring of sales advisers).

5. RELEVANT GUIDANCE ON PENALTY

Determining the level of the financial penalty

5.1 The FSA's policy in relation to the imposition of financial penalties is set out in Chapter 6 of the Decision Procedure and Penalties Manual (DEPP) which forms part of the FSA Handbook. It was previously set out in Chapter 13 of the Enforcement Manual (ENF). These Manuals set out the factors that may be of particular relevance in determining the appropriate level of financial penalty for a firm or approved person. The criteria are not exhaustive and all relevant circumstances of the case will be taken into consideration.

Deterrence

5.2 A financial penalty is required to strengthen the message to the industry that it is vital to take proper steps to ensure that a firm has in place adequate systems and controls in relation to the sale of PPI, that customers are treated fairly at all times, that they are given the appropriate and accurate information about the product, and that in advised sales the advice a firm gives customers is suitable.

5.3 As communicated to the market in the FSA's thematic update on the sale of PPI published on 26 September 2007, in line with its general approach, the FSA is seeking to increase the level of fines in PPI cases where this is warranted by the nature, seriousness and impact of the breach in question, and by the likely impact on deterrence. Firms have been given due warning of their obligations to treat customers fairly, both generally and on PPI in particular. Consequently, the FSA will now seek to impose higher fines for firms in the PPI market where standards fall below required levels.

The seriousness of the breaches

5.4 The FSA has had regard to the seriousness of the breaches, including the nature of the requirements breached, the number and duration of the breaches, the number of customers who were exposed to risk of loss, and whether the breaches revealed

serious or systemic weaknesses of the management systems or internal controls, the number of customers who were exposed to actual loss or the risk of loss and the number of customers likely actually to suffer financial detriment. For the reasons set out at paragraph 2.7 above and having regard to the impact on A&L's customers, the FSA considers that the breaches are of an especially serious nature. The seriousness is further increased by the fact that the breaches occurred over a period of 3 years.

The extent to which the breach was deliberate or reckless

5.5 The FSA has had regard to the extent to which A&L’s actions were deliberate or reckless as set out at DEPP 6.5.2(2)G. The FSA does not consider that the misconduct on the part of the firm was deliberate or reckless.

However, the FSA considers it particularly serious of the firm to continue to sell PPI by telephone and to fail to make significant changes to its sales process when it ought to have realised that it was not complying with the relevant FSA requirements. In particular, A&L should have realised that advisers were using inappropriate pressure sales techniques and were not treating customers fairly during the telephone sales process.

The FSA also considers that A&L was seriously deficient in failing to respond accurately to the FSA’s Dear CEO letter when it assured the FSA in December 2005 that the firm’s current systems and controls met FSA requirements (as well as in its failure to subsequently correct the position when it should have realised that this was incorrect).

The size, financial resources and other circumstances of the firm

5.6 A&L has a prominent position in the consumer finance market with a significant degree of public recognition. During the Relevant Period approximately 211,000 PPI single premium policies were sold on approximately 514,000 loans (including to customers who had initially declined PPI on their internet application), giving a penetration rate of approximately 41%.

5.7 There is no evidence to suggest that A&L is unable to pay the penalty.

The amount of profits accrued or the loss avoided

5.8 The FSA has taken into account the considerable profits A&L made from telephone sales of PPI during the Relevant Period.

Conduct following the breach

5.9 In October 2007 A&L instructed external reporting accountants to conduct a third party review of A&L's PPI sales processes.

5.10 As a result of the review A&L has made a significant number of changes to its sales processes. It has also agreed to strengthen its compliance monitoring and oversight arrangements. A&L has also committed to a robust remedial action plan, overseen by third party accountants, involving a comprehensive programme of customer contact to ensure that its customers are not disadvantaged.

5.11 The firm and its senior management have been open and co-operated fully with the Enforcement investigation. A&L has agreed the facts quickly ensuring efficient resolution of the matter and has received full credit for putting forward proposals for a substantial customer contact and redress package detailed at paragraph 2.7 above. Without this level of co-operation the financial penalty would have been higher.

Disciplinary record and compliance history

5.12 A&L has been authorised to conduct insurance business by the FSA since 14 January 2005, and for other regulated activities since 1 December 2001, and has not been the subject of previous FSA disciplinary action.

Previous action taken in relation to similar failings

5.13 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. However, the FSA has also had regard to the principal purpose for which it imposes sanctions, namely to promote high standards of regulatory conduct by deterring persons who have committed breaches from committing further breaches and helping to deter other persons from committing similar breaches, as well as demonstrating generally the benefits of compliant business.

FSA guidance and other published materials

5.14 The FSA has had regard to the fact that the FSA has published a series of high profile communications (in particular, as described at paragraphs 4.10 to 4.18 above) highlighting the need for firms to ensure their PPI processes were meeting FSA requirements as set out above and setting out examples of compliant behaviour. Despite this, even where A&L detected problems in its sales process, no effective remedial action was implemented until December 2007. As noted at paragraph 2.6 above, this significantly increases the seriousness with which the FSA has viewed the breaches.

Conclusion

5.15 Having regard to the seriousness of the breaches and the risk they posed to the FSA's statutory objectives of maintaining confidence in the financial system and securing the appropriate degree of protection for consumers, the FSA imposes a financial penalty of £7 million on A&L.

6. DECISION MAKER

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

7. IMPORTANT

7.1 This Final Notice is given to A&L in accordance with section 390 of the Act.

Manner of and time for Payment

7.2 The financial penalty must be paid in full by A&L to the FSA by no later than 20 October 2008, 14 days from the date of the Final Notice.

If the financial penalty is not paid

7.3 If all or any of the financial penalty is outstanding on 21 August 2008, the FSA may recover the outstanding amount as a debt owed by A&L and due to the FSA.

Publicity

7.4 Sections 391(4), 391(6) and 391(7) of the Act apply to the publication of information about the matter to which this 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 A&L or prejudicial to the interests of consumers.

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

FSA contacts

7.6 For more information concerning this matter generally, you should contact Bill Sillett (direct line: 020 7066 5880 /fax: 020 7066 5881) of the Enforcement Division of the FSA.

William Amos

Head of Retail 1

FSA Enforcement Division