FINAL NOTICE

To: **HomeServe Membership Limited**

Firm Reference Number: **312518**

Address: **Cable Drive**
Walsall
West Midlands
WS2 7BN

Date: **12 February 2014**

1. ACTION

1.1. For the reasons given in this notice, the Authority hereby imposes on HomeServe Membership Limited ("HML") a financial penalty of £30,647,400. This penalty is in respect of breaches of Principles 3, 6 and 7 of the Authority's Principles for Businesses ("the Principles") during the period 14 January 2005 to 27 October 2011 ("the Relevant Period").

1.2. HML agreed to settle at an early stage of the Authority's investigation. HML 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 £43,782,058 on HML.

2. SUMMARY OF REASONS

2.1. HML is an insurance intermediary, which advises on and arranges home emergency and repairs insurance cover. HML failed to embed a robust culture with adequate focus on compliance and treating customers fairly. In particular, it incentivised volume over quality in sales and complaints handling through its remuneration policy, and its senior management were insufficiently engaged with compliance matters.

Principle 3

2.2. The Authority has found that HML breached Principle 3 by failing to take reasonable care to organise and control its affairs responsibly and effectively, with adequate risk management systems. In particular:

(1) during the period 1 February 2008 to 27 October 2011, HML failed to ensure that its Board gave sufficient attention to compliance issues and took adequate steps to address them, including but not limited to, failing to review and react to compliance monitoring reports that raised serious concerns such as mis-selling and which subsequently led HML, a year after initial concerns had been raised, to suspend all telephone sales;

(2) during the period 1 January 2008 to 27 October 2011, HML failed to ensure that its senior management undertook adequate regulatory training, which led to a lack of regulatory knowledge and a failure adequately to identify and address issues that created a risk that customers may not be treated fairly and contributed to a culture that placed more importance on generating profits;

(3) during the period 14 January 2005 to 27 October 2011, HML failed to identify and address inappropriate bias within the remuneration structure for the sales teams, which incentivised staff to increase the volume of products sold, irrespective of the customer's need for the product;

(4) during the period 1 November 2008 to 27 October 2011, HML failed to identify and address inappropriate bias within the remuneration structure for the complaint handling teams, which incentivised staff to close as many complaints as possible, meaning that there was a risk that complaints were

not handled fairly and that customers did not receive appropriate redress; and

(5) during the period 14 January 2005 to 27 October 2011, HML failed to have in place adequate IT software and carry out effective tests on its IT systems, which meant that it failed to detect and remedy errors occurring in pricing calculations and in checks for any duplication of insurance cover, and resulted in 34,859 customers being overcharged and 8,796 customers being charged for duplicate cover that they did not need.

Principle 6

2.3. HML breached Principle 6 by failing to pay due regard to the interests of its customers and treat them fairly with regard to complaints handling. The reason for this is that during the period 13 January 2010 to 13 April 2011, HML failed to have in place an effective customer complaint handling process, which meant that it failed to investigate and resolve all customer complaints fairly, including failing to offer 8,481 customers appropriate redress. Customers, for example, were not always appropriately compensated for the failure of or delay by HML engineers in attending their home, or reimbursed the full cost of having to call out an independent engineer to deal with a home emergency, such as a plumbing emergency in the middle of winter, which should have been resolved by HML.

Principle 7

2.4. HML breached Principle 7 by failing to pay due regard to the information needs of its clients and communicate information to them in a way which was clear, fair and not misleading when conducting telephone sales. The reason for this is that during the period 1 November 2006 to 27 October 2011, HML failed to provide clear, fair and not misleading information to customers about two of its insurance policies at the point of sale, which led to an estimated 69,000 customers being mis-sold these policies. For example, sales agents at HML failed clearly and adequately to explain the comparative price and coverage of these two policies.

2.5. The Authority considers that the failings identified at HML were serious, systemic and long running, extending across many key aspects of the business. The Authority expects authorised firms to have a robust culture with adequate focus on compliance and treating customers fairly. The Authority also considers that

HML's failings were particularly serious given that a significant proportion of its customers were of retirement age and therefore more vulnerable.

2.6. Following a rapid expansion in the growth of its home emergency and repair insurance business, HML developed a profit driven culture where profit targets were met by taking advantage of existing customers in pursuit of sales. HML accepted that it needed to restore its customer focus and move away from a culture of putting profits before treating customers fairly. To date, HML has paid approximately £12.9 million to affected customers by way of redress in respect of the failings identified by the Authority, and is expected to pay a total of £16.8 million.

2.7. HML took a number of remedial steps of its own volition. For example, it voluntarily ceased new sales and marketing activity and also significantly strengthened its Board. HML also co-operated proactively with the Authority's investigation.

3. DEFINITIONS

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

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

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

"the Authority's Handbook" means the Authority's Handbook of rules and guidance.

"Compliance Department" means the department responsible for compliance at HML.

"CRC" means the Compliance and Risk Committee.

"Customer Relations Department" means the department at HML that dealt with customer complaints.

"DEPP" means the Decision Procedure and Penalties Manual as set out in the Authority's Handbook.

“DISP” means the Dispute Resolution: Complaints Sourcebook as set out in the Authority’s Handbook.

“FOS” means the Financial Ombudsman Service.

“HML” means HomeServe Membership Limited.

“MI” means management information that is collected within the firm and used by senior management to identify areas of concern and to support decision making.

“the New Penalty Regime” means the penalty regime which was effective on and from 6 March 2010.

“the Old Penalty Regime” means the penalty regime which was effective prior to 6 March 2010.

“the Principles” means the Authority’s Principles for Businesses.

“the Products” means the Complete Cover Policy and the Combined Utilities Policy products sold by HML.

“Quality Department” means the department at HML responsible for screening calls to customers in respect of sales and complaints to ensure that they were compliant with regulatory requirements.

“the Quality Pass Score” means the quality pass score of 87.5%.

“the Relevant Period” means the period from 14 January 2005 to 27 October 2011.

“SMT” means the Senior Management Team.

“the Tribunal” means the Upper Tribunal (Tax and Chancery Chamber).

“the 2009/2010 winter fast track process” means the complaint handling fast track process in place during the period 13 January 2010 to 8 October 2010.

“the 2010/2011 winter fast track process” means the complaint handling fast track process in place during the period 1 September 2010 to 13 April 2011.

4. FACTS AND MATTERS

HML Business, Management and Governance Structure

4.1. HML is an insurance intermediary, which has been authorised by the Authority since 14 January 2005. It is part of a group of companies and provides home emergency and repairs cover, ranging from boiler and central heating to drainage and plumbing cover. HML grew rapidly from the start of the Relevant Period and as at 31 March 2012 had a total annual turnover of approximately £356 million.

4.2. During the Relevant Period, HML sold approximately 12 million new policies and had a customer base of between 2.3 million to 3.3 million. These policies were sold through HML's website, telephone sales, and appointed representatives. Depending on the range of cover provided by HML, a policy could cost up to £27.89 per month.

4.3. During most of the Relevant Period, the Board at HML consisted of ten Board Members (including two non-executives) and Board meetings took place predominantly once every two months. The governance structure at HML also included two Board appointed sub-committees. These were the Senior Management Team ("SMT") and the Compliance and Risk Committee ("CRC").

4.4. The CRC was created on 26 January 2008 and replaced the Compliance Committee, which had been created in mid-2006. The CRC comprised seven of the ten Board members (including one non-executive) and its responsibilities included:

(1) promoting a culture which encouraged good practice throughout HML with regard to compliance and risk management;

(2) considering major findings arising out of the compliance function and management's response to those findings;

(3) defining HML's policy for controlling and promoting the awareness of risk management;

(4) considering how HML was meeting its regulatory requirements; and

(5) considering issues raised by internal and external auditors with a view to monitoring the objectivity and credibility of HML's reporting controls.

4.5. The SMT was set up on 23 January 2008 and comprised six of the executive Board Members. Its responsibilities included:

(1) strategic management;

(2) identifying opportunities and challenges facing the organisation;

(3) considering any significant issues arising from other committees of the Board; and

(4) discussing and agreeing the agenda for Board meetings.

4.6. In September 2010, following an effectiveness and efficiency review by an external consultancy group, HML made a series of cuts. This included the role of Legal and Compliance Director ceasing to exist. Following this, another senior member of the Compliance Department – who was not a member of the Board – began to attend SMT meetings from October 2010 and Board meetings as an observer from November 2010. By attending Board meetings as an observer only, his role was limited simply to answering any queries which might have arisen during those Board meetings. As an observer he had no formal input into the Board meetings. HML has acknowledged that the Compliance Department was not given '*sufficient weight*' to raise serious issues such as poor sales practices, and ensure its significance was understood.

Board effectiveness and lack of focus on compliance issues

4.7. From 1 February 2008 there was no formal discussion at Board level of the compliance monitoring report findings that were discussed during the quarterly CRC meetings. Although the CRC sometimes provided a brief update to the Board, it did not inform the Board about all key compliance issues that arose and which were discussed during the CRC meetings. This meant that the three Board members who were not also members of the CRC were not informed about compliance issues. The Board packs included a copy of the CRC meeting minutes, but they did not include copies of the compliance monitoring reports, even though some of these reports raised serious concerns. One compliance monitoring report dated 3 July 2009, for example, identified significant concerns with HML's Quality Department, which was responsible for screening calls to customers in respect of sales and complaints to ensure that they were compliant with regulatory requirements. The compliance monitoring report found that 21 out of

110 (19%) sales calls that had been reviewed by the Quality Department had been inappropriately assessed. This included ten calls where the Quality Department had failed to identify that the customer had been provided with misleading information at the point of sale and consequently mis-sold a product. The concerns identified indicated that there was a risk that some customers may have been mis-sold insurance policies and/or not treated fairly. Despite the seriousness of the concerns raised in this compliance monitoring report, it was not included in the Board pack, nor was it discussed during the Board meeting.

4.8. Although the majority of the Board members were also members of the CRC, the three Board members that were not part of the CRC did not have the opportunity to review the more detailed compliance related MI. This meant that significant issues which required Board attention, such as sales agents providing customers with misleading information, were discussed in CRC meetings but may not have subsequently been raised and discussed at Board level.

4.9. Discussions about compliance reports at Board level were limited and compliance issues were not given sufficient weight. This meant that senior management did not take appropriate action to manage compliance issues in a timely fashion.

4.10. Following the redundancy of the Legal and Compliance Director in September 2010, HML had no dedicated compliance representation on the Board. From 10 November 2010 the CRC began to submit a written report for discussion at Board meetings following the quarterly CRC meetings. However, the Board still did not have sufficient focus on compliance. Compliance monitoring reports were rarely considered during Board meetings and they were not included as a matter of course in the Board packs.

4.11. There were no criteria to determine when or why a particular compliance monitoring report should be discussed at Board level. For example, compliance monitoring reports into selling practices at HML dated 19 October 2010 and 29 March 2011 were not discussed by the Board, despite raising serious concerns relating to treating customers fairly, poor sales techniques, providing customers with misleading information and mis-selling. The 19 October 2010 compliance report, for example, identified that information provided to HML customers during certain combined up-sell calls was not as clear and as fair as it should have been, resulting in the overall calls being deemed potentially misleading. From the outset of the call, HML sales agents often disguised the true purpose of the call and

advised customers that they were calling in order to combine their existing policy into one direct debit to make it easier for them, without clarifying that they would also be offering additional policy enhancements at additional cost. The 29 March 2011 report identified similar concerns to those previously identified in the 19 October 2010 report. For example, a review of sales calls for that period identified concerns about sales practices in respect of 57 out of 215 (26%) sales calls. Specifically, in 13 of the 57 calls (23%) the sales agents gave misleading price information at the point of sale and in 6 of the 57 calls (10%) the sales agents failed sufficiently to establish that the product being sold was suitable for the customer.

4.12. Following the 29 March 2011 report, the Board commissioned an independent report to be carried out by a professional services firm. This report, dated 30 September 2011, identified the same issues as those in the compliance monitoring reports dated 19 October 2010 and 29 March 2011. This was considered by the Board and subsequently led HML, a year after initial concerns had been raised, to suspend all telephone sales due to concerns about mis-selling. This is discussed in more detail in paragraphs 4.56 to 4.61 below.

4.13. By 27 October 2011, HML had considerably strengthened its compliance focus, including through the appointment of a new CEO and chair of the Compliance and Risk Committee.

Inadequate complaint handling process

4.14. During the winter months of 2009/2010 and 2010/2011, extreme weather conditions led to an increase in the volume of customers that claimed on their HML home assistance insurance policy and an increase in the volume of complaints received by the Customer Relations Department at HML. In order to deal with the large volume of complaints, HML implemented a system whereby certain customer complaints were handled using a fast track process. This fast track process was in place from 13 January 2010 until 13 April 2011. Specifically, the fast track process that was implemented during the 2009/2010 winter was introduced on 13 January 2010 and remained in place until 8 October 2010. The fast track process that was implemented during the 2010/2011 winter (which was a modified version of the 2009/2010 winter fast track process), was introduced on 1 September 2010 and remained in place until 13 April 2011. This means there

was an overlap in the period that the 2009/2010 and 2010/2011 winter fast track processes were in place.

The 2009/2010 winter fast track process

4.15. The complaints that were dealt with using the 2009/2010 winter fast track process were about:

(1) customers being unable to get through to HML to report a claim;

(2) the failure by HML to deploy an engineer to a customer's home;

(3) the delay by an engineer in attending a customer's home; and

(4) the failure of an engineer to attend a customer's home.

4.16. DISP 1.4.1R states that firms must investigate customer complaints competently, diligently and impartially and offer redress to the customer if it is decided that this is appropriate. However, under the fast track process that was implemented, HML:

(1) did not investigate these complaints at all and instead resolved them simply by negotiating with the customer;

(2) closed and recorded such complaints as justified (and therefore upheld), and used a standard root cause code in order to identify/separate them;

(3) issued a standard resolution letter to all complainants that were satisfied; and

(4) passed the complaint to a senior agent in instances where the complainant was not satisfied.

4.17. If a complaint was passed to a senior agent or required an investigation in order to be resolved, it was excluded from the fast track process.

4.18. For example, one of HML's customers had originally made a claim against their policy on 15 November 2009 following a plumbing issue at their home. The HML engineer failed to attend the first appointment (for which the customer had taken annual leave) and attended the second appointment two hours late. Although the job was completed during the second appointment, the plumbing issue recurred

on Christmas Eve, 24 December 2009. Having contacted HML again, the customer was informed that the HML engineer would not be able to attend the property until five days later on 29 December 2009. Due to the severity of the plumbing issue, the customer was forced to call an independent emergency plumber who was able to resolve the problem at a cost of £160. The customer contacted HML on 29 December 2009 to make a complaint and seek reimbursement for the cost of the independent emergency plumber. In accordance with the fast track process, HML simply wrote to the customer on 15 January 2010, stating that the adverse weather had affected their normal service standards and enclosed a £50 cheque as a gesture of goodwill. HML also offered a discount for the premium on the rest of the policy, which was due for renewal in February 2010. The customer was advised that they would need to provide an invoice. The complaint was then closed. HML did not, therefore, compensate the customer for (i) the failure by the HML engineer to attend the first appointment (ii) the two hour delay by the engineer in attending the second appointment or (iii) the full cost of the independent emergency plumber that they were forced to call out on Christmas Eve.

4.19. HML's implementation of the 2009/2010 winter fast track process and its failure to investigate all complaints in accordance with DISP 1.4.1R meant that some customers that did complain did not receive appropriate redress and were not treated fairly. Some customers, for example, were not appropriately compensated for the failure of or delay by HML engineers in attending their home, or reimbursed the full cost of having to call out an alternative engineer to deal with a home emergency that should have been resolved by HML. HML's marketing material in relation to its insurance products stated that it will provide customers with protection and peace of mind. For example, one piece of marketing material relating to boiler breakdown cover stated '*With your boiler out of action, not only could you be without heating, but you could also face a search for a reliable heating engineer, plus repairs can be expensive*.' It then invited customers to purchase insurance to '*ensure peace of mind'*. Another piece of marketing material relating to plumbing and drainage cover similarly stated '*Without cover, not only could you be left searching for a plumber at short notice, but you would also have to cover the cost of any repairs*.' However, HML's failure to resolve complaints fairly meant that not only did some customers not receive protection and peace of mind, they also suffered additional financial detriment. HML has since contacted approximately 1,300 customers which it considers may

have had their complaints handled using the 2009/2010 winter fast track process, of which 82 requested that their complaint be re-opened. From these 82, HML has paid a total of £6,887 in redress to 63 customers that suffered detriment because their complaints were not investigated fairly in accordance with DISP 1.4.1R.

The 2010/2011 winter fast track process

4.20. The complaints that were dealt with using the 2010/2011 winter fast track process were slightly different to the complaints that were dealt with using the 2009/2010 winter fast track process. Specifically they related to:

(1) customers being unable to get through to HML to report a claim;

(2) the failure by HML to deploy an engineer to a customer's home;

(3) the failure of or delay by an engineer in attending a customer's home; or

(4) failures by HML to keep customers informed either about the progress of their claim and/or the deployment or attendance of an engineer at their home.

4.21. These types of claims-related complaints were the majority of complaints received during the 2010/2011 winter.

4.22. The 2010/2011 winter fast track process involved two approaches. These are set out below.

The first approach

4.23. The first approach involved simply issuing an apology to the customer. HML considered by the time the complaint came to be investigated, customer complaints concerning the issues set out at paragraph 4.20 above, could only be remedied by issuing an apology to the customer. Therefore, instead of investigating the complaints in accordance with DISP 1.4.1R, the complaint handler would:

(1) close the complaint with a letter of apology;

(2) ask the customer to get back in touch if they had any other causes of concern (for which a telephone number was provided); and

(3) provide the customer with information about their right to refer the complaint to the FOS.

4.24. On 28 February 2011, the criteria set out in paragraph 4.20, which determined which complaints should be resolved just by issuing a letter of apology, evolved to include all types of complaints, except those relating to poor workmanship, damage to property, incorrect diagnosis, administration issues and secondary aspects. This meant a much broader range of complaints were closed by HML without conducting an investigation, which was again contrary to the requirements in DISP 1.4.1R.

4.25. Where the complaint was more complex or contained additional information that needed further action, it was excluded from this fast track process and was investigated in accordance with the normal investigation process in place at HML.

The second approach

4.26. The second approach ostensibly involved conducting a 'limited investigation' into the customer's complaint. If the complaint met the criteria for the fast track process as set out at paragraph 4.20 above, but the complaint handler considered that some redress may be required, the complaint handler simply contacted the customer that had complained in order to confirm the reason for the complaint and quickly agree the appropriate redress (to a maximum value of £200). This was called the 'limited investigation' process although there was in fact no investigation of the specific detail of these complaints at all. Again this was contrary to the requirement in DISP 1.4.1R, which required a more detailed investigation than that which was conducted under this approach, and meant that customers were not treated fairly as they may not have received the appropriate amount of redress (for example, to reimburse them for the cost of having to call out an alternative engineer).

4.27. A review conducted by HML identified that the fast track process was also inappropriately applied to complaints that fell outside the criteria set out in paragraph 4.20 above, such as complaints that related to mis-selling. This was due to confusion by the complaints-handling staff over which process to use and

also inadequate training. Some complaint handlers considered that their job was purely to send an apology letter to as many complainants as possible on each shift, rather than consider whether redress might be appropriate.

4.28. The Quality Department was not adequately briefed on the fast track process to allow for effective oversight and monitoring of the way in which complaints were being handled, and the sampling by the Quality Department of complaints-handling activity was not adequately risk-based or increased during the implementation of the process.

Conclusion

4.29. During the period 1 September 2010 to 13 April 2011, HML received approximately 50,200 customer complaints, of which approximately 20,589 (41%) were complaints which met the criteria set out in paragraph 4.20 and/or paragraph 4.24 above, and were at higher risk of being handled using the 2010/2011 winter fast track process. The fast track process was implemented in order to manage the significant complaint volumes being received during the severe weather conditions. HML has admitted that the application of the fast track process during this winter meant management focused on reducing complaint numbers quickly as opposed to treating customers fairly.

4.30. HML’s failure to investigate all complaints in accordance with DISP 1.4.1R meant that some customers that did complain did not receive appropriate redress and were not treated fairly. Some customers, for example, were again not appropriately compensated for the failure of or delay in HML engineers attending their home, or were not reimbursed the full cost of having to call out an alternative engineer to deal with a home emergency that should have been resolved by HML. Instead of implementing a fast track process which was designed to close certain complaints as quickly as possible, HML should have investigated all customer complaints received during the 2010/2011 winter in accordance with DISP 1.4.1R, and offered customers appropriate redress. HML has since carried out a customer contact exercise and has paid £1,331,239 to 8,418 customers by way of redress for the complaint-handling failures relating to the 2010/2011 winter fast track process.

Inappropriate remuneration structure and incentive schemes for sales and complaint handling

Sales

4.31. The remuneration schemes and payment structures that were in place at HML for sales agents evolved during the period 14 January 2005 to 27 October 2011, and were complex and different for each of the sales departments at HML, which included for example outbound sales, inbound sales, outbound retention and inbound retention. Sales agents were rewarded predominantly on the basis of volume of products sold rather than quality of sales (for example, ensuring that a particular product sold was suitable for a customer). An internal report by HML dated 26 April 2013 stated that its sales teams '*historically were heavily incentivised, which may have created a desire to achieve. This achievement may have taken the form of setting up duplicated policies in order to gain incentive bonuses*'.

4.32. Sales agents were paid commission for sales that they generated. For example, reward in the outbound sales team was determined by a 'sales per hour' rate for each different insurance product (covering, for example, electrics, plumbing, or gas supply pipe) and with different rates depending on whether that product was sold to new or existing customers. A sales agent could earn up to £20 commission per product sold, depending on their 'sales per hour' rate (ranging from 0.2 to 2.5) on top of their basic salary of £13,500. For example, if an outbound sales agent sold five products in a seven hour working day, and the sale of each of those products was rewarded with £12.50 commission, the sales agent would earn £62.50 a day in commission, equating to £1,250 per month, which was 9% of their basic salary. Top performers in sales would take home an additional £1,400 per month in commission (i.e. more than doubling their basic salary). The 'sales per hour' rate also meant that sales agents were incentivised to spend less time on the phone with each customer with the risk that all relevant information about the product may not be given to a customer. The different rates per product also meant that there was a risk that sales agents were incentivised to sell more of the products that gained more commission, irrespective of a customer's need.

4.33. Sales agents could have 20% of their monthly commission deducted if they failed to achieve a monthly quality pass score of 87.5% (the "Quality Pass Score"). In

order to meet the monthly Quality Pass Score, sales agents had to pass call screenings conducted by the Quality Department. Approximately 5% of total sales calls were screened by the Quality Department. The call screenings included an assessment of whether the sales agent had established that a customer was eligible for the cover, whether the product was suitable for the customer, whether the correct description of the product had been given (outlining any exclusions or limitations), whether the correct cost of the product had been given and whether the customer had been treated fairly. The number of calls screened for each sales agent depended on a risk rating process, which became more stringent from 2011 and depended on whether a sales agent was deemed to be high, medium or low risk (determined by the quality performance, sales performance, number of justified complaints and number of cancellations from the previous month). For example, if a sales agent was deemed high risk, the Quality Department would screen ten of their calls a month. A medium risk sales agent would have six of their calls screened and a low risk sales agent would only have two of their calls screened. Sales agents received a score for each call that was screened and the overall score for the month was based on the average of all the sales agent's scores.

4.34. Although, as set out above, a sales agent could have 20% of their commission deducted if they failed to achieve the Quality Pass Score, they were still eligible to receive the remaining 80% of their commission regardless of the nature and/or extent of the failure. This meant that even if a sales agent only achieved a 30% monthly quality score, they were still rewarded with up to 80% commission. There was no incentive, therefore, for sales agents to improve the quality of their sales, if they believed they were not going to hit the Quality Pass Score for the month. This was, therefore, ineffective as a way of ensuring agents maintained appropriate standards.

4.35. If sales agents exceeded their sales targets, then depending on which sales team they worked in, the remuneration structure varied. If, for example, a sales agent worked in the outbound sales team, they could achieve an uplift in the amount of commission they received for all sales made, if they exceeded their sales target (which were set for different sales campaigns and for different products). The amount of the uplift received per sale increased incrementally until the sales agent reached a target of 130%, at which point the uplift was capped. So a sales agent in the outbound sales team could receive an additional 65p per sale,

(irrespective of the type of product sold or commission payable) if they met the 130% sales target. Sales agents in the outbound sales team could receive the maximum uplift of 65p per sale, even if they did not meet the Quality Pass Score. This meant that by increasing the volume of products sold, sales agents could compensate for the loss of the 20% commission for failing to meet the Quality Pass Score. Sales agents, therefore, considered that achieving the Quality Pass Score, and thereby avoiding the 20% commission being deducted, was a '*quality bonus'* on top of the commission already earned for exceeding their sales target. HML therefore incentivised sales agents to exceed their sales targets, irrespective of customers' need for the product or the quality of the sales call.

4.36. Commission earned by sales agents was clawed back if a policy that had been sold by them was cancelled within 28 days. Further, if a justified complaint was made against a sales agent, then £25 would be deducted from that sales agent's total commission. However, even if a sales agent received numerous justified complaints, resulting in a large deduction of their commission, there was no cut-off point whereby all the commission was forgone for a specific number of complaints. Even large numbers of justified complaints may be considered to have a negligible effect when sales volumes could result in high sales commission. For example, eight justified complaints would only result in £200 being deducted from a sales agent's commission. If that sales agent was a top performer earning £1,400 a month in commission, a deduction of £200 would not be significant. For a top performer to lose all their commission they would need to have 56 justified complaints per month made against them.

4.37. The culture at HML was therefore influenced by the remuneration structures which led to sales agents being rewarded for selling as much as possible with a risk, which HML failed to manage, that they would do so without paying due attention to the quality of those sales. HML failed to identify that the remuneration structures in place led to the risk of sales agents increasing the number of products sold in order to earn more commission, irrespective of a customer's need for the product.

Complaint handling

4.38. HML incentivised complaint handlers to close as many complaints as possible, without placing enough importance on the quality of how those complaints were handled. A focus on quality in handling complaints includes ensuring that

complaints are investigated competently, diligently and impartially and offering redress to the customer if it is decided that this is appropriate.

4.39. Complaint handlers at HML usually had a productivity target of closing between 3 and 22 complaints a day (depending on the type of complaint being handled) and earned a basic salary of approximately £14,000. In order to motivate complaint handlers to meet and/or exceed their targets, they were awarded bonuses for doing so. Different remuneration structures and incentive schemes were introduced during the period from 1 November 2008 to 27 October 2011, which are discussed in more detail below.

Remuneration structure in place from November 2008 to March 2010

4.40. During the period 1 November 2008 to 31 March 2010, complaint handlers were awarded monthly bonuses, which were capped at a maximum of £357 a month. The monthly bonuses were based on complaint handlers meeting their productivity target. If complaint handlers failed to meet their productivity target then they did not receive any bonus, although the majority of complaint handlers regularly achieved and exceeded their targets and therefore received a bonus. Complaint handlers also had to pass quality checks carried out by the Quality Department, which were intended to ensure that complaints were dealt with appropriately. This included checking whether or not the complaint had been investigated thoroughly and whether the appropriate resolution had been reached for the customer. The amount of bonus that complaint handlers could receive was partly dependent on their quality score, which was expressed as a percentage of the total number of closed complaints reviewed that were "passed" by the Quality Department. Quality Department agents usually had to review five complaints per complaint handler per month.

4.41. Whilst the remuneration structure in place during this period had a quality assessment component, complaint handlers would still receive a bonus payment (albeit a lower one) even if they received a low quality score. For example, one complaint handler that had a monthly productivity target of closing 118 complaints exceeded this target and was eligible to receive £357 by way of bonus. This was reduced due to failures in his complaint handling. However, even though he only achieved a quality score of 33% he still received a bonus payment of £119. As long as complaint handlers were able to meet their productivity

target, they would only lose their entire bonus if they achieved a 0% quality score.

4.42. Accordingly, HML did not adequately incentivise complaint handlers to ensure that in dealing with customer complaints, they always treated customers fairly by investigating the complaints thoroughly and reaching the appropriate resolution for the customer. The incentive scheme in place, therefore, motivated complaint handlers to achieve their productivity targets at the expense of treating customers fairly.

Remuneration structure in place from April 2010 until October 2011

4.43. In April 2010 HML introduced a different remuneration structure for complaint handlers. In addition to their basic salary, complaint handlers at HML could also receive weekly bonuses of £50 subject to achieving:

(1) 100% productivity (productivity being the total number of complaints that complaint handlers were required to close, which was between 3 and 22 per day depending on the type of complaint being handled);

(2) the Quality Pass Score (being 87.5%); and

(3) less than 1% re-opened complaints.

4.44. A further £50 bonus could also be received if the complaint handlers achieved the above measures in each of the four weeks for the month.

4.45. If the complaint handlers exceeded their productivity targets, subject to meeting the Quality Pass Score, from July 2011 onwards, they could also receive an additional productivity bonus. The additional productivity bonus grew incrementally until the complaint handler reached a productivity rate of 130%, at which point it was capped (at £50). Whilst the reward structure meant that there was a quality assessment component, the screening criteria was not tailored appropriately towards particular areas of risk. For example, the Quality Department did not carry out additional checks on the complaints that exceeded the productivity target, which would have been higher risk.

Additional incentive schemes introduced during the 2009/2010 and 2010/2011 winters

4.46. During the period that the 2009/2010 winter fast track process was in place, HML introduced an incentive scheme entitled "£s for closures" which applied to complaints that were closed outside normal working hours, whilst complaint handlers were working overtime. For example, a complaint handler could earn £110 for closing five complaints outside normal working hours, and £240 for closing ten complaints. The amount of complaints closed outside normal working hours could be spread across more than one day. This again incentivised complaint handlers to close as many complaints as possible for an additional financial reward. Quality Department agents also assisted in handling and closing complaints during the period that the 2009/2010 winter fast track process was in place. However, the Quality Department did not conduct additional reviews in respect of the complaints closed by the Quality Department agents under this incentive scheme.

4.47. During the period that the 2010/2011 winter fast track process was in place, HML introduced another reward scheme. Complaint handlers dealing with complaints under the 2010/2011 winter fast track process were usually required to close six complaints per day. However, under the new rewards scheme, complaint handlers had significantly higher targets, and were required to close between 15 and 30 complaints per day. In order to motivate complaint handlers to hit the higher volume targets, HML also offered incentives such as prizes worth up to £200, computer games consoles, holiday vouchers, early finishes from work and extra days off as a reward.

4.48. Although the Quality Department carried out checks on a sample of closed complaints in order to ensure that complaints were being dealt with appropriately, an internal report by HML dated 27 April 2011 about complaint handling during the 2010/2011 winter identified that the sampling of complaint handler activity was not risk based. As mentioned above, the Quality Department agents had to review five complaints per complaint handler per month across all of their activity, but this approach did not reflect the increased risk and targets associated with the implementation of the fast track process in the winter of 2010/2011. So although complaint handlers had to meet significantly higher targets and close between 15 and 30 complaints per day, which amounted to 660 complaints per month,

Quality Department agents were still only reviewing five complaints per month, per complaint handler. Complaint handlers, therefore, did not believe that the quality of their work was being adequately reviewed and placed less importance on closing complaints appropriately and treating customers fairly. Further, the internal report dated 27 April 2011 identified that the Customer Relations Department, within which sat the complaint handling teams, had scored consistently below the targeted Quality Pass Score. However, no feedback had been provided to enable the Customer Relations Department to improve its performance and complaint handlers did not face any repercussions for consistently failing to meet the Quality Pass Score.

4.49. In addition, the checks carried out by the Quality Department did not determine whether or not complaint handlers would receive the rewards offered as an incentive to close more complaints. HML, for example, did not require complaint handlers to make up any time for complaints that they had personally closed inappropriately and for which they had received additional time off, so complaint handlers did not suffer any consequences for not closing complaints appropriately. This led to complaint handlers inappropriately closing complaints to gain time off. The incentive to increase the volume of complaints closed led to complaint handlers applying the 2010/2011 winter fast track process to other categories of complaints which did not fit the fast track process criteria as set out in paragraphs 4.20 and 4.24 above. They did this in order to increase the volume of complaints being closed in a shorter time period, thereby receiving time off and enhanced rewards.

Conclusion

4.50. HML failed to identify that both the monetary and non-monetary incentives offered to complaint handlers and the remuneration structures in place during the period 1 November 2008 to 27 October 2011 incentivised complaint handlers to close complaints inappropriately in order to meet or exceed targets and earn bonuses and other rewards. As a result of this failure, there was a risk that customers that did complain did not receive appropriate redress and were not treated fairly.

4.51. As at September 2011, HML was upholding approximately 36% of complaints made to it. The FOS was then overturning approximately 56% of HML's rejected decisions, which was a very high overturn rate. This indicates that the risk

referred to above crystallised as a result of HML's weak complaint handling process, which was caused in part by the bias in the remuneration structures and incentives in place at HML.

Inadequate IT systems (Pricing error and Duplicate cover)

Pricing error

4.52. Between November 2006 and October 2011, HML sold two products that were very similar in nature and provided insurance cover for multiple elements such as drainage, plumbing leaks and electrical wiring all under one policy. These two products were called the Complete Cover Policy and the Combined Utilities Policy (together "the Products"). The Products were sold both to new customers and to existing customers by way of an upgrade from an existing policy. Customers who upgraded should have benefitted from a reduction to allow for premiums already paid on their existing policy. However, from 30 August 2007, an IT system coding error at HML meant that customers who upgraded to one of the Products did not receive the appropriate reduction and were consequently overcharged. This error affected customers' premiums for the first year of the policy.

4.53. HML did not carry out effective tests on its IT systems. This meant that HML failed to prevent and/or detect the IT system coding error for a period of over four years, which led to 34,859 customers suffering detriment as a result of being overcharged. HML has since paid £558,674 to these customers by way of redress.

Duplicate cover

4.54. During the period 14 January 2005 to 27 October 2011, the IT software programme at HML, which was intended to prevent overlaps in cover, failed to do so completely and led to some customers being sold multiple insurance policies, which resulted in an overlap in cover. This meant that customers paid twice for insurance cover, on which they could only claim once. The IT software programme was designed to check for and identify repeat occurrences of addresses and/or customer names but due to limitations of the programme, duplicates were not identified if the names and/or addresses had been entered inconsistently, either because of the use of abbreviations in addresses such as 'St' in place of 'Street', the use of a house name, or the use of a customer's initial instead of their full name.

4.55. HML failed to have in place an adequate IT software programme which it used for the sale of its insurance policies. It also failed to carry out effective tests on its IT systems, which would have identified the error in this IT software programme. HML's failure to prevent and/or detect this error led to 8,796 customers suffering detriment as a result of being charged for duplicate cover. HML has since paid £918,210 to these customers by way of redress.

Poor sales practices in relation to the Products

4.56. As referred to in paragraph 4.52 above, the Products were sold to both new customers and to existing customers by way of an upgrade from an existing HML policy. They were also typically sold over the telephone. However, the Products, which provided cover for multiple elements and contained numerous exclusions and detailed terms and conditions, were very complex, and should have been explained clearly and carefully when sold to customers over the telephone. Prior to being sold either policy and in order to understand the scope of the cover that was being provided, customers should have been given clearer information by HML about both the exclusions, and the terms and conditions that formed part of the policies.

4.57. In two internal reports dated 19 October 2010 and 29 March 2011 about the quality of its telephone sales, HML identified that there were significant issues regarding the sale of the Products. For example, HML identified that there was a lack of clarity in a substantial number of calls regarding the disclosure of price. Following the 29 March 2011 report, the Board commissioned a further independent report to be carried out by a professional services firm. This report, dated 30 September 2011, about the quality of HML's telephone sales also identified significant issues with regard to the sale of one of the Products, the Complete Cover Policy.

4.58. For example, the professional services firm reviewed 97 calls where a Complete Cover Policy was sold and identified that in 37 (38%) of the calls, there was either a lack of clarity, or no comparison at all between the premium of a customer's existing HML policy and the premium of the Complete Cover Policy. Customers were consequently prevented from comparing the premium of the Complete Cover Policy with their existing policy which provided similar cover, and were therefore prevented from making an informed decision about whether they needed the Complete Cover Policy.

4.59. In 17 of the 97 calls (17%) the policy was sold on the basis that the customer could cancel the policy at a later date, and in 16 of the 97 calls (16%), sales agents encouraged customers that were having difficulties understanding the product to agree to have the policy set up anyway and then to read through the documentation and call back post-sale if they had any queries or wished to cancel. Also, the professional services firm identified that 28 of the 97 calls (29%) were rushed (which may have been driven by the sales targets referred to above), meaning that complaint handlers spoke too quickly when explaining the product. This limited the ability of the customer to engage and understand the full features of the product, including the benefits, exclusions and cost. Conversations with customers should be clear and articulate to ensure that customers understand all the features of the product, and do not feel pressurised to purchase a product without feeling fully informed.

4.60. Following the concerns identified by the professional services firm in respect of the Complete Cover Policy, HML acknowledged there were similar concerns with the Combined Utilities Cover (the other of the two Products), which was a similar product with a similar sales process. The poor sales practices employed by HML in relation to the sale of the Products led to customers being mis-sold insurance cover because they did not understand the features of the Products, the cost or the extent of insurance cover that they were purchasing.

4.61. Even though the issues in respect of the sale of the Products were identified by three different reports, the first of which was in 19 October 2010, it was not until October 2011 that HML decided to suspend telephone sales of the Products. HML subsequently suspended telephone sales in respect of all products on 28 October 2011 following challenge from the Authority.

4.62. As a result of HML's failure to have regard to the information needs of its customers and communicate information to them about the Products in a way which was clear, fair and not misleading at the point of sale, customers purchased inappropriate insurance cover that they did not need or for which they were not eligible. HML is in the process of compensating customers that were mis-sold and currently estimates that it will pay affected customers a total of £14.03 million.

Lack of regulatory training

4.63. There was a widespread lack of regulatory knowledge amongst HML's senior management team. Despite HML having an Approved Persons Training and Competence Regime in place which required each Approved Person to take responsibility for their own regulatory training, it failed to ensure that its senior management undertook appropriate regulatory training. Specifically, regulatory training provided to senior management was at best, limited, ad hoc and dependent on the individual, but more often non-existent. Consequently, regulatory risks were not understood by some senior managers and the objectives that regulation seeks to achieve, such as treating customers fairly, were neither ingrained in HML's culture, nor considered by the senior management team to be as important as achieving profit targets.

4.64. HML acknowledges that it developed a profit driven culture where profit targets were met by taking advantage of existing customers in pursuit of sales, and lost its customer focus. Further, during the 2010/2011 winter period, the Customer Relations Department requested additional resource to handle the large volume of complaints that was being received by HML. Specifically, the Customer Relations Department suggested the temporary redeployment of some sales agents to the Customer Relations Department to assist with reviewing and resolving complaints. However, senior management considered that meeting sales targets was more important than resolving customer complaints and the Customer Relations Department was denied any additional resource. In order to deal with the large volume of complaints, HML instead implemented the fast track process set out in paragraphs 4.20 to 4.30 above, which meant that some customer complaints were not investigated in accordance with DISP 1.4.1R. Consequently, some customers that did complain did not receive appropriate redress and were not treated fairly.

4.65. The Authority considers, and HML acknowledges, the lessons learned from a past Skilled Person Report into its governance, risk and control mechanisms, dated 29 May 2007 had not been fully embedded. The errors identified by the Skilled Person Report in 2007 in relation to HML's lack of regulatory awareness have been repeated, illustrating that senior management had not embedded the importance of treating customers fairly and compliance with regulatory requirements into HML's culture as it should have done.

4.66. This lack of regulatory knowledge was made clear in interviews with the Authority. For example, a member of senior management admitted to being confused about the difference between controlled functions. They were also unclear about the controlled function they personally held during a certain period, or what the corresponding responsibilities were. Another senior manager admitted that they had been shocked when they did finally receive some regulatory training and realised how little training they had received to date in comparison to what they needed. Furthermore, the training and competency records of senior management demonstrated the inadequacy of the training received.

4.67. HML's failure to understand the implications of being a regulated firm meant that it addressed risks that might have an effect on treating customers fairly from a commercial and profit perspective, without recognising the regulatory impact of doing so. For example, senior management at HML were reluctant to address such risks, if there was a cost implication in doing so, and/or if it conflicted with the profit targets they had to achieve.

4.68. HML relied on the Compliance Department to ensure that it complied with regulatory matters. However, the general lack of regulatory knowledge amongst the senior management team meant that the Compliance Department did not have sufficient weight within HML to raise the severity of the regulatory issues it identified. Consequently, its findings, which were set out in the compliance monitoring reports, were not taken seriously. A report dated February 2012 refers to the fact that the initial reaction to the compliance monitoring reports '*was to discredit them, and if that did not work, to then discredit the person who had done the work*.' This problem was exacerbated when HML made the Legal and Compliance Director redundant in September 2010, as it meant that the Compliance Department no longer had a dedicated representative on the Board.

4.69. During the period 1 January 2008 to 27 October 2011, HML failed to ensure that its senior management undertook adequate regulatory training. As a result of this failure, there was a widespread lack of regulatory knowledge, which meant that HML failed adequately to identify and address regulatory risks.

5. FAILINGS

5.1. The regulatory provisions relevant to this Final Notice are referred to in Annex A.

Principle 3

5.2. On the basis of the facts and matters described above, the Authority considers that HML breached Principle 3 by failing to take reasonable care to organise and control its affairs responsibly and effectively, with adequate risk management systems. In particular:

(1) during the period 1 February 2008 to 27 October 2011, HML failed to ensure that the Board gave sufficient attention to compliance issues and took adequate steps to address them, including but not limited to, failing to review and react to compliance monitoring reports that raised serious concerns such as mis-selling and which subsequently led HML, a year after initial concerns had been raised, to suspend all telephone sales (paragraphs 4.1 to 4.13);

(2) during the period 1 January 2008 to 27 October 2011, HML failed to ensure that its senior management undertook adequate regulatory training, which led to a widespread lack of regulatory knowledge and a failure adequately to identify and address issues that created a risk that customers may not be treated fairly and contributed to a culture that placed more importance on generating profits (paragraphs 4.63 to 4.69).

(3) during the period 14 January 2005 to 27 October 2011, HML failed to identify and address the inappropriate bias within the remuneration structure for the sales teams, which incentivised staff to increase the volume of products sold irrespective of the customer’s need for the product (paragraphs 4.31 to 4.37);

(4) during the period 1 November 2008 to 27 October 2011, HML failed to identify and address the inappropriate bias within the remuneration structure for the complaint handling teams, which incentivised staff to close as many complaints as possible, meaning that there was a risk that complaints were not handled fairly and that customers did not receive appropriate redress (paragraphs 4.38 to 4.51); and

(5) during the period 14 January 2005 to 27 October 2011, HML failed to have in place adequate IT software and carry out effective tests on its IT systems, which meant that it failed to detect and remedy errors occurring in pricing calculations and in checks for any duplication of insurance cover, and resulted in 34,859 customers being overcharged and 8,796 customers being charged for duplicate cover that they did not need (paragraphs 4.52 to 4.55).

Principle 6

5.3. On the basis of the facts and matters described in paragraphs 4.14 to 4.30 above, the Authority considers that HML breached Principle 6 by failing to pay due regard to the interests of its customers and treat them fairly with regard to complaints handling. The reason for this is that during the period 13 January 2010 to 13 April 2011, HML failed to have in place an effective customer complaint handling process. Instead of investigating all customer complaints competently, diligently and impartially and offering customers redress if appropriate in accordance with DISP 1.4.1R, HML implemented a fast track process which was designed to close complaints as quickly as possible. HML's failure to investigate and resolve all customer complaints in accordance with DISP 1.4.1R meant that some customers that did complain did not receive appropriate redress and were not treated fairly.

Principle 7

5.4. On the basis of the facts and matters described in paragraphs 4.56 to 4.62 above, the Authority considers that HML breached Principle 7 by failing to 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. The reason for this is that during the period 1 November 2006 to 27 October 2011 HML failed to provide clear, fair and not misleading information to customers about the Products at the point of sale. For example, sales agents at HML failed clearly and adequately to compare the cost of a customer's existing cover against the alternative cover available under the Products. This led to customers being mis-sold the Products because they did not understand the cost or the extent of the insurance cover that they were purchasing.

6. SANCTION

6.1. The Authority has decided to impose a financial penalty of £43,782,058 (reduced to £30,647,400 after a 30% discount for early settlement) on HML because of the failings outlined above.

6.2. The misconduct took place to a significant extent both before and after 6 March 2010. As set out at paragraph 2.7 of the Authority's Policy Statement 10/4, when calculating a financial penalty where the conduct straddles penalty regimes, the Authority will have regard both to the penalty regime which was effective before 6 March 2010 ("the Old Penalty Regime") and the penalty regime which was effective from 6 March 2010 ("the New Penalty Regime").

6.3. The Authority has adopted the following approach:

(1) calculated the financial penalty for HML's misconduct from 14 January 2005 to 5 March 2010 by applying the Old Penalty Regime to the misconduct;

(2) calculated the financial penalty for HML's misconduct from 6 March 2010 to 27 October 2011 by applying the New Penalty Regime to the misconduct; and

(3) added the penalties calculated under sub-paragraphs (1) and (2) to produce the total penalty.

Financial penalty under the Old Penalty Regime

6.4. The Authority's policy on the imposition of financial penalties relevant to the misconduct prior to 6 March 2010 is set out in Chapter 6 of the version of DEPP that was in force prior to 6 March 2010. All references to DEPP in this section are references to that version of DEPP. In determining the appropriate level of financial penalty the Authority has also had regard to Chapter 7 of the Enforcement Guide.

6.5. The period of HML's breach for the purposes of calculating the financial penalty under the Old Penalty Regime is the period from 14 January 2005 to 5 March 2010.

6.6. The Authority will consider the full circumstances of each case to determine whether a financial penalty is appropriate. DEPP 6.5.2G sets out a non-exhaustive list of factors that may be relevant in determining the level of a financial penalty.

6.7. The Authority considers that the following factors are particularly relevant to this case.

Deterrence (DEPP 6.5.2G(1))

6.8. The financial penalty will deter HML from further breaches of regulatory rules and Principles. In addition it will promote high standards of regulatory conduct by deterring other firms from committing similar breaches and demonstrating generally the benefit of compliant behaviour.

The nature, seriousness and impact of the breach (DEPP 6.5.2G(2))

6.9. In determining the appropriate level of financial penalty, the Authority has had regard to the seriousness of the breaches, including the nature of the requirements breached, the number and duration of the breaches and whether the breaches revealed serious or systemic weaknesses of the management systems or internal controls.

6.10. The Authority considers HML's breaches to be serious because they:

(1) placed all of its customers at risk of being treated unfairly;

(2) led to some customers being mis-sold insurance policies;

(3) revealed systemic weaknesses in its procedures, management systems and internal controls in relation to several fundamental parts of its business, including compliance, management, sales and complaint handling;

(4) incentivised staff inappropriately, which led to a culture at the firm of pursuing profits to the detriment of treating customers fairly; and

(5) persisted over a significant period of time (with approximately five years and two months falling within the Old Penalty Regime).

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

6.11. In determining the appropriate level of the financial penalty the Authority has considered HML's size and financial resources. There is no evidence to suggest that HML is unable to pay the financial penalty.

Conduct following the breach (DEPP 6.5.2G(8))

6.12. The Authority recognises the following factors.

(1) HML has been open and co-operative with the Authority's investigation and has worked with the Authority to ensure early resolution of the matter; and

(2) remedial steps have been taken by HML to identify whether customers suffered a loss as a result of the breaches, and compensate them where they have.

Disciplinary record and compliance history (DEPP 6.5.2G(9))

6.13. HML has not been the subject of previous disciplinary action by the Authority.

Other action taken by the Authority (DEPP 6.5.2G(10))

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

Old Penalty Regime financial penalty

6.15. The Authority considers that a financial penalty is an appropriate sanction in this case, given the seriousness of the breach and the need to send out a strong message of deterrence to others. Applying those factors here, and taking into account the separate penalty being imposed under the New Penalty Regime, the appropriate level of financial penalty to be imposed under the Old Penalty Regime is £7,250,000 (reduced to £5,075,000 for early settlement at stage 1).

Financial Penalty under the New Penalty Regime

6.16. The Authority's policy on the imposition of financial penalties relevant to the misconduct from 6 March 2010 is set out in Chapter 6 of the version of DEPP that

was in force from 6 March 2010. All references to DEPP in this section are references to that version of DEPP. Under the New Penalty Regime, 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

6.17. 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.

6.18. 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.

6.19. As HML's past business reviews, which cover the relevant areas of misconduct, have resulted in redress being paid and will result in further redress being paid totalling approximately £16.8 million to affected customers, the Authority considers that no disgorgement is required.

6.20. Step 1 is therefore £0.

Step 2: the seriousness of the breach

6.21. 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.

6.22. The Authority considers that the revenue generated by HML is indicative of the harm or potential harm caused by its breach. The Authority has therefore determined a figure based on a percentage of HML's relevant revenue. HML's relevant revenue is generated from its sale of all insurance policies to the retail market and is set out in its audited accounts and regulatory returns to the Authority. The period of HML's breach for the purpose of calculating the financial

penalty under the New Penalty Regime is the period from 6 March 2010 to 27 October 2011. The Authority considers HML's relevant revenue for this period to be £365,320,584.

6.23. 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%

6.24. 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. The Authority considers the following factors to be relevant.

Impact of the breach

(1) There were relatively small losses to many consumers so in aggregate a large loss overall.

(2) The level of benefit gained by HML from the misconduct either directly or indirectly, includes the figure of £16.8 million which HML is forecasted to pay to affected customers by way of redress.

(3) The breaches have not had an adverse effect on markets.

(4) A significant proportion of HML's customers are aged 65 years or older, so the misconduct potentially had an effect on more vulnerable people.

Nature of the breach

(5) The breaches occurred over a sustained period (of which approximately 1 year and 7 months fell within the New Penalty Regime), potentially affected between 2.3 to 3.3 million customers and involved many individual breaches of regulatory rules and standards.

(6) The breaches revealed systemic weaknesses in HML's procedures, management systems and internal controls relating to several fundamental parts of the business, including management, sales and complaint handling.

(7) HML's failings placed all of its customers at risk of being treated unfairly, which presented a risk to the Authority's objective of securing protection for consumers, both of which risks crystallised and resulted in consumer detriment.

(8) No financial crime was facilitated, occasioned or otherwise attributable to the breach and there was no scope for the facilitation of financial crime.

(9) HML did not fail to conduct its business with integrity.

Whether the breach was deliberate and or reckless

(10) The breaches were not intentional on the part of HML's senior management. There was also no attempt by HML to conceal the misconduct.

6.25. Taking all of these factors into account, the Authority considers the seriousness of the breach to be level 3 and so the Step 2 figure is 10% of £365,320,584.

6.26. Step 2 is therefore £36,532,058.40.

Step 3: mitigating and aggravating factors

6.27. 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.

6.28. The Authority considers that there are no relevant mitigating or aggravating factors.

6.29. Step 3 is therefore £36,532,058.40.

Step 4: adjustment for deterrence

6.30. 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.

6.31. The Authority considers that the Step 3 figure of £36,532,058.40 represents a sufficient deterrent to HML and others, and so has not increased the penalty at Step 4.

6.32. Step 4 is therefore £36,532,058.40.

Step 5: settlement discount

6.33. 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.

6.34. The Authority and HML reached agreement at stage 1 and so a 30% discount applies to the Step 4 figure.

6.35. Step 5 is therefore £25,572,440.88, which has been rounded down to £25,572,400.

New Penalty Regime financial penalty

6.36. Having applied the five-step framework set out in DEPP, the appropriate level of financial penalty under the New Penalty Regime is £25,572,400.

Total financial penalty

6.37. The Authority considers that combining the two separate penalties calculated under the Old Penalty Regime and New Penalty Regime produces a figure which is proportionate. The Authority therefore has decided to impose a total financial penalty of £30,647,400 on HML for breaching Principles 3, 6 and 7.

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. The following statutory rights are important.

Manner of and time for Payment

7.3. The financial penalty must be paid in full by HML to the Authority by no later than 26 February 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 27 February 2014, the Authority may recover the outstanding amount as a debt owed by HML 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 HML 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 Kate Tuckley (direct line: 020 7066 7086 /email: kate.tuckley@fca.org.uk) of the Enforcement and Financial Crime Division of the Authority.

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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 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 provides:

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

2.4. Principle 7 provides:

"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."

DISP

2.5. Chapter 1 of DISP, which forms part of the Authority's Handbook, sets out the rules and guidance on how firms should deal promptly and fairly with customer complaints. The relevant rule is as follows.

2.6. DISP 1.4.1R provides:

"Once a complaint has been received by a respondent, it must:

(1) investigate the complaint competently, diligently and impartially;

(2) assess fairly consistently and promptly:

(a) the subject matter of the complaint:

(b) whether the complaint should be upheld;

(c) what remedial action or redress (or both) may be appropriate;

(d) if appropriate, whether it has reasonable grounds to be satisfied that another respondent may be solely or jointly responsible for the matter alleged in the complaint;

taking into account all relevant factors;

(3) offer redress or remedial action when it decides this is appropriate;

(4) explain to the complainant promptly and, in a way that is fair, clear and not misleading, its assessment of the complaint, its decision on it, and any offer of remedial action or redress; and

(5) comply promptly with any offer of remedial action or redress accepted by the complainant."

DEPP

2.7. 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

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

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

The Enforcement Manual

2.10. The Enforcement Manual, which was in force until 28 August 2007, set out the Authority's approach to exercising its enforcement powers prior to that date.