Financial Conduct Authority

FINAL NOTICE

To:	**The Royal Bank of Scotland plc** **National Westminster Bank Plc** **(together referred to as “the Firms”)**
Firm Reference Numbers:	**121882 & 121878**
Address:	**36 St Andrew Square, Edinburgh, Midlothian EH2 2YB** **135 Bishopsgate, London EC2M 3UR**
Date:	**27 August 2014**

1. ACTION

1.1. For the reasons given in this notice, the Financial Conduct Authority (“the Authority”) hereby imposes on the Firms a financial penalty of £14,474,600.

1.2. The Firms agreed to settle at an early stage of the Authority’s investigation. They 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 £20,678,000 on the Firms.

2. SUMMARY OF REASONS

2.1. The Authority imposes this penalty on the Firms for serious failings in their advised mortgage business between 1 June 2011 and 31 March 2013 (“the Relevant Period”). During this time the Firms were in breach of Principle 9 and Principle 2 of the Authority’s Principles for Businesses together with MCOB 4.7. They were in breach of Principle 9 (and MCOB 4.7) by failing to take reasonable care to ensure the suitability of advice to customers. They were in breach of

Principle 2 by failing to adequately remedy the failings when they were identified by the Authority (and so failing to conduct their advised mortgage business with due skill, care and diligence).

2.2. A mortgage is one of the most important purchases most consumers will make during their lifetimes. A large number of those who purchase mortgages rely on professional advice, often from a bank or building society. Firms must ensure that any mortgage recommendation is suitable for the customer. This will be even more important going forward in light of the changes made by the Authority as part of the Mortgage Market Review ("MMR"). It is of critical importance that firms providing mortgages do so in a way that ensures customers are treated fairly and in a manner which is compliant with all regulatory requirements.

Principle 9 breaches

2.3. In the Relevant Period there was an unacceptable risk that the Firms' customers would not receive suitable mortgage advice. There were three reviews of sales carried out during this time:

(1) between September and October 2011, the Authority carried out a review of the quality of mortgage advice at the Firms. This covered both branch and telephone sales made in June 2011. Numerous failings were identified in the way in which advised mortgage applications were being handled, including failure to comply with the Mortgage and Home Finance: Conduct of Business sourcebook ("MCOB") rules and failure to evidence suitability. Concerns were also raised with regard to the Firms' sales monitoring function;

(2) the Firms' Group Internal Audit ("GIA") reported (in a report dated 28 September 2012) on a review of branch sales files, telephone sales (where the recordings could be accessed) and observed live sales for the period between 31 January and 13 July 2012. A total of 91 sales were reviewed. This report found that the problems identified by the Authority had not been remedied. It concluded that only 2% of files passed (with 66% not containing sufficient evidence to demonstrate that suitable advice was given). Moreover, in 22.5% of the telephone and observed live sales (where the full conversation with the customer could be considered) the advice process was carried out in such a way as to give rise to a serious concern about whether the advice provided was suitable (for example by not obtaining sufficient information from the customer to give proper advice); and

(3) a third party review of 73 branch and telephone advised sales made during the period from January 2012 to 30 November 2012 found (in a report dated 13 May 2013) that in 31% of telephone sales the advice process was carried out in such a way as to cause an unacceptable risk that the customer would not receive suitable advice. None of the files that were reviewed passed (with 33% not containing sufficient evidence to demonstrate that suitable advice was given).

2.4. The overall results of these reviews show serious problems in the advised mortgage business during the Relevant Period. In addition, mystery shopping exercises conducted in 2012 found that in every one of the nine cases reviewed, sales advisers were not obtaining the right information from customers, were providing unsuitable advice, or no advice at all (when advice had been requested).

2.5. The Firms did not have an adequate system in place for the advised mortgage sales process. They did not take reasonable care to ensure that an individual or team within the Firms was properly accountable and responsible for it. No one was checking whether the sales process was updated and compliant with regulatory requirements.

2.6. The end result was an advised mortgage sales process which was not fit for purpose. In particular:

(1) the Firms' process for assessing affordability was inadequate. While the Firms considered expenditure based on Office of National Statistics ("ONS") data, and took into account some key customer data, they were not considering the full extent and implications of a customer's budget and additional committed or future expenditure before making a personal recommendation;

(2) the Firms were not providing compliant advice to customers who were seeking to consolidate existing debts (or were not making adequate enquiries to determine if customers would be consolidating debt into their borrowing before providing advice); and

(3) the Firms were not advising on term and were only taking account of the customers' preference. As a result, the Firms were not giving consideration as to whether the customers' preference was appropriate when recommending products to them. Whilst preference is important, firms must verify that the term is appropriate having regard to customers' circumstances.

2.7. In addition, the monitoring of advised sales was inadequate and ineffective. The Firms' principal monitoring function, the Mortgage Business Quality Unit ("MBQU"), did not assess advised mortgage sales files to determine if customers were receiving suitable advice and outcomes. MBQU tested against compliance with the sales process and did not check whether sales advisers were making sales in compliance with regulatory requirements. This had a knock-on effect on the quality of information available to the Firms and their ability to properly assess adviser risk (including for the purpose of deciding which advisers should receive a bonus).

2.8. As a result, the Firms were not aware of the full extent of the problems in the advised mortgage business. Further, when the Firms were made aware in June 2011 by their own Assurance and Standards team of concerns with their advised mortgage sales process and by Retail Compliance of concerns that guidance material provided to sales advisers (which was intended to be a compliance aid and which was tested against by MBQU) was not compliant with the Insurance: Conduct of Business sourcebook ("ICOB") and was out of date, they were slow to understand the significance and scale of the problems. Although the Firms did take some action from November 2011 in response to the review carried out by the Authority, it was not until the last quarter of 2012 that they started to take effective action to address the issues raised.

Principle 2 breaches

2.9. On 4 November 2011, the Authority drew the Firms' attention to issues it had identified with the Firms' advised mortgage sales process from the review referred to above. It also expressed an overarching concern about the files inspected not containing adequate evidence of suitability of advice.

2.10. The Firms' response to the issues raised by the Authority was seriously inadequate. This resulted in customers being placed at prolonged and continued risk of receiving unsuitable advice.

2.11. The Firms did not adequately assess the risks raised by the Authority. Further, until the end of September 2012 (following the GIA audit aimed at reviewing the Firms' remedial action, referred to above), the Firms did not begin to properly organise and conduct their response to the issues raised. The Firms' response was poorly planned and under-resourced. It was also not subject to adequate governance and oversight.

2.12. The Firms also failed to ensure that the changes they made to the advised mortgage sales process from 31 January 2012 were properly communicated to sales advisers and provided no staff training to support the initial changes (training on the new sales process eventually took place between the end of December 2012 and 31 March 2013). As a consequence, the initial changes made to the sales process did not result in sufficient changes to adviser behaviour.

2.13. Overall, the Authority considers the Firms' failings to be particularly serious because:

(1) the Firms, in combination, are one of the top six providers of mortgage products to retail customers in the UK, and provided approximately 177,000 mortgage products to customers in the Relevant Period. This included approximately 30,000 mortgage products sold on an advised basis. In addition, the Firms were seeking to increase mortgage balance growth during 2012 and were actively attempting to increase their in-house advised mortgage sales output by reducing their reliance on referrals from independent third party intermediaries;

(2) the Firms were slow to recognise the magnitude of the problems, despite being made aware by their own Assurance and Standards and Retail Compliance teams of concerns with their advised mortgage sales process and guidance material in June 2011;

(3) it was only the intervention of the Authority, following a routine review, which caused the issue to be raised and action taken. However, even then the Firms' response was seriously inadequate. Were it not for the Authority's work, failings within the advice process would have continued unaddressed for an even longer period, exposing more customers to an increased risk of receiving unsuitable advice;

(4) the Firms provided the Authority with an assurance by way of letter dated 20 July 2012 that the changes they had made or would shortly make to the advised sales process had fully addressed the concerns raised by the Authority. This was not the case; and

(5) the previous disciplinary history of the Firms. RBS Group has been fined by the Authority on seven previous occasions including six times in the last four years.

2.14. The Authority recognises that, upon receipt of the GIA report in late September 2012, the Firms did then take significant action to address the problems with their advised mortgage sales business including limiting their marketing from late November 2012 until June 2013. This aimed to give sufficient time for advisers to be retrained and accredited on a new sales process. The Firms also introduced full file checking so that they could monitor the effectiveness of the retraining and commissioned a number of further targeted reviews in an effort to identify whether there was historical customer detriment.

2.15. The Authority notes that following the further customer contact in connection with the reviews of advised mortgage sales from the Relevant Period (see further paragraphs 4.30-4.32 below) there is no evidence of systemic detriment to customers (including customers being unable to afford their mortgage). However, the Firms have agreed to conduct a customer contact exercise with the intention of identifying and addressing any customer detriment that may have resulted from the failings within the advised mortgage sales business during the Relevant Period. They will write to all customers who received mortgage advice during the Relevant Period and invite them to raise any concerns that they have about the advice received. Customers who have queries on this exercise or who wish to make a complaint should contact **0800 678 1924** or write to **Mortgage Case Handling Team, Mortgage Services, PO Box 12201, Birmingham B2 2NA.**

3. DEFINITIONS

"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;
"DEPP"	means the Authority's Decision Procedure and Penalties Manual which is part of the Authority's Handbook;
"the Firms"	means National Westminster Bank Plc and The Royal Bank of Scotland plc;
"GIA"	means the Firms' Group Internal Audit team;
"GMS"	means the Firms' Group Mortgage System, a computer operating system used by sales advisers to conduct certain mortgage applications and/or procedures;
"ICOB"	means the Insurance: Conduct of Business sourcebook, which is part of the Authority's Handbook;
"KPI"	means Key Performance Indicator;
"MAO"	means the Firms' Mortgage Account Opening computer operating system, the main system used by sales advisers to conduct mortgage applications;
"MBQU"	means the Firms' Mortgage Business Quality Unit, the Firms' key assurance function for mortgage sales which tested a sample of sales advisers' sales file to determine if they had been made in accordance with the Firms' sales process;

"MCOB"	means the Mortgages and Home Finance: Conduct of Business sourcebook, which is part of the Authority's Handbook;
"NatWest"	means National Westminster Bank Plc;
"ONS"	Office of National Statistics;
"Principle 2"	means Principle 2 of the Authority's Principles for Businesses, which is part of the Authority's Handbook;
"Principle 9"	means Principle 9 of the Authority's Principles for Businesses, which is part of the Authority's Handbook;
"Products"	means the Retail Products/Retail Products and Marketing business unit within the UK Retail Division;
"RBS"	means The Royal Bank of Scotland plc;
"RBS Group"	means Royal Bank of Scotland Group plc, the international banking and financial services group of which the Firms are members;
"Relevant Period"	means the period from 1 June 2011 and 31 March 2013;
"sales advisers" and "advisers"	means front-line sales staff in the NatWest and RBS branch and telephone networks who provide advice to customers requiring a mortgage product;
"TBIS"	means the Telephone Banking and Intermediary Services/Customer Contact group within the UK Retail Division;
"TCF"	means the Authority's Treating Customers Fairly initiative which seeks to protect consumers by requiring firms to focus on good customer outcomes in all that they do; and
"the Tribunal"	means the Upper Tribunal (Tax and Chancery Chamber).

4. FACTS AND MATTERS

Background

The Firms

4.1. The Firms are subsidiaries of RBS Group and their main sales distribution businesses sit within its UK Retail Division. They provide a wide range of banking and financial services and have been authorised by the Authority since 1 December 2001. UK Retail's management is not structured by reference to different legal entities but is managed using resources and individuals from across RBS Group.

4.2. As part of their personal banking services, the Firms provide a variety of mortgage products for purchase by retail customers. In 2011, they were the fifth largest mortgage lender in the UK based on gross mortgage lending of £14.6bn, representing an estimated 10.3% share of the market. In 2012, they were the sixth largest UK mortgage lender with gross mortgage lending of £13.9bn, representing an estimated market share of 9.7%.

4.3. During the Relevant Period, the Firms provided approximately 177,000 mortgage products to customers. This included both direct sales to customers and sales through independent third party intermediaries. Of these, approximately 30,000 were advised sales by the Firms. This involved the Firms providing advice to customers on which of its mortgage products they considered most suitable for the customers' needs. This advice was provided either in branch or over the telephone. The Firms generated gross revenue of £106,041,482 from advised sales in the Relevant Period.

4.4. The Firms were seeking to grow the mortgage business during the Relevant Period. Consumer Distribution, the business unit within UK Retail at the time responsible for both branch and telephone sales, was tasked with increasing mortgage balance growth in 2012. The Firms were also actively attempting to increase their in-house advised mortgage sales output by reducing their reliance on referrals from independent third party intermediaries. Any attempt to increase advised mortgage sales within the Firms would inevitably have increased the workload of the business and its compliance monitoring functions. In those circumstances it was important for the Firms to ensure that their systems and controls were sufficiently robust to deal with the increased capacity.

Mortgage sales

4.5. The Firms sold mortgages to retail customers through their NatWest and RBS brands. This was done in two principal ways: customers could meet sales advisers face-to-face within the Firms' bank branch network; or customers could speak to a sales adviser on the telephone. A customer could either receive advice on which of the Firms' products was most appropriate for them or could follow a non-advised sales route where they would receive information about products but not advice.

4.6. Mortgages sold by branches were the direct responsibility of the Branch Banking group within Consumer Distribution. Mortgages sold by telephone were the direct responsibility of TBIS (which changed its name to Customer Contact in 2012) within Consumer Distribution. Responsibility for private banking mortgages initially lay within the Private Banking and Advice business unit but moved to the Branch Banking group on the disbandment of Private Banking and Advice at the end of 2011. There was further reorganisation in March 2012 when responsibility for branch mortgages was transferred to the new Specialist Banking group (within Consumer Distribution). Specialist Banking also became responsible for financial planning services, investment advice, private banking advice and independent financial services.

4.7. The Consumer Distribution business unit was itself disbanded in December 2012 as part of a further UK Retail reorganisation. Each sales distribution group (such as Branch Banking, Specialist Banking, Customer Contact) then reverted to being an independent business unit within UK Retail.

4.8. Approximately 87% of advised mortgage applications submitted during the Relevant Period were made in branch. The rest (13%) were made over the telephone. On average during the Relevant Period, 383 sales advisers were working within branches and 39 were working over the telephone.

4.9. The responsibility for the design and development of the mortgage products sold by the distribution groups sat with another business unit in UK Retail, called Products (which became Retail Products and Marketing in 2012).

4.10. Although the Firms sold mortgages through both the RBS and NatWest brands, the processes and systems used to do this were the same. The Firms sold mortgages by following a computer based mortgage sales process. Sales advisers progressed through an advised sale by following a step by step set of computer screen displays. The main operating system was known as MAO but certain products and/or procedures required the use of a different operating system known as GMS.

4.11. On completion of the sales process, if a customer wished to purchase the product offered, sales advisers would send a “suitability letter” to the customer which was intended to record: (a) a summary of the Fact Find; (b) the reasons for a customer’s priorities; (c) the sales adviser’s product recommendation; and (d) the reasons for the sales adviser’s product recommendation.

4.12. To support their sales advisers, the Firms produced a large (over 200 pages long) A-Z intranet document called the Mortgage Sales Guide. Despite its title, this was not a step by step guide to help advisers make a sale, but rather a collection of policy guidelines, procedures and factual articles about parts of the general mortgage process.

4.13. The key regulatory requirement that the Firms were required to follow when providing mortgage advice was MCOB. MCOB was introduced to the mortgage market by the Authority in October 2004 and consists of a set of rules and guidance which apply to all aspects of regulated mortgage contracts (including both advised and non-advised sales). The primary objective of MCOB, in respect of the sale of mortgages, is to improve the information that those selling mortgages provide to customers and to increase a customer’s ability to make an informed choice about products. In relation to advised sales, the relevant parts of these rules focus on the need for any advice given to be suitable for the customer, depending on the demands and needs of the customer and the type of mortgage required.

4.14. During the Relevant Period, the Firms monitored the quality of branch and telephone mortgage sales by testing and assessing a sample of mortgage files through MBQU. This team was independent of the sales distribution groups and assessed files marking them either “Compliant” (if there were no compliance issues with the file), “Compliant with Remedial Action” (if the file contained no major compliance issues, or detriment to the customer, but there were elements that needed to be altered or clarified) or “Non-Compliant” (if there was a regulatory breach identified and/or possible consumer detriment). Files assessed as “Compliant with Remedial Action” or “Non-Compliant” were sent back to the sales adviser to remedy the problems. They then had to be returned to MBQU within 14 days.

Reviews carried out in the Relevant Period

4.15. A number of reviews relating to the advised mortgage sales process were carried out during the Relevant Period. The details of these are set out below. In summary they were:

Date	Reviewer	Subject matter
June 2011	**Firms' Assurance and Standards Team**	**Interest only advised mortgage sales**
June 2011	**Firms' Retail Compliance team**	**ICOBs content of Mortgage Sales Guide**
Sep/Oct 2011	**The Authority**	**Quality of advice and mortgage framework and controls**
July 2012	**Firms' Retail Compliance team**	**MCOBs content of Mortgage Sales Guide**
August 2012	**Firms' MMR Project ESG**	**MCOB advice proposition**
September 2012	**Firms' GIA**	**Firms' response to the quality of advice issues raised by the Authority**
January 2013	**Consultant A**	**Effectiveness of the Firms' response to the issues raised by the Authority**
May 2013	**Consultant B**	**Compliance testing of a sample of 2012 mortgage sales**

The Authority's review of mortgage quality of advice

4.16. On 25 July 2011, the Authority wrote to the Firms to inform them of its intention to carry out a review of the quality of mortgage advice that was being delivered to the Firms' customers. The Authority indicated that it would also be assessing the Firms' framework and controls for mortgages.

4.17. The Authority carried out a review between September and October 2011 which included testing of 36 advised mortgage sales files made in branch and over the telephone which completed during June 2011. Upon conclusion of its review, the Authority provided feedback to the Firms by letter dated 4 November 2011. The Authority raised a number of issues, including specific points on whether the sales process was compliant with MCOB. An overarching concern was expressed that only a small proportion of the files reviewed contained sufficient information to evidence the basis for the decision by the adviser or demonstrate the suitability of the sale. Concerns were also expressed about whether MBQU was operating effectively.

The Firms' response and remedial action

4.18. On 16 November 2011, the Consumer Distribution Risk team established a Working Group to produce a draft response to the Authority's letter of 4 November 2011 for executive sign-off and to deal with the issues raised. The Working Group consisted of members of staff below executive level (within the Firms, the executive grade was allocated to their most senior staff) from Branch Banking, TBIS, Credit, Products, Legal, Private Banking and Advice, Retail Compliance and Multi-Channel Performance & Development.

4.19. As a result of the work carried out by the Working Group, correspondence passed between the Firms and the Authority and the Firms introduced a number of changes to their advised mortgage sales process. The Firms attempted to put their first process change in place from 31 January 2012.

4.20. The Firms provided their final response to the Authority's letter of 4 November 2011 on 20 July 2012. The Firms provided an update on the process changes that they had made, or would shortly make, and stated that:

> "*We believe these changes now fully address the points which you have raised ...*"

The Firms provided details of changes to process that had been made. The Firms also indicated that an "*initial review*" of the Mortgage Sales Guide had "*identified areas for improvement in respect to MCOB*" and as a result they intended to create and introduce a new advice guide for advisers in 2012 (to be called the "Suitable Advice Guide") to sit alongside the Mortgage Sales Guide.

4.21. It was agreed that the Firms would carry out a review of the advised mortgage sales process through GIA to confirm whether the quality of advice issues raised by the Authority on 4 November 2011 had been addressed by the steps taken by the Firms and whether the sales process changes made had been incorporated into the business.

GIA review

4.22. The Firms' GIA review was finalised and provided to the Authority on 28 September 2012 (although the Firms had been aware of the nature of its findings since August 2012). GIA had tested 91 advised sales, consisting of 51 branch sales, four live observations of branch sales and 36 telephone sales for the period between 31 January and 13 July 2012. They were testing against a number of the process changes introduced to the mortgage sales process by UK Retail as a result of the Authority's feedback of 4 November 2011. In summary, the results were as follows:

Classification	Branch	Telephone	Live observations	Total	%
1 - Pass (fair customer outcome)	**0**	**2**	**0**	**2**	**2%**
2 - Fail (sales process failure only)	**0**	**29**	**0**	**29**	**32%**
3 - Fail (file did not evidence that sale suitable for customer)	**49**	**4**	**3**	**56**	**62%**
4 - Fail (detriment to customer established)	**2**	**1**	**1**	**4**	**4%**
Total Number of Sales	**51**	**36**	**4**	**91**	**100%**

4.23. GIA were testing files to see if there was evidence that customers had received a fair outcome. In the majority of cases (in 60 of the 91 tested – 66%) they did not find sufficient evidence of this. GIA considered that this was in part due "*... to the Mortgage Sales Guide, used by the advisers, not being fully compliant with MCOB*".

4.24. Of the 91 sales tested by GIA, 48 (53%) had previously been assessed for compliance by MBQU which had found them all to be Compliant or Compliant with Remedial Action. GIA disagreed with the MBQU assessments for 40 of the 48 files (83%). This included all 31 of the branch sales, due to there being insufficient evidence of suitability, and nine of the 17 telephone sales (53% of all telephone sales tested).

4.25. On 26 September 2012 (two days before the Firms disclosed the final GIA report to the Authority), the Firms wrote to the Authority to set out the steps they would be taking as a consequence of the findings of the GIA report. The Firms' letter evidenced a change in approach by the Firms towards their handling of the issues raised by the Authority. The Firms informed the Authority that they were now intending to make far more extensive changes to the advised sales business. They stated that they had engaged external consultants to review and amend the sales process Fact Find, the Sales Advice Guide and their suitability letters.

4.26. The Firms also explained that they would now be introducing a new advised sales process and all advisers, supervisors and sales leaders (approximately 500 people) would undergo two days of training on the new processes. They explained that there had been a deterioration in file quality results following process changes made earlier in 2012 and that the embedding of process changes had been incomplete. The Firms disclosed that there were issues with how they had been monitoring mortgage sales because MBQU had been assessing files against the Mortgage Sales Guide which had gaps on MCOB compliance.

4.27. The Firms recognised that there had been problems with the way in which they had attempted to address the issues identified by the Authority and they appointed third party consultants ("Consultant A") to conduct an independent fact-finding review of their response to the Authority's letter of 4 November 2011. Consultant A's report was provided to the Firms on 30 January 2013 and was highly critical of the Firms' response.

4.28. On 17 December 2012, the Firms instructed another firm of third party consultants ("Consultant B") to review a sample of advised mortgage sales made by the Firms between January 2012 and 30 November 2012: "*to understand whether appropriate customer outcomes have been delivered and whether there are any instances of customer detriment arising from this sample of mortgage sales interactions … The output should include a viewpoint on overall ability to evidence compliance with applicable regulations as well as conclusions on the customer outcomes*". Consultant B was also asked to highlight any weaknesses in the Firms' ability to demonstrate compliance with MCOB.

4.29. Consultant B produced its report on the Firms' sales made between January 2012 and 30 November 2012 on 13 May 2013. No files passed and 24 (33%) could not evidence that the customer had received a suitable outcome. The detailed results were as follows:

Classification	Branch	Telephone	Total	%
1 - Pass (suitable outcome)	**0**	**0**	**0**	**0%**
2 - Fail (sales process failure only)	**29**	**20**	**49**	**67%**
3 - Fail (file did not evidence that sale suitable for customer)	**12**	**7**	**19**	**26%**
4 - Fail (detriment to customer established)	**2**	**1**	**3**	**4%**
5 - Unable to conclude	**1**	**1**	**2**	**3%**
Total Number of Sales	**44**	**29**	**73**	**100%**

Customer Contact

4.30. The Firms have carried out a customer contact exercise in respect of some of the files tested by GIA to determine whether there was detriment. In this context detriment referred to cases where unsuitable advice had been provided or where the customers received an unfair outcome. The Firms were able to gather additional information for 67 of the 91 customers, whose files had been tested, including customer contact for all branch and some telephone sales. They found one additional case where there was customer detriment making a total of five (or 5.5% of files tested).

4.31. In 2013, the Firms also sought to review and/or contact 34 of the 101 customers whose sales Consultant B had tested as part of their review of sales from 2012 (the 101 figure includes 28 non-advised sales reviewed by Consultant B in addition to the 73 advised sales). The exercise was also an attempt to determine if there was any detriment. They reviewed 29 of the 34 sales (five customers could not be contacted, or refused to engage); including 13 customer contacts, and concluded that there was no evidence of detriment (i.e. there was a total of 4% detriment).

4.32. A further customer exercise involving 48 customers who were sold advised mortgages in 2012 who fitted into four categories identified by Consultant B as being areas in which there was potential for systemic detriment took place in 2013. One case of actual detriment was identified (2% of the total).

Findings by the Authority

Issues with the advised mortgage business

4.33. During the Relevant Period, there were serious issues with the Firms' advised mortgage sales. As set out below, there were significant problems with the sales process and how advisers dealt with their customers in practice.

No owner of the mortgage sales process

4.34. Mortgage products sold by the Firms were designed and developed by one business unit (Products) and sold by another (Customer Distribution). As described above, sales advisers sold mortgages by following a step by step sales process. There were certain differences in the process for some types of mortgage product (for example an offset mortgage followed an offset process), but the general principle was that sales advisers should follow the same process every time they gave advice and made a sale.

4.35. Until October 2012, there was no team or individual at the Firms who in practice took responsibility for the end-to-end advised mortgage sales process. No one was clearly accountable for maintaining, updating and changing the process, and making sure it was compliant with regulatory requirements. The Firms were aware of this fact. In June 2011, an internal Assurance and Standards review of the Firms' interest only mortgage sales process identified a large number of risk issues and made the following important observation:

> "*Whilst no specific finding has been raised, it was noted that there was no clear owner of the mortgage sales process within UK Retail. This lack of ownership may lead to problems in the longer term as there is no clear allocation of responsibility for updating the process and making required changes, or enhancement opportunities may be missed*".

4.36. No positive action was taken by the Firms in response to this warning. Shortly afterwards Products (who had received a copy of the Assurance and Standards review) instigated changes to UK Retail's high-level controls document (which described the allocation of responsibilities across each of the business areas) to remove a reference that suggested the business unit was accountable for the: "*Design of end to end product sales processes*". On 1 August 2011, they informed Consumer Distribution and Private Banking and Advice by email of their intention to make changes to the document which would affect Consumer Distribution's and Private Banking and Advice's accountabilities. Products stated in the email that they were there to support sales processes but were not there to "*tell the sales engines what their Sales process should be*" as they did not have people in the business units who engaged in selling so did not have the required expertise to do this. The changes to the high-level controls document were approved by the UK Retail Executive Committee on 24 August 2011.

4.37. The end result was that no individual or team within the Firms had clear ownership of the advised mortgage sales process. This remained the position until October 2012, when the Firms moved accountability for the advised mortgage sales process (and Mortgage Sales Guide) back to Products.

4.38. The Working Group was, however, aware very early on that there was a problem with ownership of the advised mortgage sales process and that resolution of this should be a priority for them. It was noted in the minutes of the meeting of 22 November 2011 that Products and Consumer Distribution were in discussion about who owned the sales process. However, the Working Group was unable to resolve the issue quickly despite its importance to the remedial action the Firms were to take. As late as August 2012, Products and Consumer Distribution were still debating who should have ownership of the process. Consultant A picked up on this hiatus in its report, stating that it was likely that a more coordinated effort would have driven more effective changes in sales processes.

4.39. GIA recognised the problems the lack of ownership presented and raised it as an issue in an internal document, referred to as an Exceptions Log, dated 17 October 2012. According to GIA, there had been no accountable executive for the end-to-end mortgage sales process at the start of the Relevant Period which had led to the process not being updated regularly and the Firms being without a single conduit to ensure the process was compliant with regulatory requirements.

Issues with the Mortgage Sales Guide

4.40. Until the end of December 2012, the Firms did not provide their mortgage sales advisers with dedicated guidance material to assist them with the advice elements of the mortgage sales process. They were expected to follow the processes and questions set out in the MAO and GMS systems. The only additional guidance provided to advisers was the Mortgage Sales Guide. During their induction, sales advisers were told to refer to the Mortgage Sales Guide for further details of MCOB and it was described as their comprehensive guide containing all the information they would need about mortgages and mortgage processes.

4.41. However, the Mortgage Sales Guide provided very little information to advisers on advice related matters and was not designed to assist an adviser in carrying out an end-to-end advised mortgage sale. According to Retail Compliance, which reviewed the Guide in July 2012: "*There was very little reference to advice in the whole of the MSG* [Mortgage Sales Guide]. *The MSG is more a collection of lending policy guidelines, procedures and factual articles about parts of the mortgage process*".

4.42. The Retail Compliance review found that the Mortgage Sales Guide contained a significant number of gaps in areas which would be necessary to ensure it complied with MCOB and what information there was lacked detail. The only document in the Guide to expressly cover advice was approximately a page and a half long but the Retail Compliance review found that "*This section is not sufficient to fully and robustly evidence compliance with Principle 9* [of the Authority's Principles for Businesses] *which requires a firm to take reasonable care to ensure suitability of its advice*". Retail Compliance concluded by recommending that a Suitable Advice Guide be created which would refer to all advice related points from MCOB and the application of those rules and guidance. They concluded that the new Suitable Advice Guide should have a clear owner who was responsible for maintaining and updating it going forward and that sales advisers should be annually tested on its content. This recommendation was followed by the Firms and a Suitable Advice Guide was written and introduced for the first time in late December 2012.

4.43. Some examples of the issues with the Mortgage Sales Guide (and the sales process in general) are as follows:

(1) the Firms did not have an adequate process to determine whether customers could afford the mortgages that were being recommended to them. A customer's routine expenditure was assessed using an algorithm based on ONS data to determine customer expenditure on average household expenditure together with information about credit card and loan borrowing. The algorithm included specific tolerances aimed at ensuring the affordability of mortgage products. However, the Firms were not properly considering the full extent and implications of customers' budgets and additional committed or future expenditure that customers may have had before providing personal recommendations. Whilst it is reasonable to use ONS data as part of a sales process, the Firms' process did not properly consider the customer's actual situation;

(2) the Firms were not providing proper advice to customers who were seeking to consolidate existing debts. The Firms acknowledged to the Authority that their advised sales process was not compliant with MCOB. They chose not to introduce a new compliant advice process but instead, from 1 February 2012, any customer who wished to consolidate debt could only proceed on a non-advised basis (see further paragraph 4.83 below for GIA criticism of this approach). However, following this change in practice problems in this area remained. For example, in a significant proportion of cases sales advisers were not making adequate enquiries to determine if customers would be consolidating debt into their borrowing before providing advice; and

(3) the Firms were not advising on term and were only taking account of the customers' preference. As a result, the Firms were not giving consideration as to whether the customers' preference was appropriate when recommending products to them. Whilst preference is important, firms must verify that the term is appropriate having regard to customers' circumstances.

4.44. GIA considered the Mortgage Sales Guide's failings to be a root cause of the Firms' quality of advice problems. It found that as advisers were using the Mortgage Sales Guide as an MCOB compliance tool and as it was not fully compliant "*the process executed by advisors will not be fully MCOB compliant*".

4.45. The Firms did not take the necessary steps to assure themselves that sales processes and sales made were MCOB compliant and the advice they were providing was suitable. Prior to the Retail Compliance review in July 2012, there had not been a comprehensive review of whether the Guide was MCOB compliant in the Relevant Period.

4.46. The Firms' internal Assurance and Standards team's review of the interest only mortgage sales process in June 2011 also referred to a number of the issues subsequently raised by the Authority in its letter of 4 November 2011. Again, the Firms did not act quickly enough or effectively enough to address these.

4.47. In addition, in June 2011 Retail Compliance had reviewed sections of the Mortgage Sales Guide as part of a wider review it was carrying out to determine if the Firms' sale of protection products was compliant with ICOB. It identified parts of the Guide concerning protection products which needed updating. Retail Compliance suggested twice in June 2011 that the complete content of the Mortgage Sales Guide (i.e. to include its mortgages content) be reviewed to ensure it was also up-to-date and accurate. No reviews were conducted as a consequence of these reports.

4.48. The Working Group was also aware of the potential issue from their first meeting on 22 November 2011. They asked the question '*If MBQU does not check the process is MCOB compliant, who within the business does?*' They also discussed at the next meeting, on 5 December 2011, whether the Mortgage Sales Guide was compliant with MCOB. Despite having these concerns from the start, the Working Group failed to resolve either issue successfully thereby making their task of responding to the Authority and remedying issues more difficult.

Issues with mortgage sales quality and the IT systems

4.49. In its letter of 4 November 2011, the Authority had raised an overarching concern that only a small proportion of the files reviewed contained sufficient information to evidence the basis for the decisions by the adviser, or demonstrated the suitability of the sale.

4.50. For the Firms to properly assess the suitability and affordability of the mortgages they recommend to customers, they needed to ask a variety of questions of them relating to their financial and personal background. The means by which this information is obtained is generally referred to as a "Fact Find". The sales process followed by the Firms had a limited form of Fact Find in that there were a number of basic questions that were required to be asked of customers in the MAO/GMS systems. However, this was not a comprehensive list. Beyond these basic questions it was left to the advisers to determine which questions should be asked as part of the Fact Find. The Advice Workshop training provided by the Firms to prospective sales advisers described the process as follows: "*Before you carry out a fact find you need to have a question bank stored in your head that you can draw upon at any time during your interview*".

4.51. The problem was made worse by the fact that the IT system used by the Firms did not permit advisers to properly record the result of the Fact Find. They used a free text box which was restricted to 500 characters. This inevitably led to them struggling to evidence general suitability of advice. This was picked up by GIA who saw it as one of the root causes of the Firms' problems with mortgage quality of advice. GIA stated: "*Advisers do not have systems/tools to prompt them and capture all information relevant to assess the customer's needs and determine the most suitable product, e.g. there is no fact find.*"

4.52. The free text box was linked by the MAO system to the content of the suitability letters. What was typed in the box would transfer into the suitability letters when printed off. As a result, the character limit in the system also affected the suitability letters. The letters served a dual purpose for the Firms. They were intended to inform the customer of advice but their main function for the Firms was to act as the primary record of the customer interview and they were supposed to be the way in which the Firms could evidence the suitability of the advice provided.

4.53. As a result, MBQU had to place enormous reliance on the content of suitability letters. These were the only records of advice that they saw. Unfortunately, the effectiveness of this approach was not just affected by the cumbersome nature and restrictions of the IT system but also by the quality of the information entered into the system by the advisers. As part of its review GIA found that for telephone sales (the only ones that could properly be tested), in 17 of the 20 cases where there was or should have been suitability letters, the files failed. In one case there was no letter on file at all. In the other 16 cases, the suitability letters were unclear, incomplete or inaccurate, as they did not reflect all the key information evident from the recorded call, or the information in the letter did not match the recorded call or system notes.

4.54. The issues with sales were not limited to record keeping. As set out above, the GIA review involved listening to recorded telephone sales calls and also some observed live sales. Of these 40 sales there were two cases (5%) which passed, 29 which involved a process fail (72.5%), seven (17.5%) in which suitability could not be demonstrated and two cases (5%) where the customer had suffered detriment. They also looked at specific areas which had been highlighted by the Authority. For example, in relation to affordability they found that for 72% of telephone sales (26 of 36 tested) it was unclear how affordability had been assessed.

4.55. Problems with the quality of advice being provided by sales advisers were also identified by Consultant B in its review of sales from 2012. They listened to 29 telephone sales and in nine cases (31%) found the advice process was carried out in such a way as to cause an unacceptable risk that the customer would not receive suitable advice (with not a single case passing).

4.56. Further, although the Firms made limited use of mystery shopping exercises to test the soundness of their sales processes and advice, in 2012 they carried out nine mystery shops. Sales were recorded and analysed and were rated Red, Amber or Green against a "*customer experience rating*". Each sale was reviewed to see if advisers were correctly following the end-to-end sales process and that suitable recommendations were being made to customers. Every file tested in this way in 2012 was graded as Red (meaning that the sales adviser's performance was unacceptable as they failed to meet established regulatory and in-house professional standards). The results showed serious and widespread failings, with the advisers reviewed not following the Firms' sales process and providing unsuitable and inadequate advice.

4.57. In three of the nine mystery shops, sales advisers provided customers with their own predictions as to the future movement of Bank of England base lending rates. Such conduct is highly inappropriate as sales advisers cannot predict future rate changes. It also gives rise to a very high likelihood of unsuitable advice (and possible detrimental outcome) as a customer's choice of mortgage product will be unduly influenced by an adviser's personal opinion on rate movements.

4.58. In one case when a customer asked an adviser if lending rates would rise, the adviser responded stating "*Yes. Absolutely*" and suggested that rates could reach 5.5%. The adviser recommended a five year fixed rate mortgage to the customer and told them:

> "*If we don't increase rates with this double dip recession the economy is in dire straits. Rates will rise. If you take a 2 year deal then rates will be higher after this period*".

Following the mystery shop, the supervisor recommended that the sales adviser be de-authorised (i.e. stopped from selling to the public) until such time as the

Firms could be confident that the adviser was able to conduct interviews in a compliant manner.

4.59. In another case where an adviser had been providing their views on lending rates, the supervisor assessing the sale also recorded 16 separate professional standards failings of which ten were considered to be detrimental to the customer. With respect to TCF principles (one of the regulatory principles that advisers were assessed against) the supervisor summarised the position as follows:

> "*TCF principles have not been met during this customer meeting due to misleading information being given on a number of occasions … . Given seller has recorded customer confirming affordability into retirement within the suitability letter when this was not confirmed by client, appropriate advice has not been given and inappropriate behaviour has been displayed. Further demonstrated by opinion on interest rates*".

Despite these findings, the supervisor did not recommend the de-authorisation of the sales adviser but instead allowed them to continue to sell to the public but with "*back to basics coaching*".

Monitoring of mortgage sales

4.60. MBQU was the Firms' key assurance function which they relied upon to satisfy themselves that they were making suitable and compliant sales. It was responsible for reviewing, assessing and reporting on advised mortgage sales files. MBQU would select files from the highest risk advisers (i.e. starting at the adviser rated as highest risk at that time and working down) until they reached the required sample size. Some consideration would then be given to the adviser's higher risk sales to decide which of that adviser's sales to review. During the Relevant Period, MBQU reviewed on average 11% of advised files (with branch sales and telephone sales reviewed in similar proportions).

4.61. The GIA Exceptions Log summarises the faults with MBQU:

> "*MBQU do not assess the quality of advice given by the advisors hence there is no way of identifying instances when the quality of advice is poor. As a result, sales where customers have been disadvantaged have not been identified leading to the risk of customer detriment.*
>
> *MBQU do not focus on the advice given by the adviser; instead it focuses on the process being followed by the adviser and whether the Mortgage Sales Guide has been adhered to. This leads to the risk that the adviser may have followed the process but the customer does not end up with the right product, as the advice was incorrect.*
>
> *PMA* [i.e. branch advisers] *– GIA tested 35 PMA sales that were also assessed by MBQU. We could not determine if a fair customer outcome was achieved, due to the lack of evidence on file. As a result, MBQU should also have not been able to effectively assess the sales against delivery of advice and fair outcomes to customers. MBQU have assessed 4 PMA files as Non-Compliant.*
>
> *Telephony – GIA tested 19 Telephony sales that were also assessed by MBQU. In our testing we consider that 9 of the sales should have been assessed as 'compliant with remedial action', rather than 'compliant'.*"

4.62. MBQU assessed files to see if they were compliant with the sales process (and the Mortgage Sales Guide). It did not assess against MCOB or other regulatory requirements. Moreover, it did not properly assess whether the advice given was actually suitable. This was identified by GIA as a root cause of the Firms' problems, stating: "*As MBQU methodology is not adequate and the MBQU are not operating effectively, failings in the process and the Advisers have not been identified*". Assessing against a process checklist, rather than looking at customer outcomes, made it possible for MBQU to assess a sales file as being Compliant even if it was missing crucial information relating to suitability and affordability with the resultant risk that the advice that was provided was wrong or unsuitable.

Further impact of the problems with MBQU

4.63. The results of MBQU monitoring were used in the business in several crucial ways.

4.64. Firstly, the fact that MBQU was not operating adequately had an effect on the reliability of the management information produced by the Firms. It was not able to properly identify risks relating to poor customer outcomes and as a result the Firms were unable to determine if they were meeting their regulatory responsibilities.

4.65. Further, the MBQU results were used by both the Training and Competence Scheme and by the Incentives Schemes to review individual advisers and their supervisors.

4.66. The Firms' Training and Competence Scheme was intended to play a vital risk role within the Firms. According to the Scheme's Executive Summary: "*… It operates by focussing the correct level of supervisory resource in the right areas according to risk*". As part of this they used a system to risk rate each adviser and the first line supervisors. This was called the Unified Risk Model. The primary use of the Unified Risk Model was to determine the appropriate degree of supervision required. The objective of the Training and Competence Scheme was to develop advisers from high risk to low risk and to maintain them as low risk individuals. The model was based on a series of KPIs, which resulted in points being assigned to the adviser. One KPI was "*MBQU Non-Compliant Assessments*" over a six month period. This only included files on which suitability of the advice could not be demonstrated. Process failures only resulted in points being assigned if they were not remedied within the necessary time period.

4.67. Each adviser was then risk rated based upon the results of all the KPIs. Each KPI had different weighting into the total score and was allocated a range of points. These points were then totalled and a risk rating allocated to each adviser based on the total score. There were five different risk classifications (Levels 1 to 5). Advisers at Levels 1-3 were considered low risk (with Levels 1-2 being classified as green risk rating and Level 3 as amber risk rating), whilst advisers at Levels 4-5 were considered high risk (with a red rating). Under the risk rating calculation used in 2011-2012, an adviser achieving a total score of ten points or less across the KPIs would have received a low risk rating. An adviser achieving a score of 11-16 points would have received a Level 4 high risk rating and an adviser achieving 17 points and above would have received a Level 5 high risk rating. The maximum points an advisor could be allocated for Non-Compliant MBQU ratings was ten (for eight or more fails). In 2013, the scoring system was amended to increase the weighting for certain KPIs (including the MBQU score) and to reduce the score required for the amber and red ratings within those KPIs.

4.68. The risk ratings were used by supervisors to determine the level of supervision that was required of a sales adviser. Those classed as high risk underwent a greater degree of supervision. High risk advisers were subject to one assessed mortgage observation and five file assessments per quarter. Supervisors also had to hold a formal meeting with them by the end of the first month of the quarter. For low risk advisers, the frequency of assessment was at the supervisor's discretion and they may not have been subject to any observation for long periods of time. The requirement was that, for a low risk adviser, a minimum of one mortgage sale had to be assessed as Compliant within an annual period (changed to a six-monthly period from July 2012).

4.69. There was no minimum requirement for supervisors to perform file assessments for low risk advisers (although if no file checks were conducted during an annual period the rationale for this had to be recorded in a log by a supervisor) and they only had to have at least one formal one-to-one meeting a year. The Firms were, therefore, reliant on MBQU monitoring to determine whether advisers posed a risk to customers. As a result of the failure by MBQU to properly identify sales quality issues, an adviser who was in reality not evidencing that their advice to a customer was suitable would often be provided with a "Compliant" or "Compliant with Remedial Action" rating for a file. Over time this caused a significant risk that, despite serious problems with an adviser, their Unified Risk Model rating would remain low (and inaccurate).

4.70. This in turn had a knock-on effect on the operations of MBQU itself. The risk rating of an adviser played a key part in how MBQU selected files for review. Therefore, if an adviser already had a low risk rating, as a result of their performance across the spectrum of KPIs (including number of sales, advice levels and policy cancellation rates), they would be subject to a lower number of MBQU reviews.

4.71. The flaws in the Unified Risk Model were not limited to those advisers who passed the MBQU checks. For a sales adviser to be rated a high risk individual within the relevant KPI, they must have received three or more "Non-Compliant" MBQU ratings within a six month period. More points were allocated if more Non-Compliant files were rated, but if an adviser had eight or more Non-Compliant ratings they would score no more than ten points. However, the number of checks carried out by MBQU in practice made it highly unlikely that an adviser would be assigned the higher risk ratings even if the advisers were incurring high levels of Non-Compliant MBQU ratings. For example, in the six month period between April and September 2012, approximately 23% (72) of sales advisers (who had been employed for the whole previous year) had less than three of their files checked and 20% (62) had no files at all reviewed. In this period, MBQU assessed an average of approximately six files per adviser. This means that the average adviser would have had to receive Non-Compliant ratings for at least 50% of the reviewed files to be classed as high risk within the KPI. Further, if every file the average adviser had checked in a six month period (i.e. six) failed to evidence suitable advice, and was therefore rated Non-Compliant, it would still not be possible for them to be assigned the highest risk points. Only 43% of advisers could even theoretically have scored the highest risk point rating if they failed all their MBQU assessments (i.e. these advisers had as many as eight files checked).

4.72. The flaws in the operations of MBQU and the Unified Risk Model also had an impact in relation to the sales quality threshold applied to the advisers working in the Firms' branches. In 2011, the Unified Risk Model was the only method used to determine which advisers met the necessary quality threshold to receive a bonus. The bonus was primarily based on sales performance but there was also a small part that was based on branch performance. A Level 3 (i.e. amber) risk rating on the Unified Risk Model was required to meet the quality threshold and obtain a bonus. However, advisers with a Level 4 or 5 risk rating (i.e. red or high risk advisers) could obtain a bonus at the discretion of the Regional Control Board. For example, where an adviser had six files reviewed within a six month period and that adviser received a Non-Compliant rating on all six file reviews, a score of seven would have been allocated toward that advisers overall risk rating level. Therefore, even if the adviser failed 100% of their file reviews, if their other KPIs did not score further points, they would still have received a bonus.

4.73. From 2012 there was a further requirement that an adviser received a "Compliant" or "Compliant with Remedial Action" grade in at least 95% of MBQU reviews (although that was in itself affected by the quality of the reviews). The effect of these issues was that the Firms could not properly determine who should be removed from the bonus scheme for sales quality failings.

Issues affecting the Firms' ability to respond to the Authority effectively

4.74. The Firms' response to the issues raised by the Authority in November 2011 was seriously inadequate. It was poorly planned, under-resourced and not subject to adequate oversight and governance. As a result, the serious problems in the advised mortgage business were not dealt with as quickly as they should have been and customers continued to be at risk of poor outcomes.

4.75. The problems with the Firms' response are set out below.

Risk assessment

4.76. Upon receipt of the 4 November 2011 letter from the Authority, the Firms formed a Working Group (as described at paragraph 4.18). They did not carry out a review of the advised sales process (and key related tools such as the Mortgage Sales Guide and MBQU). Nor did they take steps to investigate the Authority's overarching concern about lack of evidence of suitability in the files it reviewed.

4.77. The Working Group decided to look at each issue raised by the Authority in isolation. GIA found this approach to be a root cause of the Firms' failure to remediate its quality of advice issues, stating: "*An holistic view of the mortgage sales process would have been a beneficial action to undertake before a decision was taken on what the new processes should be; each new process was introduced on a silo approach*".

4.78. It was only after the draft GIA report was produced and circulated within the Firms in August and September 2012 (over nine months after the Authority's initial letter) that the Firms began to properly coordinate and resource the steps necessary to effectively remedy the serious issues in the advised mortgage business.

4.79. The Firms also failed to properly assess the issue raised by the Authority on the MBQU function. This is a particular concern as the Working Group was aware that there was an issue concerning MBQU not testing against MCOB or assessing customer outcomes. This issue was raised at the very first meeting on 22 November 2011. However, the Firms did not carry out a review of MBQU or seek to carry out an independent secondary review of files that MBQU had reviewed to determine if it was operating effectively. Instead, MBQU was permitted to carry on as before using its checklist approach to file monitoring. This was in circumstances where the Firms were relying on MBQU monitoring results to judge file quality (and to determine if process changes were effective). Had they carried out this review the full extent of the issues in the advised mortgage business would have been apparent to the Firms far earlier.

Project management and governance

4.80. The Working Group put together to resolve the issues raised by the Authority consisted of managers from across the business and had no executive members. In some cases the managers tasked to the Working Group would in turn delegate to someone more junior to attend on their behalf. In addition, the Working Group was poorly resourced. There was no dedicated project resource including no project manager or secretarial support.

4.81. The governance surrounding the Working Group was inadequate. There were no terms of reference or other formal governance structure in place. The Working Group was not required to report to any individual or committee (see further below). There were no agenda produced for meetings and they were not minuted (save for the first two). A project plan was not produced and a record of decisions taken was not kept. The Firms also failed to keep anything akin to a log of issues, comprehensive list of action points, list of responsibilities, or deadlines to be met. As the Firms did not keep a record of how decisions were taken, GIA could not conclude whether the decisions made by UK Retail were signed off by the appropriate level of management and if there was reasonable consideration of all aspects of the Authority's letter. GIA looked at the decisions taken by the Working Group in respect of four process changes put in place as a result of the issues raised by the Authority and found no evidence of how decisions were made for any of them.

4.82. The Firms were required by their own internal policy to classify proposed changes to policy and process as being of "Major", "Significant" or "Important" impact. Changes classified as Major or Significant had to be sanctioned by the UK Retail Risk Committee (who could delegate Significant issues to the UK Retail Operational Risk Committee) and Important changes could be sanctioned by a designated Risk executive, provided that they reported this to the UK Retail Risk Committee. This ensured that senior executives had the opportunity to consider all policy and process changes before they were made so that they could review the impact these may have had on the particular and wider UK Retail business.

4.83. In the case of the mortgage quality of advice issue, the Firms did not follow their own procedure and there is no evidence that the process changes introduced by the Working Group went through this level of scrutiny. GIA was particularly critical of this in respect of debt consolidation stating that there was: "*no documentation regarding why this change* [from advice to non-advice] *was made and who signed off on this change … It is unclear whether the customer impact of this change was considered and what alternatives were offered to the solution chosen*".

4.84. As part of this, the Firms failed to follow internal policy on risk management. The Firms used a risk management tracking system called ORBIT, but the mortgage quality of advice issue was not entered onto it until late September 2012, ten months after the issues were raised. GIA found that notice of a non-compliant sales process should have resulted in an immediate ORBIT entry.

4.85. By contrast, the Firms did follow what appears to be the correct internal procedure in respect of process changes made early in 2012 as a result of the interest only mortgages Assurance and Standards review referred to above. The difference in the two approaches is notable. With the interest only mortgages review, the issues were classified as of Significant or Important impact and were entered onto the ORBIT risk tracking system. The level of scrutiny increased as a result. For example, in order to obtain approval for policy and process changes a 'Detailed Paper' was produced and presented to the UK Retail Risk Committee by an executive for approval. It contained a full description of the proposal, its financial impact, other impacts (such as on the customer, the Firms' reputation and TCF), proposed date of implementation and how the changes would be monitored. The matter was then discussed at the UK Retail Risk Committee.

4.86. Following the GIA report in September 2012, the Firms' mortgage quality of advice issues were classified and graded as being of Major impact and were entered onto ORBIT.

Executive involvement and oversight

4.87. There was no executive in charge who was in practice taking responsibility for the Working Group and it was without meaningful executive challenge or guidance.

4.88. It appears many of those involved with the Working Group and the Firms' response to the Authority were not clear which executive had been made accountable.

4.89. When executives did become involved in the issues, this was generally a few days before a response to the Authority was required and it was necessary to approve decisions which had been taken by the Working Group (in particular to approve the correspondence that had been drafted). Executives had a minimal role in shaping the work and direction of the Working Group. They did not have any regular interaction with or oversight of the Working Group, the work it was doing, and the decisions it would take.

4.90. None of the Firms' committees provided proper oversight or challenge. The issue was a standing agenda item on the UK Retail Risk Committee but, in practice, it did not provide any active oversight or challenge on the project.

4.91. GIA found poor governance and lack of executive support to be a root cause of the Firms' inability to properly respond to the issues raised by the Authority.

Embedding of process changes

4.92. The Firms did not adequately embed the process changes they made into the advised mortgage sales process. When changes were introduced, limited steps were taken to ensure that sales advisers would actually follow the new process. GIA estimated that 14 process changes had been made in 2012 by the time it reported in September (not all relating to review of points raised by the Authority) and each change was implemented through email cascade and short informal ad hoc meetings. It is clear from GIA's and Consultant B's testing that the process changes were not fully understood by sales advisers.

4.93. The Firms should have put in place focused training so that sales advisers could be taken through the more material changes to the process. For example, the process change introduced for sales to customers who wished to borrow into retirement involved seven new "*key*" steps that advisers were required to follow. The change was introduced to sales advisers by email without any support other than three 'Frequently Asked Questions' attached to the email. GIA commented in the Exceptions Log that changes introduced in such a fashion could result in staff not receiving, reading or fully understanding the new process and "*not following the new seven step process and FSA requirements not being met*".

4.94. Focused training would have increased the chances of successfully embedding changes. Instead of taking these steps, the Firms left it to MBQU to identify any process failings that followed the introduction of a process change. Unfortunately, as the GIA report concluded, MBQU was not capable of doing this effectively as it could not target action against a process change, for example it had no way of picking out all recent debt consolidation or sales into retirement cases. Therefore its only option was to wait until it came across a process change case in the course of its ordinary reviews. MBQU also continued to review against its process checklist and did not look at customer outcomes. As a result, the effectiveness of its monitoring was limited.

5. FAILINGS

5.1. The statutory and regulatory provisions and guidance relevant to this Final Notice are set out in Annex A to this notice.

Principle 9 / MCOB 4.7

5.2. The Firms breached Principle 9 by failing to take reasonable care to ensure that the advice they were providing to customers who wished to purchase mortgages was suitable. The detailed failings are summarised below. The Firms also failed to meet several requirements of MCOB 4.7 in the Authority’s Handbook.

5.3. There were serious failings in advised mortgage sales during the Relevant Period. These were:

(1) the Firms did not have an adequate system in place for the advised mortgage sales process. They did not ensure that an individual or team within the Firms was properly accountable and responsible for the advised mortgage sales process;

(2) the mortgage sales process was not compliant with the requirements of MCOB and was not fit for purpose. In particular, the Firms:

(a) did not have an adequate process to determine whether customers could afford the mortgages that were being recommended to them. While the Firms had a process that considered expenditure based on ONS data, and took into account some key customer data, they were not considering the full extent and implications of a customer’s budget and additional committed or future expenditure before making a personal recommendation;

(b) were not providing compliant advice to customers who were seeking to consolidate existing debts, or were not making adequate enquiries to determine if customers would be consolidating debt into their borrowing before providing advice; and

(c) were not advising on term and were only taking account of the customers’ preference. As a result, the Firms were not giving consideration as to whether the customers’ preference was appropriate when recommending products to them. Whilst preference is important, firms must verify that the term is appropriate having regard to customers’ circumstances;

(3) in a significant number of cases the advice process was carried out in such a way as to cause an unacceptable risk that the customer would not receive suitable advice. This was evidenced by reviews by GIA, Consultant B and the mystery shopping results. In most cases the Firms did not keep sufficient evidence to demonstrate suitability. This was partly as a result of issues with the IT system;

(4) the monitoring of sales was inadequate and ineffective. The Firms' principal sales monitoring function, MBQU, did not assess advised mortgage sales files to determine if customers were receiving suitable advice and outcomes. MBQU tested against compliance with the sales process and did not check whether sales advisers were making sales in compliance with MCOB;

(5) the failures in the sales monitoring function resulted in:

(a) inadequate management information on file quality;

(b) sales advisers being incorrectly rated as low risk under the Training and Competence Scheme; and

(c) flawed results in the Firms' adviser risk assessment system (the Unified Risk Model) which was used to decide which advisers should receive a bonus; and

(6) the adviser risk assessment system was flawed in that, given the amount of files being reviewed by MBQU in practice, an adviser would be highly unlikely to receive a high risk rating regardless of performance (and in many cases it would be impossible).

Principle 2

5.4. The Firms breached Principle 2 by failing to conduct their advised mortgage business with due skill, care and diligence. They did not adequately remedy the problems with the business when identified by the Authority. The detailed failings are summarised below.

5.5. The Firms' response to the issues raised by the Authority on their advised mortgage sales was seriously inadequate. This resulted in customers being placed at prolonged and continued risk of receiving unsuitable advice. The failings were:

(1) the Firms did not adequately assess the risks raised by the Authority on 4 November 2011;

(2) until the end of September 2012, the Firms did not begin to organise and conduct their response to the issues raised by the Authority properly. The Firms' response was poorly planned, under-resourced and not subject to adequate governance and oversight; and

(3) the Firms failed to ensure that the changes they made to the advised mortgage sales process were properly communicated to sales advisers and provided no staff training to support the initial changes (training on the new sales process eventually took place between the end of December 2012 and 31 March 2013). As a consequence, the initial changes made to the sales process did not result in changes to adviser behaviour.

6. SANCTION

Financial penalty

6.1. The principal purpose of a financial penalty is to promote high standards of regulatory conduct by deterring firms who have breached regulatory requirements from committing further contraventions, helping to deter other firms from committing contraventions and demonstrating generally to firms the benefits of compliant behaviour. For the reasons set out above, the Authority considers that the Firms breached Principle 9 (together with MCOB 4.7) and Principle 2. In determining that a financial penalty is appropriate and proportionate in this case, the Authority has considered all the relevant circumstances.

6.2. The Authority considers that the Firms' breaches of Principle 9 (together with MCOB 4.7) and Principle 2 occurring over the Relevant Period arise from a single course of conduct. In the particular circumstances of this case, the Authority has concluded that it is appropriate to impose a combined penalty in respect of these breaches.

6.3. The Authority's policy for imposing a financial penalty is set out in Section 6 of DEPP. In respect of conduct occurring on or after 6 March 2010, the Authority applies a five step framework to determine the appropriate level of financial penalty to all of the conduct in question. 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

6.4. Pursuant to DEPP 6.5A.1G, at Step 1 the Authority seeks to deprive a firm of the financial benefit derived directly from their breaches where it is practicable to quantify this.

6.5. The Authority has not identified any financial benefit that the Firms derived from its breaches. Where customer detriment has been identified, the Firms have taken steps to compensate the customers. Step 1 is therefore £0.

Step 2: the seriousness of the breaches

6.6. Pursuant to DEPP 6.5A.2G, at Step 2 the Authority determines a figure that reflects the seriousness of the breaches. 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 breaches may cause, that figure will be based on a percentage of the firm's revenue from the relevant products or business area.

6.7. The Authority considers that the revenue derived by the Firms from the sale of advised mortgage products by their branch and telephone networks during the period of the breaches is indicative of the harm or potential harm caused by their breaches. The Authority has, therefore, determined a figure based on a percentage of the Firms' relevant revenue.

6.8. The period of the Firms' breaches was from 1 June 2011 to 31 March 2013 and the relevant revenue has been taken for this period.

6.9. The Authority considers the Firms' combined relevant revenue for this period to be £106,041,482. This represents revenue received from the sale of mortgage products to customers. The total comprises combined relevant revenue for both Firms.

6.10. In determining the percentage of the relevant revenue that forms the basis of the Step 2 figure, the Authority considers the seriousness of the breaches 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 breaches: the more serious the breaches, 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%

6.11. In assessing the seriousness level, the Authority takes into account various factors which reflect the impact and nature of the breaches. DEPP 6.5A.2G(11) lists factors likely to be considered Level 4 or Level 5 factors. Of these, the Authority considers the following factor to be relevant: the breaches revealed serious weaknesses in the Firms' management systems and internal controls relating to the mortgage business.

6.12. The Authority also considers that the following factors are relevant:

(1) the Firms are leading providers of mortgage products to retail customers in the UK. The Firms sold approximately 30,000 mortgage products to customers on an advised basis during the Relevant Period;

(2) the Firms' failings in respect of their mortgage business affected every customer they advised during the Relevant Period, in that every customer was at risk of not having received suitable advice;

(3) the Firms were slow to recognise the magnitude of the problems and, had it not been for the intervention of the Authority, there is no indication that the Firms would have identified the extent of the problems within their advised mortgage sales business or taken effective action to address them. When remedial action was taken from November 2011 in response to the Authority's original findings, this was found to be inadequate;

(4) upon receipt of the GIA report in late September 2012, the Firms did then begin to take significant action to address the problems with their advised mortgage sales business including limiting their marketing from late November 2012 until June 2013. The Firm also introduced full file checking to ensure they could monitor the effectiveness of the retraining and commissioned a number of further targeted reviews in an effort to identify whether there was historical customer detriment; and

(5) there is no evidence of significant customer detriment and where customer detriment has been identified, the Firms have taken steps to compensate the customers.

6.13. Taking all of these factors into account, the Authority considers the seriousness of the breaches to be Level 4 and so the Step 2 figure is 15% of £106,041,482.

6.14. The combined Step 2 figure for the Firms is therefore £15,906,222.

Step 3: mitigating and aggravating factors

6.15. 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 breaches.

6.16. The Authority considers that the following factors aggravate the breaches:

(1) the Firms provided the Authority with an assurance by way of letter dated 20 July 2012 that the changes they had made or would shortly make to the advised sales process had fully addressed the concerns raised by the Authority. While the Authority makes no finding that there was any intention to mislead, if the Firms had properly investigated the issues raised by the Authority in November 2011 they would have known this was not the case;

(2) the Authority has repeatedly emphasised in Final Notices and other publications the importance of firms taking appropriate steps to ensure suitable mortgage advice is given to customers;

(3) in relation to the previous disciplinary record and general compliance history of the Firms:

(a) RBS Group's provision for compensating customers who were mis-sold PPI was £3.1bn as at the first quarter of 2014;

(b) in July 2013, the Authority fined RBS (and Royal Bank of Scotland N.V.) £5.6m for failing to report transactions it was required to report in an accurate and timely manner. It was noted in this case that the systems and controls failures were not adequately prioritised when it was apparent significant work was needed to ensure they were effective;

(c) in February 2013, the Authority fined RBS £87.5m in relation to LIBOR submissions. This involved an assurance to the Authority that the systems and controls in relation to LIBOR submissions were adequate (when they were not);

(d) in March 2012, the Authority fined Coutts & Co (a wholly owned subsidiary of RBS Group) £8.75m for breach of anti-money laundering rules;

(e) in November 2011, the Authority fined Coutts & Co £6.3m in relation to the mis-selling of AIG bonds. In this matter, Coutts & Co failed to undertake an effective compliance review in a timely manner and failed to take prompt and effective action to address the issues raised;

(f) in January 2011, the Authority fined the Firms £2.8m in relation to complaints handling;

(g) in August 2010, the Authority fined the Firms, Coutts & Co and Ulster Bank Limited (a wholly owned subsidiary of RBS Group) £5.6m for breach of anti-money laundering rules. Actions to address the issues identified by the firm were not taken in a timely manner; and

(h) in December 2002, the Authority fined RBS £750,000 for breach of anti-money laundering rules.

6.17. The Authority considers that the following factor mitigates the breaches. The Firms have agreed to conduct a customer contact exercise with the intention of identifying and addressing any customer detriment that may have resulted from the failings within the advised mortgage sales business during the Relevant Period. They will write to all customers who received mortgage advice during the Relevant Period and invite them to raise any concerns that they have about the advice received.

6.18. Having taken into account the aggravating and mitigating factors, the Authority considers that the Step 2 figure should be increased by 30%.

6.19. Step 3 is therefore £20,678,089.

Step 4: adjustment for deterrence

6.20. The Authority considers that the Step 3 figure of £20,678,089 represents a sufficient deterrent to the Firms and others and so has not increased the penalty at Step 4.

6.21. Step 4 is therefore £20,678,089.

Step 5: settlement discount

6.22. Pursuant to DEPP 6.5A.5G, if the Authority and the firm on which 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.

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

6.24. Step 5 is therefore £14,474,662 which has been rounded down to £14,474,600.

Penalty

6.25. The Authority therefore imposes a combined financial penalty of **£14,474,600** on the Firms for breaching Principle 9 (together with MCOB 4.7) and Principle 2.

7. PROCEDURAL MATTERS

Decision maker

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

7.2. This Final Notice is given under, and in accordance with, section 390 of the Act.

Manner of and time for payment

7.3. The financial penalty must be paid in full by the Firms to the Authority by no later than 10 September 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 11 September 2014, the Authority may recover the outstanding amount as a debt owed by the Firms and due to the Authority.

Publicity

7.5 Sections 391(4), 391(6) and 391(7) of the Act apply to the publication of information about the matter to which this notice relates. Under those provisions, the Authority must publish such information about the matter to which this notice relates as the Authority considers appropriate. The information may be published in such manner as the Authority considers appropriate. However, the Authority may not publish information if such publication would, in the opinion of the Authority, be unfair to you or prejudicial to the interests of consumers or detrimental to the stability of the UK financial system.

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

Authority contacts

7.7. For more information concerning this matter generally, contact Andrew Wigston at the Authority (direct line: 020 7066 6286/email andrew.wigston@fca.org.uk).

Jamie Symington
Financial Conduct Authority, Enforcement and Financial Crime Division

ANNEX A

RELEVANT STATUTORY AND REGULATORY PROVISIONS AND GUIDANCE

1. STATUTORY PROVISIONS

1.1. The Authority's regulatory objectives, as previously set out in section 2(2) of the Act, included the protection of consumers.

1.2. 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 amount as it appears appropriate*."

2. REGULATORY PROVISIONS

Principles for Businesses (PRIN)

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 as set out in the Act and reflect the Authority's regulatory objectives.

2.2. Principle 2 states:

"*A firm must conduct its business with due skill, care and diligence.*"

2.3. Principle 9 states:

"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."

Handbook Rules

2.4. MCOB has applied to firms carrying out home finance activities (which include activities carried out in respect of regulated mortgage contracts) throughout the Relevant Period.

<u>Advised sales</u>

2.5. MCOB 4.7 concerned advised sales and applied throughout the Relevant Period. It was replaced by MCOB 4.7A on 26 April 2014.

2.6. MCOB rule 4.7.2 stated:

"*A firm must take reasonable steps to ensure that it does not make a personal recommendation to a customer to enter into a regulated mortgage contract, or to vary an existing regulated mortgage contract, unless the regulated mortgage contract is, or after the variation will be, suitable for that customer (see MCOB 4.3.4 R (2), MCOB 4.3.5 G and MCOB 4.3.6 G).*"

2.7 MCOB rule 4.7.4 stated:

"*For the purposes of MCOB 4.7.2 R:*

(1) a regulated mortgage contract will be suitable if, having regard to the facts disclosed by the customer and other relevant facts about the customer of which the firm is or should reasonably be aware, the firm has reasonable grounds to conclude that:

(a) the customer can afford to enter into the regulated mortgage contract;

(b) the regulated mortgage contract is appropriate to the needs and circumstances of the customer; and

(c) the regulated mortgage contract is the most suitable of those that the firm has available to it within the scope of the service provided to the customer;

(2) no recommendation must be made if there is no regulated mortgage contract from within the scope of the service provided to the customer which is appropriate to his needs and circumstances; and

(3) if a firm is dealing with an existing customer in arrears and has concluded that there is no suitable regulated mortgage contract for the purposes of MCOB 4.7.2 R, the firm must nonetheless have regard to MCOB 13.3.2A R (1), MCOB 13.3.2A R (5) and MCOB 13.3.2A R (6) (see also MCOB 13.3.4A R (1) (a) and MCOB 13.3.4A R (1) (b))."

2.8 MCOB rule 4.7.5 stated:

"*In relation to MCOB 4.7.4 R(1)(a), a firm must explain to the customer that the assessment of whether he can afford to enter into a regulated mortgage contract is based on:*

(1) current interest rates, which might rise in the future; and

(2) the customer's current circumstances, which might change in the future."

2.9 MCOB rule 4.7.6 stated:

"*In relation to MCOB 4.7.4 R(1)(a) and (b), where a firm makes a personal recommendation to a customer to enter into a regulated mortgage contract where a main purpose is to consolidate existing debts it must also take account of the following, where relevant, in assessing whether the regulated mortgage contract is suitable for the customer:*

(1) the costs associated with increasing the period over which a debt is to be repaid;

(2) whether it is appropriate for the customer to secure a previously unsecured loan; and

(3) where the customer is known to have payment difficulties, whether it would be more appropriate for the customer to negotiate an arrangement with his creditors than to take out a regulated mortgage contract."

2.10 MCOB 4.7.7 stated:

"*(1) In assessing whether a customer can afford to enter into a particular regulated mortgage contract, a firm should give due regard to the following:*

(a) information that the customer provides about his income and expenditure, and any other resources that he has available;

(b) any likely change to the customer's income, expenditure or resources; and

(c) the costs that the customer will be required to meet once any discount period in relation to the regulated mortgage contract comes to an end (on the assumption that interest rates remain unchanged).

(2) Contravention of MCOB 4.7.7 E (1) may be relied upon as tending to show contravention of MCOB 4.7.4 R (1) (a)."

2.11 MCOB 4.7.11 stated:

"*(1) In assessing whether the regulated mortgage contract is appropriate to the needs and circumstances of the customer for the purposes of MCOB 4.7.4 R (1) (b), a firm should give due regard to the following:*

(a) whether the customer's requirements meet the eligibility criteria for the regulated mortgage contract (for example, the amount that the customer wishes to borrow, or the loan-to-value ratio);

(b) whether the customer should have an interest-only mortgage, a repayment mortgage, or a combination of the two;

(c) whether the customer has a preference for a particular term;

(d) whether the customer has a preference or need for stability in the amount of required payments, especially having regard to the impact on the customer of significant interest rate changes in the future;

(e) whether the customer has a preference or need for payments to be reduced at the outset (for example, a loan with an initial discount rate period);

(f) whether the customer intends to make early repayments; and

(g) whether the customer has a preference or need for any other features of a regulated mortgage contract (for example, payment holidays).

(2) Compliance with (1) may be relied upon as tending to show compliance with MCOB 4.7.4 R (1) (b)."

2.12 MCOB rule 4.7.17 stated:

"*(1) A firm must make and retain a record:*

(a) of the customer information, including that relating to the customer's needs and circumstances, that it has obtained for the purposes of MCOB 4.7; and

(b) that explains why the firm has concluded that any personal recommendation given in accordance with MCOB 4.7.2 R satisfies the

suitability requirements in MCOB 4.7.4 R(1). This explanation must include, where this is the case, the reasons why a personal recommendation has been made on a basis other than that described in MCOB 4.7.13 E(1).

(2) The record in (1) must be retained for a minimum of three years from the date on which the personal recommendation was made."

The Decision Procedure and Penalties Manual ("DEPP")

2.13 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 ("EG")

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

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