
FINAL NOTICE

To: **Lloyds Bank plc, Bank of Scotland plc and Black Horse Limited
(together Lloyds Banking Group "LBG")**

Firm
Reference
Numbers: **119278, 169628 and 313409**

Address: 25 Gresham Street
London EC2V 7HN

Date: 4 June 2015

1. ACTION

- 1.1. For the reasons given in this Notice, the Authority hereby imposes on Lloyds Bank plc, Bank of Scotland plc and Black Horse Limited (together Lloyds Banking Group "LBG") a financial penalty of £117,430,600.
- 1.2. LBG agreed to settle at an early stage of the Authority's investigation. LBG 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 £167,758,035 on LBG.

2. SUMMARY OF REASONS

- 2.1. Customers have a right to expect that they will be treated fairly at every interaction with a firm. This is particularly important when a customer complains about a financial product purchased through the firm.

- 2.2. Between 5 March 2012 and 28 May 2013 (the "Relevant Period") LBG breached Principle 6 (Customers' Interests) of the Authority's Principles for Businesses ("the Principles") by failing to pay due regard to the interests of, or treat fairly, customers who had complained about Payment Protection Insurance ("PPI"). The failings set out in this Notice relate specifically to LBG's PPI complaint handling operation.
- 2.3. Complaint handling, and in particular PPI complaint handling, is a high priority issue for the Authority. Ensuring that every customer is treated fairly when they complain is important to the Authority's consumer protection objective and in rebuilding trust in financial institutions particularly following the widespread mis-selling of PPI.
- 2.4. Customers making complaints who had originally been mis-sold PPI had already been treated unfairly and suffered detriment. While not all customers who complain will have been mis-sold PPI, LBG's conduct in not handling PPI complaints fairly meant that a significant number of customers who had already been treated unfairly once were treated unfairly for a second time and denied the redress they were owed.
- 2.5. Before it ceased selling PPI, prior to the Relevant Period, LBG was the largest seller of PPI in the UK, and sales of PPI generated significant revenue for LBG. LBG has also received and handled a very high and unprecedented volume of PPI complaints. As at 31 December 2014 LBG had made a total provision of £12.025bn in relation to the mis-selling of PPI.
- 2.6. During the Relevant Period LBG assessed customer complaints relating to in excess of 2.3 million PPI policies and rejected 37% of those complaints.

LBG's approach to handling PPI complaints was unfair

- 2.7. The Authority's rules and guidance make it clear that firms must investigate complaints competently, diligently and impartially, obtaining additional evidence as necessary and assess complaints fairly. LBG designed and implemented a policy for handling PPI complaints seeking to comply with the Authority's rules and guidance. However, during the Relevant Period, LBG issued further guidance to PPI complaint handlers which directed them to assume that LBG's PPI sales processes were

'compliant and robust', unless notified to the contrary. This was described to complaint handlers as the *'Overriding Principle'*.

2.8. The Overriding Principle created the risk of a default assumption that LBG had not mis-sold PPI. Although it was intended to be displaced by any credible customer allegation or other evidence that PPI had been mis-sold, the Overriding Principle affected the judgements of complaint handlers in that some complaint handlers relied on the Overriding Principle to:

(1) dismiss customers' personal accounts of what had happened during the PPI sale; or

(2) not fully investigate customers' complaints.

2.9. This was contrary to the requirement to adopt a diligent, impartial and fair approach.

2.10. In addition, during the Relevant Period, LBG did not notify complaint handlers of known failings in its PPI sales process, or of any areas where LBG's PPI sales processes were not, or may not have been, *'compliant and robust'*. This was even though such information was available from LBG's own analysis and despite the widespread and well-known mis-selling of PPI across the industry.

2.11. As a result, LBG's approach created a risk that customer complaints could be unfairly rejected. The Authority's investigation found evidence that a significant number of customer complaints were unfairly rejected for these reasons during the Relevant Period.

Customer experience

2.12. Each customer's experience of being mis-sold PPI and having their complaint unfairly rejected is different. However, the Authority has identified a number of common unfair consequences for customers who had their complaints unfairly rejected by LBG. These unfair effects can be illustrated by using one of the LBG customer complaints sampled by the Authority ("Mr A").

2.13. Mr A took out a personal loan from LBG in 2006. In 2012 Mr A complained to LBG that he had been mis-sold PPI as he was unaware that PPI had been added to his loan. His complaint was rejected by the

complaint handler, although was upheld by LBG shortly thereafter following changes to its suitability tests.

- 2.14. The complaint handler justified the initial decision to reject Mr A's complaint on the basis that the sales process used by LBG was robust. This was unfair to Mr A as the complaint handler was not given access to all the relevant information about LBG's PPI sales processes which was required to assess the complaint fairly. Specifically, the complaint handler was not provided with information about any failings in the sales process that were relevant to the customer's complaint.
- 2.15. The letter sent to Mr A setting out LBG's decision to reject the complaint stated that the complaint handler had '*fully investigated*' Mr A's complaint and had given '*appropriate weight and balanced consideration to all available evidence*'. In fact, the complaint handler had relied on the assumption in the Overriding Principle of a robust sales process to reject Mr A's complaint. This was unfair to Mr A.

LBG's actions

- 2.16. The Authority acknowledges that, consistent with LBG's commitment in 2011 to become the 'Best Bank for Customers', LBG has made significant progress towards the fairer treatment of customers in its general complaint handling operation, in particular within its retail banking business.
- 2.17. Notwithstanding the progress made in other areas of its business, and while noting that the volume of customer complaints in relation to PPI presented operational difficulties for LBG management, during the Relevant Period LBG failed to treat a significant number of its customers fairly in respect of PPI complaint handling.
- 2.18. Following the Authority's intervention between February and May 2013, LBG agreed to remove the Overriding Principle from its PPI complaint assessment process and to provide information on all sales process failings to complaint handlers, which (among other policy changes) has resulted in LBG upholding a greater proportion of customer complaints.
- 2.19. The Authority has appointed a Skilled Person under section 166 of the Act to analyse the changes, to ensure they are effective and that all customers receive appropriate redress.

2.20. LBG has also undertaken an extensive remediation programme, including to re-review or automatically uphold all PPI complaints fully rejected during the Relevant Period. As a result of its past business reviews and remediation programme, LBG has taken action to provide redress to customers (such as Mr A) whose PPI complaints were unfairly rejected.

3. DEFINITIONS

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

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

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

"Authority's File Review" means the review of 50 of LBG's customer complaint files requested by the Authority in November 2012, described at paragraph 4.20;

"Authority's Site Visits" means the site visits conducted by the Authority in December 2012 and February 2013, as described at paragraph 4.21;

"BBA" means the British Bankers' Association;

"Complaint Assessment Process" has the meaning given to it at paragraph 4.24;

"CP 10/6" means *'Consultation Paper 10/6, the assessment and redress of payment protection insurance complaints; feedback on CP 09/23 and further consultation'*;

"DISP" means the Dispute Resolution: Complaints Sourcebook as set out in the FCA Handbook;

"Eligibility Tests" are the tests conducted at Step 1 of Lighthouse, as described at paragraph 4.25;

"HBOS" means the LBG brand Halifax Bank of Scotland;

"Judicial Review" means the judicial review proceedings commenced by the BBA in relation to PS 10/12, as described at paragraph 4.7;

"July to September 2012 Analysis" means the analysis undertaken by LBG between July and September 2012, as described at paragraph 4.103;

"LBG" means Lloyds Bank plc, Bank of Scotland plc and Black Horse Limited;

"LBG's 2012 Deep Dives" means the reviews (or deep dives) undertaken by LBG between June to December 2012, described at paragraph 4.57;

"Lighthouse" means the central document of LBG's Complaint Assessment Process which complaint handlers were required to follow in assessing PPI complaints made by customers, described at paragraph 4.24;

"LTSB" means the LBG brand Lloyds TSB;

"March 2012 Communication" means the guidance issued by LBG titled '*Assessing customer credibility and applying the Suitability test*', as described at paragraphs 4.37 to 4.39;

"October 2012 Decision" means the committee decision not to inform complaint handlers about the Sales Process Failings, as described at paragraph 4.106;

"Overriding Principle" means the principle contained in the March 2012 Communication and the November 2012 version of Lighthouse described at paragraphs 4.37 and 4.48;

"PS 10/12" means '*Policy Statement 10/12, the assessment and redress of Payment Protection Insurance complaints; feedback on the further consultation in CP 10/6 and final Handbook text*';

"Relevant Period" means the period from 5 March 2012 to 28 May 2013;

"Root Cause Analysis" means the process of identifying any recurring or systemic problems as required by DISP, described at paragraph 4.85;

"Sales Process Design" means the design of the PPI sales processes across LBG, that is, how LBG intended its PPI sales processes to work;

"Sales Process Failings" means the potential failings in LBG's PPI Sales Process Design ("Sales Process Design Failings") or Sales Process Implementation ("Sales Process Implementation Failings") which it identified through its Sales Process Review, described at paragraphs 4.85 to 4.86;

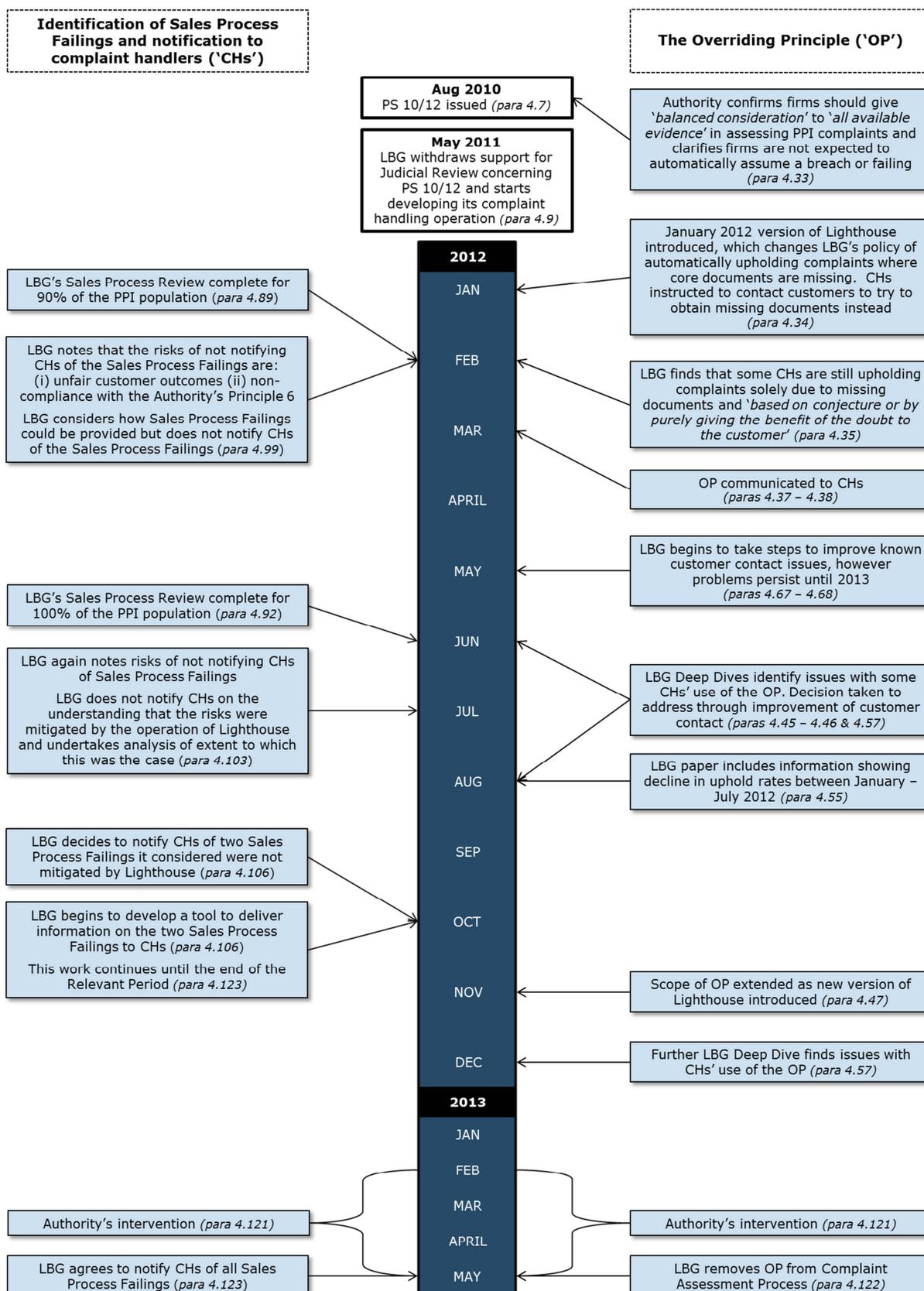
"Sales Process Implementation" means the implementation of the PPI sales processes across LBG, that is, how LBG's PPI sales processes were put into practice by individuals;

"Sales Process Review" means the detailed analysis undertaken by LBG of its PPI sales, as described at paragraph 4.85;

"Suitability Tests" are the tests conducted at Step 1 of Lighthouse, as described at paragraph 4.25; and

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

Figure 1: Timeline of key events



4. FACTS AND MATTERS

4.1. This section describes:

- (1) Background;
- (2) LBG's approach to PPI complaint handling;
- (3) LBG's treatment of identified PPI Sales Process Failings;
- (4) Final decision letters did not accurately reflect the reasons for rejecting a customer complaint;
- (5) The Authority's intervention; and
- (6) LBG's remediation programme.

Background

4.2. Lloyds Bank plc, Bank of Scotland plc and Black Horse Limited are wholly owned subsidiaries of Lloyds Banking Group plc, which was formed following the acquisition of HBOS plc by Lloyds TSB Bank plc in January 2009. Lloyds Bank plc was known as Lloyds TSB Bank plc until the divestment of some of its businesses in October 2013. LBG provides a wide range of banking and financial services.

Payment Protection Insurance

4.3. PPI is an insurance product which has often been sold to customers in connection with personal loans, credit cards, mortgages or other forms of debt. It is designed to help meet repayments in certain circumstances where the customer is unable to do so, such as in the event of an accident, sickness or unemployment and may also include life cover.

4.4. On 14 January 2005, the Authority became responsible for regulating firms selling general insurance products, including PPI.

4.5. There have been widespread and serious failings in relation to the sale of PPI across the financial services industry and high numbers of complaints about PPI in recent years.

4.6. LBG was the largest seller of PPI policies to customers and it generated a significant amount of revenue for the group. LBG stopped selling

single premium PPI in January 2009, and regular premium PPI in July 2010.

The Judicial Review of PS 10/12

- 4.7. On 10 August 2010 the Authority decided to introduce a package of measures intended to ensure that firms handled PPI complaints more fairly and consistently, and that firms delivered fairer outcomes to customers who had been mis-sold PPI but had not complained. These measures were outlined in the Authority's Policy Statement PS 10/12. On 8 October 2010, the BBA, of which LBG and other major UK banks are members, commenced judicial review proceedings in relation to PS 10/12.
- 4.8. On 20 April 2011 the High Court ruled in favour of the Authority and upheld PS 10/12 in all respects.
- 4.9. On 5 May 2011 LBG announced that it would accept the Court's decision and would not be participating in any appeal that the BBA might seek to bring. LBG was the first bank to make clear that it would implement the Authority's changes for PPI complaint handling. The BBA subsequently confirmed that it would not seek to appeal the decision that the Authority's measures should be upheld in full, bringing the Judicial Review to an end.
- 4.10. The measures outlined in PS 10/12 were implemented in the Authority's Dispute Resolution: Complaints Sourcebook. Firms are obliged to handle complaints in accordance with the rules in DISP. Appendix 3 of DISP sets out guidance and evidential provisions relevant to firms' approaches to handling complaints relating to the sale of PPI.
- 4.11. The Authority's guidance in Appendix 3 of DISP is described at paragraph 4.33.

LBG's complaint volumes

- 4.12. LBG has received, and handled, a very high and unprecedented volume of complaints about PPI. Complaint handlers dealt with large volumes of complaints, including from claims management companies. Some of these complaints were formulaic and/or contained no specific evidence of a breach or failing (in over 30% of the total complaints received there had been no sale of PPI by LBG).

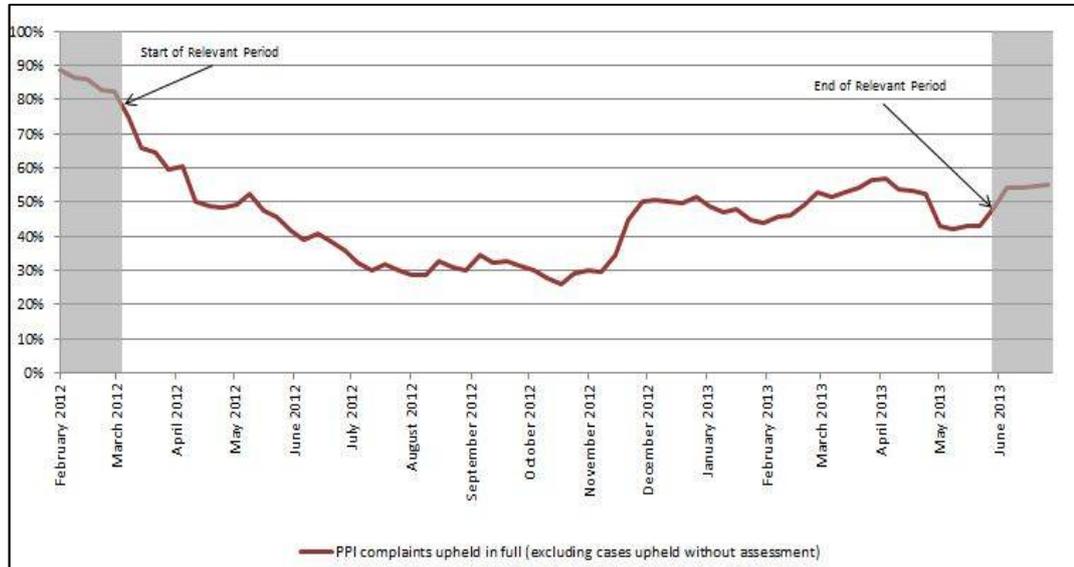
- 4.13. In addition, LBG did not always hold point of sale documents or other information often due to the historic nature of the complaint. These matters, among other things, placed a strain on LBG's PPI operations.
- 4.14. To deal with the volume of complaints, LBG rapidly built a PPI complaint handling operation which employed over 7,000 staff by the second half of 2012. LBG also located and equipped a number of centres in which complaint handlers could work.
- 4.15. From the start of 2010 to the start of the Relevant Period, LBG paid redress in relation to the majority of complaints on an '*ex gratia*' basis (i.e. LBG voluntarily made payment without assessing the merits of the complaint) while it developed its complaint assessment process and scaled up its operational capability. LBG continued to pay redress in relation to many PPI complaints received on an '*ex gratia*' basis throughout the Relevant Period.
- 4.16. During the Relevant Period, LBG reviewed customer complaints relating to in excess of 2.3 million PPI policies. Of those, LBG upheld 63% and rejected 37%.
- 4.17. As of 31 December 2014, LBG had made a provision of £12.025bn for the costs of paying redress to customers in respect of past sales of PPI policies (including approximately £2.5bn administration costs).

LBG's falling uphold rates for PPI complaints and the Authority's concerns

- 4.18. In the course of designing and implementing its PPI complaint handling policies and processes, LBG (in common with other firms) discussed with the Authority its intended approach to complying with the Authority's relevant rules and guidance. LBG did not raise the Overriding Principle or the non-provision of information relating to known Sales Process Failings to complaint handlers in these discussions with the Authority.
- 4.19. In line with its consumer protection objective, during the Relevant Period, the Authority carried out monitoring of firms' PPI complaint uphold rates. During the first week of the Relevant Period, LBG upheld 82% of the complaints that it reviewed. This percentage fell steadily to

a low of 26% in October 2012 before rising to 50% by the end of 2012. See Figure 2 below.

Figure 2: LBG PPI complaint uphold rates during the Relevant Period (excluding cases upheld without assessment)



- 4.20. As a result of the Authority’s concerns about LBG’s falling uphold rates, in November 2012, the Authority requested 50 files for review, constituting 70 customer complaints that LBG had rejected from a single day in October 2012. The Authority considered that LBG had unfairly rejected 57% of the customer complaints that it reviewed.
- 4.21. The Authority also visited two of LBG’s customer complaint review sites in December 2012 and February 2013.
- 4.22. As a result of the above, the Authority notified LBG in February 2013 that it was concerned about aspects of the way in which LBG was assessing PPI complaints (including the use of the Overriding Principle by complaint handlers and the non-provision of information relating to known Sales Process Failings to complaint handlers). Relevant parts of the Authority’s findings are set out at paragraphs 4.59 to 4.83.
- 4.23. As set out in paragraph 4.15 above, throughout the Relevant Period LBG voluntarily paid redress in relation to many PPI complaints on an ‘*ex gratia*’ basis. The uphold rates shown in Figure 2 above do not include the complaints upheld on an ‘*ex gratia*’ basis. Including ‘*ex gratia*’ complaints, LBG upheld 94% of complaints during the first week of the Relevant Period. This percentage fell to a low of 37% in October

before rising to over 56% by the end of 2012 and was 64% at the end of the Relevant Period.

LBG's PPI Complaint Assessment Process

- 4.24. During the Relevant Period, the central document of LBG's PPI complaint assessment process was called Lighthouse. Lighthouse was supplemented by additional guidance on the assessment of customer complaints provided to complaint handlers in documents and through training. Lighthouse, together with these supplementary documents, constituted the way in which complaint handlers were required to assess complaints.
- 4.25. Lighthouse required complaint handlers to assess customer complaints using four steps, summarised below at Figure 3.

Figure 3: The four steps of Lighthouse

Step	Name	Process
Step 1	Basic Documents Review, Eligibility and Suitability Tests	<ul style="list-style-type: none"> • Identification of core basic documents • Consideration of whether customer was eligible for the PPI policy ("Eligibility Tests") • Conducting suitability tests to assess if the PPI policy was suitable for the customer ("Suitability Tests") • Complaint handlers were required to assess Eligibility Tests and Suitability Tests in every complaint even if the customer had not raised these as specific concerns in their complaint • If the customer complaint was not upheld at any one of the Eligibility and Suitability Tests, the complaint handler was required to carry out a '<i>Holistic Suitability Review</i>' (a holistic review of a customer's suitability in which the complaint handler was required to consider all evidence and make a balanced judgment in the round as to whether the customer has been treated fairly and the right outcome received)
If the customer complaint was not upheld at Step 1, the complaint handler was required to move on to Step 2		
Step 2	Complaint Review	Assessment of each allegation raised by the customer and any concerns identified during the investigation of the customer complaint that were not raised by the customer
If the customer complaint was not upheld at either Step 1 or Step 2, the complaint handler was required to move on to Step 3		
Step 3	Fairness Review	Where the decision was to reject, consideration of all the evidence in the round to decide whether the decision to reject a complaint represented a fair customer outcome or whether on balance the complaint should be upheld
Step 4	Final Decision	Recording of the outcome of the assessment

Customer contact in LBG's Complaint Assessment Process

4.26. Lighthouse directed complaint handlers to contact customers if additional information was required. Where there was insufficient information to assess a complaint fairly, the fairness and effectiveness of LBG's Complaint Assessment Process relied on complaint handlers obtaining additional relevant evidence from customers, in the way described below:

- (1) LBG did not always have all of the information required to complete all of the Eligibility Tests and Suitability Tests at Step 1. Where such information was missing, complaint handlers were instructed to contact the customer and to ask appropriate questions to gather the information. If a complaint handler failed to carry out effective customer contact in these circumstances, they would not have been able to complete the tests at Step 1 and might have missed the opportunity to make a fair assessment of the customer's complaint at this step.
- (2) If the customer complaint was not upheld at Step 1, the complaint handler proceeded to Step 2. At Step 2, the complaint handler was required to assess the credibility of a customer's allegations and concerns against the assumption that LBG's PPI sales processes were '*compliant and robust*' (the Overriding Principle, set out at paragraphs 4.37 and 4.48). If there was any ambiguity as to the credibility of a customer's concerns, the complaint handler was instructed to attempt to contact the customer to clarify the concerns and the relevant circumstances of the sale. LBG instructed complaint handlers to assess customer credibility by considering, among other things, whether the customer had provided specific details about what happened when they were sold the PPI and whether the customer's representations (taken as a whole) maintained a consistent and credible account. If a complaint handler did not have a proper understanding of the above, this could result in the customer's complaint being unfairly rejected.

4.27. Where customer contact was required, LBG instructed complaint handlers to make '*reasonable attempts*' to contact the customer.

4.28. Complaint handlers were instructed, in LBG's customer contact guidance between March 2012 and February 2013, that at a minimum they should make '*reasonable attempts*' to call customers by attempting three calls (at different times of the day, and in accordance with any preferred times and telephone numbers indicated by customers). Despite this, during the Relevant Period LBG had identified that there were persistent problems with customer contact and that this was a major cause of unfair customer outcomes (see paragraphs 4.67 to

4.69). From February 2013, LBG's customer contact guidance contained more prescriptive guidance on making '*reasonable attempts*'.

4.29. If it was not clear from the available evidence that the complaint should be upheld, and customer contact was not successful, the complaint handler was instructed to reject the customer complaint and to say in the final decision letter that:

- (1) the complaint handler had tried to but was not able to make contact; but
- (2) if the customer disagreed with LBG's response, they could refer their complaint to FOS or if they wanted to provide further information, LBG would review their complaint based on the new information.

4.30. This type of customer rejection was known within LBG as a '*soft defend*'.

LBG's approach to PPI complaint handling

The fair assessment of a PPI complaint

4.31. In CP 10/6 the Authority observed that firms had sometimes rejected customer complaints, saying that customers had not met their '*burden of proof*'; that is, taking the position that the responsibility was on the customer to prove the firm's wrongdoing. The Authority said in CP 10/6 that firms should instead assess the evidence in a balanced and fair way. The Authority proposed amendments to make clearer the balanced nature of the guidance. For example, the Authority's revised proposed guidance stated that: '*The firm is not expected automatically to assume that there has been a breach or failing.*'

4.32. In PS 10/12 the Authority observed that the focus of its proposals was mainly to warn firms against placing too much weight on some types of evidence and giving too little weight to other types. The Authority confirmed that credible specific evidence about the individual sale was more persuasive than general evidence about the firm's systems and controls. However, the Authority also noted that this in no way precluded the firm assessing, fairly and in good faith, the weight of the customer's oral testimony as evidence specific to the sale, and any conflict it implies with the firm's account and evidence. The Authority

also noted that firms are entitled to weigh and balance the evidence and consider its value in the particular complaint.

- 4.33. The guidance proposed in PS 10/12 was incorporated into the Authority's Handbook at DISP Appendix 3 which provided that: *'Where a complaint is made, the firm should assess the complaint fairly, giving appropriate weight and balanced consideration to all available evidence, including what the complainant says and other information about the sale that the firm identifies. The firm is not expected automatically to assume that there has been a breach or failing'*. LBG sought to reflect the Authority's guidance in Lighthouse.

Origin of the Overriding Principle

- 4.34. Prior to December 2011 LBG automatically upheld all complaints where certain documents were missing. From December 2011, following discussion with the Authority during which the Authority had confirmed that PS 10/12 did not require firms automatically to assume a breach, LBG changed this approach by introducing a new policy (as part of the January 2012 version of Lighthouse) which provided that complaints were no longer to be upheld automatically on the basis of missing documents alone. Complaint handlers were instructed to contact the customer to try to obtain missing core documents.
- 4.35. However, in February 2012, LBG found that some complaint handlers were continuing to uphold complaints solely due to the fact that certain documents were missing and *'based on conjecture or by purely giving the benefit of the doubt to the customer'*.
- 4.36. As a result, in March 2012, LBG management approved an action plan to address this issue through communications, training and its approach to quality control. The implementation of that plan included issuing a communication titled *'Assessing customer credibility and applying the suitability test'* to complaint handlers.

The Overriding Principle

The March 2012 Communication

- 4.37. The Overriding Principle was formally communicated in writing to complaint handlers in the March 2012 Communication. It stated:

'The overriding principle when assessing a complaint is that the design of the sales processes across the Group were compliant and robust, unless notified to the contrary. However, from time to time the execution of the sales process may not have followed the sales process design'.

4.38. The March 2012 Communication went on to state that:

'This is why the credibility of the customer's allegations and concerns are important to the decision making process – as they [sic] may have been issues in the execution of the sale. Where the customer's allegations and concerns are not clearly articulated in their complaint (oral or written) customer contact can help to establish the credibility or otherwise of the allegations and concerns'.

4.39. The March 2012 Communication referred the complaint handler to a section of Lighthouse on *'evaluating the customer's recollections'*. Lighthouse also contained a section called *'Assessing the evidence'* (not referred to in the March 2012 Communication) which included (among other things) an instruction to *'adopt an 'in the round' approach to assessing all available evidence for each concern, giving appropriate weight and balanced consideration to all available evidence'*.

4.40. From February 2012, however, LBG had identified potential failings in its PPI sales processes as a result of a detailed analysis it had conducted. This analysis and the failings identified are further described at paragraphs 4.85 to 4.92. LBG considered some of the failings to be serious enough to warrant proactive contact of customers who had not complained, to invite them to complain. Where LBG had identified potential failings in its PPI sales processes, the assumption that its PPI sales process was *'compliant and robust'* (as set out in the Overriding Principle) was unfair.

4.41. Although the March 2012 Communication suggested that complaint handlers would be notified of areas where LBG was aware that its Sales Process Design did not comply with regulatory requirements, during the Relevant Period LBG did not notify complaint handlers of the potential failings it identified (set out in more detail at paragraphs 4.85 to 4.106).

4.42. In addition, for a large number of sales, LBG did not know if the sales process was, in fact, *'compliant and robust'*. LBG did not analyse the sales process in relation to:

- (1) LBG's PPI sales before 14 January 2005 (as it was not required to); and
- (2) LBG's PPI processes for sales made on or after 14 January 2005 where it had limited, or missing, documentation.

November 2012 version of Lighthouse - extension of the Overriding Principle

4.43. The March 2012 Communication stated that the assumption of a *'compliant and robust'* sales process only applied to LBG's Sales Process Design (how LBG intended its PPI sales processes to work).

4.44. The March 2012 Communication did not extend to LBG's Sales Process Implementation (how LBG's PPI sales processes were put into practice by individuals).

4.45. However, LBG found in June 2012 that some complaint handlers were wrongly using the Overriding Principle to assume that LBG's Sales Process Implementation (as well as its Sales Process Design) was also *'compliant and robust'*.

4.46. At this time LBG management decided not to clarify the March 2012 Communication or make the distinction between design and implementation for the purpose of assessing complaints, but to address the issue by improving customer contact, on the basis that customers would provide evidence of failings in LBG's Sales Process Implementation. In June 2012, it was noted in an email that the clear message had been to assume *'innocence until proven guilty'* and that this applied to both design and implementation.

4.47. The Overriding Principle was expanded, in a revised version of Lighthouse which was issued to complaint handlers on 19 November 2012, to include the assumption that LBG's Sales Process Implementation was also *'compliant and robust'*. At the same time, LBG's guidance to complaint handlers as to how they were to assess customer credibility was expanded.

4.48. The 'Principles' section of the November 2012 version of Lighthouse contained the following:

'The overriding principles [sic] when assessing a complaint is that the design of the sales processes and implementation across the Group were compliant and robust, unless notified or identified to the contrary in the following ways:

1) If it has become clear through sales process analysis and/or root cause analysis that there were potentially issues with the sales process design and/or implementation for a particular product, period and channel the issue will be highlighted within the Data Capture Tool,

and/or

2) Where an individual seller's record identifies an issue with the adviser's implementation of the sales process, this should also be considered.

However, where the customer's account of events conflicts with our records or leaves doubt, you should assess the credibility of the complainant's account fairly and in good faith. You will need to make all reasonable efforts (including contact with the customer where necessary) to clarify any ambiguous issues or conflicts of evidence before reaching your final decision.

[...]

This is why ascertaining the credibility of the customer's allegations and concerns are important to the decision making process – as there may have been issues in the execution of the sale'.

4.49. However, at this time, LBG had no mechanism to notify complaint handlers of the potential failings it had identified in its PPI sales processes. These potential failings and LBG's approach to providing such information to complaint handlers are set out at paragraphs 4.85 to 4.112.

'Innocent until proven guilty'

4.50. The Overriding Principle contained within the March 2012 Communication reflected an approach that was referred to by some

individuals within LBG as *'innocent until proven guilty'*; that is, LBG would assume it was *'innocent'* of mis-selling individual PPI policies until *'proven guilty'*.

4.51. This approach was described in an internal LBG email (from June 2011) as follows: *'Our approach assumes we are "innocent until proven guilty". Where evidence is lacking and leads to an inconclusive outcome, we will decline the complaint. The risk is FOS / FSA may deem this an unfair outcome and request we change our guidance to be "guilty until proven innocent"'*.

4.52. This phrase was used by some individuals within LBG as a shorthand to reflect the guidance in PS 10/12 that LBG was not required to assume that there had been a breach or failing in the absence of evidence.

Fall in LBG's uphold rate attributed to the March 2012 Communication

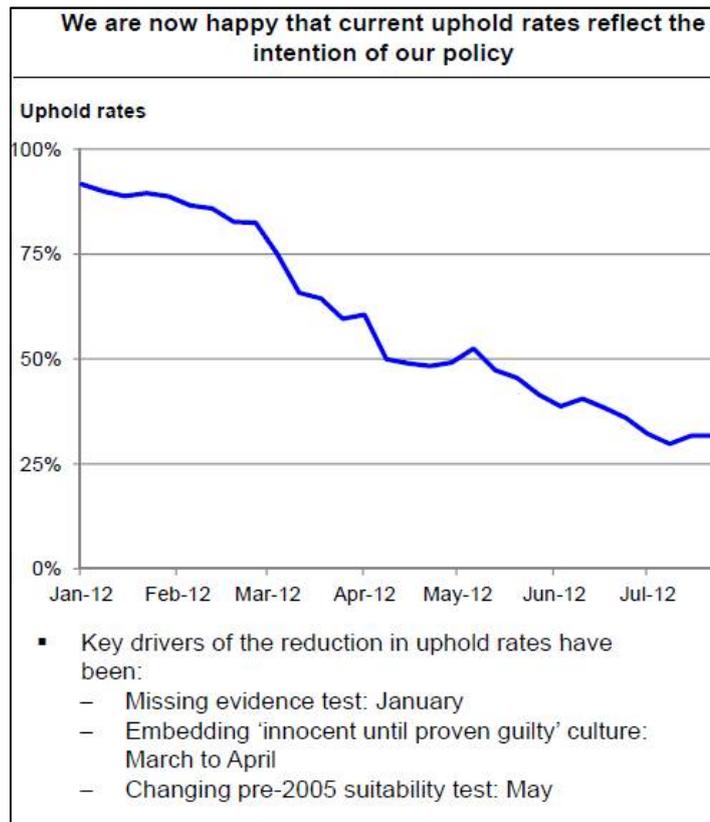
4.53. LBG attributed falls in its PPI complaint uphold rate in the spring of 2012 (at the start of the Relevant Period) partly to the introduction of the March 2012 Communication.

4.54. An LBG paper dated 12 March 2012 stated that, as a result of issuing the March 2012 Communication there had been a material impact on uphold rates and that the *'First full day saw a 10% drop'*.

4.55. Another LBG paper dated 7 August 2012 included information showing the decline in LBG's uphold rate between January 2012 and July 2012. The papers stated that:

'We are now happy that current uphold rates reflect the intention of our policy'.

Figure 4: Graph extracted from LBG paper showing LBG’s PPI complaint uphold rates from January 2012 to July 2012



4.56. ‘Embedding ‘innocent until proven guilty’ culture: March to April’ was identified in the graph as one of the ‘key drivers’ of the reduction in uphold rates. This related to the steps taken (including the release of the March 2012 Communication) to ensure complaint handlers were not upholding complaints solely on the basis of lack of evidence.

LBG deep dives identifying issues with the Overriding Principle

4.57. From June to December 2012, LBG undertook a number of reviews or ‘deep dives’, prompted by the low uphold rates for PPI complaints relating to certain products originally sold under the Lloyds TSB (“LTSB”) brand and Halifax Bank of Scotland (“HBOS”) brand. The dates of each deep dive and the relevant products are set out at Figure 5 below.

Figure 5: LBG's 2012 Deep Dives

Date of Deep Dive	Relevant Products
June 2012	LTSB Cards
August 2012	HBOS Loans
August 2012	LTSB Cards
December 2012	HBOS Cards and HBOS Mortgages

4.58. The results of LBG's 2012 Deep Dives identified concerns about the way in which complaint handlers were using the Overriding Principle.

Unfair effects of the Overriding Principle

4.59. The Overriding Principle was unfair to customers because:

- (1) there was a risk that it created a default assumption that LBG had not mis-sold the PPI policy that an individual customer was complaining about;
- (2) inadequacies in the way LBG carried out customer contact meant that customers may not have had the opportunity to provide the evidence to enable the complaint handler to reach a fair outcome; and
- (3) in some situations it affected the judgements made by complaint handlers who relied on it to rebut credible customer testimony and to not investigate complaints fully.

The Overriding Principle created the risk of a default assumption that PPI had not been mis-sold

4.60. The Overriding Principle led some complaint handlers to adopt a starting position when assessing a customer complaint that the PPI policy being complained about had not been mis-sold, rather than assessing the available evidence impartially.

4.61. Some complaint handlers interviewed by the Authority confirmed that, during the Relevant Period, they took the Overriding Principle as their starting point and looked for evidence to disprove the Overriding Principle, rather than adopting an impartial position.

- 4.62. One example of this from the Authority's File Review was Ms B who had a credit card with LBG which was accompanied by PPI. Ms B complained to LBG in 2012 that she had been mis-sold PPI as she did not give consent to the inclusion of PPI cover with her credit card. The complaint handler tried to call Ms B three times, but was unable to speak to her, and did not have sight of her consumer credit agreement. Therefore the complaint handler did not have any understanding of Ms B's account of the sale other than her initial complaint (made by telephone). Despite this Ms B's complaint was rejected on the basis that *'I have not found any evidence to support her allegation. I also believe that as the sales process was robust that the customer would have had the cover explained to her fully, been informed that it was optional and her consent would have been required in order to sell her the policy'*.
- 4.63. In the letter sent to Ms B rejecting her complaint, it was explained that her complaint had been rejected based on what the sales process would have required at the time Ms B took out the PPI policy. There was no balanced consideration of Ms B's account of what had actually happened at the time of the sale. Ms B's complaint was subsequently upheld by LBG following a review by Group Audit of the cases submitted to the Authority for the Authority's File Review.

Customers may not have had the opportunity to provide evidence in order to reach a fair outcome

- 4.64. As described in paragraphs 4.26 to 4.30, effective customer contact was a key part of LBG's complaint handling process, in circumstances where complaint handlers did not already have sufficient information to fairly assess a complaint. It was important for the completion of the Eligibility Tests and Suitability Tests required to be completed in Step 1 for all cases (whether or not a customer concern had been raised in this respect) and also for the assessment of a customer's credibility at Step 2.
- 4.65. LBG increased the importance of good customer contact by not providing complaint handlers with all of the available evidence to counter the assumption created by the Overriding Principle. In particular, LBG:

- (1) did not notify complaint handlers of failings identified from LBG's review of its PPI sales processes, despite instructing complaint handlers that they would be notified (see paragraphs 4.37 and 4.48); and
- (2) only provided complaint handlers with limited evidence of what happened when a PPI policy was sold to a customer (*'point of sale evidence'*). LBG did not provide complaint handlers with all of the available point of sale evidence, such as sales scripts or call recordings.

4.66. LBG management acknowledged that customer contact was *'a critical success factor'* in LBG's Complaint Assessment Process.

4.67. However, throughout the Relevant Period, LBG had identified that there were persistent problems with customer contact and that this was a major cause of unfair customer outcomes. The Authority's interviews with staff involved in LBG's PPI complaint handling confirmed that the issues with customer contact were identified in March 2012, when telephones and customer contact training were introduced for complaint handlers. From May 2012 LBG took steps to improve the level and quality of its customer contact. These included additional training and coaching of complaint handlers, the issuing of revised customer contact guidance, and enhanced reporting of customer contact issues to management.

4.68. The customer contact issues identified persisted despite these measures. Although there is evidence of efforts to improve customer contact in the second half of 2012, it was not until 2013 that poor customer contact was no longer considered by LBG to be the main reason for unfair outcomes.

4.69. Further, all of LBG's 2012 Deep Dives found failures around customer contact. The August 2012 Deep Dives in particular identified that in around half of the complaints sampled, complaint handlers were not:

- (1) contacting customers where necessary;
- (2) seeking clarification from customers of their concerns; or
- (3) discussing customers' allegations.

- 4.70. A discussion about the results of the August 2012 LTSB Cards Deep Dive noted that complaint handlers were still *'shying away'* from calling the customer by using the *'easy option of robust sale'* and that this appeared to be affecting more than one specific complaint handling site.
- 4.71. This meant that, due to poor customer contact, some customers may not have had an opportunity to provide further evidence needed for complaint handlers to reach a fair outcome for their complaint. As a result, complaints may have been rejected unfairly.
- 4.72. One example from the Authority's File Review was Mr C, who complained that he had been mis-sold PPI. An LBG complaint handler called and spoke to Mr C, who asked that he be called back at a specified time the next day. The complaint handler called Mr C three times in the course of the following day, as permitted by LBG's Complaint Assessment Process, at the times requested, using both Mr C's home and mobile numbers, but was unable to make contact with him. Mr C's complaint was rejected later the same day. LBG records show that this was partly on the basis that the *'allegations are unspecific and offer little information... there is no evidence to suggest that the customer was treated unfair [sic] at [point of sale]'*.
- 4.73. In December 2012, as a result of an in-depth review of the effectiveness of its customer contact strategy (undertaken in October 2012), LBG decided to require complaint handlers to attempt customer contact in every case except where the complaint could be otherwise upheld.
- 4.74. In February 2013 this revised strategy, and associated steps, were implemented, which improved the level and quality of LBG's customer contact. LBG has continued to make improvements in respect of customer contact.

The Overriding Principle affected the judgements made by some complaint handlers

- 4.75. The Overriding Principle affected the judgements made by some complaint handlers. In particular, it created a risk of complaint handlers:
- (1) dismissing customers' personal accounts as lacking in credibility, on the basis of the assumption that PPI had not been mis-sold (in other words rebutting credible customer testimony); and
 - (2) not investigating complaints fully, instead relying on the assumption that LBG's PPI sales processes were '*compliant and robust*' to reject complaints.
- 4.76. These risks crystallised, as illustrated by the findings of LBG's 2012 Deep Dives and the Authority's File Review, as described below.
- 4.77. The August 2012 LTSB Cards Deep Dive identified several cases where complaint handlers relied on the Overriding Principle to reject customer complaints, including one where a complaint handler refuted all allegations made by the customer by assuming a '*robust sales process*'. There was no evidence of the complaint handler considering each complaint point in light of available information.
- 4.78. An email in relation to the August 2012 LTSB Cards Deep Dive noted under the heading '*Conclusions*', that: (i) of those cases requiring further work there were two common themes of '*misapplication of robust sales process principle*' and failure around customer contact and (ii) there seemed to be a '*defend culture*' in which complaint handlers felt that they should reject customer complaints if they were '*in doubt*' about what the correct outcome should be.
- 4.79. Anecdotal feedback from two of LBG's complaint assessment sites in November 2012 suggested that colleagues were encouraged to rely on the '*robust sales process*' to defend cases.
- 4.80. The December 2012 Deep Dive was carried out to investigate such claims. There was evidence that some complaint handlers were relying purely, or in part, on the Overriding Principle to reject customer complaints. One example was where the '*robust sales process*' was relied upon throughout the case as part of the evidence used to defend

allegations in relation to both the suitability tests and at the complaint review step of Lighthouse (Step 2, described at paragraph 4.25). LBG records for that example showed that the '*robust sales process*' was referred to in defence of '*practically*' every suitability test and allegation and in the summary rationale for that case.

- 4.81. At the time of the Authority's File Review it was noted that the issue seemed prevalent enough that it could be expected that at least a few of the cases selected by the Authority to review would have been rejected partially on this basis. This was noted as '*something [the Authority] are likely to look dimly on*'.
- 4.82. The Authority's File Review found that complaint handlers routinely supported their rejection of the allegations made by customers by making assumptions about what '*would have*' happened in LBG's '*compliant and robust*' sales process, which often contradicted the findings of LBG's own Sales Process Review.
- 4.83. One example from the Authority's File Review was Mr D, who alleged he had been told by two sales staff in branch (whose names he provided) that a loan would not be available if PPI was not taken. Despite the specific nature of Mr D's allegation, there is no record of the complaint handler investigating this allegation. LBG records show that the complaint handler rejected the allegation on the basis that the customer '*would have received*' the terms and conditions of the loan, which gave customers the right to cancel the PPI policy. However, the final decision letter stated that '*I can assure you that I have fully investigated the circumstances relating to the sale of your policy using [...] any further information supplied by you*'. Mr D's complaint was subsequently upheld under a re-review exercise which LBG had separately decided to undertake in relation to the particular customer group which Mr D fell into.
- 4.84. As illustrated by the above, the Overriding Principle created a risk that customer complaints could be unfairly rejected and the Authority's investigation found evidence of a significant number of customer complaints being unfairly rejected on the basis of the Overriding Principle during the Relevant Period.

LBG's treatment of identified PPI Sales Process Failings

Sales Process Failings identified by LBG

- 4.85. From January 2011 to July 2012, LBG undertook a detailed analysis of its PPI sales made on or after 14 January 2005 by product type and sales channel to identify if there were any recurring or systemic problems arising from those sales. This was in accordance with the rule on Root Cause Analysis in DISP which required that LBG take reasonable steps to ensure that in handling complaints it identified and, where reasonable to do so, remedied any recurring or systemic problems.
- 4.86. As a result, LBG found evidence of failings in its Sales Process Design and its Sales Process Implementation for a number of products and sales channels at particular times.
- 4.87. Examples of Sales Process Failings identified by LBG include:
- (1) Customers receiving an initial quote (for example, for a loan) which automatically included PPI, such that they may not have been aware of the purchase of the PPI policy or may have thought buying PPI was a necessary condition of the loan.
 - (2) Customers not being informed of relevant exclusions of the PPI policy, for example that the PPI policy would not cover costs arising from their pre-existing medical conditions.
 - (3) Customers' demands and needs not being established in order to ensure the PPI policy was suitable for the customer, for example where the sales process did not capture information on the customers' existing means or where the affordability of the PPI policy for the customer was not assessed.
 - (4) Advisers may have made the sale without the customer's explicit consent to purchase the PPI policy, for example where the cost of the PPI policy may have already been added to the credit card even though the customer believed that they were only receiving details of the PPI policy in the post and could decide to purchase the PPI policy later.

- 4.88. DISP guidance states that, where a firm identifies recurring or systemic problems, it should consider whether it should contact customers who may have suffered detriment, even if they have not complained (“proactive contact”). LBG used the results of the Sales Process Review to select groups of customers who would be: (i) proactively contacted and invited to submit their PPI complaints to LBG; or (ii) offered redress directly. The remainder of the customers were to be monitored for evidence of detriment through analysis of complaints and FOS decisions.
- 4.89. On 15 February 2012, as part of ongoing discussions on the Sales Process Review, LBG informed the Authority that it had completed the Sales Process Review for 90% of the customers who had taken out a PPI policy since 2005. The Sales Process Review had identified:
- (1) Sales Process Design Failings which could have led to LBG mis-selling PPI to approximately 1.5 million customers. For approximately 0.49 million customers, LBG concluded the evidence of such failings was more limited;
 - (2) Sales Process Implementation Failings which could have led to LBG mis-selling PPI to approximately 0.53 million customers; and
 - (3) limited evidence of potential failings in its sales processes to indicate that LBG could have mis-sold PPI to approximately another 2.24 million customers.
- 4.90. In total, LBG proposed to pay redress to approximately 75,000 customers whom it considered to have suffered actual detriment, and to proactively contact approximately 2 million customers to invite them to submit complaints, as a result of particular Sales Process Failings.
- 4.91. In addition, LBG proposed contacting a representative sample of a further 0.5 million customers to invite them to request a review. These customers were in groups where the Sales Process Review had identified limited evidence of failings but the customer group was deemed higher risk.
- 4.92. On 22 June 2012, LBG provided the Authority with revised preliminary conclusions of the Sales Process Review. LBG also updated the Authority

on minor changes to the numbers of customers affected by the Sales Process Failings. LBG informed the Authority that it intended to offer redress to approximately 40,000 customers (approximately 53% of the number originally specified) and to proactively contact approximately 2.1 million customers to submit complaints.

LBG's failure to take all Sales Process Failings into account in its Complaint Assessment Process

4.93. When assessing customer complaints, LBG was required to take into account all relevant factors. In addition, DISP guidance states *'where consideration of the root causes of complaints suggests recurring or systemic problems in the firm's sales practices [...] the firm should, in assessing an individual complaint, consider whether the problems were likely to have contributed to a breach or failing in the individual case, even if those problems were not referred to specifically by the complainant'*.

4.94. However, during the Relevant Period, LBG did not provide complaint handlers with information about how individual customers might have been affected by particular Sales Process Failings identified by the Sales Process Review.

LBG was aware of the risks of not taking Sales Process Failings into account

4.95. LBG was aware throughout the Relevant Period that it should take into account issues identified in the Sales Process Review when assessing complaints.

4.96. The January 2012 version of Lighthouse instructed complaint handlers that information about relevant sales processes *'will be embedded into the assessment tool as it becomes available'* and stated that *'[k]nown sales issues and seller competence should be taken into account when considering sales processes'*.

4.97. LBG had identified that by not notifying complaint handlers of Sales Process Failings, there was a risk that:

- (1) it would not treat customers fairly; and
- (2) it would not be in compliance with the Authority's rules and guidance.

LBG management took the view that these risks would be mitigated through the operation of Lighthouse, as set out in paragraphs 4.103 to 4.106 (in particular through the assessment of suitability and eligibility in every case even where not raised by the customer as a concern).

4.98. In February 2012 (when LBG informed the Authority that it had completed 90% of its Sales Process Review (see paragraph 4.89)), an LBG draft discussion paper noted that the results of the Sales Process Review were being used to inform the development of LBG's proactive contact plans.

4.99. The draft discussion paper also noted that *'it is now possible to inform [...] case handlers of the areas where the sales process may not have been robust across most periods'*. The paper warned that if LBG did not inform complaint handlers about the Sales Process Failings there was a risk that:

'Known issues would not be taken into account when assessing a case [...] If we are found not to have taken this into consideration when we have known issues we could be seen to be in breach of Principle 6 [...]'.

4.100. The discussion paper noted that LBG was in the process of creating a proposed tool (to be integrated into the existing complaint review platform) to enable complaint handlers to identify known issues. However, LBG did not notify complaint handlers about any Sales Process Failings at this time.

4.101. In April 2012, one of LBG's PPI committees noted that LBG was not providing complaint handlers with information on the Sales Process Failings. In May 2012 the committee noted that:

(1) guidance in DISP Appendix 3 and PS 10/12 stated that LBG should provide complaint handlers with this information; and

(2) where LBG proactively invited customers who may have been affected by the Sales Process Failings to submit complaints, LBG:

'risk[ed] inviting customers to complain due to known issues but handling those complaints against a misaligned assumption'.

4.102. During May 2012, the committee also considered how the information could be provided to complaint handlers but inadequate steps were taken to do so.

4.103. In July 2012 (after LBG had informed the Authority that it had completed the Sales Process Review (see paragraph 4.92)), LBG's risk of non-compliance with DISP, as a result of not incorporating information about Sales Process Failings into the Complaint Assessment Process, was raised internally again. One of LBG's PPI committees questioned whether the operation of Lighthouse mitigated the need to inform complaint handlers about every Sales Process Failing (in the way described at paragraph 4.104 below). An analysis was undertaken between July and September 2012 to determine the extent to which this was the case.

LBG's decision to provide information about only two Sales Process Failings

4.104. The committee considered that there was no need to inform complaint handlers about every Sales Process Failing because:

- (1) the Eligibility and Suitability Tests at Step 1 of Lighthouse already directed complaint handlers to assess the eligibility and suitability of the policy in all cases where possible, whether or not the issue was raised by the customer and to obtain further information from the customer where necessary. Complaint handlers were directed to uphold a complaint if a suitability test was not met in light of any available information about the customer's circumstances; and
- (2) in relation to Sales Process Failings which were not addressed by any Eligibility or Suitability Test (for example, those involving issues of consent, optionality or pressure), customers would raise allegations about them, which would be considered at Step 2 of Lighthouse.

4.105. As a result of the July to September 2012 Analysis, LBG concluded that there were only two Sales Process Failings which (in respect of certain customer groups) were not addressed as described above in paragraph 4.104. These were where the customer:

- (1) may have received an initial loan quote which automatically included PPI; or
- (2) (for internet sales only) was required to 'opt-out' of buying the PPI policy by un-ticking the pre-ticked selection box relating to PPI.

4.106. In October 2012, LBG decided not to inform complaint handlers about the Sales Process Failings save for the two described above. During late 2012/early 2013, LBG worked to develop a tool that could provide information on the two Sales Process Failings to complaint handlers. This process included conducting a formal impact assessment and conducting several pilot tests.

Unfair outcomes arising from the October 2012 Decision

4.107. LBG took the October 2012 Decision without an adequate consideration of the resulting risk of unfair outcomes and did not re-consider this decision even where there was subsequent evidence of such unfair outcomes.

4.108. Although LBG's complaint handlers were directed to complete the Suitability and Eligibility Tests in all cases, they would not always have had sufficient information about the customer's circumstances to perform these tests and (particularly given LBG's ongoing problems with customer contact) may not have contacted the customer to obtain the additional information required. In such cases the complaint handlers would not have been able to consider whether the evidence available to LBG of Sales Process Failings was likely to have contributed to a breach in relation to each individual customer (as envisaged by DISP) because they were not aware of the Sales Process Failings. This could have resulted in them unfairly rejecting those customers' complaints. The Overriding Principle increased this risk because it effectively instructed complaint handlers to assume that there were, in fact, no Sales Process Failings.

4.109. After the October 2012 Decision was taken, there was emerging evidence that this risk was leading to unfair outcomes. The Authority's File Review and the December 2012 Deep Dive found that the '*robust sales process*' was being used as a reason to reject customer allegations relating to the Suitability Tests (see paragraphs 4.75 to 4.83). Despite

this LBG did not re-consider its October 2012 Decision until after the Authority's intervention (see paragraphs 4.121 to 4.123 for details of LBG's decision to change its Complaint Assessment Process in May 2013).

4.110. In relying on customers to raise allegations about Sales Process Failings which LBG considered were not addressed by the Suitability Tests (as set out in 4.104(2)), LBG failed to consider that:

- (1) before February 2013, LBG's Complaint Assessment Process did not require complaint handlers to make customer contact to obtain relevant evidence in all cases. So in some cases, customers may not have had an adequate opportunity to raise allegations;
- (2) if customers did not raise any allegations relating to known Sales Process Failings, those Sales Process Failings would not be considered by the complaint handler. This prejudiced customers who may not have been able to fully articulate their complaint; and
- (3) if customers did raise such allegations, the Overriding Principle could also have affected how complaint handlers assessed those allegations, in the way described at paragraphs 4.75 to 4.83.

4.111. LBG had further identified from its 2012 Deep Dives that there were issues with complaint handlers using the Overriding Principle as a justification not to contact customers, or not properly assessing customers' allegations where customers were contacted (as set out at paragraphs 4.69 to 4.70).

4.112. In taking the October 2012 Decision, LBG did not consider whether it would be fair to rely on customers to raise allegations about relevant Sales Process Failings in light of its known customer contact issues.

Final decision letters did not accurately reflect the reasons for rejecting a customer complaint

4.113. LBG's final decision letters for rejected customer complaints were based on standard templates, to seek to ensure consistency of drafting among complaint handlers. There was standard text describing the process by which complaint handlers assessed a complaint, and further standard wording for each of the potential reasons for rejection.

- 4.114. All the templates noted that the complaint handler had considered '*all the available sale related evidence*'. They also all contained the template wording '*I can assure you that I have fully investigated your complaint and all the surrounding circumstances*'.
- 4.115. However, as described at paragraphs 4.75 to 4.83 above, complaint handlers did not always investigate what actually happened at the time the PPI sale was made. In some cases, complaint handlers instead relied on the Overriding Principle to make assumptions about the sale.
- 4.116. In addition, complaint handlers may not have taken Sales Process Failings into account during their assessment of the complaint, as they were not informed whether there were any Sales Process Failings which were relevant to each individual customer (as set out above at paragraphs 4.108 and 4.110).
- 4.117. Where such customer complaints were rejected, there was a risk that the final decision letters did not accurately reflect the complaint handler's assessment of the complaint and reasons for rejection.
- 4.118. The complaint handler in those circumstances may not have considered '*all the available sale related evidence*' or '*fully investigated [the] complaint and all the surrounding circumstances*', particularly where customer contact had not been attempted or had been unsuccessful.
- 4.119. The further assurance that the complaint handler had '*fully investigated [the] complaint and all the surrounding circumstances*' was not appropriate when used in the circumstances described above.
- 4.120. This was unfair as it could have dissuaded some customers with valid complaints from:
- (1) providing further information to LBG to challenge the decision (where this option was given in the final decision letter); or
 - (2) referring complaints to the Financial Ombudsman Service for further review.

The Authority's intervention

4.121. Following intervention by the Authority between February and May 2013, from May 2013 LBG made a number of changes to how it assessed PPI complaints, including:

- (1) removing the Overriding Principle from Lighthouse; and
- (2) informing complaint handlers about all Sales Process Failings.

4.122. On 28 May 2013 LBG issued a revised version of Lighthouse which removed the Overriding Principle and instead instructed complaint handlers to assess customer complaints: *'fairly, giving appropriate weight and balanced consideration to all available evidence, including what the complainant says and other information about the sale that the firm identifies. We are not expected automatically to assume that there has been a breach or failing'*.

4.123. In June 2013, LBG started to provide complaint handlers with information about the two Sales Process Failings described at paragraphs 4.105. In November 2013, LBG issued guidance and provided training to complaint handlers on a further 21 Sales Process Failings which it considered to be *'substantial failings'* for the purposes of DISP, and seven Sales Process Failings which it considered not to be *'substantial failings'*.

4.124. The Authority makes no criticism of any individual complaint handler in relation to the facts and matters or failings set out in this Notice.

LBG's remediation programme

4.125. LBG has established a remediation programme and completed its automatic upholding or re-review (against its updated version of Lighthouse) of all PPI complaints rejected during the Relevant Period.

4.126. LBG previously estimated that it would automatically re-review or uphold approximately 1.2 million PPI complaints and had provisioned £710m (in its most recently published accounts) to pay to customers in this respect. In July 2013 a Skilled Person was appointed to analyse whether the changes to LBG's Complaint Assessment Process were effective and to perform a quality assurance role in relation to the remediation programme.

5. FAILINGS

- 5.1. The regulatory provisions relevant to this Final Notice are referred to in Annex A.
- 5.2. During the Relevant Period, LBG breached Principle 6 by failing to pay due regard to the interests of its customers, and by failing to treat them fairly when handling complaints from its customers who had purchased PPI.
- 5.3. In particular, on the basis of the facts and matters set out at section 4:
 - (1) LBG's Complaint Assessment Process included the Overriding Principle. This was unfair to customers for the reasons set out at paragraphs 4.59 to 4.83 above, which are in summary:
 - (a) there was a risk that it created a default assumption that LBG had not mis-sold the PPI policy that an individual customer was complaining about;
 - (b) customers may not have had the opportunity to provide evidence to enable the complaint handler to reach a fair outcome; and
 - (c) in some situations it affected the judgements made by complaint handlers who relied on it to rebut credible customer testimony and to not fully investigate customer complaints.
 - (2) LBG failed to take into account information about Sales Process Failings identified from Root Cause Analysis when assessing complaints as set out at paragraphs 4.85 to 4.112 above. This was unfair to customers (as set out at paragraphs 4.107 to 4.112) because it meant:
 - (a) LBG failed to give balanced consideration to all available evidence; and
 - (b) the unfair effects of the Overriding Principle were compounded because this evidence was not available to complaint handlers to counter the assumption, created by

the Overriding Principle, that LBG had not mis-sold the PPI policy that an individual customer was complaining about.

- (3) Where LBG complaint handlers relied on the Overriding Principle to reject customer complaints instead of investigating the actual circumstances of the complaint, there was a risk that the final decision letters did not accurately reflect the complaint handler's assessment of the complaint and reasons for the rejection. This was unfair as it may have dissuaded some customers with valid complaints from providing further information to LBG to challenge the decision, or referring their complaint to the Financial Ombudsman Service (as set out at paragraphs 4.113 to 4.120).
- (4) The failings set out at 5.3(1) to (3) above resulted in a significant number of customer complaints being unfairly rejected.

6. SANCTION

Financial penalty

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

Step 1: disgorgement

- 6.2. Pursuant to DEPP 6.5A.1G, at Step 1 the Authority seeks to deprive a firm of the financial benefit derived directly from the breach where it is practicable to quantify this.
- 6.3. LBG's remedial work relating to the Relevant Period should negate the financial benefit obtained by LBG as a result of the breach.
- 6.4. Step 1 is therefore £0.

Step 2: the seriousness of the breach

- 6.5. Pursuant to DEPP 6.5A.2G, at Step 2 the Authority determines a figure that reflects the seriousness of the breach. Where the amount of

revenue generated by a firm from a particular product line or business area is indicative of the harm or potential harm that its breach may cause, that figure will be based on a percentage of the firm's revenue from the relevant products or business area. The Authority considers that the revenue generated by LBG is not an appropriate indicator of the harm or potential harm caused by its breach in this case.

6.6. The Authority considers an appropriate alternative to indicate the harm or potential harm caused by the breach to be a figure based on the potential redress payable to the customer population whose PPI complaints were rejected by LBG during the Relevant Period. To reach the appropriate figure, the Authority has multiplied: (a) the number of PPI policies, the complaints in relation to which were rejected during the Relevant Period by (b) the average redress paid by LBG in respect of the above. This is equal to 863,198 multiplied by £1,495. This amounts to £1,290,446,422.

6.7. In deciding on the percentage of the relevant figure that forms the basis of the Step 2 figure, the Authority considers the seriousness of the breach and chooses an appropriate percentage level. In this case, the Authority considers it appropriate to use a range between 0% and 20%. This range is divided into five fixed levels which represent, on a sliding scale, the seriousness of the breach; the more serious the breach, the higher the level. For penalties imposed on firms there are the following five levels:

Level 1 – 0%

Level 2 – 5%

Level 3 – 10%

Level 4 – 15%

Level 5 – 20%

6.8. In assessing the seriousness level, the Authority takes into account various factors which reflect the impact and nature of the breach, and whether it was committed deliberately or recklessly. DEPP 6.5A.2G(11) lists factors likely to be considered 'level 4 or 5 factors'. Of these, the Authority considers the following factors to be relevant:

- (1) The breach caused a significant loss or risk of loss to individual consumers who had lodged a PPI complaint. During the Relevant Period, LBG assessed customer complaints relating to in excess of 2.3 million PPI policies and rejected 37% of those complaints. In the Authority's File Review of November 2012, the Authority considered that LBG had unfairly rejected 57% of the customer complaints that it reviewed. LBG's misconduct was serious and resulted in significant potential customer detriment.
- (2) The breach revealed a serious weakness in LBG's policy in relation to the handling of PPI complaints.

6.9. DEPP 6.5A.2G(12) lists factors likely to be considered 'level 1, 2 or 3 factors'. Of these, the Authority considers the following factors to be relevant:

- (1) There is no evidence that the breach indicates a widespread problem or weakness at LBG, but the breach did have a widespread effect on PPI complaint handling at LBG.
- (2) The Authority has not found that LBG acted deliberately or recklessly in the context of the Principle 6 breach, but that it made serious errors in its PPI complaint handling.

6.10. The Authority also considers that the following factor is relevant:

- (1) Complaint handling and, in particular PPI complaint handling, is a high priority issue for the Authority. Ensuring that every customer, especially one previously mis-sold a financial product, is treated fairly when they complain is important to the Authority's consumer protection objective and in rebuilding trust in financial institutions particularly following the mis-selling of PPI.

6.11. Taking all of these factors into account, the Authority considers the seriousness of the breach to be level 3 and so the Step 2 figure is 10% of £1,290,446,422.

6.12. Step 2 is therefore £129,044,642.

Step 3: mitigating and aggravating factors

- 6.13. Pursuant to DEPP 6.5A.3G, at Step 3 the Authority may increase or decrease the amount of the financial penalty arrived at after Step 2, but not including any amount to be disgorged as set out in Step 1, to take into account factors which aggravate or mitigate the breach.
- 6.14. The Authority considers that the following factors aggravate the breach:
- (1) From 2005 onwards the Authority has published numerous papers, guidance and enforcement notices that highlighted issues around the way PPI was sold and the standards expected of firms in handling complaints about PPI. Given the number of publications, and the time period elapsed since publication, LBG should have ensured that its Complaint Assessment Process during the Relevant Period reflected the Authority's standards in relation to the fair assessment of PPI complaints. The publications included:
 - (a) Consultation Paper 09/23 '*The assessment and redress of payment protection insurance complaints*' dated September 2009. This paper consulted on, among other things, guidance on the fair assessment of a complaint. This was intended to ensure that firms gave balanced and evenly weighted consideration to evidence about complaints and considered them fully and in the round;
 - (b) Consultation Paper 10/6 '*The assessment and redress of payment protection insurance complaints; feedback on CP 09/23 and further consultation*' dated March 2010. This paper set out the Authority's expectation that firms should investigate complaints, collect information, assess the evidence and reach a conclusion in a balanced and fair way;
 - (c) Policy Statement 10/12 '*The assessment and redress of payment protection insurance complaints; feedback on the further consultation in CP 10/6 and final Handbook text*' dated August 2010. In this paper the Authority stated that it saw nothing in the responses received to CP 10/6 to change its view regarding the fair assessment of evidence (as described above);

- (d) an open letter addressed to the industry detailing '*common point of sale failings for PPI sales*' first published in September 2009 and subsequently amended in March and August 2010;
 - (e) '*Review of complaint handling in banking groups*' dated April 2010;
 - (f) the Authority also published results of its thematic work on the sale of PPI generally, in November 2005, October 2006 and September 2007; and
 - (g) the Financial Ombudsman Service has published a PPI Online Resource on its website throughout the Relevant Period which details the relevant considerations when assessing PPI complaints.
- (2) The Authority has imposed significant financial penalties on LBG on previous occasions in relation to misconduct:
- (a) in September 2003, the Authority fined Lloyds TSB Bank plc £1.9m for its conduct in selling high income bonds, which also resulted in it paying over £98m in redress to customers. The Authority found that sales advisers in the firm's branch network were put under general pressure to meet targets, and that its failure to implement sufficiently rigorous controls over this contributed to unsuitable sales;
 - (b) in May 2011, the Authority fined Bank of Scotland plc £3.5m in relation to its handling of complaints relating to retail investments;
 - (c) in March 2012, the Authority imposed a public censure on Bank of Scotland plc in relation to the management and control of its corporate lending;
 - (d) in October 2012, the Authority fined Bank of Scotland plc £4.2m in relation to incorrect mortgage terms and conditions that it gave to standard variable rate customers;

- (e) in February 2013, the Authority fined Lloyds TSB Bank plc, Lloyds TSB Scotland plc and Bank of Scotland plc £4.3m for their failure to pay redress promptly to PPI complainants;
 - (f) in December 2013, the Authority fined Lloyds TSB Bank plc and Bank of Scotland plc £28m due to serious failings in the systems and controls governing the financial incentives that they gave to investment sales staff; and
 - (g) in July 2014, the Authority fined Lloyds Bank plc and Bank of Scotland plc £105m for manipulating submissions to two benchmark reference rates, the Repo Rate and LIBOR, in order to seek to manipulate those rates.
- (3) The Authority issued LBG with a private warning in March 2012 for sending final decision letters to PPI complainants without explaining how redress was to be calculated.
 - (4) The Authority only became aware of the breaches as a result of the Authority's File Review and the Authority's Site Visits, as described in paragraphs 4.18 to 4.22.

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

- (1) Following the High Court's ruling in favour of the Authority in relation to the Judicial Review, LBG decided at an early stage not to appeal the decision of the High Court and to implement the Authority's changes for PPI complaints handling as described in paragraph 4.9; and
- (2) LBG has undertaken a significant remediation programme as described above and has spent significant sums instructing third parties to assist it in the remediation of customers who have been treated unfairly.

6.16. Having taken into account these factors, the Authority considers that the Step 2 figure should be increased by 30%.

6.17. Step 3 is therefore £167,758,035.

Step 4: adjustment for deterrence

- 6.18. Pursuant to DEPP 6.5A.4G, if the Authority considers the figure arrived at after Step 3 is insufficient to deter the firm who committed the breach, or others, from committing further or similar breaches, then the Authority may increase the penalty.
- 6.19. The Authority considers that the Step 3 figure of £167,758,035 represents a sufficient deterrent to LBG and others, and so has not increased the penalty at Step 4.
- 6.20. Step 4 is therefore £167,758,035.

Step 5: settlement discount

- 6.21. Pursuant to DEPP 6.5A.5G, if the Authority and the firm on whom a penalty is to be imposed agree the amount of the financial penalty and other terms, DEPP 6.7 provides that the amount of the financial penalty which might otherwise have been payable will be reduced to reflect the stage at which the Authority and the firm reached agreement. The settlement discount does not apply to the disgorgement of any benefit calculated at Step 1.
- 6.22. The Authority and LBG reached agreement at Stage 1 and so a 30% discount applies to the Step 4 figure.
- 6.23. Step 5 is therefore £117,430,600.

Financial penalty

- 6.24. The Authority therefore imposes a total financial penalty of £117,430,600 on LBG for breaching Principle 6.

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 Lloyds Bank plc, Bank of Scotland plc and Black Horse Limited to the Authority by no later than 18 June 2015, 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 19 June 2015, the Authority may recover the outstanding amount as a debt owed by LBG 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 Nicholas Hills (direct line: 020 7066 4162 / fax: 020 7066 4163) of the Enforcement and Market Oversight Division of the Authority.

Guy Wilkes
Project Sponsor
Financial Conduct Authority, Enforcement and Market Oversight Division

ANNEX A

RELEVANT STATUTORY AND REGULATORY PROVISIONS AND GUIDANCE

1. RELEVANT STATUTORY PROVISIONS

1.1. The Authority's operational objectives are set out in section 1B(3) of the Act (as amended by the Financial Services Act 2012) and include the consumer protection objective.

1.2. Section 206(1) of the Act provides:

'If the [Authority] considers that an authorised person has contravened a relevant requirement imposed on the person, it may impose on him a penalty, in respect of the contravention, of such amount as it appears appropriate.'

2. RELEVANT REGULATORY PROVISIONS

2.1. In exercising its power to impose a financial penalty, the Authority has had regard to the relevant regulatory provisions and policy published in the Authority's Handbook. The main provisions that the Authority considers relevant to this case are set out below.

Principles for Businesses (Principles)

2.2. The Principles are a general statement of the fundamental obligations of firms under the regulatory system and are set out in the Authority's Handbook. They derive their authority from the Authority's rule-making powers set out in the Act. The relevant Principle is Principle 6 (Customers' interests) which provides that:

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

Dispute Resolution: Complaints (DISP)

2.3. DISP sets out how complaints are to be dealt with by respondents.

2.4. DISP 1 contains rules and guidance on how respondents should deal with complaints promptly and fairly, including complaints that could be referred to the Financial Ombudsman Service.

2.5. DISP 1.4.1R states:

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

- (1) *investigate the complaint competently, diligently and impartially, obtaining additional information as necessary;*
- (2) *assess fairly, consistently and promptly:*
 - (a) *the subject matter of the complaint;*
 - (b) *whether the complaint should be upheld;*
 - (c) *what remedial action or redress (or both) may be appropriate;*
 - (d) *if appropriate, whether it has reasonable grounds to be satisfied that another respondent may be solely or jointly responsible for the matter alleged in the complaint;*

taking into account all relevant factors;
- (3) *offer redress or remedial action when it decides this is appropriate;*
- (4) *explain to the complainant promptly and, in a way that is fair, clear and not misleading, its assessment of the complaint, its decision on it, and any offer of remedial action or redress; and*
- (5) *comply promptly with any offer of remedial action or redress accepted by the complainant.'*

Handling PPI complaints

- 2.6. DISP App 3 sets out how a firm should handle complaints, relating to the sale of a payment protection contract by the firm, which express dissatisfaction about the sale, or matters related to the sale, including where there is a rejection of claims on the grounds of ineligibility or exclusion (but not matters unrelated to the sale, such as delays in claims handling).
- 2.7. DISP App 3.1.2G states that DISP App 3 sets out, among others, how a firm should assess a complaint in order to establish whether the firm's conduct of the sale failed to comply with the rules.
- 2.8. DISP App 3.2.1G provides:

'The firm should consider, in the light of all the information provided by the complainant and otherwise already held by or available to the firm, whether there was a breach or failing by the firm'.

2.9. DISP App 3.2.6G provides:

'The firm should take into account any information it already holds about the sale and consider other issues that may be relevant to the sale identified by the firm through other means, for example, the root cause analysis described in DISP App 3.4'.

2.10. DISP App 3.3.1G provides:

'Where a complaint is made, the firm should assess the complaint fairly, giving appropriate weight and balanced consideration to all available evidence, including what the complainant says and other information about the sale that firm identifies. The firm is not expected automatically to assume that there has been a breach or failing'.

2.11. DISP App 3.3.4G provides:

'Where the complainant's account of events conflicts with the firm's own records or leaves doubt, the firm should assess the reliability of the complainant's account fairly and in good faith. The firm should make all reasonable efforts (including by contact with the complainant where necessary) to clarify ambiguous issues or conflicts of evidence before making any finding against the complainant'.

2.12. DISP App 3.3.9G provides:

'In determining a particular complaint, the firm should (unless there are reasons not to because of the quality and plausibility of the respective evidence) give more weight to any specific evidence of what happened during the sale (including any relevant documentation and oral testimony) than to general evidence of selling practices at the time (such as training, instructions or sales scripts or relevant audit or compliance reports on those practices)'.

2.13. DISP App 3.4.1G provides:

'DISP 1.3.3 R requires the firm to put in place appropriate management controls and take reasonable steps to ensure that in handling

complaints it identifies and remedies any recurring or systemic problems. If a firm receives complaints about its sales of payment protection contracts it should analyse the root causes of those complaints including, but not limited to, the consideration of:

- (1) the concerns raised by complainants (both at the time of the sale and subsequently);*
- (2) the reasons for both rejected claims and complaints;*
- (3) the firm's stated sales practice(s) at the relevant time(s);*
- (4) evidence available to the firm about the actual sales practice(s) at the relevant time(s) (this might include recollections of staff and complainants, compliance records, and other material produced at the time about specific transactions, for example call recordings and incentives given to advisers);*
- (5) relevant regulatory findings; and*
- (6) relevant decisions by the Financial Ombudsman Service'.*

2.14. DISP App 3.4.2G provides:

'Where consideration of the root causes of complaints suggests recurring or systemic problems in the firm's sales practices for payment protection contracts, the firm should, in assessing an individual complaint, consider whether the problems were likely to have contributed to a breach or failing in the individual case, even if those problems were not referred to specifically by the complainant'.

Decision Procedure and Penalties Manual (DEPP)

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

The Enforcement Guide

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

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