
FINAL NOTICE

To: Friends Provident Life and Pensions Limited

**Of: Pixham End
Dorking
Surrey RH4 1QA**

Date: 15 December 2003

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

1. PENALTY

1.1. The FSA gave you a decision notice on 12 December 2003 which notified you that pursuant to Section 206 of the Financial Services and Markets Act 2000 (“FSMA”) and for the reasons set out below, the FSA had decided to impose a financial penalty of £675,000 on Friends Provident Life and Pensions Limited (“Friends Provident”). This financial penalty is in respect of breaches of:

- (a) Rules 4.1, 7.1.2, 7.1.5, 8.2.1 and 8.2.4 of the Rules of the Personal Investment Authority (“the PIA Rules”) and Principle 2 of the Statements of Principle of the Securities and Investments Board (“the SIB Principles”) in the period from 1 October 2001 to 30 November 2001 and
- (b) SYSC Rule 3.1.1, COB Rule 2.1.3 and DISP Rules 1.2.1 and 1.2.22 in the FSA Handbook (“the FSA Rules”) and Principles 2, 3, 6 and 7 of the FSA's

Principles for Businesses ("the FSA Principles") in the period from 1 December 2001 to 10 February 2003.

- 1.2. Friends Provident has confirmed that it does not intend to refer the matter to the Financial Services and Markets Tribunal.

2. RELEVANT STATUTORY PROVISIONS AND REGULATORY RULES

- 2.1. Section 206 of FSMA provides:

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

- 2.2. The Financial Services and Markets Act 2000 (Transitional Provisions and Savings) (Civil Remedies, Discipline, Criminal Offences etc) (No2) Order 2001 ("the Pre N2 Misconduct Order") provides, at Article 8(2), that the power conferred by Section 206 of FSMA can be exercised by the FSA in respect of failures by a firm to comply with any of the provisions specified in Rule 1.3.1(6) of the PIA Rules as if the firm had contravened a requirement imposed by FSMA.
- 2.3. PIA Rule 1.3.1(6) provided that a Member of the Personal Investment Authority ("PIA") which failed to comply with PIA Rule 1.3.1(2) or any of the SIB Principles was liable to disciplinary action.
- 2.4. PIA Rule 1.3.1(2) provided that a PIA Member had to obey the PIA Rules.
- 2.5. The SIB Principles are universal statements of the standards expected of regulated firms that were issued by the SIB and applied to PIA Members.
- 2.6. Extracts of the relevant PIA Rules and SIB Principles and of the FSA Rules and FSA Principles are attached to this Warning Notice as Appendix A.

3. REASONS FOR THE ACTION

Conduct in Issue – Summary

- 3.1. The FSA has decided to impose a financial penalty on Friends Provident in respect of breaches of the respective PIA Rules and SIB Principles and the FSA Rules and FSA Principles arising out of its mis-handling of mortgage endowment complaints received from customers in the period from 1 October 2001 to 10 February 2003.
- 3.2. Mortgage endowment policies are savings vehicles into which customers pay regular premiums with the aim of building up a sum to be used to pay off the capital amount owing on a mortgage.
- 3.3. Specifically, Friends Provident's breaches are that it:
 - (a) failed to establish and maintain appropriate and effective procedures for the proper handling of mortgage endowment complaints;

- (b) failed to identify and remedy recurring or systemic problems in its mortgage endowment complaints handling procedures;
- (c) failed to ensure that each mortgage endowment complaint received was adequately investigated;
- (d) failed to put in place appropriate management controls, and failed to take reasonable steps, to ensure that it handled mortgage endowment complaints fairly, consistently and promptly;
- (e) failed to ensure, and failed to take reasonable steps to ensure, that decision letters to customers regarding mortgage endowment complaints were clear and fair, and not misleading, in content.

3.4. In so doing, Friends Provident demonstrated failings that demand a significant financial penalty. The seriousness of these failings is demonstrated particularly by the following factors:

- (a) the failures related to the handling of complaints about the sale of mortgage endowment policies used as vehicles to repay a mortgage. The purchase of a house is for most people the most significant transaction of their lives and where the financial arrangements supporting that purchase are mis-sold, and a valid complaint regarding the mis-sale is unfairly rejected, the consequences can be most serious;
- (b) the failures persisted from 1 October 2001 to 10 February 2003 and arose from a systemic weakness in Friends Provident's procedures. The FSA places very great emphasis on the importance of adequate complaints handling systems to ensure compliance with regulatory rules and standards;
- (c) there was a particular responsibility on firms in the industry to ensure that their mortgage endowment complaint handling procedures and practices were fair and appropriate. This was because the FSA had determined that an industry-wide review of mortgage endowment sales along the lines of the Pensions Review would be disproportionate and that the appropriate mechanism for delivering redress in relation to mis-sales of mortgage endowments was therefore through the complaints-handling processes of firms. This means that it represents a significant risk to the FSA's consumer protection objective if firms do not handle mortgage endowment complaints fairly and effectively;
- (d) the size and nature of Friends Provident meant that its failures exposed a large number of consumers to potential loss. The consumers who were put at risk or disadvantaged by Friends Provident's conduct fall into 3 categories:
 - all policyholders who might have had reason to raise complaints with Friends Provident were potentially put at risk because they did not have the safety net of adequate mortgage endowment complaints handling procedures (Friends Provident sold 216,679 mortgage endowment policies in the period from 29 April 1988 to 31 December 2001);

- those customers who did actually complain were disadvantageded because they could not be sure that their complaints were subjected to fair and adequate assessment (Friends Provident received 21,788 mortgage endowment complaints between March 2000 when its dedicated complaints-handling team was established and 10 February 2003 when its defective procedures were replaced);
 - those customers whose complaints were rejected were exposed to the risk that their complaints were in fact genuine and deserving of redress but were rejected because procedures were inherently unfair and biased against customers and did not adequately reflect the issues raised in the Tiner letter of April 2002. (Friends Provident rejected approximately 6,500 complaints in the period January 2000 to 10 February 2003);
- (e) the failures occurred at a time when there was a high level of awareness and concern within the industry of the issues surrounding mortgage endowment sales and complaints handling and notwithstanding that regulatory guidance and updates had been issued to the industry from 1999 onwards, including detailed guidance in a letter from John Tiner, Managing Director of the FSA of April 2002 (“the Tiner Letter”). The FSA's guidance reminded firms of the particular importance, in relation to mortgage endowment complaints, of their general obligation to establish and maintain appropriate and effective written procedures for the proper handling of complaints and to ensure that each complaint was promptly and adequately investigated;
- (f) firms had been specifically warned in October 2000 that the regulator would be monitoring firms to assess whether that guidance had been followed. Friends Provident's failures were identified by the FSA's Supervision Division ("Supervision") in the course of a supervision visit in October 2001. The findings of the visit, which were based on a sample of 46 mortgage endowment complaint files, were reported to Friends Provident in a letter dated 11 January 2002. Failures were also identified during a further Supervision visit in September 2002, when 81 mortgage endowment complaint files were reviewed;
- (g) Friends Provident and its senior management failed to respond in a timely and effective manner to guidance regarding the handling of mortgage endowment complaints where it had a reasonable opportunity to do so. The FSA considers it imperative that, when detailed regulatory guidance is issued, firms and their senior management react to it in a timely and effective manner.
- 3.5. While noting that the failings in this case merit a significant financial penalty and that Friends Provident responded robustly only after the further Supervision visit in September 2002, the FSA considers that these failings have been mitigated significantly by the co-operation demonstrated by Friends Provident and the remedial action taken. Steps taken by Friends Provident include:
- committing to the adoption of a new approach to mortgage endowment complaints, which provided more favourable treatment to customers;

- setting up a separate group to review past mortgage endowment complaints in order to ensure customers were treated fairly, taking into account the principles in the Tiner Letter;
 - deciding to review all mortgage endowment complaints rejected between 1 January 2000 and 10 February 2003, and appointing independent accountants to oversee the review;
 - seeking external support and guidance in bringing about the required changes by engaging an independent firm of accountants to review existing procedures, design new written procedures, design and deliver a training programme and complete quality assurance work on the new mortgage endowment complaints-handling system;
 - allocating additional resources to its Mortgage Endowment Complaints team;
 - making the issue of mortgage endowment complaints-handling a standing item on the agenda of all Friends Provident Board meetings, at both subsidiary and group level, until it has been concluded in a manner acceptable to both the FSA and the Boards.
- 3.6. These steps have meant that Friends Provident has in place processes which should ensure that past mortgage endowment complainants have been and will be offered redress where appropriate and that past mistakes in the handling of mortgage endowment complaints are not repeated in the future. Friends Provident has incurred significant costs in responding in this manner, especially in relation to the appointment of two firms of independent accountants. Further, by virtue of the co-operation with the FSA displayed by Friends Provident, the necessary remedial action has been undertaken quickly and efficiently so that the risk of disadvantage to customers has been minimised.
- 3.7. Accordingly, Friends Provident has received considerable credit for this in the amount of the financial penalty the FSA has decided to impose. Without this level of co-operation, the financial penalty would have been substantially higher.

4. BACKGROUND

Regulated Firm

- 4.1. Friends Provident is the principal operating company of the life and pensions business within the Friends Provident group. Its ultimate holding company is Friends Provident plc. The life and pensions business markets a broadly based range of life and pensions products via Independent Financial Advisers and through a number of tied distribution channels.
- 4.2. Friends Provident was regulated by the PIA until 30 November 2001. Since then it has been regulated by the FSA.
- 4.3. Friends Provident was one of the firms in the industry to whom the various regulatory updates and guidance detailed below (including the Tiner Letter) were directed.
- 4.4. Complaints received by Friends Provident in relation to mortgage endowments were handled by the Customer Relations Department. The team dedicated to handling

mortgage endowment complaints was established at the beginning of March 2000 and specific mortgage endowment complaints-handling procedures were introduced in February 2001 with a second edition introduced in April 2002.

Regulatory Context

- 4.5. Friends Provident's failings should be placed in the regulatory context of 1999 to 2003; that is that they occurred at a time when there was a high level of awareness within the industry of the issues surrounding mortgage endowment sales and associated concerns with respect to the handling of complaints regarding mortgage endowment sales.
- 4.6. In 1999, the FSA and the PIA started a programme of work on mortgage endowments to help ensure that consumers understood the consequences of the changed economic environment and to check that firms' selling practices and complaints-handling procedures were adequate.
- 4.7. Since the introduction of the PIA Rules in 1994, firms had been subject to an obligation to establish and maintain appropriate and effective written procedures for the proper handling of complaints and were required to ensure that each complaint was promptly and adequately investigated.
- 4.8. This obligation had particular importance in relation to mortgage endowments. The FSA publicly stated in December 1999 that an industry-wide review of mortgage endowment sales along the lines of the Pensions Review would be disproportionate and in October 2000 that the appropriate mechanism for delivering redress in relation to mis-sales of mortgage endowments was through the complaints-handling processes of firms.
- 4.9. The October 2000 statement was contained in the FSA's "Progress Report on Mortgage Endowments" which confirmed that the existing complaints-handling process, in conjunction with the issue and promotion of factsheets, was viewed by the FSA as the most effective way of ensuring redress for those consumers who had lost out as a result of mis-selling and that there were no grounds for a blanket industry-wide review.
- 4.10. The FSA stated in paragraph 3.23 of the Progress Report:

"It is in consumers' interests that the bulk of complaints arising on endowment mortgages are resolved, and promptly, by firms and these steps will help to ensure this is achieved. Firms are under a regulatory obligation to ensure that all complaints are properly and adequately investigated. The FSA monitors to check that firms are carrying out these obligations promptly and will act where it finds weaknesses that put consumers' interests at risk."
- 4.11. The FSA's factsheet "Endowment Mortgage Complaints" was also released in October 2000. It explained how an endowment holder should take up any complaint with the firm which sold him the endowment and how to take his case to the Financial Ombudsman Service ("the FOS") if the firm's response was unsatisfactory. It also included information about how consumers could seek compensation if they felt they were in any way misled at the point of sale and may have lost out financially as a

result. This factsheet was updated at regular intervals and was required to be included in the reprojection letters that firms were to send out to all mortgage endowment holders.

- 4.12. The importance of mortgage endowment complaints-handling processes was highlighted again in November 2000, via Regulatory Update 80, and again in July 2001, via Regulatory Update 91.

The Tiner Letter

- 4.13. On 4 April 2002, the Tiner Letter was sent to Chief Executives of product providers and large IFAs who were known to have sold mortgage endowment policies. This letter drew attention to the concerns of the FSA about the way in which mortgage endowment complaints were being dealt with. Most notably, its purpose was to accentuate the importance of fair handling of complaints. Firms were asked to respond to the letter and to review and, if necessary, to revise their complaints-handling procedures in the light of the concerns expressed.

- 4.14. The Tiner letter identified three main issues for the firms' attention:

- (a) some firms were not assessing some or all of their consumer complaints fairly, particularly in respect of the assessment of consumers' understanding and acceptance of risk at time of sale;
- (b) many firms' complaint handlers placed an over reliance on the decision tree process for complaints published by the FOS in June 2000; and
- (c) it was important to consider each complaint separately and avoid the application of precedent (especially previous Ombudsman decisions in respect of other cases) without due regard to the facts of the specific case under review.

- 4.15. To support the three key issues, and in particular the first, the Tiner Letter included an annex which listed nine specific points ("TP(s)"). The nine TPs were provisional messages for firms wanting to avoid unfairness in respect of their complaint handling. Specifically, firms should:

- (a) recognise in the assessment of the complaint that the key risk for the consumer is that the endowment may not repay the mortgage loan ("TP1");
- (b) avoid too narrow a view of the scope of the advisory duty in the context of mortgage advice ("TP2");
- (c) recognise that oral evidence can be good and sufficient evidence, avoiding too ready a dismissal of evidence from the consumer which is not supported by documentary proof ("TP3");
- (d) investigate the issue diligently in particular so as to take into account the selling practices at the time, the training, instruction, sales scripts and incentives given to advisers at the time and the track record of the particular adviser ("TP4");

- (e) go the extra mile to clarify ambiguous issues or conflicts of evidence before finding against the consumer (“TP5”);
- (f) avoid making a conclusive assumption that a pre-existing endowment held at time of sale, whether for purposes of savings or mortgage repayment, is sufficient evidence of understanding and acceptance of key risk (“TP6”);
- (g) avoid making too literal and narrow an interpretation of the issue of the complaint as expressed by the consumer (“TP7”);
- (h) avoid rejecting complaints solely on the basis that the consumer signed a proposal form or failed to exercise the cancellation right and so must have presumed to have been satisfied with the advice and the product at time of sale (“TP8”); and
- (i) avoid claiming as evidence of risk warning at time of sale (so as to justify rejection of the complaint) either:
 - the absence of a statement in product literature that repayment of the mortgage was guaranteed; or
 - a statement in product particulars that the firm will monitor the plan and advise the consumer if the level of contribution is insufficient for the target amount to be repaid (“TP9”).

Chronology of Events

- 4.16. In a letter dated 9 August 2001, the FSA advised Friends Provident that the FSA had established a specific project to review the handling of mortgage endowment complaints by firms.
- 4.17. From 22 to 24 October 2001, Supervision conducted a focused visit to review the systems and procedures that Friends Provident had in place to deal with mortgage endowment complaints (the “First Supervision Visit”). The FSA review included a sample of 46 complaint files.
- 4.18. The results of the First Supervision Visit were communicated to the Firm in a letter dated 11 January 2002. The FSA reported that the FSA was not happy with 12 of the cases reviewed. The FSA found that in eight cases Friends Provident had not taken sufficient steps to find missing information and that three cases had been incorrectly categorised. The report required that each individual case was investigated and that a review was undertaken to ensure that other cases had not been incorrectly classified. This work was completed and the results communicated to the FSA.
- 4.19. Friends Provident received the Tiner Letter in April 2002 and provided its response to on 29 April 2002. On 3 July 2002, the FSA raised questions with Friends Provident about its letter of 29 April 2002. In its further response dated 17 July 2002, Friends Provident confirmed that it agreed with and applied each of the points raised in the Tiner Letter.

- 4.20. The Tiner letter required firms to carry out a review of their mortgage endowment complaints handling procedures to confirm that they met the standards expressed in that letter. Friends Provident carried out an internal review. Friends Provident's internal report, which was published and reviewed on 11 September 2002, was not accepted by management since it had not adequately addressed all of the issues identified in the Tiner letter. Management decided that additional external work would be commissioned.
- 4.21. From 17 to 20 September 2002, Supervision conducted a second focused visit to review the systems and procedures that Friends Provident had in place to deal with mortgage endowment complaints (the "Second Supervision Visit"). The FSA review again included a review of 81 complaint files.
- 4.22. On 18 October 2002 independent accountants were appointed by Friends Provident to review a sample of 100 mortgage endowment complaint files against the issues set out in the Tiner Letter.
- 4.23. The results of the Second Supervision Visit were communicated to Friends Provident in a letter dated 30 October 2002. The FSA was particularly concerned to note that from an overall sample of 81 cases reviewed by the FSA, 30 (37%) were queried for a failure to conduct an adequate investigation. In relation to procedures, the letter noted that;
- (a) its review of its processes, as required by the Tiner Letter, did not appear to look at or address the specific matters intended. It was noted that Friends Provident intended to do the review again;
 - (b) it had failed to demonstrate that there was an adequate system in place to monitor the consistency and adequacy of decisions made and, in particular, there was little evidence of counter checking;
 - (c) written procedures were out of date with practices.

The 30 October 2002 letter also advised that, due to the significance of the concerns identified, a referral of the case to the FSA's Enforcement Division ("Enforcement") was being considered.

- 4.24. On 19 November 2002, the independent accountants provided their report to Friends Provident on the 100 complaint files that they had reviewed (the "Independent Review").
- 4.25. At their respective meetings on 21 and 26 November 2002 the Boards of Friends Provident plc and Friends Provident considered the results of the Second Supervision Visit and the Independent Review. Friends Provident acknowledged that its approach to mortgage endowment complaints handling was not in accordance with the regulatory requirements as expressed in the Tiner letter and that changes were necessary. The changes outlined in paragraph 3.5 then began to be implemented.
- 4.26. On 27 November 2002, Friends Provident received written confirmation from Supervision that the matter had been formally referred to Enforcement.

- 4.27. On 28 November 2002, Friends Provident wrote to FSA setting out their proposals for addressing the issues raised. At a meeting on 18 December 2002, attended by representatives from both Supervision and Enforcement, the FSA indicated that it was happy in principle with these proposals.
- 4.28. On 16 December 2002, Enforcement notified Friends Provident that investigators had been appointed. The FSA sent Friends Provident a copy of its draft Investigation Report on 17 July 2003. Friends Provident provided its responses on 15 August 2003 and 3 September 2003.

5. CONTRAVENTIONS OF RELEVANT REQUIREMENTS

Overview

- 5.1. The penalty is to be imposed pursuant to Section 206 of FSMA in respect of breaches by Friends Provident of the PIA Rules and SIB Principles and the FSA Rules and FSA's Principles as detailed below in two sections: Defects in Mortgage Endowment Complaints-Handling Procedures; and Review of Complaints Considered.

6. DEFECTS IN MORTGAGE ENDOWMENT COMPLAINTS-HANDLING PROCEDURES

Rule Breaches

- 6.1. The following particular breaches occurred in relation to Friends Provident's mortgage endowment complaints-handling procedures:
- (a) in the period from 1 October 2001 to 30 November 2001, with respect to the PIA Rules and
 - (b) in the period from 1 December 2001 to 10 February 2003, with respect to the FSA Rules.

- 6.2. Specifically, Friends Provident was in breach of:

Complaints-Handling Procedures

- (a) PIA Rule 8.2.1, in that it failed to establish and maintain a written procedure for the proper handling of mortgage endowment complaints;
- (b) DISP Rule 1.2.1, in that it failed to have in place and operate an appropriate and effective internal mortgage endowment complaint handling procedure in line with the standards set out in the Tiner letter;

Systems and Controls

- (c) PIA Rule 7.1.2, in that it failed to establish procedures with a view to ensuring that its investment staff and other employees carried out their functions in such a way that it complied at all times with the PIA Rules and SIB Principles. In addition, Friends Provident, through those of its employees responsible for mortgage endowment complaints handling, breached PIA Rules 8.2.4(1) and 8.2.1;

- (d) PIA Rule 7.1.5, in that it failed to establish and maintain a system of internal control for the handling of mortgage endowment complaints appropriate to the size and type of its business;
- (e) DISP Rule 1.2.22, in that it failed to put in place appropriate management controls and to take reasonable steps to ensure that it handled mortgage endowment complaints fairly and identified and remedied any recurring or systemic problems within a reasonable time;
- (f) SYSC Rule 3.1.1, in that it failed to take reasonable care to establish and maintain such systems and controls in relation to mortgage endowment complaints as were appropriate to its business.

Facts and Matters relied upon

Complaints-Handling Procedures - Tiner Points

- 6.3. Both the first edition dated February 2001 and the second edition dated April 2002 of Friends Provident's specific mortgage endowment complaints-handling procedures were deficient in a number of areas.
- 6.4. It was not until February 2003, when new procedures were introduced, that appropriate amendments were made to incorporate the issues raised in the Tiner Letter. The new procedures were prepared by independent third party accountants who reviewed and adapted Friends Provident's procedures to take into account the concerns raised in the Tiner Letter.
- 6.5. For ease of exposition, these deficiencies in the first and second editions of the procedures are set out below by reference to the relevant TPs. However, it should be noted that the FSA considers these deficiencies to be objective faults within Friends Provident's procedures, giving rise to the breaches detailed in paragraph 6.2. The articulation and classification of such faults within the Tiner Letter in April 2002 does not prevent the FSA from taking action in respect of breaches of Rules which occurred by reason of these deficiencies existing prior to April 2002.
- 6.6. The deficiencies in the procedures included the following:
 - TP 3 – The requirement for documentary proof*
- 6.7. Friends Provident's specific procedures were not in accordance with TP 3 as they failed to recognise that the oral evidence of the customer can be good and sufficient evidence and they encouraged too ready a dismissal of evidence from the customer which was not supported by documentary proof.
 - TP 6 - Assumptions based on pre-existing endowments and investments*
- 6.8. Friends Provident's specific procedures were not in accordance with TP 6 as they advised Friends Provident's complaint handlers to make a conclusive assumption that a pre-existing endowment, or other investments held at time of sale, was sufficient evidence that the customer had a sufficient understanding and acceptance of the risk of a shortfall with a mortgage endowment.

- 6.9. This is not a safe conclusion to make because there is no direct correlation between investment risk and mortgage repayment risk. Customers may be willing to accept varying degrees of risk in relation to certain investments but might be unwilling to accept a risk in relation to the repayment of sums borrowed to finance the purchase of their home. Furthermore, the existence of a pre-existing endowment policy is not sufficient to establish customers' understanding of the risks involved – that policy too may have been mis-sold.

TPs 8 and 9 - Rejections based on failure to exercise cancellation right

- 6.10. Friends Provident's standard template reply letters were not in accordance with TPs 8 and 9 as they included a template section which could be used by complaint handlers to reject a complaint solely on the basis that the consumer, having received all of the post sale disclosure information (product particulars) failed to exercise the cancellation right, and so must be presumed to have been satisfied with the advice and the product at time of sale.
- 6.11. This approach failed to recognise that, if the sale was unsuitable from the outset, the failure to cancel the policy does not make the sale valid. The customer was entitled to assume the advice was suitable and should not be penalised for failing to cancel the policy.

TPs 2 and 3 - Unfair reliance on previous Ombudsman decisions

- 6.12. Friends Provident's complaints-handling procedures improperly prompted complaint handlers to apply Ombudsman decisions in specific cases generically. In addition, the standard letter template included a paragraph which potentially deterred customers from exercising their right to refer the case to the Ombudsman.

Systems and Controls

- 6.13. The existence of the deficiencies in Friends Provident's mortgage endowment complaints-handling procedures (until replaced in February 2003) evidences failings in its management and internal controls.
- 6.14. In particular:
- (a) while Friends Provident had in place systems of oversight and reporting in relation to mortgage endowment complaints, these were inadequate in the context of the substantial volume of mortgage endowments for which Friends Provident had sales responsibility and the consequent high volumes of complaints received. In particular, they failed to ensure that the complaints-handling procedures that were in place were adequate for the purposes of delivering fairly handled complaints;
 - (b) while the systems provided monitoring of the volumes of mortgage endowment complaints, they failed to provide for any adequate qualitative assessment of the standard of mortgage endowment complaints handling being delivered by the complaints-handling procedures that were in place. This was typified by the failure adequately to review and/or amend those complaints-handling procedures when requested to do so by the FSA in the Tiner Letter;

- (c) Friends Provident failed to demonstrate that there was an adequate system in place to monitor the consistency and adequacy of decisions made and, in particular, there was little evidence of counter checking;
- (d) Friends Provident's written procedures were out of date with its practices.

7. REVIEW OF COMPLAINTS CONSIDERED

Rule Breaches

- 7.1. Friends Provident's mortgage endowment complaints-handling procedures and individual case files have been analysed in three separate reviews: the First Supervision Visit, the Second Supervision Visit and the review by Enforcement following the reference in November 2002 ("the Enforcement Review"). The Independent Review also looked at individual case files against the standards expressed in the Tiner letter. The failings and deficiencies identified in each of these reviews demonstrate that Friends Provident's procedures and the manner in which individual complaints were handled were not appropriate and constitute evidence that Friends Provident did not comply with its regulatory obligations.
- 7.2. The following particular breaches occurred in relation to Friends Provident's handling of mortgage endowment complaints:
 - (a) the findings of the First Supervision Visit constitute evidence of breaches of the PIA Rules and SIB Principles prior to 1 December 2001;
 - (b) the findings of the Second Supervision Visit and the Enforcement Review constitute evidence of breaches of the FSA Rules and FSA Principles in the period from 1 December 2001 to 10 February 2003 (the date when the new complaints handling procedures were adopted).
- 7.3. Specifically, Friends Provident was in breach of:
 - (a) PIA Rule 4.1, in that it had failed to ensure that decision letters sent to its customers in relation to mortgage endowment complaints were clear and fair, and were not misleading, in content;
 - (b) PIA Rule 8.2.1, in that it failed to establish and maintain a written procedure for the proper handling of mortgage endowment complaints;
 - (c) PIA Rule 8.2.4, in that it failed to ensure that each of the mortgage endowment complaints categorised as a "fail" (as described below) was adequately investigated;
 - (d) COB Rule 2.1.3, in that it failed to take reasonable steps to communicate in a way which was clear and fair, and was not misleading, in relation to decision letters with respect to mortgage endowment complaints;
 - (e) DISP Rule 1.2.1, in that, as evidenced by the high proportion of "fail" detailed in paragraph 7.8, it failed to have in place and operate appropriate and

effective internal complaint procedures for handling mortgage endowment complaints;

- (f) DISP Rule 1.2.22, in that, in relation to mortgage endowment complaints, it failed to put in place appropriate management controls, failed to take reasonable steps to ensure that, in complying with DISP Rule 1.2.1, it handled the complaints fairly and promptly, and failed to identify and remedy recurring or systemic problems, as well as any specific problem identified by a complaint.

Facts and Matters relied upon

The First Supervision Visit

- 7.4. The results of the First Supervision Visit were communicated to Friends Provident in a letter dated 11 January 2002.

The Enforcement Review

- 7.5. The Enforcement Review comprised a separate review of the cases that had been the subject of the Second Supervision Visit and the Independent Review.
- 7.6. Enforcement reviewed 88 of the 100 Independent Review cases. Of those 88 cases, 10 also formed part of the 30 cases about which concerns had been raised by the Second Supervision Visit. Enforcement also conducted a separate review of all those 30 cases.
- 7.7. Having regard to the criteria/factors outlined in the Tiner Letter and issues raised in the Supervision Visit reports, Enforcement reached conclusions as to whether each case was to be categorised as “pass” or “fail”. A case was categorised as a pass where Enforcement concluded that overall Friends Provident had handled the complaint fairly and adequately.
- 7.8. The results of Enforcement’s review of the 108 cases were as follows:
- 82 (76%) cases were categorised as "fail";
 - 26 (24%) cases were categorised as "pass".

- 7.9. Deficiencies identified by the Enforcement Review included that in a significant number of cases:

Insufficient Evidence to Support the Outcome

- (a) The client file did not contain sufficient evidence to support the decision reached by Friends Provident. In particular, there was a lack of evidence indicative of the customer’s attitude to mortgage risk at the time of sale.

Inadequate Investigation

- (b) Friends Provident had failed to carry out an adequate investigation. Examples of Friends Provident's failings included taking insufficient steps to clarify

ambiguous issues and/or conflicts of evidence before finding against the complainant and failing adequately to consider the key risk in issue (ie the risk that the endowment policy might not cover the customer's mortgage).

Unsafe Conclusions

- (c) Friends Provident failed to reach a safe conclusion. Reasons as to why it was unsafe for Friends Provident to reach particular conclusions included the following:
- it relied, to an inappropriate extent, on the customer's pre-existing endowment/other investment(s);
 - it relied, to an inappropriate extent, on the customer's signed proposal and failure to exercise cancellation rights;
 - it relied, to an inappropriate extent, on the sales practice in place at the time of sale;
 - it failed to give proper weight to the oral/written evidence of the customer.

Communication with the Customer

- (d) Enforcement also identified failings in respect of Friends Provident's communication with customers in a significant number of mortgage endowment complaint cases. Overall, Friends Provident's decision letters were excessively long, often running to three or four pages in length, and were very technical. As a result, in cases of rejected complaints, the decision letter frequently failed to make the rationale for rejection sufficiently clear. Furthermore, the rejection was often not immediately apparent from the decision letter in that it was not communicated until page three or four.

In addition, decision letters frequently contained references to the likely views of the Ombudsman that could discourage the customer from taking the complaint further.

8. BREACHES OF PRINCIPLES

- 8.1. The extent and seriousness of its failings and Rule breaches with respect to mortgage endowment complaints-handling, together with its failure to identify or remedy the problems prior to the intervention of the FSA, indicate that Friends Provident also failed to meet the regulatory standards required of it by the SIB Principles and the FSA Principles.
- 8.2. The seriousness of this is demonstrated particularly by the fact that concerns had been notified to Friends Provident - both through the Tiner Letter in April 2002 and also, with respect to particular case files, through the report on the First Supervision Visit which was sent to Friends Provident in January 2002. Despite the regulatory

measures highlighting the importance of fair and adequate complaint-handling procedures (such as RU91 and RU80 and the FSA's October 2000 announcement) together with the specific contact with Friends Provident by Supervision, Friends Provident failed to identify that its mortgage endowment complaints-handling procedures and practices were not appropriate and effective.

- 8.3. Accordingly, and by virtue of the failings identified above, Friends Provident has breached the following regulatory principles.¹
- 8.4. In breach of SIB Principle 2, Friends Provident did not act with due care, skill and diligence in relation to its handling of mortgage endowment complaints.
- 8.5. In breach of SIB Principle 9, Friends Provident did not organise and control its internal affairs in a responsible manner and it did not have well-defined compliance procedures in relation to mortgage endowment complaints.
- 8.6. In breach of FSA Principle 2, Friends Provident did not conduct the operation and / or management of its mortgage endowment complaints-handling with due skill, care and diligence.
- 8.7. In breach of FSA Principle 3, Friends Provident did not take reasonable care to organise and control its affairs responsibly and effectively, with adequate risk management systems in relation to mortgage endowment complaints.
- 8.8. In breach of FSA Principle 6, Friends Provident did not in relation to mortgage endowment complaints pay due regard to the interests of its customers and treat them fairly; in particular, it did not assess complaints in accordance with the standards set out in the Tiner letter.
- 8.9. In breach of FSA Principle 7, Friends Provident in relation to decision letters issued in relation to mortgage endowment complaints did not pay due regard to the information needs of its clients, and communicate information to them in a way which was clear, fair and not misleading.

9. ANALYSIS OF SANCTION

- 9.1. In determining whether a financial penalty is appropriate and its level, the FSA is required to consider all the relevant circumstances of the case. Paragraph 13.3.3 of the Enforcement Manual and Annex D of “PIA’s Approach to Discipline – Statement of Policy” that was issued in December 1995 indicate the factors that may be of particular relevance in determining the level of a financial penalty. These are discussed below by reference to the circumstances of this case.
- 9.2. Article 8 (4) of the Pre-N2 Misconduct Order provides that, where the FSA proposes to impose a financial penalty, it must have regard to:

¹ Cases handled from 1 December 2001 (“N2”) cannot be seen as being in breach of the PIA Rules. However, the conclusion that Friends Provident breached the SIB Principles as well as the PIA Rules is evidenced by (i) the case reviews which predate N2 and (ii) the defects in Friends Provident’s procedures which were in evidence both before and after N2.

“any statement made by the self regulating organisation...which was in force when the conduct in question took place with respect to the policy on the taking of disciplinary action and the imposition of, and amount of penalties (whether issued as guidance, contained in the rules of the organisation or otherwise)”.

9.3. In all material respects, the relevant PIA guidance, contained in Annex D of “PIA’s Approach to Discipline – Statement of Policy” issued in December 1995, required consideration of the same factors as are identified in Chapter 13 of the Enforcement Manual. Both have been taken into account by the FSA in determining the appropriate sanction in this case.

9.4. PIA’s Statement of Policy makes it clear, however, that the criteria for determining the level of sanction are not to be applied rigidly, as stated in paragraph 2 of Annex D:

“Each case is different and needs to be treated on its own merits. It is not possible to apply a mechanistic approach to the determination of the circumstances in which disciplinary action should be taken or of the sanctions to be applied. The criteria... should not be treated as exhaustive. Nor should it be assumed that regard would necessarily be had to a particular criterion in any given circumstances”.

9.5. Similarly, it is stated in Chapter 13 of the Enforcement Manual at paragraph 13.3.4 that the criteria listed in the Manual are not exhaustive and all relevant circumstances of the case will be taken into consideration.

9.6. In determining whether a financial penalty is appropriate and its level, the FSA considers all the relevant circumstances of the case. The FSA considers the following factors to be particularly relevant in this case.

ENF 13: The seriousness of the misconduct or contravention

PIA Guidance: The seriousness of the breaches. The scale of any investor losses and / or the extent to which investors were exposed to the risk of such losses.

9.7. The level of financial penalty must be proportionate to the nature and seriousness of the contravention. The seriousness of Friends Provident's failings is demonstrated particularly by the factors highlighted in paragraph 3.4.

9.8. The mis-selling of mortgage endowment policies is a significant industry-wide issue. The FSA has made a number of policy statements about its approach to endowment mis-selling. In particular, the FSA has decided that an industry-wide review along the lines of the Pensions Review would be disproportionate, and instead placed reliance on firms to identify valid complaints regarding mis-sales. It therefore represents a significant risk to the FSA’s consumer protection objective if firms do not handle mortgage endowment complaints fairly and effectively.

9.9. Targeted disciplinary action is appropriate in the case of mis-handling mortgage endowment complaints in order to contribute to the FSA’s objective of maintaining public confidence in the financial system and to protect consumers.

9.10. There is also a significant potential deterrent effect from such action. While mortgage endowment policies are no longer sold in significant numbers, substantial work

remains to be done to ensure that consumers who have been harmed by mis-sales have valid complaints dealt with appropriately and receive compensation. Regulated firms need to be aware of the importance the FSA places on the existence of proper complaints-handling procedures, as well as the importance of ensuring compliance with procedures established by these firms and the importance of reacting appropriately and effectively to any deficiencies identified, whether by the regulator or by their own internal compliance teams.

ENF 13: The extent to which the contravention or misconduct was deliberate or reckless

PIA Guidance: Whether the Member intentionally or recklessly failed to meet the PIA's requirements.

- 9.11. There is no indication that the breaches by Friends Provident of the PIA Rules and SIB Principles or the FSA Rules and FSA Principles were deliberate or reckless.

ENF 13: The size, financial resources and other circumstances of the firm or individual

PIA Guidance: The Member's ability to pay: The scale of any investor losses and / or extent to which investors were exposed to the risk of such losses.

- 9.12. Friends Provident is part of one of the UK's largest financial services groups, the Friends Provident group. There can be no doubt regarding Friend Provident's ability to pay the penalty.

ENF 13: The amount of profits accrued or loss avoided

PIA Guidance: The extent to which, as a result of the breaches, the Member gained a benefit or avoided a loss.

- 9.13. There is no evidence that Friends Provident deliberately set out to accrue additional profits as a result of its failings. The FSA considers that procedures are in place, through the review of past complaints, which should ensure that all customers who are due redress will be compensated. As a result, there is nothing to suggest that Friends Provident will have benefited financially from its earlier mis-handling of complaints. Friends Provident has spent considerable sums on its remedial work.

ENF 13: Conduct following the contravention

PIA Guidance: The Firm's response once the breaches were identified.

- 9.14. The FSA attaches importance to the way in which Friends Provident has conducted itself following the Second Supervision Visit. Accordingly, this is a factor that has been taken into consideration in setting the financial penalty, as specified in paragraphs 3.5 to 3.7.

ENF 13: Action taken by other regulatory authorities and the FSA in relation to similar failings

PIA Guidance: The way in which the PIA has dealt with similar cases in the past.

- 9.15. Discipline for pure mortgage endowment complaints-handling failures is a new area in terms of regulatory action. However, both PIA, the predecessor regulator of Friends Provident, and the FSA have taken action against firms for systems and control failings, including compliance and past business review failings. The PIA has also imposed penalties for generic complaints-handling failures. This action has included the imposition of financial penalties. In determining the level of penalty to be imposed in this case, the FSA has taken these cases into account together with all the particular circumstances described in this Notice.

ENF 13: Disciplinary record and compliance history

PIA Guidance: The Firm's regulatory history

- 9.16. Friends Provident has been the subject of formal disciplinary action on one previous occasion.
- 9.17. On 30 September 1997, PIA announced that it had fined and reprimanded the Friends Provident Group of Companies. Friends Provident was ordered by PIA's Disciplinary Committee to pay a fine of £450,000 for its failure to take all reasonable steps to carry out the review of past pension transfer and opt-out business sold by Friends Provident or to monitor the review by other businesses for which it had accepted responsibility. Friends Provident was also ordered to pay PIA's costs in the sum of £20,000.

10. DECISION MAKER

- 10.1. The decision, which gave rise to the obligation to give this Notice, was made by the Regulatory Decisions Committee.

11. IMPORTANT NOTICES

- 11.1. The Final Notice is given to you in accordance with section 390 of the Act

Manner of payment

- 11.2. The Penalty must be to the FSA in full.

Time for payment

- 11.3. The Penalty must be paid to the FSA within 14 days beginning with the date on which the notice is given to you.

If the penalty is not paid

- 11.4. If all or any of the Penalty is outstanding after 14 days, the FSA may recover the outstanding amounts as a debt owed by you due to the FSA.

Publicity

- 11.5. 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 FSA must publish such information about the matter to which this notice relates as the FSA considers appropriate. The information may be published in such manner as the FSA considers appropriate. However, the FSA may not publish information if such publication would, in the opinion of the FSA, be unfair to you or prejudicial to the interests of consumers.
- 11.6. The FSA intends to publish such information about the matter to which this Final Notice relates as it considers appropriate.
- 11.7. For more information concerning this matter generally, please contact Martin Cole at the FSA (direct lines: and 020 7066 1706 / fax: 020 7066 1707).

Julia MR Dunn
Head of Retail Selling
FSA Enforcement Division

APPENDIX A

RELEVANT STATUTORY PROVISIONS AND REGULATORY RULES

Relevant PIA Rules

Complaints Handling

1. PIA Rule 4.1 provided:

“4.1 Communication

A Member must ensure that anything said or written, or any document sent, given or shown, to an investor or potential investor by the Member or on its behalf in the course of its relevant business is clear and fair, and is not misleading, either in design or content.”

2. PIA Rule 8.2.1 provided:

“8.2 Complaints Procedure

8.2.1 *A Member must establish and maintain a written procedure for the proper handling of complaints and must take reasonable steps to ensure that its staff, its appointed representatives and their staff, are aware of the procedure and their duty to act in conformity with it.*

8.2.2 *The procedure established under Rule 8.2.1 must include adequate provisions as respects the matters contained in Rules 8.2.3 to 8.3.2. “*

3. PIA Rule 8.2.4 provided:

“8.2.4 A Member must ensure that each complaint

- (1) is promptly and adequately investigated; and*
- (2) if it is practicable to do so, that it is investigated by a person of sufficient experience and competence who was not directly involved in the subject matter giving rise to the complaint.*

Guidance -

PIA expects all Members, other than sole traders, to arrange for complaints to be investigated by persons who meet the requirements of (2) above.”

General

4. PIA Rule 7.1.2 provided:

“7.1.2 Compliance Procedures

A Member must establish procedures, including procedures for complying with the training and competence requirements in accordance with Rule 2.6, with a view to ensuring that its investment staff and other employees and its appointed representatives and their employees carry out their functions in such a way that the Member complies at all times with the Rules and Principles.”

5. PIA Rule 7.1.5 provided:

“7.1.5 Internal Control

A Member must establish and maintain a system of internal control appropriate to the size and type of its business.”

Relevant SIB Principles

6. Principle 2 of the Statements of Principle provided:

“A firm must act with due care, skill and diligence.”

7. Principle 9 of the Statements of Principle provided:

“A firm should organise and control its internal affairs in a responsible manner, keeping proper records, and where the firm employs staff or is responsible for the conduct of investment business by others, should have adequate arrangements to ensure that they are suitable, adequately trained and properly supervised and that it has well-defined compliance procedures.”

Relevant FSA Rules

Systems and Controls

8. SYSC Rule 3.1.1 provides:

“A firm must take reasonable care to establish and maintain such systems and controls as are appropriate to its business.”

Communication with customers

9. COB Rule 2.1.3 provides that:

“When a firm communicates information to a customer, a firm must take reasonable steps to communicate in a way which is clear, fair and not misleading.”

Requirement to have internal complaint handling procedures

10. DISP Rule 1.2.1 provides that:

“A firm must have in place and operate appropriate and effective internal complaint handling procedures (which must be written down) for handling any expression of dissatisfaction, whether oral or written, and whether justified or not, from or on behalf of an eligible complainant about that firm’s provision of, or failure to provide, a financial service.”

Using the procedures

11. DISP Rule 1.2.22 provides that:

“A firm must put in place appropriate management controls and take reasonable steps to ensure that in complying with DISP 1.2.1R it handles complaints fairly, consistently and promptly and that it identifies and remedies any recurring or systemic problems, as well as any specific problem identified by a complaint.”

Relevant FSA Principles

12. Principle 2 “Skill, care and diligence” provides that *“A firm must conduct its business with due skill, care and diligence.”*
13. Principle 3 “Management and control” provides that *“A firm must take reasonable care to organise and control its affairs responsibly and effectively, with adequate risk management systems.”*
14. Principle 6 “Customers' interests” provides that *“A firm must pay due regard to the interests of its customers and treat them fairly.”*
15. Principle 7 “Communications with clients” provides that *“A firm must pay due regard to the information needs of its clients, and communicate information to them in a way which is clear, fair and not misleading”.*