
FINAL NOTICE

To: Approved Financial Solutions Limited

Address: Jubilee House
Sheffield Road
Dronfield
Derbyshire
S18 2GF

Date: 28 August 2008

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

1. THE PENALTY

1.1. The FSA gave AFS a Decision Notice on 28 August 2008 (“the Decision Notice”) which notified AFS that, for the reasons set out below and pursuant to section 206 of the Financial Services and Markets Act 2000 (“the Act”), the FSA had decided to

impose a financial penalty of £63,000 on AFS. This penalty is in respect of breaches of Principles 3, 7 and 9 of the FSA's Principles for Businesses ("the Principles") and of the rules in Chapter 4 of the section of the FSA's Handbook entitled "Mortgages and Home Finance: Conduct of Business Sourcebook" ("MCOB") between 1 March 2006 and 24 July 2007 ("the relevant period").

- 1.2. AFS agreed to settle at an early stage of the FSA's investigation and therefore qualified for a 30% (stage 1) discount under the FSA's executive settlement procedures. Were it not for this reduction the FSA would have sought to impose on AFS a financial penalty of £90,000.

2. REASONS FOR THE PENALTY

- 2.1. The FSA has concluded that, during the relevant period, AFS failed to take reasonable care to organise and control its affairs responsibly and effectively, with adequate risk management systems, failed to pay due regard to the information needs of its clients and to communicate with them in a way which was clear, fair and not misleading and failed to take reasonable steps to ensure the suitability of advice given to customers.

- 2.2. The FSA has made the following findings.

- (1) AFS failed to take reasonable care to organise and control its affairs responsibly and effectively, with adequate risk management systems, in breach of Principle 3, in that it:

- (a) failed to take reasonable steps to mitigate the risk of it being used by its customers as a vehicle for financial crime. In particular, it failed to take reasonable steps to counter the risk that income and employment related information provided by customers in support of their mortgage applications was false; and

- (b) gave responsibility for compliance (CF10) to a compliance officer who was not sufficiently competent or capable to perform that function in that he failed to ensure that AFS complied with regulatory requirements.

- (2) AFS failed to pay due regard to the information needs of its clients, and communicate information to them in a way that is clear, fair and not misleading, in breach of Principle 7, in that it:
 - (a) failed to provide customers with accurate suitability letters and Key Facts Illustration (“KFI”) documents reflecting the recommendation made and containing the correct factual information at the appropriate time; and
 - (b) failed to ensure that procurement fees were disclosed accurately to customers at the appropriate time.

- (3) AFS failed to take reasonable steps to ensure the suitability of advice given to its customers, in breach of Principle 9, in that it:
 - (a) failed to obtain from customers, and make records of, sufficient information to demonstrate the suitability of its advice, including information about their particular needs and preferences and personal and financial circumstances;
 - (b) failed to carry out adequate affordability assessments prior to recommending mortgage contracts including, but not limited to, a failure to assess affordability into retirement and/or the impact of Early Repayment Charges (“ERCs”) where relevant;
 - (c) failed to demonstrate it had conducted adequate research of available mortgage products prior to making recommendations to its customers;
 - (d) failed to make adequate records of the basis of its recommendations, including a failure to record reasons why the recommended product was the most suitable of those available and to demonstrate that a variety of options had been considered;
 - (e) recommended self-certification mortgage contracts in inappropriate cases, such as where customers were in full-time employment with no irregular or non-guaranteed income or where self-employed customers

stated that they could provide three years' worth of business accounts to support their application; and

- (f) failed to ensure that the mortgage application forms it submitted to lenders for its customers contained all relevant personal and financial information provided by customers during the fact finding process, and/or failed to disclose that information accurately.

2.3. AFS agreed to settle at an early stage of the FSA's investigation and therefore qualified for a 30% (stage 1) discount under the FSA's executive settlement procedure. Were it not for this reduction, the FSA would have sought to impose a financial penalty of £90,000 on AFS.

2.4. AFS' failures are considered by the FSA to be serious for the following reasons.

- (1) The failure to record sufficient personal and financial information, undertake and/or record the details of product research, make adequate assessments of affordability, provide customers with full, accurate information during the sales process and monitor the quality of advice provided by individual mortgage advisers meant that the suitability of advice could not be demonstrated. As a result, there is a risk that all customers may have been recommended unsuitable mortgage contracts.

- (2) Lenders may have entered into mortgage contracts in circumstances where the information regarding customers' personal and financial positions made available by AFS was incomplete or inaccurate.

2.5. In the FSA's opinion, AFS' misconduct merits the imposition of a financial penalty.

2.6. In determining the level of penalty, the FSA had regard to the following mitigating factors:

- (1) AFS co-operated fully with the FSA from an early date and throughout the investigation and agreed the facts of the case quickly.
- (2) From the point at which the FSA first gave AFS notice of its concerns, AFS was proactive in taking steps to remedy the deficiencies identified by the FSA

during the thematic visit. In addition, from November 2007, AFS undertook a comprehensive programme of action to improve its compliance controls and sales procedures. For example, it appointed two new compliance staff and improved its procedures for obtaining and recording information from customers about their needs and preferences and personal and financial circumstances.

(3) AFS has also agreed to the appointment of a skilled person to report to the FSA on the effectiveness of its new arrangements.

(4) AFS has no previous disciplinary or compliance history.

3. STATUTORY PROVISIONS, GUIDANCE AND REGULATORY REQUIREMENTS

Statutory provisions

3.1. The FSA's statutory objectives, set out in section 2(2) of the Act, are: market confidence, public awareness, the protection of consumers and the reduction of financial crime.

3.2. The FSA has the power, pursuant to section 206 of the Act, to impose a financial penalty of such amount as it considers appropriate where the FSA considers that an authorised person has contravened a requirement imposed upon it by or under the Act.

Determining the level of financial penalty

3.3. The FSA's policy in relation to the imposition of financial penalties is set out in Chapter 6 of the Decision Procedure and Penalties Manual (DEPP) which forms part of the FSA's Handbook. The principle purpose of a financial penalty is to promote high standards of regulatory conduct by deterring firms who have committed breaches from committing further breaches and helping to deter other firms from committing similar breaches, as well as demonstrating generally the benefits of compliant business.

3.4. In determining the appropriate level of financial penalty the FSA has also had regard to Chapter 13 of the Enforcement Manual ("ENF"), the part of the FSA's Handbook

setting out the FSA's policy on the imposition of financial penalties in force until 27 August 2007, and therefore during part of the relevant period.

- 3.5. Chapter 6 of DEPP sets out the factors that may be of particular relevance in determining the appropriate level of financial penalty for a firm or an approved person. However, the criteria listed in DEPP are not exhaustive and all relevant circumstances of the case will be taken into consideration.
- 3.6. In determining the level of financial penalty to be imposed, the FSA has considered the seriousness of the regulatory misconduct, including the nature of the requirements breached and the number and duration of the breaches, whether the breach revealed serious or systemic weaknesses in the firm's procedures or of the management systems or internal controls relating to all or part of its business, the loss or risk of loss caused to consumers, and the nature and extent of any financial crime facilitated, occasioned or otherwise attributable to the breaches. The FSA has also considered the amount of benefit gained, AFS' conduct following the breach and the firm's disciplinary record and compliance history.

FSA's Principles for Businesses

- 3.7. The Principles are a general statement of the fundamental obligations of firms under the regulatory system. They derive their authority from the FSA's rule-making powers as set out in the Act and reflect the FSA's regulatory objectives. The relevant Principles breached are as follows:
 - (1) Principle 3 (Management and control): A firm must take reasonable care to organise and control its affairs responsibly and effectively, with adequate risk management systems.
 - (2) Principle 7 (Communications with clients): A firm must pay due regard to the information needs of its clients, and communicate information to them in a way that is clear, fair and not misleading.
 - (3) Principle 9 (Customers: relationships of trust): A firm must take reasonable care to ensure the suitability of its advice and discretionary decisions for any customers who is entitled to rely upon its judgment.

Relevant MCOB provisions

- 3.8. Chapter 4.7 of MCOB sets out the requirements which a firm must comply with in the event of it completing advised mortgage sales.
- 3.9. MCOB 4.7.2R requires a firm to take reasonable steps to ensure that it does not make a personal recommendation to a customer to enter into a regulated mortgage contract or to vary an existing regulated mortgage contract, unless, in either case, the contract is suitable for the customer.
- 3.10. MCOB 4.7.4R requires that in considering the suitability of a regulated mortgage contract for its customer, a firm, having regard to the facts disclosed by the customer and other relevant facts about the customer of which it should reasonably be aware, must have reasonable grounds in order for it to conclude:
- (1) that the customer can afford to enter into the regulated mortgage contract;
 - (2) the regulated mortgage contract is suitable to the needs and circumstances of the customer; and
 - (3) the regulated mortgage contract is the most suitable of those that, in the circumstances, are available to it.
- 3.11. MCOB 4.7.17R requires that a firm must make and retain a record:
- (1) of the customer information, including the customer's needs and circumstances; and
 - (2) that explains why the firm has concluded that any personal recommendation given in accordance with MCOB 4.7.2 satisfies the suitability requirements in MCOB 4.7.4.

4. FACTS AND MATTERS RELIED ON

Background

- 4.1. AFS is a limited company, incorporated on 27 July 2005, operating in the Derbyshire area as a mortgage broker. On 1 March 2006, AFS became authorised to carry on the following regulated activities:
- (1) Advising (except Pension Transfers/Opt Outs) - non-investment insurance contracts;
 - (2) Arranging (bringing about) deals in investments - non-investment insurance contracts;
 - (3) Advising on regulated mortgage contracts;
 - (4) Agreeing to carry on a regulated activity;
 - (5) Arranging (bringing about) regulated mortgage contracts;
 - (6) Making arrangements with a view to regulated mortgage contracts; and
 - (7) Making arrangements with a view to transactions in investments – non-investment insurance contracts.
- 4.2. Three AFS directors hold controlled function CF1 (Director), one of whom also holds Controlled Function CF3 (Chief Executive) and CF8 (Apportionment and Oversight). During the relevant period, an internal compliance consultant held CF10 (Compliance Oversight), CF11 (Money Laundering) and CF14 (Risk Assessment).
- 4.3. AFS' customer base is largely 'sub-prime'. Sub-prime mortgages are generally sold to customers with low or impaired credit ratings who may find it difficult to obtain finance from traditional sources. Many of its customers were seeking to re-mortgage to consolidate existing debts and to continue to meet their financial commitments and, as such, were in a particularly vulnerable financial position.
- 4.4. The FSA's Small Firms Division ("SFD") visited AFS on 24 and 25 July 2007 as part of the FSA's thematic project on the self-certification and affordability of mortgage contracts. The purpose of the visit was to assess the suitability of recommendations to clients to enter into self-certification mortgage contracts and the steps taken to ensure the affordability of recommended mortgage contracts.

- 4.5. During the visit, SFD reviewed 20 client files and conducted interviews with members of AFS' senior management. SFD's findings identified serious concerns about AFS' systems and controls, the adequacy of Know Your Customer information gathered by AFS' advisors, AFS' approach to affordability and use of self-certification mortgage contracts, the suitability of advice given to customers and the way in which AFS communicated with its clients.
- 4.6. The FSA identified the following main areas of concern about AFS:
- (1) Material personal and/or financial information provided by customers during the fact finding process was not disclosed on mortgage application forms submitted to the lenders by AFS. When the income and employment details provided to AFS by its customers during the fact finding process were submitted to Her Majesty's Revenue and Customs ("HMRC") for verification, it became clear that in each of the 20 reviewed files the information provided was false, with salaries being significantly inflated and in some cases falsified altogether.
 - (2) AFS did not have in place adequate systems to monitor the quality of advice provided by individual advisers. AFS' advisers were supervised in an informal manner, by means of non-documented, ad hoc discussions.
 - (3) The person to whom responsibility for compliance matters was delegated was not sufficiently competent or capable to ensure that AFS complied with regulatory requirements. This was apparent to the FSA from the content of that person's compliance reports, provided to senior management at monthly meetings. AFS should have recognised that person's deficiencies and addressed these issues.
 - (4) AFS did not provide its customers with adequate suitability letters. The letters often did not relate to the recommended product and contained factual errors. The FSA found that in many cases customers received suitability letters and KFI documents after they had applied for a mortgage. This made all the information contained within the suitability letters and KFI documents, even if

accurate, redundant for their purpose of informing customers about the recommended mortgage contracts before they applied for the mortgage.

- (5) AFS did not disclose the correct procurement fees to customers. The procurement fee stated in mortgage offers was significantly higher than that disclosed to the customers.
- (6) AFS could not demonstrate the suitability of the recommended mortgage contracts because its client files contained insufficient personal and financial information and information regarding customers' needs and preferences.
- (7) The FSA found that the assessments of affordability on the 20 files it reviewed were inadequate. AFS failed to correctly complete the affordability calculator on its fact finds (with improbably low sums being recorded for monthly expenditure, resulting in an inflated estimate of monthly disposable income) and also failed to consider affordability into retirement in some cases.
- (8) The FSA found that in re-mortgage cases AFS did not pay due regard to customers' existing mortgages, as in the majority of cases an ERC was imposed by the lender if the mortgage was redeemed in the first three years of the mortgage term. The ERC increases the redemption cost of an existing mortgage. In addition to the ERC, customers would incur extra charges for effecting a re-mortgage. This included a broker fee payable to AFS for advising on and arranging the remortgage. These fees were added to the new mortgage debt, increasing the amount of debt secured against a customer's property. In some cases, the combined costs incurred by the customer by re-mortgaging were significantly greater than the capital raised.
- (9) There was insufficient evidence on the client files to demonstrate that adequate product research had been undertaken prior to making recommendations. AFS accepted that the product database in use during the relevant period did not cater for sub-prime customers because it only sourced mortgages from the prime market, yet it continued to be used for all product sourcing despite the fact that the large majority of AFS' customers required sub-prime contracts.

- (10) It was unclear from the majority of the client files what the recommendations were based upon. In particular, there was no evidence that alternative courses of action had been considered in appropriate cases. For example, in cases where customers wanted to remortgage in order to raise small amounts of capital for home improvements, there was no evidence that AFS advised the customer to contact their existing lender first and discuss the possibility of a loan increase, which would help them avoid brokers' fees and/or ERCs.
- (11) In a number of cases self-certification mortgages had been recommended despite the fact that a full status product was clearly more suitable, such as in cases where the customer could prove their income with accounts or self assessment tax returns or where they were employed full-time with no additional, non-guaranteed income. Interest-only products were also recommended in potentially inappropriate circumstances, for example where customers had no savings or investment vehicle in place to ensure the repayment of the capital sum at the end of the mortgage term.

Analysis of breaches of Principles and rules

- 4.7. AFS' failure to implement systems and controls to counter the risk that it would be used to commit financial crime together with its failure to monitor the quality of advice provided by its advisers are examples its failure to take reasonable care to organise and control its affairs responsibly and effectively with proper risk management systems, in breach of Principle 3. In the FSA's opinion, AFS should have taken particular care to manage the financial crime risk given that it operates almost entirely in the sub-prime market, generating business via leads purchased from debt management companies and conducts a large amount of self-certification business.
- 4.8. AFS' failure to ensure that the role of compliance oversight (CF10) was held by a competent and capable person and the failure to notice the obvious inadequacies in his work amounts to a further breach of Principle 3.
- 4.9. By failing to provide customers with accurate suitability letters and KFIs at the right time during the sales process or disclose procurement fees correctly, AFS did not pay

due regard to the information needs of its clients or communicate information to them in a clear, fair and not misleading manner. As such, AFS contravened Principle 7.

- 4.10. AFS did not obtain and make records of sufficient personal or financial information to demonstrate the suitability of its recommendations. It also failed to carry out proper assessments of affordability (including a failure to assess affordability into retirement or the impact of early repayment charges in appropriate cases), failed to conduct and/or make records of adequate product research, failed to make adequate records to demonstrate the basis of advice given, and recommended self-certification and interest-only mortgage contracts in inappropriate circumstances.
- 4.11. The conduct described in paragraph 4.10 amounts to a failure by AFS to take reasonable steps to ensure that it did not recommend customers to enter into mortgage contracts (or vary existing mortgage contracts) unless the relevant contract (or variation) is suitable for that customer, which constitutes a breach of MCOB 4.7.2R.
- 4.12. In particular, the failure to have regard to customers' stated needs and preferences represents a breach of MCOB 4.7.2R and MCOB 4.7.4R (1). The failure to set out and record on the customers' files the facts and matters supporting the assessment of suitability of recommended mortgage contracts represents a breach of MCOB 4.7.17R.
- 4.13. As a result of the failings referred to at paragraphs 4.11 to 4.13 above, AFS failed to take reasonable steps to ensure the suitability of its advice for customers who were entitled to rely upon its judgement, in breach of Principle 9.

5. ANALYSIS OF THE SANCTION

- 5.1. The FSA has had regard to the guidance published in the FSA's Enforcement Guide ("EG") and in the Decision Procedures and Penalties Manual ("DEPP"). The FSA has also had regard to the appropriate provisions of the FSA's Enforcement Manual ("ENF") which applied during part of the relevant period in which AFS's misconduct occurred.

- 5.2. The FSA considered the nature and seriousness of the contraventions by AFS, whether the breaches identified were deliberate or reckless, the number and duration of the breaches, and the number of customers placed at risk.
- 5.3. The FSA concluded that there was a risk that customers may have been given unsuitable advice but it also took into account that many customers may have provided AFS with false information about their employment and incomes.
- 5.4. The FSA has taken into account AFS' full co-operation and the fact that it quickly agreed with the FSA the facts of the case. The FSA has also taken into account its commitment to take all reasonable steps to comply with regulatory requirements (which includes the appointment of a skilled person to report on the effectiveness of its new arrangements). AFS has not previously been the subject of disciplinary action.
- 5.5. The FSA has taken into account penalties imposed on other authorised persons for similar and more serious conduct and to previous cases where private warnings were given to authorised persons for less serious conduct or more limited record-keeping failures.
- 5.6. The FSA has also taken into account AFS' size and financial resources.
- 5.7. Having considered all the circumstances above, the FSA has determined that £90,000 (before any discount for early settlement) is the appropriate financial penalty to impose on AFS.

6. DECISION MAKER

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

7. IMPORTANT

- 7.1. This Final Notice is given to AFS under section 206 and in accordance with section 390 of the Act.

Publicity

- 7.2. 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.
- 7.3. The FSA intends to publish such information about the matter to which this Final Notice relates as it considers appropriate.

FSA contacts

- 7.4. For more information concerning this matter generally, you should contact Chris Walmsley at the FSA (direct line: 020 7066 5894, or fax: 020 7066 5895).

Jonathan Phelan
Head of Department
FSA Enforcement Division