FSA fines HSBC £10.5million for mis-selling products to elderly customers

FSA/PN/105/2011
05 Dec 2011

The Financial Services Authority (FSA) has issued its largest ever retail fine of £10.5 million to HSBC because of inappropriate investment advice provided by one of its subsidiaries, NHFA Limited (NHFA) to elderly customers. HSBC estimates that the amount of compensation to be paid to NHFA customers will be approximately £29.3 million in addition to the fine.

Between 2005 and 2010 NHFA advised 2,485 customers to invest in asset-backed investment products, typically investment bonds, to fund long-term care costs for elderly customers. The products were sold to individuals entering, or already in, long-term care and in many cases these elderly customers were reliant on the investments to pay for their care. Typically these investments are recommended for a minimum period of five years.

The advice and sales were unsuitable because in a number of cases the individual's life expectancy was below the recommended five-year investment period. As a result customers with shorter life expectancies had to make withdrawals from these investments sooner than is recommended. The combination of withdrawals and product charges led to faster reduction of capital than should have been the case if customers had received the right advice. A review by a third party of a sample of customer files found unsuitable sales had been made to 87% of customers involving these types of investments.

It was clear that HSBC's subsidiary, NHFA, had not considered the individual needs of its elderly customers and failed in many cases to recommend suitable products for their circumstances, for example higher fixed interest rate savings accounts and ISAs. It was also apparent that NHFA's advisers failed to consider the tax status of customers before making a recommendation.

The FSA views the failings as particularly significant because:

- NHFA's customer base was particularly vulnerable. The average customer age was almost 83 and they therefore had limited means or opportunity to make up any financial loss resulting from an unsuitable sale;
- NHFA was the leading supplier in the UK of independent financial advice on long-term care products to help pay for care costs, with a market share in recent years approaching 60%;
- the mis-conduct occurred over a period of approximately five years; and
- a significant number of customers may have suffered financial detriment. During the Relevant Period 2,485 customers invested in asset-backed products. The total amount invested was close to £285 million, meaning the average amount invested per customer was approximately £115,000.

The failings breached Principle 9 which states that a firm must take reasonable care to ensure the suitability of its advice and discretionary decisions for any customer who is entitled to rely upon its judgment. HSBC is undertaking a past business review to determine if customers of NHFA or their families are entitled to redress and will contact customers directly. HSBC has indicated that it expects the cost of redress alone to be £29.3 million.

HSBC agreed to settle at an early stage entitling it to a 30% discount on its fine. It also demonstrated its commitment to making changes to its operations. HSBC closed NHFA to new business on 1 July 2011.

Tracey McDermott, acting director of enforcement and financial crime, said

"NHFA was trusted by its vulnerable and elderly customers. It breached that trust to sell them unsuitable products. This type of behaviour undermines confidence in the financial services sector.

"HSBC, who owned NHFA, has now recognised the issues and taken steps to do the right thing. They have been given credit for that - but for some customers it will be too late.

"This penalty should serve as a warning to firms that they must have the right systems and controls in place to manage and identify risks when they acquire new businesses. A failure to do so can lead not only to detriment to their customers but to significant reputational and regulatory cost."

Notes for editors

1. The Final Notice can be found on the FSA's website.
2. NHFA was a firm that HSBC acquired in July 2005 and, until May 2010, was separately authorised and regulated by the FSA. NHFA specialised in the provision of independent financial advice to customers, who were either currently receiving care or about to enter long-term care arrangements. HSBC closed NHFA to new business on 1 July 2011.
3. NHFA recommended investment bonds to a considerable proportion of its customers. In the majority of cases sales were made through their families or representatives. Investment bonds are single premium life assurance contracts under which a lump sum is invested for the customer until the bond is either cashed in or until the death of the last life assured.
4. Principle 9 is set out in the FSA's Handbook and states: A firm must take reasonable care to ensure the suitability of its advice and discretionary decisions for any customer who is entitled to rely upon its judgement.
5. The FSA regulates the financial services industry and has four objectives under the Financial Services and Markets Act 2000: maintaining market confidence; securing the appropriate degree of protection for consumers; fighting financial crime; and contributing to the protection and enhancement of the stability of the UK financial system.

Financial Services Authority

FSA

FINAL NOTICE

To: **HSBC Bank Plc (HSBC)**

FSA Reference Number: 114216

Address: 8 Canada Square, London E14 5HQ

Date: 2 December 2011

1. ACTION

1.1. For the reasons given in this Notice, the Financial Services Authority (the FSA) hereby imposes on HSBC a financial penalty of £10.5 million.

1.2. HSBC agreed to settle at an early stage of the FSA's investigation. It therefore qualified for a 30% (Stage 1) discount under the FSA's executive settlement procedures. Were it not for this discount, the FSA would have imposed a financial penalty of £15 million on HSBC.

2. SUMMARY OF REASONS

2.1. The penalty imposed on HSBC relates to investment advice and sales of investment products provided by NHFA Limited (NHFA) to NHFA customers between 15 July 2005 and 20 July 2010 (the Relevant Period). NHFA was a firm that HSBC acquired in July 2005 and, until May 2010, was separately authorised and regulated by the FSA.

2.2. During the Relevant Period, 2,485 customers were advised to invest in asset-backed investment products, typically investment bonds, which were used to fund long-term care costs for elderly customers. The sales were made by NHFA and resulted in a breach of Principle 9 (Customers: relationships of trust) of the FSA's Principles for Businesses (the Principles) in that there was a failure to take reasonable care to ensure the suitability of the advice given to customers entitled to rely upon its judgement.

NHFA also breached the following rules in the FSA Handbook entitled Conduct of Business (COB) and the provisions which replaced COB on 1 November 2007, entitled Conduct of Business Sourcebook (COBS), during the periods referred to in the Appendix: COB 5.2.5R, COB 5.3.5R, COB 5.3.16R(1) and (2), COB 6.6.49R(2), COBS 9.2.1R, COBS 9.2.2R, COBS 9.4.7R and COBS 13 Annex 2.2.3R and 2.4R(1).

2.3. NHFA specialised in the provision of independent financial advice to customers, who were either currently receiving care or about to enter long-term care arrangements. In the majority of cases sales were made through their families or representatives. The typical NHFA customer was elderly (the average age was almost 83). Its customers were particularly vulnerable and in many cases relied on investments to fund their care costs. HSBC closed NHFA to new business on 1 July 2011.

2.4. The failings in the suitability of advice were serious, systemic and persisted over a long period of time. For example, a third party reviewed 421 NHFA customer files in relation to sales made between April 2004 and July 2010 and identified unsuitable sales in relation to 367 customers (87%) where one or more asset-backed products were sold. In terms of policies sold, 625 of the 841 asset-backed policies sold were deemed to be unsuitable for the customer (74%).

2.5. The failings identified in respect of NHFA sales included the following:

(1) In a number of cases reviewed the customer's life expectancy at the point of sale was less than the minimum recommended term of the investment (five years). That meant that it was likely the charges on the bond would reduce capital to such an extent that the product was unsuitable.

(2) There was no consistent approach to assessing customers' attitude to risk (ATR) or use of a suitable risk profiling questionnaire. This deficiency in the sales process meant that advisers often recommended investment strategies to customers that were inconsistent with the customers' tolerance for risk.

(3) There was inadequate diversification of investments and savings plans. The majority of recommendations were for investment bonds with little or no consideration given to the use of other suitable forms of investments such as OEICs/unit trusts, ISAs, National Savings and fixed rate deposits. The review of customer files showed that, in the majority of cases, a different product should have been recommended or no product should have been recommended at all.

(4) Advisers failed to consider the tax status of customers before making a recommendation. As a result customers may not have been aware of suitable alternative investments which were potentially more tax efficient for their individual circumstances.

(5) Customers were given recommendations to invest a high proportion of funds into asset-backed investments with only a small amount of funds left readily available to them on deposit. This resulted in many cases in high levels of withdrawals from the invested assets being necessary despite this being foreseeable at the time of the recommendation. The combination of withdrawals and product charges led to faster reduction of capital than should have been the case if customers had received the right advice. High levels of

withdrawals at the start of the investment, in particular, reduce the possibility of the investment growing in value to cover the charges incurred.

(6) The suitability letters issued by NHFA advisers to customers:

(a) used standard paragraphs instead of being tailored to the circumstances of the individual customer. They therefore failed adequately to explain to the customer why the adviser had concluded that the investments were suitable for them, having regard to their personal and financial circumstances;

(b) contained a number of inaccuracies in the standard wordings;

(c) failed to give balanced information by focussing unduly on the benefits of an investment while failing to provide sufficient warnings about the possible disadvantages; and

(d) included standard appendices with out-of-date or irrelevant information.

As a consequence of the failings, NHFA customers were exposed to an unacceptable risk of mis-selling and, as described in paragraph 2.4 above, a significant number of asset-backed investments were in fact mis-sold.

2.6. The FSA views these failings as particularly serious because:

(1) NHFA was the leading supplier in the UK of independent financial advice on long-term care products to help pay for care costs, with a market share in recent years approaching 60%;

(2) NHFA's customer base was particularly vulnerable given the customers' age and in many cases they were reliant upon their investments to fund their care costs. They therefore had limited means or opportunity to make up any financial loss resulting from an unsuitable sale. This risked impacting on their ability to fund care arrangements. However, no complaints have been received at this time by HSBC or NHFA to suggest that customers were required to leave their care home as a result of the advice given by NHFA;

(3) the mis-conduct occurred over a period of approximately 5 years;

(4) a significant number of customers may have suffered financial detriment. During the Relevant Period 2,485 customers invested in asset-backed products. The total amount invested was approximately £285 million, meaning the average amount invested per customer was approximately £115,000. HSBC estimates that the amount of redress to be paid to affected customers will be approximately £29.3 million; and

(5) HSBC is a major global financial services provider with a prominent position in the retail consumer market.

2.7. The failings therefore merit the imposition of a substantial financial penalty. In deciding upon the appropriate level of penalty, the FSA has taken the following into account:

(1) HSBC identified the serious failings at NHFA, provided a report to the FSA and implemented a comprehensive improvement programme at NHFA to address its failings. This involved making improvements to NHFA's sales processes and the training provided to its managers and advisers. As a result, a review by a third party of a sample of NHFA sales made after July 2010 demonstrated significant improvements;

(2) HSBC has taken a proactive approach to reviewing all sales made by NHFA between April 2004 and July 2010 to determine where redress should be paid. Given the vulnerability of the customer base and the time elapsed, HSBC will not make contact with the customers or the advisers involved. Sales have been reviewed on the basis of the information available on the file only. Where it is unclear if the file was suitable, HSBC will assess the file as unsuitable and pay full redress;

(3) HSBC implemented the customer redress programme, with a third party, before the referral to enforcement was made; and

(4) HSBC agreed the facts of the investigation quickly and the FSA was able to rely on its review of NHFA sales and a review by a third party without further extensive investigation being necessary.

2.8. Were it not for the significant level of co-operation shown by HSBC, both prior to and after the referral to enforcement, the fine would have been significantly greater.

2.9. The failures at NHFA highlight the need for regulated firms to ensure that where they acquire new businesses they implement appropriate systems and controls to manage and oversee their activities effectively. This includes positioning the new business in reporting structures that allow the wider Group to identify promptly and monitor any risks associated with new business. Where firms do not do this there is a significant risk of regulatory breaches, customer detriment and reputational damage.

3. DEFINITIONS

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

(1) "**the Act**" means the Financial Services and Markets Act 2000;

(2) "**ATR**" means customers' attitude to investment risk;

(3) "**COB**" means the rules in the FSA Handbook entitled Conduct of Business;

(4) "**COBS**" means the provisions which replaced COB on 1 November 2007 entitled Conduct of Business Sourcebook;

(5) "**Compliance**" means HSBC's Compliance Monitoring Department;

(6) "**DEPP**" means the FSA's Decision Procedure and Penalties manual;

(7) "**ENF**" means the Enforcement manual;

(8) "**the FSA**" means the Financial Services Authority;

(9) "**HSBC**" means HSBC Bank plc;

(10) "**ICPs**" means Immediate Care Plans, which involve an immediate annuity, offered to customers who are assessed through medical underwriting as needing immediate care, and provide tax free income directly to a customer's care provider;

(11) "**ISAs**" means Individual Savings Accounts;

(12) "**NHFA**" means NHFA Limited;

(13) "**OEICs**" means Open Ended Investment Companies, which are structured to invest in other companies with the ability to constantly adjust their investment criteria and fund size;

(14) "**the Principles**" means the FSA's Principles for Businesses;

(15) "**the Relevant Period**" means 15 July 2005 to 20 July 2010;

(16) "**sales managers**" means the NHFA Regional Sales Managers seconded from HSBC to oversee the advisers and check the quality of sales made; and

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

4. FACTS AND MATTERS

4.1. HSBC is a major global financial services provider with a prominent position in the retail consumer market. It has been authorised by the FSA since 1 December 2001. HSBC has permission from the FSA to perform a number of regulated activities, including advising on investments and arranging deals in investments.

4.2. NHFA was launched in 1991 and specialised in the provision of independent financial advice for people requiring long-term care products to help pay for their care costs. It promoted itself as the leading supplier in the UK for this type of advice and its market share in recent years was approaching 60%. NHFA regularly received customer referrals from Health Authorities and charities supporting the elderly.

4.3. During the Relevant Period, 4,726 customers purchased one or more products following advice given by NHFA. In addition, a significant number of customers received advice from NHFA but the majority did not, or were advised not to, purchase any products.

4.4. Approximately 80% of NHFA's customers during the Relevant Period were seeking advice on how to fund their long-term care costs. The typical NHFA customer was elderly (the average customer age was almost 83), with an average life expectancy of up to 9 years recorded by NHFA at the point of sale. NHFA's customers therefore had limited means or opportunity to make up any financial loss. NHFA's customer base also included family members acting in the interests of an elderly and/or ill relative (often by Enduring or Lasting Powers of Attorney).

4.5. The HSBC Group acquired NHFA in July 2005 and placed it under the control of HSBC Actuaries and Consultants Limited, with compliance oversight from HSBC Insurance, Europe. In January 2009 NHFA was transferred to the management control of HSBC and, in March 2009, compliance oversight responsibility passed to HSBC's UK Banking Compliance team. Until May 2010, NHFA was separately authorised and regulated by the FSA. HSBC closed NHFA to new business on 1 July 2011.

The asset-backed products

4.6. In total 4,726 NHFA customers purchased one or more products during the Relevant Period. Of those customers 2,485 (52%) purchased asset-backed products. Where customers received advice specifically about investments, NHFA recommended an investment bond to a considerable proportion of its customers. These investment bonds were from a number of providers.

4.7. Investment bonds are single premium life assurance contracts under which a lump sum is invested for the customer until the bond is either cashed in or until the death of the last life assured. Investment bonds are designed to produce capital growth but can also be used to provide an income. The charging structure varied between different bonds but included charges to the customer to establish and manage the bond and charges for management of the underlying funds. Customers may also have been charged for making withdrawals from the bond and for cashing in either part or all of the bond, particularly when changes were made during the early life of the bond.

4.8. The investment bonds sold by NHFA were typically suitable for medium to long-term investments as the funds should usually be invested for a minimum term of five years to allow the growth on the investment to cover any charges applied.

Compliance Monitoring Review of NHFA

4.9. In April 2009 HSBC's Compliance Monitoring Department (Compliance) visited NHFA to gain a greater understanding of how the business operated ahead of a planned compliance review. The review was then conducted by Compliance in July 2009. The objective of this was to assess the standard of supervision, management control and sales quality at NHFA, which were the responsibility of NHFA Regional Sales Managers (sales managers). At the time there were three sales managers, each of whom had been seconded to NHFA from HSBC.

4.10. At the time, the sales quality checking of customer files was the sole responsibility of the sales managers. The level of checking was a minimum of one case per month per adviser (of which there were 31 at the time), although this varied depending upon the competency level of the adviser. Prior to March 2009 a compliance team within NHFA had been undertaking a 100% check of cases prior to submission to the product providers.

Systemic issues

4.11. Compliance found that the standard of supervision by the sales managers posed a high risk of customer detriment. When Compliance checked 27 customer files that had been subjected to review by the sales managers it became apparent that there were failings in the suitability of the advice given. These issues were not being picked up by the sales managers during their file checks.

4.12. To establish whether these suitability issues were present in the sales made prior to the sales managers taking over file checking (i.e. when checks were being undertaken by NHFA's compliance team), Compliance tested, in November 2009, an additional 17 customer files selected from business written by NHFA advisers between September 2008 and March 2009. The review of these files identified clear evidence that the suitability issues were systemic and had persisted for some time.

4.13. The final report from Compliance was issued in March 2010. It described the following issues:

(1) There was no standard approach to assessing customers' ATR and a suitable risk profiling questionnaire needed to be introduced. There was also a lack of clarity as to how the customer's ATR had been determined. In some cases, there appeared to be confusion over whether the ATR assessed was that of the customer or the person(s) who held the Power of Attorney.

(2) The tax status of customers was not being taken into account when making recommendations. For example, ISAs were rarely recommended, or investment bonds (taxed investments) were recommended for nil rate payers without being told they were unable to reclaim this tax. Where personal allowances were not fully utilised, mention was not made that the customer could complete Inland Revenue form R85 in order to have bank and/or building society interest paid gross.

(3) There was a lack of diversification of recommended investments, with the majority being for investment bonds. Little or no consideration was given to using other investments or savings accounts, such as OEICs/unit trusts, ISAs, National Savings, and fixed rate deposits; nor were reasons given for discounting such investments or savings accounts.

(4) In following NHFA advisers' recommendations to invest a high proportion of funds in asset-backed investments, customers were left with only a small amount of funds readily available to them. This resulted in many cases in high levels of withdrawals from the invested assets during the early years to meet customers' care costs.

High levels of withdrawals at the start of the investment mean that any growth in the investment may not be sufficient to cover the charges incurred and the capital may be depleted faster than is necessary. Where large amounts are withdrawn annually the customer can become liable to pay increased tax charges. There may therefore be potentially no benefit to the customer compared to retaining the funds in a bank or building society deposit account.

The ATR for these customers was often recorded as 'low to medium', although this was not consistent with the strategy of withdrawing capital from these asset-backed investments.

(5) The sales process did not require the adviser to consider whether it was appropriate to write investment bonds on a multiple life basis. For example, including the customer's ultimate beneficiary (often the Power of Attorney) in the policy as an additional life assured would have meant that the investment would not need to be encashed on first death. This would have increased the probability of the bond running for the medium to long-term.

(6) Recommendations were not given for investment bonds to be written under trust where appropriate. For the right customers, this could have aligned care fees planning with inheritance tax planning. In addition, where a trust existed it would not have been necessary to wait for probate before the executors could access the funds.

(7) NHFA advisers recommended investment bonds to customers based on an unsuitable projection rate that overstated the potential future returns on these investments.

Mostly, firms use the default projection rate assumptions from FSA rules to illustrate the impact of the bond's charges on the investment. These assume future investment returns of: i) a lower projection rate of 4%; ii) a mid-projection rate of 6%; and iii) a higher projection rate of 8%. For investment periods shorter than five years or when using lower risk assets that are unlikely to generate strong returns (as was the situation in many cases at NHFA), 4% or a lower rate should be used as appropriate.

Despite this, NHFA based its recommendations for customers to invest in investment bonds on an overstated default mid-projection rate of 6%.

(8) The suitability letters issued by NHFA advisers to customers:

(a) used standard paragraphs instead of being tailored to their personal and financial circumstances;

(b) contained a number of inaccuracies in the standard wordings;

(c) failed to give balanced information by focussing unduly on the benefits of an investment while failing to provide sufficient warnings about the possible disadvantages. For example, risk warnings around high levels of withdrawals did not appear to take account of the effect of charges, potential investment performance of the fund(s) or the fact that capital would be depleted; and

(d) used standard appendices containing out-of-date information, as well as information not relevant to the recommendations.

4.14. As a result of the report, HSBC took steps to review and amend the sales process and training for sales managers and advisers at NHFA.

HBSC 380 file review

4.15. In August 2010 the FSA and HSBC had agreed the need for a wider review of advice given by NHFA and customer outcomes covering the period 15 July 2005 to 1 March 2010. A sample of 380 customer files was selected in order to:

(1) assess the suitability of advice provided;

(2) make recommendations on whether a full review of past customer files would be required, based on the overall outcome;

(3) decide on the redress methodology to be applied; and

(4) consider whether changes should be made to the approach to advice and sales going forward.

4.16. The 380 customer files included:

(1) 175 with asset-backed investments only (50 with a Guaranteed Death Benefit and 125 with no such benefit); and

(2) 80 where there was an asset-backed investment sold alongside an ICP, which is an annuity that provides tax free income directly to a customer's care provider.

4.17. The file checks were carried out by a third party. The review found unsuitable sales within 238 out of the 255 customer files that involved the sale of asset-backed investments (93%).

Third party 22 file review

4.18. HSBC then selected 22 NHFA customer files from the wider population of 380 that it considered were representative of those categorised as unsuitable sales during the 380 file review. A third party was appointed to review the 22 customer files.

4.19. In relation to the 21 customers who were recommended asset-backed investments the third party reported that:

(1) in 11 cases no sales should have been made;

(2) in 5 cases the wrong product was sold as an alternative product would have been suitable;

(3) in 3 cases the correct product was sold but the amount retained in a savings account was insufficient;

(4) in 1 case the correct product was sold but the recommended withdrawals strategy was unsuitable for the customer;

(5) in 1 case the advice given was wholly suitable; and

(6) in 4 of the above cases the customer received both suitable and unsuitable advice.

Therefore, out of the 22 customer files reviewed by the third party, only 2 were deemed to contain wholly suitable recommendations (one involving the sale of both an ICP and asset-backed investment and the other involving the sale of an ICP only).

4.20. Examples of the reasons given for assessing the sales as unsuitable included:

(1) the customer's life expectancy was less than the minimum recommended investment term of five years. For example, one customer was 94 at the point of sale and had a life expectancy of 3 years and 3 months;

(2) high levels of withdrawals were arranged during the early life of the investments. Investment bonds should be given sufficient time to make up initial charges through capital growth before being accessed for income or regular withdrawals. They should also not generally be recommended if capital needs to be accessed within the early years of the investment as the high levels of withdrawals are effectively eroding capital.

In one example, after the sale of the investment bond the remaining cash the customer had on deposit was only sufficient to fund care costs for 1 year, 2 months. Withdrawals of 12% of the original money invested were therefore necessary each year which did not allow the bond to cover the charges applied;

(3) selling a bond with no Guaranteed Death Benefit when one would have been appropriate. A Guaranteed Death Benefit pays out a minimum guaranteed amount (reduced by any withdrawals taken) to the owner of the bond upon the death of the life assured. The owner may therefore be guaranteed at least a return of the initial investment even if the investment has performed poorly and the value of the bond has reduced;

(4) failing to mention or make use of the customer's ISA allowance; and

(5) poor diversification with an unacceptable proportion (more that 30%) of the customer's investment being in property funds which may pose an inappropriate investment risk for the customer.

4.21. Other general observations from the review included:

(1) inconsistencies in the way that investment ATR was discussed and documented at the point of sale which could have caused confusion for the customer, for example:

(a) 'cautious' and 'low to medium' were used interchangeably; and

(b) the 'low to medium' ATR assessment often appeared to be attributed to customers as a default position; and

(2) some evidence of product bias in the point of sale documentation towards investment bonds and OEICs above other equally suitable options.

Third Party 529 file review

4.22. The third party that conducted the 22 file review was appointed to conduct a further review of a sample of 529 NHFA customer files (which included the prior 380) relating to sales made between April 2004 and July 2010. Of those, there were 421 customer files that contained sales of asset-backed investments (841 policies in total). The review found unsuitable sales in 367 of the 421 customer files (87%). In terms of policies, 625 of the 841 asset-backed policies sold were deemed to be unsuitable for the customer (74%).

Non-detection of the mis-selling at NHFA

4.23. HSBC UK Banking Compliance has determined that there were a number of issues concerning the management and oversight of NHFA within the HSBC Group which meant that the mis-selling was not detected until the review by Compliance in July 2009. The following issues were identified:

(1) NHFA was an independent financial adviser operating in a highly specialised area and the complexity of its business and the associated risks were not assessed and managed adequately.

(2) Insufficient consideration was given to appropriate examination of the quality of sales.

(3) NHFA was required to align itself with the HSBC Group policies following its acquisition in July 2005, however little progress had been made in integrating its operations into those of the HSBC Group before management control was passed to HSBC in January 2009.

(4) After acquisition, reliance was placed on the fact that all sales were reviewed by the compliance team within NHFA before they were processed, with the result that the standard of NHFA's compliance processes were not scrutinised until the review by Compliance in July 2009.

5. FAILINGS

5.1. The regulatory provisions relevant to this Final Notice are referred to in the Appendix.

5.2. Principle 9 requires firms to take reasonable care to ensure the suitability of their advice and discretionary decisions for any customer who is entitled to rely upon their judgement. On the basis of the facts and matters set out above, the FSA considers that HSBC and NHFA did not take reasonable care to ensure the suitability of NHFA's advice to customers.

5.3. The inadequate sales process and standard of supervision and management control at NHFA resulted in a significant number of unsuitable sales of asset-backed investments being made to customers during the Relevant Period. The sales process at NHFA failed to:

(1) provide a consistent approach to assessing customers' ATR;

(2) take into account all the relevant financial and personal circumstances of customers, such as their tax status and whether asset-backed investments were appropriate in view of their life expectancy;

(3) give sufficient consideration to the use of other suitable forms of investments meaning that the majority of recommendations were for investment bonds; and

(4) provide customers with adequate suitability letters.

The standard of supervision by management posed a high risk of customer detriment. Management failed to implement adequate procedures for monitoring the quality of sales which meant that the issues relating to the suitability of advice given to customers were not identified.

5.4. NHFA breached COB 5.2.5R, COB 5.3.5R, COB 5.3.16R(1) and (2), COB 6.6.49R(2), COBS 9.2.1R, COBS 9.2.2R, COBS 9.4.7R and COBS 13 Annex 2.2.3R and 2.4R(1) during the periods referred to in the Appendix because it failed to take reasonable steps to ensure that the advice it provided to its customers was suitable for them.

6. SANCTION

6.1. The FSA's policy on the imposition of financial penalties is set out in Chapter 6 of the Decision Procedure & Penalties Manual (DEPP) which forms part of the FSA Handbook. It was previously set out in Chapter 13 of the Enforcement Manual (ENF). The Manuals set out the factors that may be of particular relevance in determining the appropriate level of financial penalty for a firm or approved person. The criteria are not exhaustive and all relevant circumstances of the case are taken into consideration.

6.2. Since the majority of the relevant conduct occurred before the introduction of the new penalty regime on 6 March 2010, the FSA has applied the penalty regime that was in place prior to 6 March 2010.

Deterrence

6.3. The financial penalty is required to promote high standards of regulatory conduct by deterring firms who have breached regulatory requirements from committing further contraventions, helping to deter other firms from committing contraventions, and demonstrating generally to firms the benefits of compliant behaviour. It strengthens the message to the industry that it is vital to take proper steps to ensure in advised sales that the advice a firm gives is suitable.

Seriousness of the breaches

6.4. The FSA has had regard to the seriousness of the breaches, including the nature of the requirements breached, the number and duration of the breaches and the number of customers who were exposed to the risk of loss. The FSA considers the breaches identified in this case are of a particularly serious nature given the vulnerability of NHFA's customer base and the timescale over which the practices occurred (approximately 5 years).

The extent to which the breaches were deliberate or reckless

6.5. The FSA considers that neither HSBC nor NHFA deliberately or recklessly contravened regulatory requirements.

The size, financial resources and other circumstances of the firm

6.6. There is no evidence to suggest that HSBC is unable to pay the penalty.

Conduct following the breaches

6.7. HSBC and its senior management worked in an open and co-operative way with the FSA from the outset of the investigation through to settlement of the case as detailed in paragraph 2.7. HSBC has been given full credit for its proactive approach to addressing the failures at NHFA and implementing a comprehensive redress package for customers.

6.8. HSBC closed NHFA to new business on 1 July 2011.

6.9. At this point, NHFA customers do not need to take any action. HSBC will shortly be writing to all existing NHFA customers advising them of the closure of the business. Those customers whose files are being reviewed will be informed within their letter and in due course HSBC will write to them again letting them know the outcome of the review. However, any individuals who may have any questions relating to NHFA concerning asset-backed investments may contact HSBC on the following number:

Customer Contact Number: 0800 917 8072

Disciplinary record and compliance history

6.10. HSBC was fined in December 2005 for transaction reporting failures. NHFA has no history of disciplinary action.

Previous action taken by the FSA in relation to similar findings

6.11. In determining whether and what financial penalty to impose on HSBC the FSA has taken into account action taken by the FSA in relation to other authorised persons for comparable behaviour.

FSA guidance and other published material

6.12. The FSA has had regard to the fact that the FSA has published a series of high profile communications highlighting the requirement upon firms to treat customers fairly. The publications emphasise the need for firms to ensure the suitability of sales to customers, including by clearly identifying target customers for particular products and implementing appropriate controls during the sales process.

Conclusion

6.13. Having regard to the seriousness of the breaches and the risk they posed to the FSA's statutory objectives of maintaining confidence in the financial system and securing the appropriate degree of protection for consumers, the FSA has imposed a financial penalty of £10.5 million on HSBC.

7. PROCEDURAL MATTERS

Decision maker

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

7.2. This Final Notice is given to HSBC 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 HSBC to the FSA by no later than 16 December 2011, 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 17 December 2011, the FSA may recover the outstanding amount as debt owed by HSBC and due to the FSA.

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 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 HSBC or prejudicial to the interests of consumers.

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

FSA contacts

7.7. For more information concerning this matter generally, contact Helen Smith of the Enforcement and Financial Crime Division of the FSA (direct line: 020 7066 0656 / fax: 020 7066 0657)

…………………………………………………

William Amos

FSA Enforcement and Financial Crime Division

APPENDIX

1. THE PRINCIPLES

1.1. Principle 9

A firm must take reasonable care to ensure the suitability of its advice and discretionary decisions for any customer who is entitled to rely upon its judgement.

2. THE RULES

For the period from 15 July 2005 to 31 October 2007 (inclusive)

2.1. COB 5.2.5 R

Before a firm gives a personal recommendation concerning a designated investment to a private customer, or acts as an investment manager for a private customer, it must take reasonable steps to ensure that it is in possession of sufficient personal and financial information about that customer relevant to the services that the firm has agreed to provide.

2.2. COB 5.3.5 R

(1) A firm must take reasonable steps to ensure that, if in the course of designated investment business:

(a) it makes any personal recommendation to a private customer to:

(i) buy, sell, subscribe for or underwrite a designated investment (or to exercise any right conferred by such an investment to do so); or

(ii) elect to make income withdrawals, or purchase a short-term annuity or not; or

(iii) enter into a pension transfer or pension opt-out from an occupational pension scheme; or

(b) it effects a discretionary transaction for a private customer (except as in (5)); or

(c) it makes a personal recommendation to an immediate customer or a market counterparty to take out a life policy;

the advice on investments or transaction is suitable for the client.

(2) If the recommendation or transaction in (1) relates to a packaged product:

(a) it must, subject to COB 5.3.8 G – COB 5.3.10 R, be the most suitable from the range of packaged products, on which advice on investments is given to the client as determined by COB 5.1.7 R; and

(b) if there is no packaged product in the firm's relevant range of packaged products which is suitable for the client, no recommendation must be made.

(3) In making the recommendation or effecting the transaction in (1), the firm must have regard to:

(a) the facts disclosed by the client; and

(b) other relevant facts about the client of which the firm is, or reasonably should be, aware.

2.3. COB 5.3.16 R

The suitability letter in COB 5.3.14 R must:

(1) explain why the firm has concluded that the transaction is suitable for the customer, having regard to his personal and financial circumstances;

(2) contain a summary of the main consequences and any possible disadvantages of the transaction;

….

2.4. COB 6.6.49 R

(1) The appropriate rates of return for the type of contract being projected, taken from COB 6.6.50 R – COB 6.6.52 R, must be used when calculating a projection;

(2) reduced rates of return must be used if the firm expects the rates in the tables to overstate the investment potential of a contract;

(3) reduced rates of return may be used if requested by a customer; and

(4) whenever reduced rates are used, they must be disclosed in the document containing the projection.

2.5. COB 6.6.50 R

This table belongs to COB 6.6.49 R

Rate of return assumptions for all key features schemes, simplified prospectus schemes, ordinary branch non-pensions, industrial branch, friendly society, immediate annuity and Holloway sickness policies (all monetary rates of return)			
	Lower rate	Intermediate rate	Higher rate
(a) Non-tax-exempt business relating to key features schemes, simplified prospectus schemes, ordinary branch non-pensions and industrial branch business.	4%	6%	8%

For the period from 1 November 2007 to 20 July 2010 (inclusive)

2.6. COBS 9.2.1 R

(1) A firm must take reasonable steps to ensure that a personal recommendation, or a decision to trade, is suitable for its client.

(2) When making the personal recommendation or managing his investments, the firm must obtain the necessary information regarding the client's:

(a) knowledge and experience in the investment field relevant to the specific type of designated investment or service;

(b) financial situation; and

(c) investment objectives;

so as to enable the firm to make the recommendation, or take the decision, which is suitable for him.

2.7. COBS 9.2.2 R

(1) A firm must obtain from the client such information as is necessary for the firm to understand the essential facts about him and have a reasonable basis for believing, giving due consideration to the nature and extent of the service provided, that the specific transaction to be recommended, or entered into in the course of managing:

(a) meets his investment objectives;

(b) is such that he is able financially to bear any related investment risks consistent with his investment objectives; and

(c) is such that he has the necessary experience and knowledge in order to understand the risks involved in the transaction or in the management of his portfolio.

(2) The information regarding the investment objectives of a client must include, where relevant, information on the length of time for which he wishes to hold the investment, his preferences regarding risk taking, his risk profile, and the purposes of the investment.

(3) The information regarding the financial situation of a client must include, where relevant, information on the source and extent of his regular income, his assets, including liquid assets, investments and real property, and his regular financial commitments.

2.8. COBS 9.4.7 R

The suitability report must, at least:

(1) specify the client's demands and needs;

(2) explain why the firm has concluded that the recommended transaction is suitable for the client having regard to the information provided by the client; and

(3) explain any possible disadvantages of the transaction for the client.

2.9. COBS 13 Annex 2.2.3 R

R			
Assumptions: rates of return			
2.3 A standardised deterministic projection must be calculated using the following rates of return:			
Nominal rates	Lower rate	Inter-mediate rate	Higher rate
Tax-exempt business held in a wrapper or by a friendly society personal pensions schemes, stakeholder pension schemes and investment-linked annuities	5%	7%	9%
all other products	4%	6%	8%

2.10. COBS 13 Annex 2.2.4 R

R	
Exception	
2.4	A standardised deterministic projection:
(1)	must be calculated using lower rates of return, if the rates described in this section overstate the investment potential of the product;
(2)	may be calculated using a lower rate of return if a retail client requests it.