Financial Services Authority

FINAL NOTICE

To: Welcome Financial Services Limited

Address: Mere Way
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Date: 28 March 2012

TAKE NOTICE: The Financial Services Authority, of 25 The North Colonnade, Canary Wharf, London E14 5HS ("the FSA") gives you final notice about the following action:

1. ACTION

1.1. The FSA served on Welcome Financial Services Limited ("Welcome") a Decision Notice on 18 January 2012 which notified it that, for the reasons set out below and pursuant to:

(1) section 123(3) (Power to impose penalties in cases of market abuse); and

(2) section 205 (Public censure);

of the Financial Services and Markets Act 2000 ("the Act"), the Financial Services Authority ("the FSA") had decided to publish a statement in the form of this notice to the effect that Welcome has engaged in market abuse and censuring Welcome because it:

(1) engaged in market abuse as defined by section 118(7) of the Act (dissemination); and

(2) failed to comply with Principle 3 (management and control) of the FSA's Principles for Businesses.

1.2. If Welcome had been a going concern with significant surplus assets, the very serious nature of the breaches identified in this Notice would have led the FSA to impose a substantial financial penalty.

1.3. Welcome has not referred the matter to the Upper Tribunal (Tax and Chancery Chamber).

1.4. Accordingly, for the reasons set out below, the FSA hereby publishes a statement in the form of this notice to the effect that Welcome has engaged in market abuse and censuring Welcome.

2. SUMMARY REASONS FOR THE ACTION

2.1. Between August 2007 and February 2009 (the "Relevant Period"), Welcome was the principal subsidiary of Cattles Limited (then known as 'Cattles plc'), a subprime lender.

2.2. At all relevant times, the Finance Director of Welcome was Peter Miller (who held the CF1 controlled function) and the Managing Director of Welcome was John Blake (who held the CF1 and CF8 controlled functions). Their actions and state of mind described in this Notice are attributable to Welcome.

The false and misleading statements

2.3. Welcome, in its Annual Report and Financial Statements for the year ending 31 December 2007 ("Welcome's 2007 Annual Report"), published false and misleading information about the credit quality of its loan book by stating that:

(1) as at 31 December 2007, around £2.1 billion of its approximately £3 billion loan book was "*neither past due nor impaired*" (ie not in contractual arrears);

(2) Welcome treated a loan account as impaired when the account was 120 days in contractual arrears; and

(3) Welcome had made a pre-tax profit of £130 million for the year to 31 December.

2.4. On 28 February 2008, Welcome's 2007 Annual Report (as approved by its Board) was consolidated into Cattles' Annual Report and Financial Statements for the period ending 31 December 2007 ("Cattles' 2007 Annual Report"). Cattles' 2007 Annual Report, which reported a pre-tax profit of £165.2 million, was published on 28 February 2008. The same misleading information was also published in Cattles' rights issue prospectus dated 23 April 2008 (the "Rights Issue Prospectus") that raised £200 million.

2.5. Cattles also announced misleading arrears and profit figures to the market on 28 August 2008 and it announced misleading arrears figures to the market on 18 December 2008 ("the 2008 Announcements"). The 2008 Announcements contained false and misleading information about the credit quality of Welcome's loan book in that they provided arrears figures and profit figures based on International Financial Reporting Standard 7 ("IFRS 7") without clarifying the role played by deferments in calculating the figures provided.

The true position in respect of the loan book

2.6. In fact, deferments had been routinely employed in the business and a correct application of IFRS7 would have resulted in loans which had been deferred being treated either as past due or as re-negotiated. Because deferments had not been

stripped out of the 'neither past due nor impaired' category, around £2.1 billion of the loan book was disclosed as not being in contractual arrears, creating the impression that far more customers were repaying their loans on time than was actually the case. The level of a lender's contractual arrears as a proportion of its loan book is a key measure of financial performance.

2.7. On the basis of the stated impairment trigger, Welcome had made a loss of £94.9 million (a reduction of £224.9 million).

The failure to disclose the use of deferments

2.8. The business made extensive use of 'deferments' whereby missed contractually due payments could be deferred to the end of the loan period, usually without contacting the relevant customer, and a deferment was deemed to either re-start or pause the arrears clock, depending on the circumstances. This had the effect that a loan on which interest payments had been deferred might be deemed by the business to be:

(1) up-to-date and not in arrears despite a number of contractually due payments having been missed; or

(2) in arrears but not impaired (ie not more than 120 days in arrears) despite more than four contractual monthly payments having been missed.

2.9. The effect of Welcome's conduct (through Peter Miller and John Blake) was that the use of deferments was not disclosed to the market. Neither Cattles' auditors (PricewaterhouseCoopers - "PwC") nor Cattles' Audit Committee were aware of the significance of the use of deferments within the business and, despite this being obviously relevant information to an assessment of the credit quality of the loan book, it took insufficient steps to ensure that PwC and Cattles' Audit Committee understood the significance of deferments. It failed to ensure that the use, extent and significance of the use of deferments was explicitly brought to the attention of PwC, Cattles' Audit Committee and a major shareholder of Cattles.

2.10. Contrary to statements made in its 2007 Annual Report, the Rights Issue Prospectus and the 2008 Announcements, the arrears and impairment figures provided had not been calculated simply on the basis of missed contractually due payments.

The contraventions and public censure

2.11. Welcome approved its 2007 Annual Report knowing (through Peter Miller and John Blake) that its 2007 Annual Report contained information which would be disseminated to the market. Welcome therefore committed market abuse and failed to take reasonable steps to organise and control its affairs responsibly and effectively in breach of Principle 3.

2.12. In the light of all the circumstances, the FSA considers it appropriate to publish a statement in the form of this notice to the effect that Welcome has engaged in market abuse and censuring Welcome. The FSA would have imposed a substantial financial penalty on Welcome but for its circumstances.

3. LEGISLATION, RULES AND GUIDANCE

3.1. The provisions set out below are those applicable during the Relevant Period.

Relevant legislative provisions

3.2. The FSA has the power under section 206(1) of the Act to impose a financial penalty, of such amount as it considers appropriate, if an authorised person has contravened a requirement imposed on him under the Act. Pursuant to section 205 of the Act, if the FSA considers that an authorised person has contravened a requirement imposed on him by or under the Act, the FSA may publish a statement to that effect.

3.3. The FSA has the power, pursuant to section 123(1) of the Act, to impose a financial penalty where it is satisfied that a person has engaged in market abuse. Section 123(3) states that if the FSA is entitled to impose a penalty on a person under section 123 it may, instead of imposing a penalty on him, publish a statement to the effect that he has engaged in market abuse.

3.4. Section 118(1) of the Act defines "market abuse" as behaviour (whether by one person alone or by two or more persons jointly or in concert) which:

> "occurs in relation to ... qualifying investments admitted to trading on a prescribed market; … and … falls within any one or more of the types of behaviour set out in subsections (2) to (8)."

3.5. Section 118A(1) of the Act provides that:

> "[b]ehaviour is to be taken into account for the purposes of … [sections 118 to 131A of the Act] … if it occurs in the United Kingdom or … in relation to qualifying investments which are admitted to trading on a prescribed market situated in, or operating in, the United Kingdom ..."

3.6. Section 130A of the Act provides that the Treasury may by order specify markets and investments which are "prescribed markets" and "qualifying investments" for the purposes of any or all of sections 118 to 131A of the Act.

3.7. The LSE is a prescribed market for the purposes of section 118(7) of the Act by reason of the Financial Services and Markets Act 2000 (Prescribed Markets and Qualifying Investments) Order 2001. Shares are, by reason of the same Order and relevant European legislation, qualifying investments.

3.8. Section 118(7) defines as a form of market abuse behaviour which:

> "… consists of the dissemination of information by any means which gives, or is likely to give, a false or misleading impression as to a qualifying investment by a person who knew or could reasonably be expected to have known that the information was false or misleading."

Relevant regulatory provisions

3.9. Pursuant to Principle 3 of the FSA's Principles for Businesses (PRIN) a firm must take reasonable care to organise and control its affairs responsibly and effectively, with adequate risk management systems. PRIN 3.2.3R provides, amongst other things, that Principle 3 applies with respect to the carrying on of unregulated activities in a prudential context, 'prudential context' being defined as:

> "in relation to activities carried on by a *firm*, the context in which the activities have, or might reasonably be regarded as likely to have, a negative effect on:
>
> (a) confidence in the *financial system*; or
>
> (b) the ability of the *firm* to meet either:
>
> (i) the "fit and proper" test in *threshold condition* 5 (Suitability); or
>
> (ii) the applicable requirements and standards under the *regulatory system* relating to the *firm's* financial resources."

3.10. Paragraph 5 to Schedule 6 of the Act sets out threshold condition 5 which says that:

> "The person concerned must satisfy the Authority that he is a fit and proper person having regard to all the circumstances, including:
>
> (a) his connection with any person;
>
> (b) the nature of any regulated activity that he carries on or seeks to carry on; and
>
> (c) the need to ensure that his affairs are conducted soundly and prudently."

3.11. COND 2.5.4G(2)(a) sets out that in determining whether a firm will satisfy and continue to satisfy threshold condition 5, the FSA will have regard to all relevant matters including but not limited to whether a firm conducts its business with integrity and in compliance with proper standards.

3.12. DEPP 6.4.1G states that the FSA will consider all the relevant circumstances of the case when deciding whether to impose a financial penalty or issue a public censure. DEPP 6.4.2G(8)(a) makes clear that verifiable evidence that a person would suffer serious financial hardship if the FSA imposed a financial penalty will be taken into account.

3.13. Further regulatory provisions are set out in the Annex to this Notice.

4. FACTS AND MATTERS RELIED ON

Background

4.1. This Notice concerns Welcome's misconduct during the Relevant Period, during which time Cattles was a publicly listed financial services company, having been admitted to the Official List of the LSE in 1963.

4.2. Welcome, a wholly owned subsidiary of Cattles, is authorised and regulated by the FSA (FSA registration no. 305742). Welcome's principal business (which was not a regulated activity) was retail consumer lending, providing low value secured, unsecured and hire purchase loans to subprime borrowers at high levels of interest. The significance of this part of the business is indicated by figures taken from Cattles'

2007 Annual Report, which showed that it represented approximately 89.5% of Cattles' revenue.

4.3. As Finance Director of Welcome, Peter Miller was the director primarily responsible for Welcome's financial statements (which he knew formed by far the most significant part of Cattles' financial statements) and for ensuring that all relevant information was provided to PwC. Whilst he did not generally attend Cattles' Audit Committee meetings, he was, as Finance Director of Cattles' principal subsidiary, aware of their significance. To the extent that he was aware that relevant information was being withheld from, or that misleading information was being provided to, Cattles' Audit Committee or PwC (or both), he should have taken steps to remedy the position.

4.4. As Managing Director of Welcome, and holding the Chief Executive controlled function (CF3), John Blake had overall responsibility for Welcome's business and exercised significant influence over Welcome's culture and the way in Welcome's business was conducted. John Blake knew Welcome's financial statements formed by far the most significant part of Cattles' financial statements. He also attended meetings of Cattex (a committee including Cattles' executive directors) and Cattles' Audit Committee (which meetings were also attended by PwC) and was therefore in a key position to influence the information provided to Cattles' Audit Committee and PwC. To the extent that he was aware that relevant information was being withheld from, or that misleading information was being provided to, Cattles' Audit Committee or PwC (or both), he should have taken steps to remedy the position.

Management of customer arrears within Welcome

4.5. In 2006, Welcome developed an operational structure whereby:

(1) loans that were less than 60 days in arrears were managed by 'Operational Branches';

(2) loans that were more than 60 days but less than 120 days in arrears were managed by Local Management Branches ("LMBs"). The LMBs were described in Welcome's 2007 Annual Report as comprising "*specialist collectors who work with customers to ensure regular payments resume so as*

to enable the account to be transferred back to the Operational Branch and to prevent the account from falling into more serious arrears";

(3) loans that were more than 120 days in arrears were considered impaired and were transferred to a Local Collection Unit ("LCU").

4.6. Importantly, within Welcome the arrears status of a loan (and therefore whether it sat within an Operational Branch, an LMB or an LCU) was not a simple calculation done on the basis of the number of contractually due payments missed (on which basis, for example, two missed monthly payments would equate to a loan being 60 days in arrears). Instead, Welcome's internal calculation of arrears allowed for the deferment of missed payments in certain circumstances, with the application of a deferment to a loan being treated within Welcome as either re-starting or pausing the calculation of arrears, depending on the circumstances. Therefore a loan showing as up-to-date (not in arrears) in Welcome's internal management information might in fact be a loan on which a number of contractually due payments had been missed but deferred and, similarly, a loan showing as unimpaired (ie not more than 120 days in arrears) might in fact be a loan on which more than four contractually due payment had been missed but where some of those payments had been deferred.

4.7. As Peter Miller and John Blake were aware, the financial impact of the setting up of the LMBs in 2006 was considerable. In 2006, but for the LMBs around £260 million of loans would have been expected to be transferred to the LCUs and therefore classified as impaired. However, in fact only around £164 million was transferred to the LCUs. A substantial amount of this £96 million improvement was due to debt being held back from impairment through the use of deferments by the LMBs (ie deferments were used to pause debt at between 60 and 120 days that would otherwise have been impaired). As profit was calculated by reference to impairment, there was a corresponding £45 million improvement to Cattles' reported profit for that year. Within Welcome this impact was justified on the basis that holding debt as unimpaired in the LMBs would allow specialist collectors time to work with customers. However, Peter Miller and John Blake were also aware that within the business certain individuals referred to the impact deferments used in the LMBs as an "overdraft" that had allowed Cattles to hit its profit target.

Introduction of International Financial Reporting Standard 7

4.8. As Peter Miller and John Blake were aware, Cattles' 2007 Annual Report was required to comply with IFRS 7 for the first time and Welcome's 2007 Annual Report also adopted the standard.

4.9. The introduction of IFRS 7 states:

> *"The International Accounting Standards Board believes that users of financial statements need information about an entity's exposure to risks and how those risks are managed. Such information can influence a user's assessment of the financial position and financial performance of an entity or of the amount, timing and uncertainty of its future cash flows. Greater transparency regarding those risks allows users to make more informed judgments about risk and return."*

4.10. Paragraph 31 of IFRS 7 requires an entity to:

> *"disclose information that enables users to evaluate the nature and extent of risks arising from financial instruments to which the entity is exposed"*

4.11. In disclosing the nature and extent of the risks, entities are required to give both qualitative information on the risks (how they have changed in the period and how they are managed) and quantitative disclosures in respect of the risks. IFRS 7 states that the risks are to include, but not be limited to, credit risk, liquidity risk and market risk. The quantitive disclosures for credit risk should include:

(1) *"information about the credit quality of financial assets that are neither past due or impaired"* (paragraph 36(c));

(2) *"the carrying amount of financial assets that would otherwise be past due or impaired whose terms have been renegotiated"* (paragraph 36(d)); and

(3) *"an analysis of the age of financial assets that are past due as at the reporting date but are not impaired"* (paragraph 37(a)).

4.12. "*Past due*" is defined in IFRS 7 as when a counterparty has failed to make a payment when contractually due, for example failing to pay interest or principal payments due in the time period specified in the contract.

4.13. Under IFRS 7 a loan that is contractually overdue (but not impaired) but to which a deferment has been applied should be treated as:

(1) *"past due but not impaired"* where the deferment has not been agreed with the customer, which cannot have happened if there has been no contact with the customer); or

(2) *"renegotiated"* where the deferment has been agreed with the customer.

4.14. A loan on which interest payments have been deferred should be disclosed accordingly to give important information about credit quality.

Impairment

4.15. International Accounting Standard 39 requires loans to be treated as impaired where there is objective evidence that a loan asset is impaired. As referred to above, Welcome treated loans that were more than 120 days in arrears (importantly after the application of deferments) as impaired.

Events prior to publication of Welcome's and Cattles' 2007 Annual Reports

4.16. The information required to be disclosed by IFRS 7 was not information that Cattles had made public and therefore, in April 2007, Cattles and Welcome formed a project team to consider the impact of the new requirements.

The meeting in June 2007

4.17. Early in its deliberations, the IFRS 7 project team informed Peter Miller that it "*would appear a challenge to argue that debt having deferments is neither renegotiated nor in arrears*" and took the correct view that deferments fell to be disclosed as either past due or renegotiated loans but he told the project team that he was reluctant to accept this view.

4.18. In light of the clear steer being given by senior management, the project team sought to develop arguments to support the position that a deferred loan was neither renegotiated nor past due. At a meeting in June 2007 between the project team, certain of Cattles' directors and John Blake, the project team reported that classifying deferments as either renegotiated or as past due was "*unacceptable*" because it would mean disclosing 34% of the loan book as either renegotiated or as past due. However,

the arguments suggested by the project team to avoid disclosure had not been fully and openly debated. Nonetheless John Blake, along with the Cattles directors present, endorsed the approach being proposed.

4.19. The clear inference is that the disclosure of deferments was deemed "*unacceptable*" to the business because it would reveal significant negative information about the credit quality of the loan book.

The communications with PwC in August and September 2007

4.20. As noted at paragraph 4.7 above, Peter Miller and John Blake were aware that within the business certain individuals referred to the impact of the LMBs as an "overdraft" that had allowed Cattles to hit its profit target for 2006. In mid-2007 John Blake instructed staff at Welcome to refrain from using the term "overdraft" in respect of the debt held back from impairment by the LMBs. Around the same time, as Peter Miller and John Blake knew, Welcome set up the Asset Management Branches ("AMBs"), a subset of the LMBs, to specialise in the collection of contractual payments on hire purchase and secured loans. It was deemed appropriate for loans to remain in the AMBs for up to a year without being treated as impaired, even if contractually due payments were not being received during that period. This was achieved by the application of multiple deferments which had a significant financial impact by holding back debt from impairment.

4.21. A Cattles Audit Committee meeting took place on 6 September 2007, attended by James Corr and John Blake among others. At that meeting, PwC outlined the IFRS 7 requirements as understood by them, without referring to the question whether deferments should be disclosed as renegotiated loans (or indeed as past due loans) and neither James Corr nor John Blake highlighted that fundamental issue. At that meeting, PwC referred to the IFRS 7 requirements which would apply to the 2007 financial statements for the first time. They explained that:

> *"… this might produce some strange looking numbers because the standard related to the debt which was not repaid in accordance with its contractual terms and this was in the ordinary course of business for [Welcome]. The plan was to produce for discussion at the December meeting IFRS 7 numbers for the 2006 financial statements as if IFRS 7 had then been in force."*

4.22. On 20 September 2007 certain members of the IFRS 7 project team met with PwC to discuss the IFRS 7 disclosures. In advance of that meeting, the project team had produced two versions of an IFRS 7 progress report. The first version was for the Cattles Board and outlined the arguments to be used as to why deferments should not be classified as renegotiated or past due. The second version, sent to PwC, made no mention of deferments at all. Peter Miller knew that the progress report sent to PwC made no mention of deferments, despite their fundamental importance to the question of what disclosures should be made.

4.23. Following that meeting, a member of the IFRS 7 project team updated James Corr and others that:

> *"IFRS 7 meeting with PWC also went very well ... there was absolutely no mention of deferments ... as they did not raise any challenge re deferments, we did not raise it either. I feel that deferments are not particularly on their radar screen either re IFRS 7 or generally and I suggest we keep it that way ... Can you run these thoughts by Peter* [Miller – the Finance Director of Welcome] *and John* [Blake] *when you are back next week?"*.

4.24. Peter Miller and John Blake were aware in the months leading up to signing Welcome's 2007 Annual Report that deferments were not on PwC's *"radar screen*" but did nothing to ensure that they were properly informed.

October and November 2007

4.25. In October 2007, an IFRS 7 Progress Report was prepared to update certain members of the Cattles Board and also John Blake. Assurances were given in the following terms, *"Whilst we did not specifically discuss deferments, PwC are fully aware of their use within the business and did not raise this as a potential issue."*

4.26. As Peter Miller was aware, in November 2007 there was around £120 million of unimpaired debt in the AMBs and a Welcome employee who reported to him sent him a document titled "*Key Audit Risks 2007*", in which he stated that:

> "*... the major area of audit risk at the year-end again related to impairment provisions ... as at 31/10/07, the amount of debt at the AMBs totalled £120M ... this debt is classified as non-impaired ... the AMB debt could be queried as to its nature, its recent payment performance and deferment activity*".

4.27. By November 2007 at the latest, James Corr, John Blake and Peter Miller were receiving information in the form of contractual delinquency graphs that clearly distinguished between Welcome's *"contractual arrears"* and *"deferred arrears"* impairment positions. The distinction between contractual and deferred arrears, and the potential implications of an unfavourable IFRS 7 interpretation, was therefore appreciated by each of them.

The Audit Committee meeting on 13 December 2007

4.28. On 13 December 2007, John Blake attended an Audit Committee meeting. At that meeting, he explained that the reason for the disparity between the loan loss provision in 2006 and the higher 2007 provision was the *"change in product mix following the significant increase in unsecured lending during 2007."* He did not explain that one of the key reasons for the lower loss provision in 2006 was the use of deferments in the LMBs which had prevented a substantial amount of debt from flowing through to impairment (see paragraph 4.6 above). He was fully aware of this important information but did nothing to bring it to the attention of the Audit Committee.

The draft paper to the Cattles Board in December 2007 on the use of deferments

4.29. In late December 2007, Peter Miller and John Blake were involved in drafting a paper to brief the full Cattles Board on IFRS 7 disclosures. An initial draft was prepared which claimed that "*collection tools such as … deferments are available for use in the LMBs, in restricted circumstances*". No other mention of deferments was made. Given that over a third of the book had had a deferment applied, it was, as Peter Miller and John Blake were aware, highly misleading for the paper to claim that deferments were used in restricted circumstances. The paper also stated that Welcome's impairment trigger was *"120 days arrears"*. However, the paper made no mention of:

(1) the role of deferments in calculating the number of days in arrears for purposes of the impairment trigger and therefore the level of impairment;

(2) the approach being adopted on the treatment of deferments under IFRS 7 despite, as Peter Miller and John Blake were aware, the issue not having been raised with PwC; and

(3) the fact that deferments were used as more than simply a "*collection tool*" ie the impact of deferments on what needed to be disclosed under IFRS 7 and on Welcome's the arrears calculation was not explained.

4.30. However, rather than flag up the wholly inadequate explanation of deferments in the draft paper, John Blake emailed a colleague working on the draft to say *"do we need to mention deferments?...re-writes are fairly self explanatory but deferments are not!"* and was told that Peter Miller had already made the same point. The single reference to deferments in the draft paper was therefore deleted and the paper that went to the Cattles Board made no reference to deferments at all, despite their fundamental importance to what needed to be disclosed under IFRS 7 and to Welcome's internal arrears calculation.

The Key Audit Risks 2007 document January 2008

4.31. In January 2008, Peter Miller and John Blake were sent a further *"Key Audit Risks 2007"* document. This explained that there was now £169 million in the AMBs and (under the heading "*Work Performed by PwC*") that:

> *"the risk still remains that as a part of other testing, the AMB ... debt could be queried as to its nature, its recent payment performance and deferment activity ... were we pushed into exactly how these accounts are prevented from reaching impairment it could highlight the level of deferments used as opposed to actual cash collected"*.

From this it is clear that Peter Miller and John Blake knew that the extent and significance of Welcome's use of deferments were not fully understood by all concerned and that there were concerns over the amount of cash being collected on the unimpaired debt in the AMBs.

The Audit Committee meeting and Annual Report in February 2008

4.32. On 21 February 2008, Cattles' Audit Committee reviewed a draft internal audit report that it had commissioned to consider whether a 120 day impairment trigger remained appropriate when mainstream banks impaired after 90 days.

4.33. The draft report stated that:

> *"The ageing of accounts is based on the "contractual arrears calculation" ... options to stop the customer becoming impaired are limited to ... deferring payment ... management has noted that ... deferments ... start the "clock" again with regard to ageing ... deferments occur where it has been agreed with the customer that missed payments (necessary because of short term payment difficulties) can be made up at the end of the contract ...".*

4.34. It is clear from this that the internal auditors had not been accurately informed about Welcome's use of deferments. In contrast to what the report stated, deferments were mostly applied without agreement with the customer. In addition to "restarting the clock", deferments were also used to keep loans in arrears but not impaired as described in paragraph 4.6 above. Moreover, in making this comparison, the internal auditors were unaware (as was the Audit Committee and PwC) of the extent to which Welcome's impairment trigger allowed for deferments, having been told at a meeting with James Corr and others that deferments were "tightly controlled". This lack of understanding severely limited the value of the comparison being made.

4.35. During the Audit Committee meeting on 21 February 2008, attended by John Blake, James Corr explained that Cattles had been advised that it *"... should explain the 120 days impairment trigger and the banding of the overdue debt up to that point by reference to the commercial reality of [the] business ..."* and assured the Audit Committee that a detailed explanation of the impairment policy would be set out in the accounting notes to Cattles' 2007 Annual Report.

4.36. A draft of Welcome's 2007 Annual Report was approved by Peter Miller, John Blake and the rest of the Welcome Board on 25 February 2008 which stated that IFRS 7 had been adopted and contained the following figures:

Loans and receivables	**£ '000**
Neither past due nor impaired	2,184,553
Past due but not impaired (total)	458,158
Past due up to 29 days (but not impaired)	142,657
Past due 30-59 days (but not impaired)	118,945
Past due 60-89 days (but not impaired)	102,008
Past due 90-119 days (but not impaired)	94,548
Past due 120 days or more (but not impaired)	-
Impaired	440,989

4.37. The impairment trigger statement referred to in paragraph 4.43 below was not contained in the approved draft. However, as shown by the table above the draft stated that there were no loans "*Past due 120 days or more*" that were unimpaired, by implication stating that any loans over 120 days in contractual arrears were treated as impaired (which was untrue). The draft of Welcome's 2007 Annual Report acknowledged that the directors were required to "*Make judgements and estimates that are reasonable and prudent*".

4.38. The draft of Welcome's 2007 Annual Report contained highly misleading information in relation to the credit quality of Welcome's loan book because it:

(1) stated that IFRS 7 had been adopted but, in fact, the arrears figures provided failed to strip out deferments, giving the impression that far more of Welcome's customers were repaying their loans on time than was actually the case. It stated that around £2.1 billion of Welcome's approximately £3 billion loan book was *"neither past due nor impaired"* (ie not in contractual arrears) when, in fact, calculated on the contractual basis required by IFRS 7, only around £1.5 billion of the book was "*neither past due nor impaired*";

(2) implied that any loans more than 120 days in contractual arrears were treated as impaired when in fact £445 million of the loan book was more than 120 days in contractual arrears and treated as unimpaired;

(3) Welcome had made a pre-tax profit of £130 million for the year to 31 December 2007 whereas, in fact, on the implied basis that all loans more than 120 days in contractual arrears were impaired, Welcome had made a loss of £94.9 million (a reduction of £224.9 million).

4.39. Before Welcome's 2007 Annual Report was approved by the Welcome Board, Peter Miller signed a representation letter to PwC in connection with its audit of the financial statements of Welcome for the year ended 31 December 2007 in which, among other representations, he made the following representations:

(1) *"Each director has taken all the steps that he or she ought to have taken as a director in order to make himself or herself aware of any relevant audit information and to establish that [PwC] are aware of that information, including that ... All other records and related information which might affect the truth and fairness of, or necessary disclosure in, the financial statements ... and no such information has been withheld"*;

(2) *"So far as each director is aware, there is no relevant audit information of which [PwC is] unaware."*; and

(3) *"... the financial statements are free from material misstatement, including omissions."*;

without having made adequate enquiries to satisfy himself that these statements were true.

4.40. In addition, the letter acknowledged the directors' *"responsibility for the design and implementation of internal control to prevent and detect error"*.

4.41. On 18 March 2008 the finalised version of Welcome's 2007 Annual Report was approved by Peter Miller and John Blake and the rest of the Welcome Board (and filed at Companies House on 29 May 2008).

4.42. Welcome's 2007 Annual Report stated that it complied with IFRS 7 and contained the same information as the table above and also acknowledged that the directors were required to "*Make judgements and estimates that are reasonable and prudent*". It also stated that:

> "*Welcome Financial Services determines that there is objective evidence of an impairment loss at the point at which they are not prepared to offer any further credit to a customer who has encountered serious repayment difficulties. In Welcome Finance this is assessed by reference to the number of*

days an account is contractually in arrears. When an account has reached 120 days in arrears, there is an acceptance that the original contractual relationship has broken down".

4.43. Peter Miller and John Blake were aware that this was not an accurate description of the impairment trigger as it made no mention of the role of deferments in calculating the impairment trigger and therefore the level of impairment. For the same reason John Blake knew that this was not a detailed explanation of the commercial reality of Welcome's business (which as he knew the Audit Committee had been told would be provided). Instead, the statement reinforced the impression given by the IFRS 7 disclosures that Welcome calculated arrears simply on the basis of the number of contractual payments missed. This was further reinforced by Welcome's statement that it had no loans *"Past due 120 days or more"* that were unimpaired (see the table below), which gave the impression that all loans that were more than 120 days in contractual arrears were treated as impaired.

4.44. Welcome's 2007 Annual Report contained highly misleading information in relation to the credit quality of Welcome's loan book because it stated that:

(1) IFRS 7 had been adopted but, in fact, the *"neither past due nor impaired"* figures provided failed to strip out deferments, giving the impression that far more of Welcome's customers were repaying their loans on time than was actually the case. It stated that around £2.1 billion of Welcome's approximately £3 billion loan book was *"neither past due nor impaired"* (ie not in contractual arrears) when, in fact, calculated on the contractual basis required by IFRS 7, only around £1.5 billion of the book was *"neither past due nor impaired"*;

(2) Welcome treated a loan account as impaired when the account was 120 days in contractual arrears and that on this basis around £450 million of Welcome's loan book was *"past due but not impaired"* (when, in fact, with deferments of less than four monthly payments treated as past due loans over £600 million of the loan book was *"past due but not impaired"*) and £441 million of Welcome's loan book was impaired (when, in fact, with deferments of more than four monthly payments treated as impaired loans over £886 million of the book was impaired);

(3) Welcome had made a pre-tax profit of £130 million for the year to 31 December 2007 whereas, in fact, on the basis of the stated impairment trigger, Welcome had made a pre-tax loss of £94.9 million (a reduction of £224.9 million).

4.45. At the time Peter Miller and John Blake approved Welcome's 2007 Annual Report, the requirements of IFRS 7 were in effect. As illustrated in the table below, the accounts did not comply with IFRS 7. Consequently, Welcome's 2007 Annual Report contained information which was false and misleading.

4.46. The table below shows the original IFRS 7 and impairment disclosures relating to Welcome taken from Cattles' 2007 Annual Report as against the corrected figures calculated on a contractual basis and restated in Cattles' 2008 Annual Report (published on 12 May 2010):

Loans and receivables (Welcome)	**Original 2007 (£m)**	**Restated 2007 (£m)**
Neither past due nor impaired	2,184.5	1,572.4
Past due but not impaired (total)	458.2	601.2
Past due up to 29 days (but not impaired)	142.7	143.1
Past due 30 - 59 days (but not impaired)	119.0	221.3
Past due 60 - 89 days (but not impaired)	102.0	139.0
Past due 90 - 119 days (but not impaired)	94.5	97.8
Past due 120 days or more (but not impaired)	-	-
Impaired	**441.0**	**886.7**

4.47. It is clear that the original figures for 2007 gave a misleading impression as to Welcome's credit quality. As a result of the adjustments made to those figures, Welcome's reported pre-tax profit figure was reduced by £224.9 million, resulting in a reported pre-tax loss for Welcome of £94.9 million. As a result, Cattles was required to reduce its overall pre-tax profit figure by £261.7 million, resulting in a reported pre-tax loss to Cattles of £96.5 million.

Events after publication of Cattles' 2007 Annual Report

Questions from analysts in March 2008

4.48. Cattles' 2007 Annual Report recorded a significant increase in Welcome's arrears classified as *"past due but not impaired"* from the previous year (2006 IFRS 7 figures were also provided for the first time in Cattles' 2007 Annual Report). Unaware of the role played by deferments, analysts raised queries on the issue in early March 2008.

4.49. In anticipation of these questions, it was pointed out to Peter Miller that the increase in the *"past due but not impaired"* number could easily be explained by reference to the unimpaired deferred debt housed within AMBs (where he knew the collections performance was poor). He agreed, but decided not to explain this to analysts.

4.50. Similarly, John Blake made it clear to the person working on a 'Questions and Answers' document that he did not consider that analysts should be told about the role played by deferments. It is clear the individual was uncomfortable with these instructions as he subsequently sent the 'Questions & Answers' document to James Corr under cover of an email saying *"I have deliberately not referred to … deferments … I worry that this is ignoring a big part of the picture"*.

April 2008

4.51. On 23 April 2008, Cattles issued the Rights Issue Prospectus. Like Welcome's and Cattles' 2007 Annual Reports, it contained misleading information because it contained the same statement as that set out in paragraph 4.42 above regarding the basis for impairment and the financial statements in Cattles' 2007 Annual Report (which were stated to have adopted IFRS 7) were incorporated by reference.

4.52. Although neither Peter Miller nor John Blake were involved in approving the Rights Issue Prospectus, they were aware of its contents (even if only after it was made public). The Rights Issue was fully subscribed and raised £200 million. Had Cattles' shareholders been aware that the application of deferments impacted on the calculation of the level of contractual arrears and the impairment to the extent it did, it is likely that they would have regarded this as highly material and been significantly less likely to subscribe to the Rights Issue.

The events of August 2008 including the estimate for removing deferments from the I impairment figures

4.53. On 19 August 2008, Peter Miller and John Blake received an internal audit report highlighting the lack of management information as to the aggregate level of deferments and detailing concerns over the impact of a £42 million 'bulk deferment' (which had been by approved by Welcome's management in May 2008 despite not meeting standard policy requirements) on reported profit.

4.54. On 20 August 2008, Peter Miller received an email setting out an estimate of the impact of removing all deferments from Welcome's impairment figure as at June 2008, which he forwarded to James Corr and John Blake. The estimate showed that such a calculation would move £611 million of debt from non-impaired to impaired, requiring a provision of £488 million. In addition to the concerns raised by the internal audit report described in the above paragraph, Peter Miller and John Blake knew that certain Cattles' directors were seeking information on the level of deferments within Welcome (in Peter Miller's words to John Blake "*any differences over…contractual and deferred arrears* [had] *dawned on"* on one of the directors) but neither of them took any steps to pass on their knowledge about the overall level of deferments or their impact on reported profit.

4.55. On 21 August 2008, John Blake and James Corr attended the Cattles Audit Committee meeting which considered the internal audit report and the impact of the £42 million "bulk deferment". The aggregate level of deferments would have been highly material to the discussions. Nonetheless, John Blake did nothing to bring to the attention of the Audit Committee the true scale of deferments within Welcome or the information explicitly set out for him on the previous day as to their impact on impairment and profit.

The events between October to December 2008

4.56. By October 2008, the value of loans held within the AMBs had reached £230 million. On 24 October 2008, Peter Miller and John Blake, amongst others, received by email a draft Welcome Compliance Review of the AMBs. The first issue identified by the Compliance Review was *"Potential bad-debt on accounts held within AMB"* with the recommendation that:

> *"In line with current policy a/cs held within AMB are not subject to provisioning. However, where it is identified that no asset exists, or the asset is insufficient to settle the customers balance, management should review the appropriateness of retaining the a/c within AMD or whether such a/cs should be transferred to the LCU and provided against".*

4.57. Attached to the Compliance Review was a schedule entitled "AMD Account Review (Random Sample)". By way of example only, this schedule showed the following accounts which were unimpaired despite being considerably greater than 120 days in contractual arrears:

(1) an account on which £9,878.72 was owed which had had 87 deferments applied and where it was not known that there was an asset in place;

(2) an account on which £57,431.12 was owed which had had 22 deferments applied and where it was known that *"House repossessed by 1st lender – no equity"*;

(3) an account on which £35,000.42 was owed which had had 34 deferments applied and where it was known that *"House repossessed by 1st lender – no equity. Notes indicate customer confirmed bankrupt 29/5/08."*

4.58. On 27 October 2008, a colleague emailed it to Peter Miller and John Blake to say, *"Now that* [the Compliance Director] *is on holiday you might find this report looking a lot nearer reality by the time he returns – trust me".* Peter Miller replied *"I do explicitly, bizarre was my first impression, …".*

4.59. On 10 November 2008, the same colleague sent to Peter Miller and John Blake a revised version of the Compliance Review, saying "*I think you will find the updated version more accurate than the first*". This version made no mention of the first issue previously identified (ie in relation to potential bad debt in the AMBs and the lack of assets to use as security). In addition, the "*AMD Account Review (Random Sample)*" schedule had been deleted in its entirety. The only reasonable inference is that Peter Miller and John Blake wanted to avoid any reference to these issues appearing in the Compliance Review in case it was seen by parties unaware of the true state of the debt housed within the AMBs.

4.60. By this stage concerns as to provisioning on the loan book and in particular on debt housed within the AMBs had been raised directly with PwC by a member of Cattles' management team who had learned that none of the debt housed within that division was provided for. Accordingly, a paper was drafted by Peter Miller and John Blake, among others, to provide further explanation. The paper was distributed at a Cattles Audit Committee meeting on 4 December 2008. The paper informed the Audit Committee, for the first time, that the 120 days arrears trigger in fact allowed for multiple deferments, albeit that it claimed these were only allowed *"within strictly controlled circumstances"*.

4.61. In fact, as Peter Miller and John Blake were aware from the *"Random Sample"* attached to the Welcome Compliance Review, it was misleading to describe the use of deferments as "*strictly controlled"*. In addition, the paper claimed that *"The establishment of the AMBs has provided greater visibility of collections performance, as well as an improvement in cash recoveries"* when Peter Miller and John Blake knew that cash collection in the AMBs was poor and had been declining during 2008.

4.62. The Audit Committee was very concerned to learn that debt that was more than 120 days in contractual arrears could remain unimpaired and without a provision and arranged for a further meeting on 15 December 2008 to discuss the AMBs, which as at October 2008 held £230 million of unimpaired debt. Peter Miller and John Blake attended the meeting, specifically convened to address the Audit Committee's concerns over the level of deferments in the AMBs and the effect on impairment, but at no stage did they explain the true extent to which deferments were used in the business, namely that in fact there was over £600 million of debt that was only unimpaired because of the application of deferments.

4.63. The Audit Committee also sought an explanation as to why there appeared to be unsecured loan accounts housed within the AMBs and was assured by John Blake that each loan was secured by an asset, such as a car or property charge notwithstanding the Welcome Compliance Review. John Blake also gave assurances to the Audit Committee that AMBs were *"designed to collect cash and reduce impairment"* without any indication of how ineffective the AMBs were in collecting cash. Peter Miller did nothing to correct the misleading impression given by John Blake.

February to April 2009

4.64. After further investigation, PwC refused to sign off Cattles' 2008 Annual Report and on 20 February 2009 it was announced that publication of the 2008 Annual Report would be delayed. The market reaction to this announcement was a 74% drop in the share price from 13.25 pence on 19 February 2008 to 3.5 pence the next day.

4.65. On 1 April 2009, Cattles announced that it would need to make a provision of around £700 million in excess of that originally anticipated for 2008. On 23 April 2009, Cattles announced that, in light of its inability to publish its 2008 Annual Report by the requisite deadline, it had requested a suspension of trading in its shares. Trading in Cattles' shares was duly suspended on the same day.

5. REPRESENTATIONS

5.1. Welcome made a number of representations principally in writing on 22 June 2011 and orally on 8 September 2011. What follows is a brief summary of the key representations on liability.

5.2. Welcome made its representations jointly with Cattles. In those representations, reference was made throughout to 'the Individuals' meaning James Corr, Peter Miller and John Blake. For the purposes of this summary, this is taken to mean Peter Miller and John Blake.

Legal submissions

Attribution

5.3. The principle in *re Hampshire Land Co [1986] 2 Ch 743* was that if a company director acts in breach of duty, the director's conduct and knowledge should not generally be attributed to the company. The conduct of James Corr amounted to a breach of his duties to Cattles.

5.4. The case against Cattles was purely 'parasitic' based solely on the attribution of the actions and state of mind of James Corr.

5.5. The case of *Meridian Global Funds Management Asia Ltd v Securities Commission [1995] 2 A.C. 500* confirms that the test for attribution may be different depending on

the purpose for which you seek to attribute. Cattles accepted that in regulatory matters, and market abuse in particular, public policy was a consideration. However, it would be inappropriate to attribute knowledge in circumstances where some directors deliberately chose to mislead others. Not to attribute in such circumstances would not defeat the purpose.

5.6. It would be wholly unfair to attribute the misconduct of James Corr to Cattles which was itself the victim of the misconduct. Cattles was entitled to, and did, rely on him.

Market abuse

5.7. A company should only be liable for market abuse where it is complicit and culpability is properly made out or where the companies own internal corporate governance and its systems and controls are found wanting in such a material way that it permitted market abuse to occur. No deficiency in corporate governance was alleged. Those systems operated but were frustrated by a number of individuals' deliberate and determined conduct.

Other submissions

5.8. This was a case of individual misconduct and lack of integrity not corporate wrongdoing.

5.9. James Corr misled Cattles principally through the Audit Committee through which it made appropriate challenges to him. Important information which should have been communicated to it was withheld from the committee. Had the information been brought to the attention of the committee, the market abuse would not have been allowed to occur.

5.10. It would be unfair and inappropriate to seek to send a message to the market of the risks of failures of good corporate governance where no such failures have been identified.

6. FINDINGS AND CONCLUSIONS

Legal submissions

Attribution

6.1. It is central to the purpose of financial services regulation that a firm is accountable for the activities carried on in its name. This is particularly so in cases of market abuse which may have an adverse affect on market confidence. The market abuse provisions are designed with this in mind. They are effect based and do not depend on knowledge. It is the effect of market abuse which can be so damaging. One of the statutory objectives of the FSA is 'market confidence' which depends, among other things, on full and accurate information being equally available to all market participants.

6.2. Against this background, the FSA notes that Peter Miller was engaged by Cattles as Finance Director to, amongst other things, ensure compliance with IFRS 7 in the financial statements. He failed to do so and by disseminating false and misleading information in the Welcome 2007 Annual Report in the circumstances set out in the related Decision Notice given to him on the same date as this notice committed market abuse.

6.3. The FSA also notes that John Blake as a director and a person with the responsibilities of a chief executive was engaged to have responsibility for the whole of the business.

6.4. In *Meridian Global*, Lord Hoffman was concerned that the intention behind a provision would not be defeated:

> *"In such a case, the court must fashion a special rule of attribution for the particular substantive rule. This is always a matter of interpretation: given that it was intended to apply to a company, how was it intended to apply? Whose act (or knowledge, or state of mind) was for this purpose intended to count as the act etc of the company?"*

6.5. The answer to the question in this case clearly includes Peter Miller, the Finance Director with particular responsibility for the accuracy of the financial information and John Blake who had responsibility for the whole of the business and operations in particular. The FSA is therefore unable to accept the argument that in regulatory

cases such as this the principle of *Hampshire Land* outlined above applies in preference to the purposive approach of *Meridian Global*.

Market abuse

6.6. The FSA does not accept that a company can only be liable for market abuse when it is complicit and there has been a breakdown in its corporate governance. Neither intent nor knowledge nor matters relating to governance are necessary elements in the provisions of section 118 of the Act (Market abuse). Matters which may go to mitigation cannot, and do not, avoid liability.

Other submissions

6.7. The FSA makes no findings in respect of corporate governance – any corporate wrongdoing for the purposes of this notice is limited to market abuse and the listing rules.

6.8. The FSA notes the importance placed in the representations on the role of the Audit Committee in the operation of Cattles but makes no finding in relation to it.

7. ANALYSIS OF SANCTION

7.1. The FSA views Welcome's conduct as particularly serious because:

(1) its misconduct took place over a sustained period (approximately 18 months);

(2) it had numerous opportunities, over a sustained period, to provide full details to PwC and Cattles' Audit Committee of its use of deferments and to seek advice as to the correct accounting treatment of deferments. However, it failed to ensure that the issues relating to deferments were properly understood and reflected in the accounts; and

(3) there was a very serious impact on Cattles' shareholders, who have lost all or virtually all of their investment, and on market confidence. During the period of the misconduct Cattles was a member of the FTSE 250 and at its height had a market capitalisation of over £1 billion. When the true state of Welcome's loan book emerged in early 2009, trading in Cattles' shares was suspended and on 16 December 2009 Cattles announced that its shares "*are likely to have*

little or no value". In Cattles' 2008 Annual Report published on 12 May 2009, the 2007 arrears and impairment figures contained in Cattles' 2007 Annual Report were restated, as a result of which Cattles' pre-tax profit figure for 2007 was adjusted from a pre-tax profit of £165.2 million to a pre-tax loss of £96.5 million. It is likely that the Rights Issue in April 2008, which raised £200 million, would have been significantly less successful had the market known the true state of Welcome's loan book.

7.2. The FSA has also had regard to the contemporaneous provisions of the Decision Procedure and Penalties Manual ("DEPP") set out in the Annex to this Notice, its regulatory objectives, as described above, and the penalties imposed in other market abuse and analogous cases.

7.3. In deciding that the imposition of public censure is appropriate (and in deciding that, if Welcome had been a going concern with significant surplus assets, a substantial financial penalty would have been imposed), the FSA has taken all of the circumstances of the case into account and has had regard to the contemporaneous provisions of DEPP set out in this Notice, its regulatory objectives and the penalties imposed in analogous cases.

8. DECISION MAKER

8.1. The decision which gave rise to the obligation to give this notice was made by the Regulatory Decisions Committee.

9. IMPORTANT

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

Publicity

9.2. 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.

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

FSA contacts

9.4. For more information concerning this matter generally, you should contact Celyn Armstrong (direct line: 020 7066 2818) or Dan Enraght-Moony (direct line: 020 7066 0166).

Jamie Symington
Head of Department
FSA Enforcement and Financial Crime Division

ANNEX

Relevant Regulatory Guidance

1. The provisions quoted below are those in force at the time of all the material events, acts and omissions described above.

Code of Market Conduct

2. The FSA issued MAR pursuant to section 119 of the Act, which requires the FSA to "prepare and issue a code containing such provisions as the … [FSA] … considers will give appropriate guidance to those determining whether or not behaviour amounts to market abuse." Under section 122 of the Act, MAR may be relied on "so far as it indicates whether or not particular behaviour should be taken to amount to market abuse."

3. MAR 1.8.3E provides examples of conduct which amount, in the opinion of the FSA, to behaviour falling within section 118(7) of the Act. Those examples include:

   "knowingly or recklessly spreading false or misleading information about a *qualifying investment* through the media, including in particular through an *RIS* or similar information channel."

4. MAR 1.8.4E adds as follows:

   "… if a normal and reasonable *person* would have known or should have known in all the circumstances that the information was false or misleading, that indicates that the *person* disseminating the information knew or could reasonably be expected to have known it was false or misleading."

5. MAR 1.8.6E states further that, in the FSA's opinion, the following is an example of market abuse falling within the terms of section 118(7) of the Act:

   "a *person* responsible for the content of information submitted to … [an *RIS*] … submits information which is false or misleading as to *qualifying investments* and that *person* is reckless as to whether the information is false or misleading."

COND

6. COND 2.5.6G sets out that that in determining whether a firm will satisfy, and continue to satisfy, threshold condition 5 in respect of conducting its business with integrity and in compliance with proper standards, the relevant matters may include but are not limited to whether:

   (a) the *firm* has been open and co-operative in all its dealings with the *FSA* and any other regulatory body (see *Principle* 11 (Relations with regulators)) and is ready, willing and organised to comply with the requirements and standards under the *regulatory system* and other legal, regulatory and professional obligations (COND 2.5.6G(1)); and

(b) the *firm* has contravened, or is connected with a *person* who has contravened, any provisions of the *Act* or any preceding financial services legislation, the *regulatory system* or the rules, regulations, statements of principles or codes of practice of other regulatory authorities, *clearing houses* or *exchanges*, *professional bodies*, or government bodies or agencies or relevant industry standards; the *FSA* will, however, take into account both the status of codes of practice or relevant industry standards and the nature of the contravention (for example, whether a *firm* has flouted or ignored a particular code) (COND 2.5.6G(4)).

Decision Procedure and Penalties Manual (DEPP)

7. In deciding to take the action described above, the FSA has had regard to the policy it has published, in Chapter 6 of DEPP, under section 124 of the Act, which requires the FSA to "issue a statement of its policy with respect to the imposition of penalties under section 123 and the amount of" such penalties. The FSA has also had regard to the provisions of the Enforcement Manual ("ENF"), which were in force for the early part of the Relevant Period. The extracts from DEPP reflect the provisions as they were in effect between 28 August 2007 and 5 March 2010.

8. The principal purpose of imposing a financial penalty or issuing a public censure is to promote high standards of regulatory conduct by deterring firms and approved persons who have breached regulatory requirements from committing further contraventions, helping to deter other firms and approved persons from committing contraventions and demonstrating, generally, to firms and approved persons, the benefit of compliant behaviour (DEPP 6.1.2G).

9. DEPP 6.2.1G sets out a number of factors to be taken into account when the FSA decides whether or not to take action for a financial penalty or public censure. They are not exhaustive but include:

"(1) the nature, seriousness and impact of the suspected *breach*, including:

(a) whether the *breach* was deliberate or reckless;

(b) the duration and frequency of the *breach*;

…

(e) the impact or potential impact of the *breach* on the orderliness of markets including whether confidence in those markets has been damaged or put at risk;

(f) the loss or risk of loss caused to *consumers* or other market users;

…

(2) The conduct of the person after the breach, including the following:

(a) how quickly, effectively and completely the person brought the breach to the attention of the FSA or another relevant regulatory authority;

(b) the degree of co-operation the person showed during the investigation of the breach;

(c) any remedial steps the person has taken in respect of the breach;

(d) the likelihood that the same type of breach (whether on the part of the person under investigation or others) will recur if no action is taken.

…

(3) The previous disciplinary record and compliance history of the *person*…

…

(5) Action taken by the FSA in previous similar cases

10. DEPP 6.2.2G sets out additional factors specific to the decision whether to take action for market abuse or for requiring or encouraging it. These include:

"The impact, having regard to the nature of the *behaviour*, that any financial penalty or *public censure* may have on the financial markets or on the interests of *consumers*:

(a) a penalty may show that high standards of market conduct are being enforced in the financial markets, and may bolster market confidence;

(b) a penalty may protect the interests of *consumers* by deterring future *market abuse* and improving standards of conduct in a market."

11. In enforcing the market abuse regime, the FSA's priority is to protect prescribed markets from any damage to their fairness and efficiency caused by the manipulation of shares in relation to the market in question. Effective and appropriate use of the power to impose penalties for market abuse will help to maintain confidence in the UK financial system by demonstrating that high standards of market conduct are enforced in the UK financial markets. The public enforcement of these standards also furthers public awareness and the FSA's protection of consumers objective, as well as deterring potential future market abuse.

12. DEPP 6.4.1G states that the FSA will consider all the relevant circumstances of the case when deciding whether to impose a financial penalty or issue a public censure. DEPP 6.4.2(8)(a) makes clear that verifiable evidence that a person would suffer serious financial hardship if the FSA imposed a financial penalty will be taken into account.

Relevant guidance as to level of penalty

13. DEPP 6.5.1G states that the "*FSA* will consider all the relevant circumstances of a case when it determines the level of a financial penalty (if any) that is appropriate and in proportion to the *breach* concerned."

14. DEPP 6.5.2G sets out a non-exhaustive list of factors which might be relevant to the level of financial penalty imposed by the FSA, as follows:

"(1) Deterrence

When determining the appropriate level of penalty, the *FSA* will have regard to the principal purpose for which it imposes sanctions, namely to promote high standards of regulatory and/or market conduct by deterring *persons* who have committed *breaches* from committing further *breaches* and helping to deter other *persons* from committing similar *breaches*, as well as demonstrating generally the benefits of compliant business.

(2) The nature, seriousness and impact of the *breach* in question

The FSA will consider the seriousness of the *breach* in relation to the nature of the *rule*, requirement or provision breached. The following considerations are among those that may be relevant:

(a) the duration and frequency of the *breach*;

…

(c) in market abuse cases, the *FSA* will consider whether the *breach* had an adverse effect on markets and, if it did, how serious that effect was, which may include having regard to whether the orderliness of, or confidence in, the markets in question has been damaged or put at risk …;

(d) the loss or risk of loss caused to *consumers*, investors or other market users;

…

(3) The extent to which the *breach* was deliberate or reckless

The *FSA* will regard as more serious a *breach* which is deliberately or recklessly committed. The matters to which the *FSA* may have regard in determining whether a *breach* was deliberate or reckless include, but are not limited to, the following:

(a) whether the *breach* was intentional, in that the *person* intended or foresaw the potential or actual consequences of its actions;

…

If the *FSA* decides that the *breach* was deliberate or reckless, it is more likely to impose a higher penalty on a *person* than would otherwise be the case.

…

(5) The size, financial resources and other circumstances of the *person* on whom the penalty is to be imposed

…

(8) Conduct following the *breach*

The *FSA* may take the following factors into account:

(a) the conduct of the *person* in bringing (or failing to bring) quickly, effectively and completely the *breach* to the *FSA's* attention (or the attention of other regulatory authorities, where relevant);

(b) the degree of co-operation the *person* showed during the investigation of the *breach* by the *FSA*…

(c) any remedial steps taken since the *breach* was identified, ...

…

(9) Disciplinary record and compliance history

…

(10) Other action taken by the *FSA* …"