



Financial Services Authority

FINAL NOTICE

To: Cattles Ltd

Address: Kingston House,
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Birstall, Batley,
WF17 9TD

Date: 28 March 2012

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

1. ACTION

1.1. The Financial Services Authority (“the FSA”) served on Cattles Limited (“Cattles”) 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 91(3) (Penalties for breach of Part 6 rules);

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

- (1) engaged in market abuse as defined by section 118(7) of the Act (dissemination); and
- (2) breached Listing Rule 1.3.3R (Misleading information not to be published), Listing Principle 3 (integrity) and Listing Principle 4 (creation of a false market).

- 1.2. If Cattles 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. Cattles 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 Cattles has engaged in market abuse and censuring Cattles.

2. SUMMARY REASONS FOR THE ACTION

- 2.1. Between August 2007 and February 2009 (the “Relevant Period”), Cattles - then known as ‘Cattles plc’ - was a subprime lender, most of whose business was conducted through a subsidiary, Welcome Financial Services Limited (“Welcome”).
- 2.2. At all material times, the Finance Director of Cattles was James Corr. James Corr was therefore the director primarily responsible for Cattles’ financial statements and for ensuring that all relevant information was provided to Cattles’ auditors (PricewaterhouseCoopers - “PwC”). In the circumstances, James Corr’s actions and state of mind described in this Notice are attributable to Cattles.

The false and misleading statements

- 2.3. In its Annual Report and Financial Statements for the period ending 31 December 2007 (“the Cattles’ 2007 Annual Report”) and its rights issue prospectus dated 23 April 2008 that raised £200 million (“the Rights Issue Prospectus”), Cattles published false and misleading information about the credit quality of Welcome’s loan book by stating that:
- (1) as at 31 December 2007, around £2.1 billion of Welcome’s approximately £3 billion loan book was “neither past due nor impaired” (ie not in contractual arrears);
 - (2) the business (ie the business of Cattles conducted through Welcome) treated a loan account as impaired when the account was 120 days in contractual arrears; and
 - (3) Cattles had made a pre-tax profit of £165.2 million for the year to 31 December 2007.
- 2.4. 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.
- 2.5. Had loans which had been deferred been treated as being in contractual arrears, the application of Cattles’ stated impairment trigger would have resulted in a pre-tax loss of £96.5 million (a reduction of £261.7 million against the disclosed pre-tax profit of £165.2 million).

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, Cattles had made a loss of £96.5 million (a reduction of £261.7 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 Cattles’ conduct (through James Corr) was that the use of deferments was not disclosed to the market. Neither PwC nor its 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 its 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, the Audit Committee and a major shareholder.

- 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. By its actions in relation to the Public Statements, Cattles disseminated information that gave a false and misleading impression to the market as to the value of its shares in circumstances where it could reasonably be expected to have knowledge that the information was false or misleading. It, therefore, engaged in market abuse contrary to section 118(7) of the Act.

2.12. Cattles also failed to:

- (1) take reasonable care to ensure that information it made available through the FSA (as both the Cattles' 2007 Annual Report and Rights Issue Prospectus were) and information it notified to a RIS (as the 2008 Announcements were) was not misleading, false or deceptive and did not omit anything likely to affect the import of the information (in breach of LR 1.3.3R);
- (2) act with integrity towards holders and potential holders of its listed equity securities (in breach of Listing Principle 3); and
- (3) communicate information to holders and potential holders of its listed equity securities in such a way as to avoid the creation or continuation of a false market in such listed equity securities (in breach of Listing Principle 4).

2.13. 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 Cattles has engaged in market abuse and censuring Cattles. The FSA would have imposed a substantial financial penalty on Cattles 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 power, pursuant to section 91(1) of the Act, to impose a financial penalty on an issuer of listed securities if the FSA considers that the issuer has contravened any provision of listing rules. Pursuant to section 91(3) of the Act if the FSA is entitled to impose a penalty on a person under section 91 it may, instead of

imposing a penalty on him in respect of that matter, publish a statement censuring him.

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 London Stock Exchange (“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. Listing Rule 1.3.3R provides that:

“An *issuer* must take reasonable care to ensure that any information it notifies to a *RIS* or makes available through the *FSA* is not misleading, false or deceptive and does not omit anything likely to affect the import of the information.”

3.10. Listing Principle 3 (LR 7.2.1R) provides that:

“A *listed company* must act with integrity towards holders and potential holders of its *listed equity securities*.”

3.11. Listing Principle 4 (LR 7.2.1R) provides that:

“A *listed company* must communicate information to holders and potential holders of its *listed equity securities* in such a way as to avoid the creation or continuation of a false market in such *listed equity securities*.”

3.12. MAR 1.2.3G makes clear that the Act does not require the person engaging in the behaviour in question to have intended to commit market abuse.

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 Cattles’ 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 is a wholly owned subsidiary of Cattles, and is authorised and regulated by the FSA (FSA registration no. 305742). Welcome’s principal business 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 within the Cattles Group is indicated by figures taken from Cattles’ 2007 Annual Report, which showed that it represented approximately 89.5% of Cattles’ revenue.

Management of customer arrears within Welcome

4.3. 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 (“LMB’s”). 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*”; and
- (3) loans that were more than 120 days in arrears were considered impaired and were transferred to a Local Collection Unit (“LCU”).

4.4. 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.

4.5. As James Corr was 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.

Introduction of International Financial Reporting Standard 7

4.6. The Cattles' 2007 Annual Report was required to comply with International Financial Reporting Standard 7 ("IFRS 7") for the first time.

4.7. 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."

4.8. 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"

4.9. 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 quantitative 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)).

4.10. "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.

- 4.11. 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.
- 4.12. A loan on which interest payments have been deferred should be disclosed accordingly to give important information about credit quality.

Impairment

- 4.13. 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 Cattles’ 2007 Annual Report

- 4.14. The information required to be disclosed by IFRS 7 was not information that Cattles had previously 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

- 4.15. Early on in its deliberations, the IFRS 7 project team took the correct view that deferments fell to be disclosed as either past due or renegotiated loans. However, in light of the clear steer being given by James Corr and others within 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 and certain of Cattles’ directors including James Corr, as well as John Blake the Managing Director of Welcome, 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 James Corr, along with the other Cattles directors present and John Blake, endorsed the approach.

- 4.16. 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

- 4.17. On 28 August 2007, an internal IFRS 7 progress report was prepared for the Cattles Board, the contents of which were approved by James Corr, in which it was explained that:

“We propose to acknowledge that while re-writes represent a form of renegotiation ... deferments do not. Our argument is based on the “10 out of 12 instalments being a good Welcome customer” view and deferments typically being used as a normal management tool in the non-standard consumer finance market ... This view is fundamental to our approach to complying with IFRS 7 and is something we must secure PWC’s agreement to. They may be expecting deferments to be included in the value of renegotiated loans and we expect to debate this point with them.”

- 4.18. On the same day, a different IFRS 7 progress report was sent to PwC, again the contents of which were approved by James Corr, that made no reference whatsoever to deferments.
- 4.19. James Corr decided not to include it in the formal Board pack which he knew would be received by PwC as a matter of routine and instead he sent it separately to the Board after the upcoming Board meeting. This had the effect of failing to highlight the issue with PwC. James Corr committed to the Board that PwC’s agreement should and would be obtained in respect of Cattles’ treatment of deferments under IFRS 7.
- 4.20. 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.”

- 4.21. 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. James Corr 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.
- 4.22. 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?”

As a result, Cattles failed to ensure that the issues surrounding deferments were properly debated with PwC and resolved.

October and November 2007

- 4.23. In October 2007, a further IFRS 7 Progress Report was prepared to update certain members of Cattex (ie a committee of the Cattles’ executive directors including therefore James Corr but also including 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.”*

- 4.24. 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

- 4.25. On 13 December 2007, James Corr attended a Cattles Audit Committee meeting. At that meeting, it was explained by John Blake 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.*" John Blake 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 4.4 above). James Corr was fully aware of this important information but did nothing to bring it to the attention of the Audit Committee.
- 4.26. In addition, at the same meeting there was a discussion of PwC's Pre-Year End Audit Committee Report for December 2007, which stated that "*IFRS 7 defines past due as being 1 day in contractual arrears*" and appended an analysis of past due but not impaired figures as at 31 December 2006 prepared by management that failed to take deferments into account. Neither James Corr nor John Blake took this opportunity to explain to the Audit Committee or PwC that the 2006 figures had been calculated in accordance with that definition of past due, on the basis that loans on which interest payments had been deferred could be treated as being not past due, and that the basis was highly material.
- 4.27. In relation to IFRS 7, the minutes stated:

"PwC reported that the Appendix to the PwC Report contained the quantitative disclosures relating to credit, liquidity and treasury risk for the 2006 numbers as if IFRS 7 had been in force at that date. [James Corr] agreed to circulate to the Directors IFRS 7 qualitative disclosures for 2007, together with prior year disclosures for 2005 and 2006, accompanied by commentary explaining any spikes during the week commencing 17 December. [James Corr] also noted that the revised Management Information to be

circulated to the Directors from January 2008 would include IFRS 7 numbers.”

but there was no evidence that full and accurate information, including a discussion on the material issue of the treatment of deferments, had been or was later circulated as promised.

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

4.28. In late December 2007, James Corr received in draft a paper intended to brief the Cattles Board on IFRS 7 disclosures. The paper 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 James Corr was 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 fact that James Corr had failed to debate and agree the treatment of deferments under IFRS 7 with PwC, despite the assurances he had previously given to the Board that this would be done; 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 internal arrears calculation was not explained.

4.29. However, James Corr did not flag up this wholly inadequate explanation of deferments. Rather the single reference to deferments in the draft paper was deleted at the behest of Peter Miller (a request also made by John Blake), who had also received it. The finalised paper on IFRS 7 disclosures that went to the Cattles Board, following James Corr’s review and under his direction, therefore 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. James Corr’s covering

note to the paper addressed to the Board simply advised that “120 days arrears [was] the appropriate impairment trigger point”, and that this view was supported by PwC.

The Audit Committee meeting and Annual Report in February 2008

- 4.30. 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.

- 4.31. 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 ...”.

- 4.32. 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 4.4 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.

- 4.33. During the Audit Committee meeting on 21 February 2008 which reviewed this report, 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.

- 4.34. On 27 February 2008, James Corr signed a representation letter to PwC in connection with its audit of the financial statements of Cattles 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.

4.35. On 28 February 2008, the Cattles’ Board approved the Cattles’ 2007 Annual Report.

4.36. Cattles’ 2007 Annual Report stated that IFRS 7 had been adopted. 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”.

4.37. James Corr was aware that this was not a detailed explanation of the commercial reality of Welcome’s business (which he had specifically undertaken to provide in Cattles’ Audit Committee meeting on 21 February 2008) as it made no mention of the role of deferments in calculating the impairment trigger and therefore the level of impairment. 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 table at paragraph 4.39 below), which gave the impression that all loans that were more than 120 days in contractual arrears were treated as impaired.

4.38. Cattles’ 2007 Annual Report, and subsequently the Rights Issue Prospectus, contained highly misleading information in relation to the credit quality of Welcome’s loan book because they stated that:

- (1) IFRS 7 had been adopted when, 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) Cattles had made a pre-tax profit of £165.2 million for the year to 31 December 2007. In the re-stated accounts, this figure, on the basis of the stated impairment trigger, was given as a pre-tax loss of £96.5 million.

4.39. At the time James Corr approved and signed Cattles’ 2007 Annual Report, the requirements of IFRS 7 (see paragraphs 4.5 to 4.12) were in effect. As illustrated in the table below, the accounts did not comply with IFRS 7. Consequently, Cattles’ 2007 Annual Report contained information which was false and misleading.

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

Loans and receivables (Welcome)	Original 2007	Restated 2007
	(£m)	(£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

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

4.42. Cattles' 2007 Annual Report was published on Cattles' website on 28 February 2008 and made available for public inspection through the document viewing facility located at the FSA's offices on 9 April 2008.

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Events after publication of Cattles' 2007 Annual Report

Questions from analysts in March 2008

4.44. In preparation for questions from analysts in relation to the arrears figures contained in Cattles' 2007 Annual Report, James Corr was sent a 'Questions and Answers' document in early March 2008 that made no reference to deferments. The person responsible for drafting the 'Questions and Answers' made it clear to James Corr that he had deliberately not referred to deferments but that he was uncomfortable with this approach as he considered they formed a significant element of any explanation of the arrears figures.

4.45. However, James Corr failed to inform analysts about deferments. Later in March 2008, two analysts from one of Cattles' major shareholders asked James Corr directly why the company did not treat as impaired debt with arrears of less than 120 days as impaired and told him that the *"general feedback from the analyst community is that they still need more information to fully understand what is going on with impairments"*.

4.46. The response, approved by James Corr, stated that:

"... we do not believe that there is objective evidence of impairment until a customer reaches the 120 day contractual arrears point. This trigger point is not 4 consecutive monthly payments missed but 4 misses since inception ... We are currently analysing investor feedback re our disclosure around impairment. Once we have completed this exercise we will be better placed to understand what further information we might be able to provide in order to aid the market's understanding of the [Welcome] business model".

It gave no explanation of what comprised 'contractual arrears'.

4.47. This was a highly misleading and disingenuous answer as loans with 'deferments' were not included in loans with 'contractual arrears'. James Corr knew that the impairment trigger was not as simple as "4 misses since inception". It was also obvious what further information would have aided the market's understanding, namely an explanation of Welcome's use of deferments, and their significance.

April 2008

4.48. On 23 April 2008, Cattles issued the Rights Issue Prospectus. Like Cattles' 2007 Annual Report, it contained misleading information because it contained the same statement as that set out in paragraph 4.36 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.

4.49. James Corr was aware, as set out at paragraph 4.45 above, that the analyst community needed more information to understand impairment and that this was not set out in the Rights Issue Prospectus. Nevertheless Cattles approved the Rights Issue Prospectus and it was made available through the FSA's viewing facility on 24 April 2008. 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 deferrals from the impairment figures

- 4.50. In August 2008, James Corr was aware that a key area of concern for the internal auditors was a £42 million “bulk deferment” processed in May 2008, apparently outside of Welcome’s standard policy requirements, and its attendant impact on the company’s profit.
- 4.51. On 19 August 2008, James Corr received an internal audit report highlighting the lack of management information as to the aggregate level of deferrals and detailing concerns over the impact of the £42 million ‘bulk deferment’.
- 4.52. On 20 August 2008, James Corr received an email setting out an estimate of the impact of removing all deferrals from Welcome’s impairment figure as at June 2008. 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, James Corr knew that certain Cattles’ directors were seeking information on the level of deferrals within Welcome but he took no steps to pass on his knowledge about the overall level of deferrals or their impact on reported profit.
- 4.53. On 21 August 2008, James Corr and John Blake attended a Cattles Audit Committee meeting which considered the internal audit report and the impact of the £42 million “bulk deferment”. The aggregate level of deferrals would have been highly material to the discussions.
- 4.54. On 28 August 2008, Cattles published its interim announcement for the six months to 30 June 2008, reiterating, by reference to the accounting policies as set out in the 2007 Annual Report, its adoption of IFRS 7 and the misleading statement that Welcome’s impairment trigger was 120 days contractual arrears. Pre-tax profit for the six months to 30 June 2008 was stated to be £70.2 million. This was misleading because the stated impairment trigger made no mention of the significant role played by

deferments. In addition the announcement stated that “*customer balances with a proportion in arrears were 31.4% (FY 2007: 29.2%)*” without mentioning the role played by deferments in calculating these figures. In fact, on a contractual basis, the proportion of customer balances with a proportion in arrears for financial year 2007 was much higher at 48.6%. This was misleading because the arrears percentages were in fact calculated on a deferred arrears basis rather than the contractual basis required by IFRS 7. Cattles failed to take the necessary steps to ensure that IFRS 7 was being complied with and failed, again, to resolve the matter with PwC.

The events of October and December 2008 including the concern of the Audit Committee at the lack of provision

- 4.55. In October 2008, a member of Cattles’ management team reported to PwC that he was concerned over the level of provisioning on Welcome’s loan book, in particular on debt housed within a sub-set of the LMBs (which, as mentioned above, dealt with loans between 60 and 120 days in arrears) known as the Asset Management Branches. In response, a paper was drafted to provide Cattles’ Audit Committee with an explanation on the rationale behind the Asset Management Branches (“the AMBs”). The Audit Committee had not previously been briefed on this.
- 4.56. Having reviewed the paper, James Corr distributed it 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 (on the basis that these were only allowed “*within strictly controlled circumstances*”) and that debt in the AMBs was permitted to remain within that division for twelve months and not be treated as impaired even if contractually due payments were not being received during that period.
- 4.57. 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. At no stage during that meeting, specifically convened to address the Audit Committee’s concerns over the level of deferments in the AMBs and the effect on impairment, did James Corr explain the true extent to which deferments were used in the business, namely that

there was over £600 million of debt (approximately 20% per cent of Welcome's loan book) that was only unimpaired because of the application of deferments. This was despite the fact that James Corr had received an email explaining how, if impairment was at 120 days but with no deferments, the estimated IFRS 7 disclosure would move £611 million of debt from not impaired to impaired (see paragraph 4.52).

- 4.58. On 18 December 2008, Cattles published its pre-close trading statement for the period ended 30 November 2008. Cattles reported that trading was in line with expectations, repeating IFRS 7 arrears figures (as percentages) for 2007 and providing corresponding figures for June, September and November 2008. It claimed that IFRS 7 arrears had grown from 29.2% for financial year 2007 to 35.0% in November 2008 (this significantly downplayed the true percentage of the book in arrears - as stated above for financial year 2007 the proportion in arrears for 2007, calculated on a contractual basis, was 48.6%). Cattles, through James Corr, failed to take steps to ensure that IFRS 7 was being complied with and therefore that the information provided was not misleading. Cattles, through James Corr, failed to resolve the matter with PwC.

February to April 2009

- 4.59. 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.
- 4.60. 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. Cattles made a number of representations principally in writing on 22 June 2011 and orally 8 September 2011. What follows is a brief summary of the key representations on liability.

- 5.2. Cattles made its representations jointly with Welcome. 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 James Corr.

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 attribution is sought. 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 James Corr 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 Cattles’ 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. 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?”

- 6.4. The answer to the question in this case clearly includes James Corr, the Finance Director with particular responsibility for the accuracy of the financial information. 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

- 6.5. 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

- 6.6. 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.

7. ANALYSIS OF SANCTION

- 7.1. The FSA views Cattles’ misconduct 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 its 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;

- (3) there was a very serious impact on shareholders, who have lost all or virtually all of their investment, and on market confidence. During the period of the market abuse, 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 Cattles' 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 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 the loan book.

7.2. The FSA has also had regard to the contemporaneous provisions of 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 a public censure is appropriate (and in deciding that, if Cattles 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.”

6. The provisions of MAR as quoted above were in force at the time of all the material events, acts and omissions described above.

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

Relevant guidance as to level of penalty

10. 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.

11. 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.”
12. 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*;

...

- (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*..."