



Banc Ceannais na hÉireann
Central Bank of Ireland

Eurosystem

Settlement Agreement between the Central Bank and Octagon Online Services Limited

The Central Bank of Ireland fines Octagon Online Services Limited €105,000 for own account dealing without authorisation

The Central Bank of Ireland (the “Central Bank”) fined Octagon Online Services Limited (the “Firm” or “Octagon”) €105,000 in relation to a breach of Regulation 72 of the European Communities (Markets in Financial Instruments) Regulations 2007 (S.I. No. 60 of 2007) (“MiFID Regulations”) which requires an investment firm to comply at all times with the conditions and requirements of its initial authorisation.

Between 11 June 2014 and 20 February 2015, Octagon traded in financial instruments using its proprietary capital without being authorised by the Central Bank to do so.

This finding has been accepted by Octagon in a settlement agreement concluded between the Central Bank and the Firm on 8 December 2015.

Derville Rowland, the Central Bank’s Director of Enforcement, said:

“For a period of eight months, until February this year, Octagon engaged in the investment service of dealing on own account¹ in breach of its MiFID authorisation. This is the second time the Firm has exceeded the limits of its authorisation. The Central Bank warned Octagon not to conduct unauthorised activity in 2002 and twice in 2008. We also told the Firm to expect enforcement action if it should engage in own account dealing in the future.

Octagon’s breaches were caused mainly by its failure of institutional memory. The Firm forgot about its own prior regulatory failings and our warnings not to deal on own account.

The Central Bank expects regulated financial service providers to be sufficiently well controlled to engage with their Supervisors in an informed and open manner. We expect firms to have regard to previous regulatory contacts and to take all necessary steps to avoid repeated regulatory failings. Firms must organise themselves in a manner that ensures they understand fully their regulatory obligations, are aware of their own operational and regulatory history and make certain that when their officers and employees engage with the Central Bank they do so with access to and knowledge of that history.

¹ Dealing on own account under MiFID means trading against proprietary capital resulting in the conclusion of transactions in one or more financial instruments (Schedule 1, Part 1(3) MiFID Regulations).

We also expect all firms to be absolutely clear on the extent of their authorisation and to operate at all times within the limits of those prescribed boundaries. In addition to Octagon's failure to remember the Central Bank's warnings the Firm admits to doubting in 2014 whether its authorisation permitted own account dealing. It proceeded in any event. This is totally unacceptable.

For much of the duration of the breach Octagon was classified as a Low Impact Firm under the Central Bank's PRISM system of supervision. Such Firms must ensure they comply fully with all regulatory requirements in the same fashion as higher impact firms notwithstanding the regularity and method of direct engagement with the Central Bank may differ. The Central Bank cannot countenance a situation where, despite repeated regulatory engagements on an issue, a firm continues to be deficient in meeting its obligations.

Own account dealing represents a prudential risk reflected in the amount of initial capital that firms which engage in such activity must hold. It requires a minimum level of capital far beyond that held by Octagon². While the Firm drafted procedures to govern its trading they were neither fully implemented nor adequate to govern its trading risk."

BACKGROUND

Octagon's initial authorisation and regulated activity

The Central Bank authorised Octagon as an investment firm on 6 December 2001 pursuant to the Investment Intermediaries Act 1995. The Firm's authorisation was limited to receiving and transmitting orders on behalf of investors. On 1 November 2007 Octagon's authorisation was transposed under the MiFID Regulations. It was and remains limited to the reception and transmission of orders.

Octagon provides clients access to an online platform to deal in U.S. securities. The Firm earns commission on each trade placed by clients.

Section 72 of the MiFID Regulations requires an investment firm to comply at all times with the conditions and requirements of its initial authorisation. Octagon's authorisation is limited to the investment service specified in Schedule 1, Part 1 (1) of the MiFID Regulations: the reception and transmission of orders. Octagon is not authorised for the investment service specified in Schedule 1, Part 1(3): dealing on own account.

Octagon's initial regulatory capital requirement is €50,000 pursuant to Regulation 27(2) of the European Union (Capital Requirements) Regulations 2014 (S.I. No. 158 of 2014) ("**Capital Requirements Regulations 2014**"). Regulation 26(2) of the Capital Requirements Regulations 2014 requires firms which engage in the investment service of dealing on own

² €730,000 instead of €50,000, 14 times the amount required to be held by Octagon.

account to hold initial capital of €730,000. This reflects, among other things, the prudential risk involved in dealing on own account.

Octagon's regulatory history regarding own account dealing

The Central Bank inspected Octagon in 2002 and discovered it was operating a proprietary trading account. We reminded Octagon it was not authorised to deal on own account. The Firm told us it opened the account to demonstrate live trading to clients. It ceased the activity.

On two occasions in 2008 Octagon contacted the Central Bank expressing a desire to deal on own account for profit. We reminded the Firm, as we had in 2002, that it is not authorised to deal on own account. We also threatened Enforcement activity should Octagon exceed the limits of its authorisation in this way.

PRESCRIBED CONTRAVENTION

The breach

At Octagon's board meeting on 27 May 2014 the Firm resolved to "*...trade options and generate more income.*" Between 11 June 2014 and 20 February 2015, the Firm traded in financial instruments through a U.S. broker and generated a profit of \$22,927.87.

Regulation 72(1) of the MiFID Regulations states:

"An authorised investment firm...shall comply at all times with the conditions and requirements of its initial authorisation."

The Firm's initial authorisation is limited to the reception and transmission of orders pursuant to Schedule 1, Part 1(1) of the MiFID Regulations. Octagon performed the investment service specified in Schedule 1, Part 1(3) MiFID Regulations:

"Dealing on own account, meaning the activity of trading against proprietary capital resulting in the conclusion of transactions in one or more financial instruments."

Accordingly, Octagon breached its authorisation through performing the investment service of dealing on own account without authorisation.

The Central Bank commenced its investigation after receiving the Firm's annual management accounts in which it recognised an unexplained financial gain. Octagon's Supervisors queried the gain and the Firm disclosed it related to own account dealing. The Central Bank issued a Direction requiring Octagon to cease taking proprietary positions. The Firm remediated the breach within the time required by the Central Bank.

Conduct relevant to the breach

This is the second time Octagon has breached its authorisation in this way and the conduct occurred despite Central Bank warnings not to engage in unauthorised activity.

Octagon informally outsourced aspects of its compliance function without implementing controls that were adequate to ensure the Firm remained compliant with its regulatory obligations. Where firms choose to outsource compliance or other regulatory functions to third parties we require them to put in place controls that are adequate to ensure the function is performed correctly. Ultimate accountability for compliance remains with firms and they must ensure that they maintain oversight of outsourced activities. Poorly controlled outsourcing was a material factor in this breach.

Enforcement staff interviewed an Octagon officer who told us that before the board meeting on 27 May 2014 the Firm commissioned a review of MiFID to clarify whether Octagon was permitted to deal on own account. That review concluded (erroneously, from the Central Bank's perspective) that the MiFID Regulations are unclear on the issue. The officer nevertheless acknowledged that, *"We went ahead and did it..."*

The primary cause of Octagon's breach was its loss of institutional memory. The relevant records pertaining to the Firm's previous dealings with the Central Bank were available but there was no procedure for review and access to those records and no one reviewed them before the Firm engaged in the unauthorised activity.

That failure of institutional memory also resulted in Octagon making inaccurate statements to its Supervisors:

1. Octagon told its Supervisors during a conference call that it was in possession of Central Bank correspondence permitting it to deal on own account provided it did not fall beneath its required regulatory capital level. No such correspondence exists. The statement made by the Firm was not deliberately inaccurate or misleading. It was made absent knowledge of the Firm's previous regulatory history. Investigating that claim led to Central Bank staff searching for records which do not exist.
2. Octagon provided inaccurate information to its Supervisors regarding the types of financial instruments it traded. Again, we are satisfied this was not a deliberate misrepresentation by any individual. The inaccurate statement resulted from a lack of knowledge of the Firm's operational history.

Octagon's prescribed contravention did not lead to its regulatory capital falling below the required level. This was, however, a risk, particularly in light of the fact that the trading was primarily focused on derivatives. Octagon's internal procedures did not prevent representatives of Octagon from dealing in certain derivatives that potentially exposed Octagon to unlimited risk. Further, Octagon drafted procedures in May 2014 that required the Firm's directors to review its trading activity twice-daily which was not, in fact, done.

PENALTY DECISION FACTORS

In deciding the appropriate penalty, the Central Bank took the following into account:

1. This is a particularly serious breach: Octagon failed to comply with the conditions and requirements of its initial authorisation and exceeded the limits of that authorisation. It engaged in an investment service for which the Capital Requirements Regulations 2014 require capitalisation in an amount 14 times that of the Firm's minimum requirement.
2. The Firm engaged in this trading activity to generate income.
3. This is the second time Octagon has engaged in unauthorised business.
4. The Central Bank repeatedly warned Octagon not to engage in unauthorised activity, threatening Enforcement action should it do so in the future.
5. While the conduct did not result in a capital breach, throughout the period of the breach, there was a risk that the Firm would fall beneath its required regulatory capital levels should its trading activity be unsuccessful.
6. The nature of the trading in which Octagon engaged was high risk and its procedures to govern trading activity were inadequate and not fully implemented.
7. The conduct continued for eight months and was only resolved following Central Bank intervention.
8. The conduct occurred because the Firm was not sufficiently well controlled to comply with its regulatory obligations including its fundamental obligation to remain within the limits of its authorisation.
9. The breach occurred despite Octagon having concerns as to whether it was permitted activity. The Firm had doubts but nevertheless proceeded.
10. Octagon routinely outsourced its compliance function without exercising the appropriate level of oversight. This was a material factor in the breach.
11. Octagon was a Low Impact Firm for most of the duration of the breach. The Central Bank expects all firms to be well controlled. When regulatory intervention is required, it is essential to the functioning of PRISM that Low Impact Firms respond proactively and remediate in a timely manner through the supervisory process.
12. The need to have an appropriate deterrent impact.
13. As part of the settlement, the firm agreed to appoint a dedicated in-house compliance officer.

14. The cooperation of the Firm during the investigation and in settling at an early stage in the Central Bank's Administrative Sanctions Procedure.

The Central Bank confirms its investigation into the Firm in respect of this matter is closed.

-End-

NOTES TO EDITORS

1. On 1 December 2015 the Central Bank entered into a settlement agreement with Lambay Capital Limited regarding breaches of Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 (the "CRR") and the MiFID Regulations. An aggravating feature of that case was a failure of institutional memory. The Public Statement is [here](#).
2. In November 2014 the Central Bank entered into a settlement agreement with Ulster Bank Ireland Limited regarding IT and governance failings, including governance of outsourced tasks. The public statement is [here](#). In May 2015 the Central Bank entered into a settlement agreement with Western Union Payment Services Limited regarding its AML-CFT procedures, including its outsourcing procedures. The public statement is [here](#).
3. A link to the Central Bank publication "PRISM Explained" is [here](#).
4. The fine imposed by the Central Bank was imposed under Section 33AQ of the Central Bank Act 1942. The maximum penalty was €10,000,000.
5. The Central Bank had regard to Section 33AS(1) of the Central Bank Act 1942 and imposed a monetary penalty that would not cause the financial service provider to cease business.
6. The fine reflects the application of the maximum percentage settlement discount of 30%, as per the Early Discount Scheme set out in the Central Bank's "Outline of the Administrative Sanctions Procedure" which is [here](#).
7. This case involves two key cross-sectoral Enforcement priorities for 2015: (1) prudential requirements; and (2) appropriate governance and oversight of outsourced activities. Further, those priorities stressed that The Central Bank has specifically allocated resources for enforcement actions against firms with a low impact PRISM rating on the Bank's risk assessment framework. The Central Bank's Enforcement priorities for 2015 are available on the Central Bank website ([here](#)).