



Banc Ceannais na hÉireann  
Central Bank of Ireland

Eurosystem

## **ENFORCEMENT ACTION**

Central Bank of Ireland  
and  
J&E Davy

### **J&E Davy fined €4,130,000 and reprimanded by the Central Bank of Ireland for regulatory breaches arising from personal account dealing**

On 1 March 2021, the Central Bank of Ireland (the **Central Bank**) reprimanded and fined J&E Davy (**Davy**) €4,130,000 in respect of four breaches of the European Communities (Markets in Financial Instruments) Regulations 2007 (the **MiFID Regulations**) that occurred over different intervals between July 2014 and May 2016.

The Central Bank's investigation arose from a transaction a group of 16 Davy employees (the **Consortium**) undertook in a personal capacity with a Davy client (the **Client**) in November 2014 (the **Transaction**). Within the Consortium was a group of senior executives (the **Committee**). In permitting the Transaction, Davy prioritised facilitating an opportunity for the Consortium to make a personal financial gain over ensuring that it was complying with its regulatory obligations. The Transaction highlighted a weak internal control framework within Davy in relation to conflicts of interest management and personal account dealing. All of this served to create an elevated risk of investor detriment.

Following details about the Transaction becoming public four months after it occurred, Davy contacted the Central Bank to provide an explanation. At that stage, Davy failed to disclose the full extent of the wrongdoing. This lack of candour was treated as an aggravating factor in this case.

The MiFID Regulations aim to ensure high levels of market transparency and investor protection and include important regulatory requirements in relation to conflicts of interest and personal account dealing (where employees of an authorised firm trade for themselves rather than clients.)

The Central Bank's investigation found failings in the following areas:

1. **Conflicts of interest identification and management:** In permitting the Transaction, Davy breached the MiFID Regulations by failing to take all reasonable steps to identify whether a conflict of interest arose. At the time of the Transaction, Davy was not operating in a conflicts of interest aware environment. Whilst Davy did have a conflicts of interest policy, employees were permitted to decide whether transactions in which they had an interest could give rise to a conflict of interest on a case-by-case basis, without independent oversight and without a requirement to keep a record of steps taken. In deciding at the outset whether the Transaction was permissible, Davy's primary focus should have been to identify whether any conflict of interest arose between the Consortium and the Client. Davy failed to do this properly because the only cursory discussion of this issue was by senior individuals who intended to participate in the Transaction and were therefore not impartial. In effect, this amounted to no consideration of the issue at all by Davy.
2. **Personal account dealing framework:** Davy did not have a robust control framework in place to prevent employees from entering into personal transactions that could give rise to a conflict of interest. The Consortium circumvented the personal account dealing framework completely, such that Davy's compliance function (**Davy Compliance**) first became aware of the Transaction four months later, when certain information about the Transaction became public.
3. **Ensuring the compliance function can discharge its role properly:** A compliance function can only discharge its role effectively when it has access to all relevant information. Davy permitted the Transaction to proceed without any oversight by Davy Compliance. Davy Compliance was sidestepped by the Consortium, and as the personal account dealing framework was circumvented, Davy Compliance did not detect the Transaction as part of its monitoring.

The Central Bank determined the appropriate fine to be €5,900,000, which was reduced by 30% to €4,130,000 in accordance with the settlement discount scheme provided for in the Central Bank's Administrative Sanctions Procedure.

The Central Bank's Director of Enforcement and Anti-Money Laundering, Seána Cunningham said:

*"The Central Bank's investigation found that Davy fell well below the standard required in meeting its regulatory obligations in relation to conflicts of interest and personal account dealing. In permitting a group of employees to pursue a personal investment opportunity, conflicts of interest were not properly considered, the rules in place in relation to personal account dealing were easily sidestepped and Davy's compliance function was kept in the dark. The serious issues identified in this investigation required the imposition of a significant financial penalty on Davy.*

*This case serves as an important reminder that conflicts of interest are an inherent risk to all regulated entities. When not properly managed, they pose a risk to investors and diminish market integrity. Where investment firms permit employees to engage in personal account dealing - i.e. to trade for themselves rather than for a client - the risk of conflicts of interest arising is heightened.*

*In promoting a relationship of trust between regulated entities and their clients, the Central Bank expects boards to embed conflicts of interest awareness into their firm's culture. This is critical to ensure that clients' interests are consistently prioritised, and not overlooked in favour of commercial or personal interests. To achieve this in practical terms, firms are required to have in place a robust framework and to ensure that there is a no-exceptions approach taken to adherence to the applicable rules. It must be driven from the top and embraced by all employees of the firm. It was a striking feature of our investigation, how easy it was for the individuals involved to circumvent Davy's personal account dealing framework.*

*Finally, when failures do occur, the Central Bank expects firms to demonstrate accountability in terms of how they deal with regulatory breaches. In this investigation, Davy's lack of candour when first reporting the matter to the Central Bank was treated as an aggravating factor."*

## **Background to Davy**

Davy is authorised as an investment firm under the European Union (Markets in Financial Instruments) Regulations 2017. Davy is Ireland's largest stockbroker and wealth manager, with approximately 48,000 active clients and €8.5bn assets under management.

## **The Transaction**

In 2014, the Client opened an execution only account<sup>1</sup> with Davy for the purposes of carrying out the Transaction and transferred bonds into Davy. The Consortium subsequently entered

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<sup>1</sup> This is a type of client account, where the client provides instructions to buy or sell securities, without the provision of any investment advice by the investment firm.

into an agreement with the Client to advance a loan to settle debt secured on the bonds and to buy the bonds from the Client at an agreed price. Davy took no steps to ensure that the Client was aware that the Consortium was comprised of Davy employees. No written disclosure was made to that effect.

While Davy employees are permitted to trade on their own accounts, they are required to do so on a designated system (**System A**) that is monitored by Davy Compliance. An account specifically for the Transaction was opened by a member of the Committee on Davy's system for institutional clients (**System B**), a system that the Committee knew or ought to have known was not monitored by Davy Compliance.

The Transaction involved an off-market transfer.<sup>2</sup> Following instructions, Davy transferred the bonds internally from the Client's account to the Consortium's account on System B. A payment was made by Davy, from Davy funds, on behalf of the Committee. This was repaid by the Committee later the same day. Three weeks later the Consortium sold a large tranche of the bonds to a fund manager. In the weeks prior to that sale, certain Consortium members engaged with interested buyers to provide a Davy "house view" on the value of the bonds. In so doing, the Consortium members drew no distinction between whether they were acting in a professional capacity (i.e. as broker) or personal capacity, as the seller of the bonds. The Central Bank's investigation found this to be a particularly serious example of the many potential conflicts of interest that can arise between a firm, its clients and its employees, in the course of one transaction.

There are two important features of the Transaction, as follows:

- (i) It was between Davy employees and a Davy client – this meant that Davy's obligations under the MiFID Regulations in relation to conflicts of interest were triggered; and
- (ii) As a group, the Consortium members were dealing in their personal rather than professional capacity – this meant that Davy's obligations under the MiFID Regulations in relation to personal transactions were triggered.

Any approvals with respect to the Transaction came from the Committee, without consultation with Davy Compliance. As the Committee were also members of the Consortium, this meant that they approved their own involvement without any independent oversight.

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<sup>2</sup> An off-market transfer is settled privately between parties, not involving a clearing house or a stock exchange

The Transaction was not detected by the daily monitoring of personal transactions, and Davy Compliance first learnt of the Transaction four months later when information about it entered the public domain. This revealed a serious weakness in Davy's internal control mechanisms relating to personal account dealing; it was possible to avoid the monitoring carried out by Davy Compliance by opening an account on System B. As a result, Davy Compliance did not have access to the relevant information in order to discharge its function properly and independently.

## **Prescribed Contraventions**

### **1. Conflicts of Interest**

Regulation 74(1) of the MiFID Regulations requires investment firms to take all reasonable steps to identify conflicts of interest that arise within the firm, between the firm and third parties, between the firm and a client, or between one client and another.

The MiFID Regulations are not prescriptive as to what "reasonable steps" are required in every case; it is an objective standard that depends on the specific set of circumstances where a potential conflict of interest may arise. Regulation 75(1) does however provide the **minimum criteria** to be taken into account when identifying conflicts of interest, which includes considering whether a firm/its employees: (i) are likely to make a financial gain or avoid a financial loss at the expense of a client and/or, (ii) have an interest in the outcome of the service provided to a client which is distinct from the client's interest.

**Davy breached Regulations 74(1) and 75(1) of the MiFID Regulations between 13 October 2014 and 14 November 2014, by failing to take all reasonable steps to identify the actual and/or potential conflict of interest that arose between the Consortium and the Client in the context of the Transaction.**

A number of years before the Transaction occurred, the Client (who at that stage was not a client of Davy) had contacted a Davy employee informally and sought the employee's view on the value of bonds he owned. The bonds in question were unlisted and traded infrequently by a small number of hedge and distressed debt funds.

In the weeks prior to the Transaction the Client, through his financial advisor, contacted the Davy employee. He wanted to know the Davy employee's opinion on the value of the bonds. At that point in time, the Client was trying to sell the bonds. The Davy employee spoke to members of the Committee about the opportunity to buy the bonds.

The Client subsequently opened an execution only account with Davy and transferred the bonds into this account in anticipation of a possible transaction. Initially the Davy employee, the

Client and his advisor discussed selling the bonds on the open market subject to achieving a minimum price. The Client agreed to a profit share between himself, his advisor and the Davy employee. The amount of the profit depended on the price achieved for the bonds.

The Committee were interested in buying the bonds. They formed the Consortium with other staff members, including the Davy employee. A draft legal agreement was provided to the Client, whereby the bonds would be transferred to the Consortium off-market at an agreed price. No disclosure was made to the Client as to the identity of the Consortium members. The Transaction proceeded on that basis.

The Central Bank's investigation found that the foregoing gave rise to, at the very least, a potential conflict of interest between Davy, the Consortium and the Client, due to:

- (i) The informal nature of the initial engagement between the Client and the Davy employee;
- (ii) The potential for the Client to believe that the Davy employee was advising him on the highest achievable price for the bonds;
- (iii) The fact that the Davy employee had been offered a form of inducement by the Client to find a buyer for the bonds; and
- (iv) The fact that at the same time the Davy employee was a member of the Consortium who were buying the bonds.

The potential conflict of interest should have been identified by Davy and managed properly through explicit written disclosure to the Client before undertaking any business on the Client's behalf.

Davy kept no written record of what steps were taken to identify whether any conflicts of interest arose with respect to the Transaction. The investigation found that the decision that no conflict of interest arose was taken by the Committee, each of whom were members of the Consortium. They did not minute any discussion in relation to the matter. The investigation found no evidence that the members of the Committee had considered the minimum criteria set out in Regulation 75(1). The investigation found that the Committee decided it was not necessary to consult with Compliance.

The Central Bank's investigation found, that given the particular set of circumstances associated with the Transaction, Davy should have taken the following steps to consider whether a conflict of interest arose:

- (i) Davy should have considered the minimum criteria set out in Regulation 75(1);

- (ii) The Committee should have abstained from participating in decision making on behalf of Davy in respect of a matter in which they had an interest in a personal capacity or where their objectivity was compromised;
- (iii) The Committee should have highlighted the potential conflict of interest to Davy Compliance; and
- (iv) Davy should have documented this process.

Davy undertook none of these steps.

## **2. Personal Account Dealing**

Regulation 39(1) of the MiFID Regulations requires firms to have adequate arrangements in place aimed at preventing “relevant persons” (meaning directors, partners and employees of the firm) from entering into a personal transaction that could give rise to a conflict of interest or market abuse.

In particular, Regulation 39(2) of the MiFID Regulations provides that the arrangements must be designed to ensure that:

- (i) Relevant persons are aware of the restrictions on personal account dealing and the measures in place in the firm in relation to personal account dealing;
- (ii) The firm is informed promptly of any personal account dealing; and
- (iii) A record is made of the personal account dealing, including any authorisation or prohibition in connection with the personal account dealing.

**Davy breached Regulation 39(1) and 39(2) of the MiFID Regulations between 1 July 2014 and 1 May 2016, by failing to have in place an adequate framework in relation to personal account dealing.**

The arrangements that Davy had in place in relation to personal account dealing were as follows:

- (i) Davy had a policy document in relation to personal account dealing (the **Rules**) that applied to all employees;
- (ii) Certain investments required pre-trade approval, however personal account dealing was primarily monitored by Davy Compliance on a post-trade basis; and
- (iii) Employees were required to carry out all personal account dealing on System A. Davy Compliance generated a daily report from System A and checked that each personal transaction had followed the requirements of the Rules.

The Transaction revealed inadequacies in the personal account dealing framework for the following reasons:

- (i) There were gaps in how the Rules operated in terms of pre-trade approval;
- (ii) A lack of clarity in relation to aspects of the Rules meant that employees were not fully aware of the restrictions in place; and
- (iii) The personal account dealing framework was easily circumvented by the Committee.

Particularly serious examples of this were as follows:

- (i) There was nothing in the Rules to prevent members of the Committee from approving a transaction in which they themselves were participating;
- (ii) In fact, the Committee themselves claimed to be unclear on whether or not the Rules applied to the Transaction and if so, whether pre-trade approval was required. When the Transaction was approved by the Committee, the Consortium had not yet been formed, but a member of the Committee prospectively gave pre-trade approval to a group of unidentified individuals for any transactions involving the bonds;
- (iii) Davy Compliance did not detect that the Transaction had taken place because it was not on System A and they were not otherwise consulted; and
- (iv) There was nothing in the Rules to prevent members of the Consortium providing a Davy “house view” of the bonds whilst at the same time acting as sellers of the bonds.

The foregoing demonstrates a failure by Davy to have adequate arrangements in place with respect to personal account dealing. Furthermore, due to the fact that the Transaction was carried out on System B and was therefore not detected by Davy Compliance on its daily report, Davy failed to satisfy the requirements of Regulation 39(2) that the firm be promptly informed of all personal account dealing and that a record was made of same, including any authorisation required.

### **3. Internal Control Mechanisms**

Regulation 33(1)(f)(i) of the MiFID Regulations requires firms to have in place and use sound administrative and accounting procedures and internal control mechanisms.

**Davy breached Regulation 33(1)(f)(i) of the MiFID Regulations between 13 October 2014 and 14 November 2014, by failing to ensure, in the context of the Transaction, that it used sound administrative procedures, accounting procedures and internal control mechanisms.**



The fact that the Transaction was carried out on System B, meant that it went undetected by Davy Compliance. This resulted in a failure by Davy to use the administrative procedures, accounting procedures and internal control mechanisms it had in place with respect to identification of conflicts of interest and personal account dealing.

#### **4. Compliance**

Regulation 35(3)(a) of the MiFID Regulations requires firms to ensure that its compliance function has access to all relevant information in order to enable the compliance function to discharge its responsibilities properly and independently.

**Davy breached Regulation 35(3)(a) of the MiFID Regulations between 13 October 2014 and 15 April 2015 by failing to ensure that Davy Compliance had access to all relevant information in relation to the Transaction.**

Davy Compliance did not find out about the Transaction until four months after it occurred, when information entered the public domain. This is because, save for in a very limited respect, Davy Compliance was not consulted in relation to the Transaction prior to it taking place. It was not detected by Davy Compliance after the fact either, as System B, being a system for institutional clients only, was not monitored for personal account dealing.

The potential conflict of interest between the Consortium and the Client should have been flagged to Davy Compliance under the terms of Davy's conflict of interest policy. The Committee, having taken the view that no potential conflict of interest arose in relation to the Transaction, decided it was not necessary to consult with Davy Compliance. This meant that rather than seeking independent oversight as to whether a conflict of interest arose, the Committee decided the matter for themselves.

Shortly after the Client had opened the account, Davy Compliance was asked to consider draft documentation. One member of the Davy Compliance team followed up with a Committee member (also a member of the Consortium) to clarify certain points. During the course of that engagement, the Committee member misled Davy Compliance by not providing relevant information in relation to the type of transaction contemplated – the most glaring omission being a failure to tell Davy Compliance that it was a personal transaction involving a group of Davy employees. This resulted in a very serious failure by Davy to provide Davy Compliance with access to all relevant information to allow it to discharge its function properly and independently and fulfil its crucial role in the second line of defence in line with good corporate governance practices.

## **Remediation**

The board of Davy oversaw two independent reviews of the issues arising from the Transaction. Following on from this, Davy introduced a revised conflicts of interest policy and revised personal account dealing rules in May 2016.

## **Penalty Decision Factors**

In deciding the appropriate penalty to impose, the Central Bank considered the ASP Sanctions Guidance issued in November 2019. The following particular factors are highlighted in this case:

### **The Nature, Seriousness and Impact of the Contraventions**

- In permitting the Transaction to proceed, Davy acted in a reckless manner in the way that it failed to:
  - identify and manage a potential conflict of interest between Davy employees and a Davy client,
  - ensure adherence to the arrangements in place relating to personal account dealing; and
  - ensure transparency with Davy Compliance.
- Davy did not operate within a conflicts of interest aware environment, particularly in permitting employees to engage in personal account dealing without having adequate safeguards being in place. The serious weaknesses in Davy's internal controls in relation to personal account dealing meant that, as was the case with respect to the Transaction, it was possible to circumvent Davy Compliance's monitoring of personal account dealing. This created a risk that Davy employees could engage in personal transactions that gave rise to conflicts of interest, without detection by Davy Compliance along with an attendant risk of detriment to investors or other market users.
- The contraventions each represent a serious departure from the standard required under legislation and the Central Bank's expectations regarding compliance culture within regulated firms.

### **Aggravating Factor**

Co-operation with the Regulator is a basic expectation of the Central Bank in the context of engagement with firms, whether in a supervisory or enforcement context. The Central Bank expects firms to engage in an open and transparent manner, and that information provided is timely, accurate and reliable.

When information about the Transaction entered the public domain, Davy contacted the Central Bank to provide an explanation. During the course of that first engagement, Davy provided vague and misleading details and wilfully withheld information that would have disclosed the full extent of the wrongdoing as was known to Davy at the time.

The Central Bank subsequently wrote to Davy identifying specific areas of concern and seeking additional information from Davy. In a letter of response, Davy once again failed to disclose the full extent of the wrongdoing as it was known to it at the time.

It was only after the commencement of the investigation that the Central Bank realised the extent of the inaccurate information provided. In particular, the information provided by Davy was presented in such a way as to make the involvement of certain individuals appear more central to the Transaction than in fact was the case. This has been treated as an aggravating factor in this case.

The Central Bank confirms that the investigation is now closed.

## Notes to Editors

1. J&E Davy, an unlimited company, is the largest trading entity in the J&E Davy Group, and is a wholly owned subsidiary of J&E Davy Holdings. J&E Davy Holdings is wholly owned by Davy management and staff, and former employees.
2. The fine imposed by the Central Bank was imposed under Section 33AQ of the Central Bank Act 1942. The maximum penalty under Section 33AQ is €10,000,000 or an amount equal to 10% of the annual turnover of a regulated financial services provider, whichever is the greater.
3. This is the Central Bank's 141st settlement since 2006 under its Administrative Sanctions Procedure, bringing the total fines imposed by the Central Bank to over €128m.
4. Funds collected from penalties are included in the Central Bank's Surplus Income, which is payable directly to the Exchequer, following approval of the Statement of Accounts. The penalties are not included in general Central Bank revenue.
5. The Central Bank's 'Outline of the Administrative Sanctions Procedure' provides for an early settlement discount of up to 30% in order to promote early resolution of matters, which in turn leads to better utilisation of the resources of the Central Bank. For further information on the discount scheme, see the Central Bank's 'Outline of the Administrative Sanctions Procedure'. It is available [here](#).
6. On 25 February 2016, following the conclusion of a thematic inspection to examine the processes for the identification and management of conflicts of interest in investment firms, the Central Bank issued a Dear CEO letter highlighting the main issues that arose from the review. The Dear CEO letter is available [here](#).
7. On 21 January 2020, following the conclusion of a thematic review to assess the approach of regulated entities operating in the wholesale market to market conduct risk, the Central Bank issued a Dear CEO letter outlining the findings of its review, which included a lack of proactive identification of conflicts of interest. The Dear CEO letter is available [here](#).

8. J&E Davy is subject to continuous supervisory engagement and oversight by the Central Bank in line with our Probability Risk and Impact System (PRISM).