

Insurance Quarterly Legal and Regulatory Update

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DILLON  EUSTACE

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■ INSURANCE QUARTERLY LEGAL AND REGULATORY UPDATE

Solvency II

Due to delays in agreement on the final text of the Solvency II Directive the previously anticipated timetable for the transposition of Solvency II by June 30, 2013 with implementation by January 1, 2014 will now not be met.

The Central Bank of Ireland (the '**Central Bank**') has confirmed that it will not bring forward proposals for early Solvency II implementation independently of its European counterparts.

The Central Bank has called on the European authorities to provide certainty as to when Solvency II will be implemented.

We would hope to be in a position to give a better indication regarding Solvency II's implementation in the next Insurance Quarterly Legal and Regulatory Update.

EIOPA Updates

(i) **EIOPA to launch the technical assessment of the long-term guarantees package**

On December 19, 2012 it was announced that EIOPA is to assess the impact of the Solvency II Long Term Guarantees package, as requested by the Trilogue parties (the European Parliament, the Council of the European Union and the European Commission).

The assessment will cover the effects that the implementation of the various elements of the Long Term Guarantees package might have on policyholders and beneficiaries, together with the wider insurance and reinsurance industry.

The assessment is due to commence on January 28, 2013 and will involve co-operation with national supervisory authorities. It is anticipated that EIOPA's findings will be published in mid- 2013.

(ii) **EIOPA publishes opinion on interim measures regarding Solvency II**

On December 20, 2012 EIOPA published an opinion on interim measures regarding Solvency II.

The opinion proposes that national competent authorities should put certain important aspects of the prospective and risk based supervisory approach in place with effect from January 1, 2014. These include ensuring that insurers have an effective system of governance which provides for sound and

prudent management of the insurer and an effective risk management system to assess the readiness of insurers' Solvency II internal models.

EIOPA has also stated that it will issue Guidelines for national supervisors on how to proceed in the interim phase leading up to Solvency II. EIOPA expects to commence a public consultation process on these guidelines in Spring 2013.

(iii) Guidelines on Complaints-Handling by Insurance Undertakings

On November 16, 2012 EIOPA published Guidelines on Complaints-Handling by Insurance Undertakings in all official languages of the European Union.

The Guidelines are addressed to national supervisors and set down minimum standards on suitable internal systems and controls for complaints-handling by insurers such as having a complaints management policy and complaints management function in place. An insurer will be required to notify its competent authority as to the number of complaints it has received. Procedures for responding to complaints must be set out by the national supervisor.

National supervisors will have until January 15, 2013 to declare whether they intend to comply with the Guidelines or, alternatively, explain the reasons for non-compliance.

The Guidelines may be viewed at the following link:

https://eiopa.europa.eu/fileadmin/tx_dam/files/consultations/consultationpapers/CP10-11/final/Guidelines_on_complaints-handling_by_Insurance_Undertakings_EIOPA-BoS-12069_.pdf

(iv) EIOPA responds to EC consultation on a possible recovery and resolution framework for financial institutions other than banks

On December 5, 2012 EIOPA submitted a response to the European Commission's consultation on a possible recovery and resolution framework for financial institutions other than banks. EIOPA's response notes the fact that (re)insurers have a more stable business model, are less interconnected and are more substitutable than banks.

EIOPA's response may be viewed at the following link:

https://eiopa.europa.eu/fileadmin/tx_dam/files/publications/submissionstotheec/EIOPA_Response-COM_Consultation_on_recovery_and_resolution_for_nonbank_financial_institutions.pdf

Central Bank of Ireland

(i) Probability Risk and Impact System ('PRISM')

The Central Bank launched its risk-based supervision framework, PRISM on December 1, 2011. The Central Bank has recently started to engage with regulated firms under the framework whereby regulated firms have been requested to attend a meeting with the Central Bank.

Under PRISM, the Central Bank aims to supervise regulated firms in a manner that will make it less likely that they will fail in a way that would damage financial stability or endanger consumers. The Central Bank aims to further improve its culture of regulation and to ensure a consistent approach to supervision of firms.

PRISM has the effect of making it easier for the Central Bank's supervisors to judge risks, challenge firms they regulate and take action to mitigate those risks. The main focus is on preventing these larger regulated firms from failing in a disorderly fashion. Regulated firms which are low risk shall be supervised reactively or through systemic assessments. PRISM is designed to use the Central Bank's supervisors in an effective and cost-effective manner. It is expected that PRISM will make a significant contribution to the Central Bank's efforts to help the economy recover.

On October 11, 2012, Ms. Fiona Muldoon (Director, Credit Institutions & Insurance Supervision) of the Central Bank delivered a presentation entitled "Enterprise Risk Management in Insurance Undertakings". This presentation looked at the impact of firms by sector under PRISM as of September 2012. Of the 26 domestic insurers, 10 were deemed high risk, 4 medium-high risk, 7 medium-low risk and 5 low risk. Of the 242 international insurers, 3 were deemed high risk, 20 medium-high risk, 75 medium-low risk and 144 low risk.

(ii) The Central Bank Strategic Plan 2013-2015

The Central Bank published its Strategic Plan 2013-2015 in November, 2012. A list of planned reviews/inspections will be published in early 2013.

The main objectives of the Strategic Plan are as follows;

- (1) To restore financial stability and support economic recovery through a successful exit from the EU-IMF Programme of Financial Support and restoring a fully functioning banking system;
- (2) Reform of the regulatory and supervisory framework to ensure risks to stability and consumer protection are identified and effectively mitigated;

- (3) Protection of consumers by challenging firms' compliance, promoting a better culture in the financial sector and helping consumers have more confidence in financial services; and
- (4) Influencing the increasingly international policy-making framework for monetary policy, financial stability and regulatory standard setting.

The key focus shall be on "improved operational efficiency and cost effectiveness".

The Strategic Plan is available to view on the Central Bank's website;

<http://www.centralbank.ie/publications/Documents/Central%20Bank%20of%20Ireland%20Strategic%20Plan%202013%20-%202015.pdf>

(iii) Consultation on Impact Based Levies and Other Levy Related Matters

The Central Bank published Consultation Paper 61 on November 20, 2012 on proposed changes to the basis for calculating the industry funding levy payable by regulated entities. The most notable proposed change is to more closely align the funding levies paid by regulated entities with the costs of their supervision. This is logical because the impact categorisation of regulated entities, as determined by PRISM, determines the number of supervisors assigned to that firm.

The Central Bank also proposes introducing application fees for firms seeking authorisation to provide financial services. These application fees will reflect the average cost involved in processing applications.

The consultation runs until February 22, 2013. The paper may be viewed here:

<http://www.centralbank.ie/regulation/poldocs/consultation-papers/Documents/CP61%20Consultation%20on%20Impact%20Based%20Levies%20and%20Other%20Levy%20Related%20Matters/2012%20Impact%20Based%20Levy%20Consultation%20Paper%20CP61.pdf>

(iv) Central Bank holds Enforcement conference

The Central Bank held its first Enforcement conference (the '**Conference**') on December 11, 2012. The Deputy Governor of the Central Bank, Matthew Elderfield, strongly defended the imposition of public sanctions on firms that breach banking rules and urged more action on financial white collar crime. Those in attendance at the Conference were told that in the last three years, the Central Bank has concluded 30 administrative sanctions cases and imposed approximately €13.3 million in fines.

While it was acknowledged that the current sanction regime has made firms in the industry uncomfortable, Mr. Elderfield noted that enforcement is usual practice in Britain, the US and across the European Union, for example in France, Germany, Sweden, Malta and Luxembourg.

Enforcement actions may be taken for a number of reasons and there are various outcomes of enforcement actions including;

- ▣ to hold persons accountable for wrongdoing;
- ▣ to deter others from behaving in a similar fashion;
- ▣ to protect stakeholders (including consumers, investors and of course the public);
- ▣ to educate and signal the intention of regulators;
- ▣ to improve behaviours;
- ▣ to improve the current state/level of compliance;
- ▣ to improve the standards we expect of regulated persons;
- ▣ allow for more efficient and effective supervision (i.e. help with the deployment of scarce supervisory resources to areas where the return on policy initiatives is greatest, e.g. *PRISM*);
- ▣ to improve reputation (of Ireland, firms and industries);
- ▣ to compensate harmed investors; and
- ▣ to restore the special trust consumers, investors and the public place in firms and markets.

Enforcement action may be used in all sections of the regulated market and many different firms have been pursued to date such as banks, insurers, re-insurers, firms operating in the international financial services sector, retail intermediaries, stockbrokers and specialist MiFID firms among others.

Matters investigated to date include complaints handling, payment protection insurance, transaction reporting, prudential requirements, securities lending, client assets, AML/CFT, systems and controls and specific retail intermediaries.

All administrative sanctions to date have been resolved by settlement, which includes the disqualifications of nine individuals.

The Central Bank's role as competent authority for the purposes of both the Third Anti-Money Laundering Directive and international obligations extending from FATF was addressed at the Conference. It was noted where there are concerns about a firm's compliance with the Act, referrals from the AML/CTF supervisory team can be made to the enforcement activity teams for enforcement investigation.

The Central Bank will shortly have a broader range of supervisory and enforcement tools to implement desired outcomes which will strengthen the Central Bank's powers to safeguard stability, to effectively regulate markets and financial firms and to protect consumers. An example of a development on the horizon is the Central Bank (Supervision and Enforcement) Bill 2011 which will

have the effect of doubling the current administrative sanction penalties taking the maximum fine for individuals from €500,000 to €1 million and for corporate bodies from € 1 million to €10 million (or 10% of prior year turnover) respectively.

The presentation delivered at the conference may be viewed here;

[http://www.centralbank.ie/regulation/processes/enforcement/Documents/Enforcement%20Conference%20Presentations%20\(for%20circulation\).pdf](http://www.centralbank.ie/regulation/processes/enforcement/Documents/Enforcement%20Conference%20Presentations%20(for%20circulation).pdf)

Companies Bill 2012

The Minister for Jobs, Enterprise and Innovation Richard Bruton (the “Minister”) published the Companies Bill 2012 (the “Bill”) on 21 December 2012. The Bill aims to reduce the costs associated with incorporating companies in Ireland, to reduce certain administrative red tape with which companies in Ireland must currently comply with and proposes to make company law obligation easier to understand. The Bill proposes to consolidate the existing 16 Companies Acts, which date from 1963 to 2012, into a single Act.

The Bill also proposes wide-ranging reforms which include the following;

- ▣ the codification of directors' duties;
- ▣ permitting a private company limited by shares to be formed with one director;
- ▣ removing the obligation for companies to have an objects clause;
- ▣ permitting companies to have a one-document constitution;
- ▣ “summary approval procedures” which will allow companies to carry out certain activities by means of a directors’ declaration and a shareholders’ resolution for those activities which under the current law would require High Court approval (for example, certain transactions with directors, capital reductions, and solvent windings up);
- ▣ new procedures regarding mergers and divisions; and
- ▣ proposals to extend the audit exemption.

While the Government has indicated that it will prioritise the progress of this Bill through the Oireachtas, it is unlikely to be enacted before the end of 2013 due to its size and the fact that it is a reforming Bill.

Gender neutral insurance premiums

As of December 21, 2012, Article 5.2 of the European Community adopted Council Directive 2004/113/EC (the ‘**Directive**’) has ceased to have legal effect. The consequence of this is that Member States now have an obligation to introduce measures ensuring that premiums for ‘new’

contracts of insurance and related financial services entered into as of December 21, 2012 are calculated on a gender neutral basis.

The concept as to what determines a contract as being 'new' is the subject of European Commission guidance. This matter has been discussed in greater detail in the last Quarterly Legal and Regulatory Update, available on our website.

Health Insurance

New Risk Equalisation Scheme for 2013

The Government has approved the text of a Bill for a new Risk Equalisation scheme in the private health insurance market. The Health Insurance (Amendment) Bill provides for a permanent Risk Equalisation scheme for private health insurance in Ireland.

Risk Equalisation has the purpose of taking account of differences in health insurers' costs that arise due to the age or health of customers. Our system of community rating is protected, as older and sicker people can buy health insurance for the same price as younger and healthier customers. Originally due to become effective as of January 1, 2013 the Bill is currently at the Committee Stage in the Oireachtas and is yet to be enacted.

Pensions Update

The Pensions Board revises timeframe for defined benefit schemes to submit funding proposals

The Pensions Board has revised the timeframe for defined benefit schemes with funding deficits to submit funding proposals.

Trustees of schemes required to submit funding proposals over the period December 31, 2012 to May 31, 2013 now have until June 30, 2013 to submit their funding proposal.

This will allow trustees additional time to explore all available options regarding scheme funding deficits.

Data Protection

(i) Data Protection Regulation

On January 25, 2012 the European Commission outlined its proposals for a fundamental overhaul of data protection rules in the European Union.

The European Parliament's Committee on Employment and Social Affairs published its draft opinion on the revised General Data Protection Regulation on November 8, 2012. The Committee's draft opinion focuses on employee data issues. In particular, the draft opinion raises a concern with attempts to regulate the privacy of employee data in one article and notes that the Regulation only provides a minimum level of protection for employees.

(ii) Data Protection Commissioner commences action on 'Cookie' law

In December 2012 the Office of the Data Protection Commissioner wrote to the operators of 80 websites seeking information as to their compliance with the so called 'cookie' obligations placed upon them with effect from July 1, 2011.

The action is in response to what is seen as a disappointing level of compliance by websites with the new rules which require websites to provide prominent and clear information to users as to what data they are collecting or allowing to be collected via cookies on their site.

Anti-Money Laundering/Counter-Terrorism Financing

(i) Criminal Justice (Money Laundering and Terrorist Financing) (Amendment) Bill 2012

The Department of Justice has published the draft heads of a new Bill in the area of anti money laundering ('**AML**') - the Criminal Justice (Money Laundering and Terrorist Financing) (Amendment) Bill 2012 (the '**Bill**'). The Bill is seeking to clarify certain aspects of the Criminal Justice (Money Laundering and Terrorist Financing) Act 2010 (the '**Act**'), following concerns raised by the Department of Justice as well as matters raised by the Central Bank. The accompanying press release to the Bill states that the Government intends to make further amendments to the Bill at a later date as it considers its response to the Mahon Tribunal and representations from IFSC firms who use the services of parties outside the State for customer identification purposes. It is expected that the Bill be published during 2013.

The amendments proposed in the Bill include;

- ▣ Lowering the identification threshold for private members gaming clubs from €15,000 to €2,000;
 - ▣ Section 31 of the Act (which permits the Minister for Justice, Equality and Law Reform (the ‘**Minister**’) to designate certain countries outside the EU as having equivalent standards to those specified in the Third AML Directive) will be amended such that a designated person must carry out its own risk assessment on such specified countries if the designated person wishes to rely on a relevant third party in such countries or apply simplified due diligence to specified customers from such countries. Unfortunately the Bill is silent as to what measures a designated person can take in relation to third parties in those Non-EU countries which are not on the list of specified countries (i.e. those countries which are not on the good list of countries under Section 31 or the bad list of countries under Section 32);
 - ▣ Section 34 of the Act, which deals with specified customers and specified products – i.e. the situations where simplified due diligence can be applied – is proposed to be amended whereby the designated person can apply simplified due diligence to such customers/products where the designated person has taken steps to determine whether or not the customer or product is a specified customer or product;
 - ▣ Section 54 of the Act will be amended to specifically include the keeping up to date of documents obtained for due diligence purposes and the future-proofing of procedures to accommodate new technological developments; and
 - ▣ Section 55 of the Act is to be amended such that records will no longer have to be kept in the State.
- (ii) **Central Bank issue letter with regard to the Criminal Justice (Money Laundering and Terrorist Financing) Act 2010 (the ‘Act’)**

On October 12, 2012, the Central Bank issued a letter to all Irish-regulated credit and financial institutions on foot of a number of inspections conducted across all regulated sectors. The letter sets out an overview of control deficiencies the Central Bank has recognised and actions the Central Bank expects firms to take to identify similar deficiencies in their anti-money laundering and counter-terrorism financing frameworks.

The letter detailed the following control failures;

Governance

Board/Senior Management were unable to demonstrate that they;

- ▣ had considered the implications of the Act for their business;
- ▣ had allocated the necessary resources to implement the changes required as a result of the enactment of the Act;
- ▣ had an appropriate governance framework to ensure ongoing oversight of compliance by the firm with the Act; and
- ▣ understood the potentially serious implications for the firm and for individual staff members/directors where the firm failed to comply with the Act.

Risk Management

Firms were not able to demonstrate that they had;

- ▣ evaluated the risks of anti-money laundering and terrorist financing pertinent to their business sector;
- ▣ adopted appropriate risk mitigation plans to mitigate risks; and
- ▣ evaluated specific risks for their business activities or were unable to produce detailed rationale for risk mitigation plans adopted.

Policies and Procedures

The Central Bank felt that firm's anti-money laundering and counter terrorist financing policies were deficient in the following ways;

- ▣ There was material gaps in the anti-money laundering and counter terrorist financing policies and procedures adopted by firms to prevent and detect money laundering and terrorist financing;
- ▣ Anti-money laundering and counter terrorist financing procedures must cover all areas of the business.

The Central Bank expects ongoing senior management oversight as to the appropriateness and effectiveness of such anti-money laundering and counter terrorist financing procedures.

Training

The Central Bank stated that firms could not adequately demonstrate that directors/employees had received adequate training in the area of anti-money laundering and counter-terrorist financing.

Customer Due Diligence ('CDD')

The Central Bank stated that CDD remediation work for existing customers was not being carried out in a systematic or comprehensive manner. They also stated that the verification of customers was not being completed as soon as practicable and that firms were not documenting the point at which

they would terminate the customer relationship if a customer continues to fail to provide CDD documentation.

Suspicious Transaction Reporting ('STR')

The Central Bank felt that firms were not filing STRs as soon as practicable, which is the standard required by the Act.

A copy of the letter may be viewed here:

<http://www.centralbank.ie/regulation/processes/enforcement/Documents/Dear%20CEO%20AML-CTF%20letter.pdf>

(iii) Sectoral Guidance Notes for the Life Assurance Sector

On October 16, 2012 the Department of Finance published on its website the Sectoral AML Guidance Notes for the Life Assurance Sector. These Sectoral Guidance Notes are in addition to the Core Guidance Notes issued in February 2012.

The Sectoral Guidance Notes provide more detail in applying the risk based approach in the life assurance sector by drawing a distinction between those products which have indicative features which would generally deem them low risk (such as term assurance) versus those products which have indicative features which would generally deem them high risk (such as single premium investment products), however it is acknowledged that it is the responsibility of the designated person to consider whether their own branded versions of these products have features that either reduce or increase the indicative risk.

The Sectoral Guidance Notes may be viewed at the following link:

<http://www.finance.gov.ie/documents/guidelines/guidelaunderssep2012.pdf>

(iv) Fourth Anti-Money Laundering Directive

The Commission plans to publish a legislative proposal for a Fourth Anti-Money Laundering Directive in early 2013. Prompted by the new international Financial Action Task Force ('FATF') recommendations published in February 2012, the Fourth Anti-Money Laundering Directive will most likely address the following issues;

- ▣ broadening the risk based approach to incorporate more risk based elements so that resources can be focused where they are most needed;
- ▣ possible clarification of the CDD rules so that it is clear that the simplified procedures are not wrongly perceived as full exemptions from CDD;

- ▣ incorporating new provisions to deal with Politically Exposed Persons (**'PEPs'**) at domestic level;
- ▣ clarification as to how AML supervisory powers will apply in cross border situations;
- ▣ strengthening the powers and co-operation between the different Financial Intelligence Units within the EU; and
- ▣ incorporating new provisions on data protection to deal with the Commission's proposals on data protection reform as published in January 2012.

Ugo Bassi, Head of Unit at DG Internal Market and Services at the Commission has said that the proposal for the fourth Anti-Money Laundering Directive "should be ready in early 2013 and would hopefully be adopted by the two co-legislators by the end of 2013".

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CONTACT US

Our Offices

Dublin

33 Sir John Rogerson's Quay
Dublin 2
Ireland
Tel: +353 1 667 0022
Fax: +353 1 667 0042

Cayman Islands

Landmark Square
West Bay Road, PO Box 775
Grand Cayman KY1-9006
Cayman Islands
Tel: +1 345 949 0022
Fax: +1 345 945 0042

Hong Kong

604, 6/F, Printing House
6 Duddell Street
Central
Hong Kong
Tel: +852 35210352

New York

245 Park Avenue
39th Floor
New York, NY 10167
United States
Tel: +1 212 792 4166
Fax: +1 212 792 4167

Tokyo

12th Floor,
Yurakucho Itocia Building
2-7-1 Yurakucho, Chiyoda-ku
Tokyo 100-0006, Japan
Tel: +813 6860 4885
Fax: +813 6860 4501

e-mail: enquiries@dilloneustace.ie
website: www.dilloneustace.ie

Contact Points

For more details on how we can help you, to request copies of most recent newsletters, briefings or articles, or simply to be included on our mailing list going forward, please contact any of the team members below.

Mary Canning

E-mail: mary.canning@dilloneustace.ie
Tel : + 353 1 673 1759
Fax: + 353 1 667 0042

Breeda Cunningham

E-mail: breeda.cunningham@dilloneustace.ie
Tel : + 353 1 673 1846
Fax: + 353 1 667 0042

Michele Barker

E-mail: michele.barker@dilloneustace.ie
Tel : + 353 1 673 1886
Fax: + 353 1 667 0042

Matthew Ryan

E-mail: matthew.ryan@dilloneustace.ie
Tel : + 353 1 673 1716
Fax: + 353 1 667 0042

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