

Insurance Quarterly Legal and Regulatory Update

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INSURANCE QUARTERLY LEGAL AND REGULATORY UPDATE

Solvency II

Omnibus II update

Trilogue discussions between the European Parliament, the Council of Ministers and the European Commission in which the parties are seeking to reach agreement on the final text of Omnibus II are still ongoing.

Originally it was hoped that agreement might be reached by the end of June with a view to the text being put to a European Economic Affairs Committee vote in September of this year.

Anticipating a further delay in the agreement on the text of Omnibus II which would cause Member States to miss the deadline for transposition of Directive 2009/138/EC at October 31, 2012, the European Commission has published a Directive to amend the original Solvency II transposition date to June 30, 2013 and implementation date to January 1, 2014.

The governments of the Czech Republic and Sweden have raised concerns that the delay in finalising the text of Omnibus II will leave national authorities and insurance companies with little time to prepare for Solvency II's introduction, particularly given the fact that level 2 and level 3 implementing measures may not be finalised before June 30, 2013. As a consequence, they are of the view that Solvency II's implementation should be postponed until January 1, 2015.

From an Irish perspective, the Central Bank is working from the following timetable:

-  Solvency II will be transposed by Member States by June 30, 2013; and
-  Solvency II will come into full effect for all undertakings on January 1, 2014.

EIOPA Updates

(i) Report on good practices for disclosure and selling of variable annuities

On April 10, 2012 the European Insurance and Occupational Pensions Authority ("EIOPA") published a report on good practices for disclosure and selling of variable annuities.

The report is part of EIOPA's initiative on consumer protection and financial innovation and seeks to promote common supervisory approaches and practices relating to variable annuities.

With regard to good disclosure practices, the report provides that customers should be informed as to:

- (i) How a particular product functions in different market conditions;
- (ii) The details of charges that apply;
- (iii) The options available throughout the life of the contract; and
- (iv) General information on the product provider, the law applicable to the contract and details of the relevant supervisory authorities.

With regard to good selling practices, the report provides that the sale of variable annuities should always be based on advice by suitably qualified salespersons so that customers can make informed decisions.

A list of FAQ's is also provided to assist product providers in meeting the recommendations of the report.

The full text of the report may be found on EIOPA's website <https://eiopa.europa.eu/>

(ii) EIOPA publishes an opinion on external models/data used for the calculation of Solvency II Capital Requirements

On May 7, 2012 EIOPA published an "Opinion on External Models/Data used for the calculation of Solvency II capital requirements". The opinion is addressed to national supervisory authorities and is designed to promote common supervisory approaches and practices throughout the European Union.

The primary points raised by EIOPA in the opinion may be summarised as follows:

- (i) National supervisory authorities may request any additional information on external models/data in order to assess an insurer's compliance with Solvency II requirements;
- (ii) National supervisory authorities will be obliged to reject an internal model application in circumstances where the insurer fails to provide sufficient information for an appropriate assessment of its application; and

- (iii) Contractual conditions between vendors of models/data and insurance companies must not be used to justify the insurer's refusal to demonstrate that its external model/data fulfils the necessary requirements.

The full text of the opinion may be found on EIOPA's website <https://eiopa.europa.eu/>

Department of Justice publishes Draft General Scheme of the Proposed Mediation Bill

On March 1, 2012 the Department of Justice published a draft general scheme for the proposed Mediation Bill. Once enacted, it is hoped that the legislation will promote the use of mediation in the resolution of civil disputes, ultimately expediting and reducing the cost of dispute resolution.

In its current draft form, the general scheme of the Bill proposes the following:

- (i) There will be a statutory obligation on barristers and solicitors to advise their clients (prior to issuing proceedings) to consider using mediation as an alternative means of resolving the dispute;
- (ii) Any communication between relevant parties relating to mediation will be deemed confidential;
- (iii) The parties to a mediation will have the right to determine whether or not any agreement made during the course of mediation will be enforceable between them;
- (iv) The court may invite the parties to use mediation to settle the dispute and may suspend any court procedures during the mediation. Where mediation is utilised in such circumstances, the mediator will be obliged to prepare and submit a report on the outcome of the process to the court;
- (v) The Minister may prepare, or approve, and publish a code of practice for the conduct of mediation by qualified mediators; and
- (vi) Certain statutory obligations will be imposed on mediators (i.e. provision of certain information to participating parties).

It is anticipated that the draft heads of bill will be proposed as a draft bill in the coming months.

The full text of the draft heads of Bill may be found on the Department of Justice and Equality website <http://justice.ie> .

Finance Act 2012

The Finance Act 2012 (the "Act") (referenced in our Insurance Quarterly Legal and Regulatory Update for Q2 2012) was signed into law on March 31, 2012.

The provisions of the Act of relevance for the insurance sector are as follows:

Life Assurance:

The Act provides for an increase of 3% in the rate of exit tax applying to life assurance products. Additionally the Act provides for a reduction in the exit tax rate from 33% to 25% for Irish corporate investors who have invested in funds and life policies.

General Insurance Levies:

The Act brings forward the due date for the payment of both the 3% levy on non-life insurance policies and the 2% Insurance Compensation Levy to the 25th day of the month following the quarter end.

The 3% duty and the 2% contribution will be collected together via a return form (the first such return was due on or before April 25, 2012).

Health Insurance Levy:

The Act also provides for an increased levy to all health insurance renewals and new contracts entered into from January 1, 2012. The rate has increased from €205 to €285 for each insured person. In the case of insured person under the age of 18 the increase is from €66 to €95.

Pensions Update

Social Welfare and Pensions Act 2012

The Social Welfare and Pensions Act 2012, enacted in February 2012, makes various amendments to the Pensions Act 1990. The aim of these amendments is to support defined benefit pension schemes, enabling them to become more sustainable, stable and secure into the future.

The key amendments may be summarised as follows:

- (i) A risk reserve has been introduced into the funding standard. Its introduction (which is intended to create a buffer that will allow schemes to absorb future financial downturns) will

apply to all the schemes that did not meet the statutory minimum funding standard on June 1, 2012.

The risk reserve will not take effect until January 1, 2016. The current statutory minimum funding will also be restored as of this date (where schemes hold sovereign annuities or sovereign bonds they will be allowed credit for these in their funding standard calculations);

- (ii) In addition to the submission of an actuarial funding certificate, the trustees of a pension scheme will also be required to submit an actuarial funding reserve certificate with effect from January 1, 2016;
- (iii) Section 50 orders may now include an order to reduce prior revaluations of a preserved benefit;
- (iv) In the case of a defined benefit scheme the rules of which include an early retirement rule, the consent of the trustees to an application for early retirement may be required where the actuary is not certain that the scheme would satisfy the funding standard reserve requirements at the date of the commencement of retirement;
- (v) The trustees of a pension scheme must include a statement in the annual report indicating whether or not the scheme satisfies the funding standard reserve requirements; and
- (vi) The provisions relating to the failure to comply with the funding requirement are being augmented so that the trustees of a pension scheme must report to the Pensions Board within a prescribed timeframe on the measures taken to restructure scheme benefits on foot of a notice issued by the Pensions Board under section 50 of the Pensions Act.

Following these changes, the Pensions Board has published revised rules for defined benefit schemes which may be found at www.pensionsboard.ie .

Health Insurance

Health Insurance Authority publishes national survey of the private health insurance market in Ireland

On May 24, 2012, the Health Insurance Authority (“HIA”) published a “Report on the Health Insurance Market” (the “Report”), a national survey of the private health insurance market in Ireland prepared by MillwardBrowne Lansdowne.

The Report provides an insight as to consumer attitude in the marketplace. The main findings are:

- (i) At the end of 2008, 2.3 million people were covered by private health insurance in Ireland. This figure had declined to 2.14 million as at the end of March 2012;
- (ii) Since 2005 the 25-34 age group record the biggest contraction in levels of private health insurance held. Over 65's have increased their holding profile – from 15 to 21 per cent;
- (iii) Currently 43 per cent of the population has private health insurance, down 3 per cent in two years;
- (iv) One in three people are now part of a work group scheme; and
- (v) More than 8 in 10 policyholders do not plan to change their policy this year.

The Report may be viewed on the HIA's website www.hia.ie .

Central Bank of Ireland

(i) Central Bank (Supervision and Enforcement) Bill 2011 - Consultation Document

The Minister for Finance has issued a Consultation Document on the proposed Committee Stage amendments to the Central Bank (Supervision and Enforcement) Bill 2011 (the “**Bill**”). The Bill was published on July 28, 2011 as part of Ireland's legislative programme imposed by the European Union/International Monetary Fund Programme of Financial Support for Ireland. The Bill will apply to financial service providers regulated by the Central Bank and provides a range of additional powers for the Central Bank to ensure proper and effective regulation of financial services.

The amendments are the result of a comprehensive collaboration between the Department of Finance and the Central Bank to improve and complement the provisions in the published Bill. The Minister said that the purpose of the consultation was “to ensure that all stakeholders are fully informed of the intent of the Committee stage amendments and can submit their views on what is proposed”.

The deadline for comments was May 25, 2012.

(ii) Fitness and Probity

On the 29th of June 2012 the Central Bank published new Fitness and Probity Service Standards outlining target turnaround times for processing Individual Questionnaires. The document contains a summary of the targets and reasons why an Individual Questionnaire may be returned by the Central Bank. The document is available on the Central Bank site.

<http://www.centralbank.ie/regulation/processes/fandp/Documents/Fitness%20and%20Probity%20Service%20Standard.pdf>.

(iii) Annual Compliance Statement

Pursuant to Section 25 of the Corporate Governance Code for Credit Institutions and Insurance Undertakings (the “Code”), insurance undertakings are required to submit an annual compliance statement to the Central Bank as to their observance of the Code. The first such statement (with regard to compliance with the Code during 2011) is due to be submitted to the Central Bank on or before 30 June 2012.

The Central Bank has issued guidelines on the completion of the annual compliance statement. These guidelines (entitled “Guidelines on the Annual Compliance Statement in accordance with Section 25”) are available on the Central Bank’s website www.centralbank.ie.

(iv) Central Bank withdraws its “Guidelines for Insurance Undertakings – Distributing Products on a Cross Border Basis”

In our Insurance Quarterly Legal and Regulatory Update for Q2 2012 we referred to the Central Bank’s introduction of “Guidelines for Insurance Undertakings – Distributing Products on a Cross Border Basis”. The Guidelines set out the requirements to which life insurance undertakings authorised by the Central Bank are required to adhere when distributing products on a cross-border basis in another EU/EEA Member State or third country.

Following various concerns being raised by industry, the Central Bank has withdrawn the Guidelines so as to allow a period of consultation with relevant parties. The issues raised by industry related to the legislative basis for the guidelines, whether they were to be binding and why no consultation with industry occurred prior to their introduction. In subsequent consultations it became clear that the Central Bank never intended that the Guidelines were to have any binding legal effect on insurers.

It remains unclear as to how the revised version of the Guidelines will be issued. It has been suggested that they may take the form of a non-binding advisory letter from the Central Bank to Irish authorised life insurers.

We expect to be in a position to provide further detail in relation to the Guidelines in next Insurance Quarterly Legal and Regulatory Update.

(v) Private Motor Insurance Statistics 2009

On April 19, 2012, the Central Bank published its “Private Motor Insurance Statistics for 2009”. The report examines the level of accident frequency and claim costs, and assesses the impact of these factors on premiums paid by different categories of drivers.

The following are the main findings of the report:

- (i) Premiums have decreased by over 2 per cent on 2008 levels;
- (ii) Premiums have on average decreased by 40 per cent since 2002;
- (iii) The frequency of accidents decreased as compared to 2008 figures (down from 8.6 to 7.8 accidents per 100 policies for comprehensive cover and 6.5 to 5.9 for third party fire and theft cover);
- (iv) Policy surplus for third party fire and theft and comprehensive cover increased by 5 per cent and 21 per cent respectively over 2008 figures; and
- (v) In 2009, the average premium for female policyholders was €479 and €593 for their male counterparts. This represents roughly a 24 per cent gender differential.

The report may be viewed on the Central Bank’s website www.centralbank.ie

(vi) Consultation on the handling of insider information

The Central Bank has issued Consultation Paper 58 on “The Handling of Inside Information under the Market Abuse (Directive 2003/6/EC) Regulations 2005.” The consultation paper sought commentary on three issues:-

1. Determining what information is sufficiently significant for it to be deemed inside information;
2. Types of insider lists; and
3. Director and personal account dealing and the definition of persons discharging managerial responsibility.

The consultation closed on the 14th June 2012.

Anti-Money Laundering/Counter-Terrorism Financing

(i) Reports relating to the implementation of the Third Anti-Money Laundering Directive

On April 11, 2012 the Joint Committee of the three European Supervisory Authorities (EBA, ESMA and EIOPA) published two reports on the implementation of the third Anti-Money Laundering Directive.

The “Report on the legal, regulatory and supervisory implementation across EU Member States in relation to the Beneficial Owners Customer Due Diligence requirements” analyses EU Member States’ current legal, regulatory and supervisory implementation of the anti-money laundering/counter terrorist financing (AML/CTF) frameworks related to the application by different credit and financial institutions of Customer Due Diligence (CDD) measures on their customers’ beneficial owners. The aim of the report was to pinpoint discrepancies in the implementation of the Directive to establish whether such divergences create a gap in the EU AML/CTF regime that could be exploited by criminals for money laundering and terrorist financing purposes.

The “Report on the legal and regulatory provisions and supervisory expectations across EU Member States of Simplified Due Diligence requirements where the customers are credit and financial institutions” provides an overview of EU Member States’ legal and regulatory provisions and supervisory expectations in relation to the application of Simplified Due Diligence (SDD) requirements. The report focuses exclusively on one particular situation of low risk where SDD is applicable, namely where the customer is a credit or financial institution situated in an EU/EEA state or in a country that imposes equivalent AML/CFT requirements. The aim of the report was to identify differences in the implementation of the Directive and to establish whether such divergences could be exploited by criminals for money laundering and terrorist financing purposes.

The conclusion of both reports is that significant divergences exist in relation to the implementation of the Directive by EU Member States. The reports state that a number of these differences could create undesirable effects on the common European Anti Money Laundering Regime. The reports find that some of these differences are not due to the Directive’s minimum harmonisation approach, but instead arise from different national interpretations of the Directive’s requirements.

The reports have invited the Commission to consider whether convergence of national beneficial ownership identification standards should occur.

(ii) Shah Case

The English High Court recently delivered its judgment in the long running dispute between HSBC Private Bank (UK) Limited and Mr. Jayesh Shah, a former customer of HSBC. Although the ruling relates to particular aspects of the English Proceeds of Crime Act, 2002 (“2002 Act”) the ruling provides guidance as to how a court in Ireland may interpret certain provisions of the Criminal Justice (Money Laundering and Terrorist Financing) Act, 2010 (“2010 Act”), (notwithstanding that there are differences between the statutory regime in Ireland and in the United Kingdom). In particular the judgment should prove useful to MLRO’s and should also provide guidance about the procedures which an organisation should put in place with regards to its suspicious transaction reporting regime.

Mr. Shah and his wife brought a claim for damages of over USD300 million arising out of delays caused by HSBC in executing four transfers from his account during the period September 2006 to March 2007 and the failure of HSBC to explain the reasons for the delays. The reason that HSBC delayed the transactions was because it suspected that the funds constituted the proceeds of criminal activity and consequently made a Suspicious Activity Report (“SAR”) to the Serious Organised Crime Agency (“SOCR”). In the United Kingdom a designated person must obtain the “appropriate consent” of SOCR before proceeding with any transactions which are the subject of a SAR (there is no similar requirement in Ireland). HSBC explained the delay to Mr. Shah by saying that it was complying with its statutory obligations. HSBC did not want to provide any further information as it did not want to be guilty of the “tipping off” offence in the 2002 Act.

The Court held that there was an implied term in its contract that permitted HSBC to refuse to execute payment instructions in the absence of “appropriate consent” under 2002 Act where HSBC suspected a transaction constituted money laundering. In order to be able to rely on the implied term enabling it to refuse to execute payment instructions, HSBC had to demonstrate that it did in fact suspect that the transaction constituted money laundering. The MLRO gave evidence that there were several factors which gave rise to his suspicion and led to his decision to send the SAR to SOCR. The Court held that in the case of each SAR, the submission was made after the MLRO had formed his own independent suspicion based on the factual information known to him. The word of each SAR was examined and the MLRO was extensively cross examined. This underlines the importance of an MLRO having robust systems in place to demonstrate that any decisions are made independently and appropriately documented.

The Court also held that HSBC was correct to refuse to provide information where in providing such information it might contravene its duties under 2002 Act, in particular the provisions relating to tipping off. The Court held that HSBC was correct not to provide any information to Mr. Shah relating to his communications with SOCR. This serves to underline that MLRO’s should not engage in any dialogue about the fact of a SAR having been made.

(iii) **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 - 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.

The amendments proposed in the Bill include;

- (i) Lowering the identification threshold for private members gaming clubs from €15,000 to €2,000;
- (ii) 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);
- (iii) 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;
- (iv) 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
- (v) Section 55 of the Act is to be amended such that records will no longer have to be kept in the State.

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