Insurance Quarterly Legal and Regulatory Update

Period covered:

1 July 2011 – 30 September 2011

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Insurance Quarterly Legal and Regulatory Update

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INSURANCE QUARTERLY LEGAL AND REGULATORY UPDATE

Solvency II

A seventh revision of the EU Presidency compromise text for the proposed Omnibus II Directive was released on the 21 September 2011, which further develops the amendments to the existing Solvency II Directive proposed in the original Omnibus II which was released in January 2011.

The seventh revision text includes further details on the areas for which companies shall be required to provide information as part of their implementation plans to be submitted to regulators in the period prior to full adoption of Solvency II. Under the current proposal, companies would have to provide information on their state of preparedness regarding (inter alia):

- the calculation of capital requirements;
- the valuation of assets and liabilities;
- the adaptation of processes and procedures for supervisory reporting and public disclosures; and
- the adaptation of a system of governance, including the Own Risk and Solvency Assessment.

While the European Council and the European Parliament now propose that companies have until 1 January 2014 to comply with Solvency II, companies will need to submit an implementation plan to their regulators in 2013. The precise date that such an implementation plan should be submitted has yet to be agreed.

It is expected that the Central Bank will update its position in light of the revised draft text for Omnibus II, which should provide further clarity for companies as to the expected timeframe for implementing Solvency II plans.

A copy of the latest compromise text (Document Number: 14485/11) is available on the Council's website: www.consilium.europa.eu.

Central Bank Solvency II Matters - Issue 5

The fifth edition of the newsletter, circulated on 5 August 2011, focuses on the latest Solvency II policy developments and implementation activities and events, including the following:-

- Formal Application – over 50 firms have declared their intention to use internal models to calculate their Solvency Capital Requirement ("SCR") upon the implementation of Solvency II. The Central Bank stresses that participating in the internal model pre-application process does not imply the approval of models;
- European Insurance and Occupational Pensions Authority ("EIOPA") Consultation – EIOPA is currently developing XBRL taxonomy, describing Solvency II reporting in the harmonised data format to be used for the transmission of Quantitative Reporting Templates. On 22 July 2011, it launched a technical consultation on Solvency II XBRL Taxonomy with comments to be submitted by 7 September 2011. Undertakings were encouraged to participate, as the decisions made will impact on Solvency II reporting requirements; and
- Solvency II Forum – a third Industry Forum on Pillar 1 themes is due to be held in November 2011. Information on the event will be made available on the Central Bank's website in due course.

A copy of the newsletter is available on the Central Bank's website www.centralbank.ie.

European Insurance Stress Test

On 4 July 2011, EIOPA announced the results of the second Europe-wide stress test for the insurance sector which took place between March and May 2011. Overall it considered that the European insurance industry remains robust.

The stress test sought to ascertain the exposure of the insurance industry to adverse capital market developments based on future Solvency II requirements. As such, it assessed whether the European insurance industry can meet minimum capital requirements ("MCR"), the ultimate regulatory threshold, under a number of stress scenarios comprising market, credit and insurance related risks. The main market risk drivers identified were equity prices, interest rates and sovereign bonds, while the main insurance risks were increased claims inflation and natural disasters.

The stress test scenarios employed, which aimed at replicating macroeconomic scenarios and identifying and quantifying the impact of same based on 2010 financial results, were as follows:-

- baseline scenario – severe stress;
- adverse scenario – a more severe market deterioration; and
- inflation stress – assumes an increase in inflation, forcing national supervisory authorities to rapidly increase interest rates.

While the exercise was completed by 221 insurance and reinsurance groups and companies in the EU, EEA and Switzerland, the results reported are for 58 groups and 71 companies due to aggregation of the results within groups. This figure represents approximately 60% of the European insurance sector and surpasses EIOPA's aim of including a minimum of 50% of insurance companies from each country as measured by gross premium income. EIOPA considers that the results of the stress test indicate that overall the European insurance sector is well prepared for potential future shocks as tested in the exercise. However, data did reveal that approximately 10% of the participating groups and companies would not meet the MCR under the adverse scenario and would show a solvency deficit of €4.4 billion if it were to occur, while 8% would fail to meet it in the inflation scenario and would show a €2.5 billion deficit if it were to occur.

At an aggregate level, EIOPA identified the main drivers of the results as being adverse developments in equity prices, interest rates and sovereign debt markets. On the liability side it noted that non-life risks are more critical, triggered by increased claims inflation and natural disasters.

It is however worth stressing that 90% of the groups and companies tested continue to comply with the MCR even in the most adverse scenario. Moreover, EIOPA emphasised that the results of the stress test should be understood in light of the fact that they were based on a future regulatory system and highlight an exposure to hypothetical risks rather than being necessarily indicative of any current solvency problems.

EIOPA's press release noted that national supervisory authorities will discuss the main findings of the stress test with the insurance groups and companies. A copy of the results is available on EIOPA's website www.eiopa.europa.eu.

New Legislation to Combat White Collar Crime

On the 9 August 2011, the main provisions of the Criminal Justice Act 2011 (the "Act"), came into operation, namely Part 1 (other than Section 5), Section 7 (other than paragraph (c)) and Section 8 of Part 2, Part 3 and Schedules 1 and 2.

The Act provides protection for whistleblowers, extends the Garda Síochána's powers of investigations into suspected breaches and creates a wide range of "serious and complex offences", which attract a penalty of at least five years' imprisonment, in the following areas:-

- banking, investment of funds and other financial activities;
- company law;
- money laundering and financing terrorism;
- theft and fraud;
- bribery and corruption;
- competition and consumer protection;
- cybercrime; and
- the raising and collection of taxes and duties.

The comprehensive nature of the offences covered by the Act demonstrates a commitment to vigorously pursue white-collar crime.

The Act makes provision for the following:-

- the suspension of detention periods of arrested persons on up to two occasions, for not more than four months from the date on which the detention was first suspended, if the Gardaí have reasonable grounds to believe this is necessary to conduct further investigations in order to make more effective use of detention periods;
- District Court order may require the subject to furnish the Gardaí with documents and/or to provide information obtained in the ordinary course of business by answering questions or making a statement for the purposes of investigating relevant offences;
- measures relating to how documents should be furnished to the Gardaí so as to reduce delays associated with the production of large volumes of poorly ordered and uncategorised documents to them in the course of their investigations;
- measures to prevent unnecessary delays in investigations arising from claims of legal privilege; and

- a new offence of failing to provide information to the Gardaí in relation to the prevention or investigation of relevant offences without reasonable excuse. This is however offset by the introduction of strong legal protection for whistleblowers which makes it an offence for employers to penalise an employee (by way of dismissal, demotion, reduction of wages, etc.) as a result of making a disclosure in good faith in relation to a relevant offence to the Gardaí.

Guidance Note on Data Protection in the Electronic Communications Sector

On 1 July 2011 the Data Protection Commissioner (the "Commissioner") issued a Guidance Note to assist organisations comply with new data protection requirements in relation to electronic communications and networks following the commencement of the European Communities (Electronic Communications Networks and Services) (Privacy and Electronic Communications) Regulations, 2011 (the "Regulations") which transpose the ePrivacy Directive.

Key requirements which have been introduced include the following:-

- compulsory notification of data breaches by all telecommunication companies and internet service providers to the Office of the Data Protection Commissioner and notification of customers where there is a risk their data may be accessed. Failure to do so can lead to prosecution by the Commissioner and a possible fine of up to €5,000 per instance. The Commissioner can also, for the first time, prosecute such companies for allowing a data breach, which upon conviction on indictment attracts a fine of up to €250,000;
- more stringent requirements for all companies relating to the provision of information and obtaining the consent of users prior to placing "cookies" on electronic devices, save in limited circumstances where the cookie is strictly necessary for the provision of the service in question. In practice this means that websites placing cookies on user equipment that are not deleted when the user leaves the website must identify a means of obtaining user consent; and
- stricter requirements for the sending of electronic marketing messages and the making of marketing phone calls. For instance, it is now an offence for any company or entity to phone a person on their mobile phone for a marketing purpose without having obtained their prior consent for such contact. The requirements now extend to all forms of marketing carried out by means of a publicly available electronic

communications service – including for example the soliciting of support for charitable organisations or political parties.

The guidance is available at www.dataprotection.ie.

Financial Services Ombudsman Annual Report 2010

On 25 July 2011 the Financial Services Ombudsman Bureau (the "FSO") published its Annual Report for 2010 (the "Report"). Of the 7,230 complaints received in 2010 by the FSO, 3,587 were made in relation to the insurance sector, which is an increase from the 2,999 made in 2009. In particular, the Report noted that complaints relating to payment protection insurance and mortgage protection insurance continued to increase. It reflected that "the types of complaints received are reflective of the financial distress that many consumers find themselves in during these challenging times".

It was noted that the FSO upholds approximately 25% of complaints received (either in full or in part) and the Report documented in greater detail some of the complaints substantiated, in full or partially, including a number of insurance-related complaints for instance regarding personal accident/business travel insurance, house insurance and motor insurance policies.

The FSO also issued a press release inviting comments from financial service providers and interested parties on a proposal to publish in its Bi-Annual Review a breakdown of the information provided by financial service provider in respect of whom complaints have been made, regarding, for instance the: total number of complaints; complaints upheld; complaints upheld in part; and total compensation awarded. The deadline for submissions was 9 September 2011.

The Report and press release are available on the FSO website: www.financialombudsman.ie.

Proposed Amendments to the Insurance Compensation Fund Regime

The Insurance (Amendment) Bill 2011 (the "**Bill**") which amends the Insurance Act 1964 (the "**1964 Act**"), was passed by the Oireachtas on the 28 September 2011. The Bill proposes to update the existing legislation relating to the Insurance Compensation Fund (the "**ICF"**)

The main changes proposed by the Bill are:

(i) the application of the 2% levy to the aggregate of the gross premiums paid to an insurer (the definition of which will be expanded to include an insurer duly authorised in another Member State) in respect of policies issued to cover "risks in the State" which relate to any of the following;
- a building in the State;
- a vehicle registered in the State;
- travel/holiday insurance taken out in the State where that policy is for a duration of 4 months or less; or
- any other case provided the policy holder is an individual who is habitually resident in the State or, if the policy holder is not an individual, the establishment of the policy holder to which the policy relates is in the State. However, this will not include a policy of insurance in respect of a building in another Member State or travel/holiday insurance taken out in another Member State where the risk is situated in another Member State.

(ii) the dis-application of the levy to policies that do not relate to "risks in the State";

(iii) the introduction of "excluded risks", policies of insurance in respect of which will not be subjected to the levy (e.g. reinsurance, marine insurance and health insurance, amongst others will not be subjected to the levy); and

(iv) the introduction of new offences; such as the suspension of a non-paying insurers' authorisation and the creation of an offence for failure to pay the appropriate contribution. An insurer that is found guilty of such an offence is liable on conviction on indictment to an unspecified fine and/or imprisonment for a term not exceeding 5 years. The Bill imposes personal liability on directors, managers, secretaries or other officers of an insurer where the offence was committed with that person's consent, connivance or willful neglect.

These changes are required to ensure that the ICF levy legislation is consistent with EU law.

The introduction of the 2% levy is in addition to the existing 3% stamp duty on premiums. The Chief Executive of the IIF, Mr Mike Kemp has welcomed the introduction of the new Bill as it provides clarity on which policies will be subject to it and what purposes administrators will be able to use Compensation Fund drawdown's in the future. However, the IIF has called on the Minister to abolish or reduce the 3% stamp duty already levied on home, motor and commercial insurance costs in light of the additional 2% levy so as not to unfairly burden policy holders who have difficulty in paying insurance costs.

More in-depth information on this Bill can be found on the Dillon Eustace website under the Insurance publications at: www.dilloneustace.ie/publications/Insurance

European Court of Justice Ruling: Commission v Ireland

The European Court of Justice (the "**ECJ**") has ruled against Ireland in a judgement handed down on the 29 September 2011.

The case, which was brought against Ireland by the EU Commission, effectively centred on exemptions currently enjoyed by the VHI from certain EU rules on non-life insurance. In essence the case was over the fact the VHI is not subject to regulation or "authorisation" by the Central Bank in the same manner as competitors in the market. The VHI was granted a derogation from such regulation under Article 4 of the First Non-Life Insurance Directive. Significantly, in order for the derogation to apply, no change in the VHI's capacity as it was then could occur.

Under various amending legislation, the VHI's capacity was altered and the VHI subsequently obtained, inter alia, the right to provide other 'health-related' services, the power to act 'as agent for an insurer in respect of the provision of insurance cover pursuant to an international healthcare plan' and the right to carry out 'activities of an advisory or consultative nature' under the 'additional powers' granted to it.

Ireland did not dispute the fact that the VHI's capacity had been altered, however it argued that such changes were immaterial on two counts. First, the changes were related to the VHI's original basic activity (i.e. the provision of voluntary health insurance). Second, the changes accounted for such a minor percentage of the VHI's total revenues.

The ECJ is of the opinion that the concept of 'capacity' in the derogation set out in Article 4 must be strictly interpreted. As such, if the essential functions or activities carried out by the VHI were altered by the addition of new activities or functions that did not come within its existing capacity at the time the derogation was granted, that derogation should cease to be applicable.

By way of background in November 2007, following a complaint, the European Commission issued a reasoned opinion to Ireland requesting that it take the measures necessary to ensure compliance with the European Union Non-Life Insurance Directives within two months. In response, Ireland informed the European Commission that it applied for Central Bank authorisation in respect of the VHI and that it had enacted legislation which would ensure compliance with the European Union Non-Life Insurance Directives. It transpired that this legislation was not implemented due to certain national issues relating to the economic crisis. In this regard the ECJ held that a Member State cannot plead provisions, practices or situations prevailing in its domestic legal order to justify failure to observe obligations arising under European Union law.

Failure to comply with the ECJ's decision will be a breach of Ireland's duty of loyal cooperation under the Treaty on the Functioning of the European Union. As such, should the necessary implementing measures in respect of the European Union Non-Life Insurance Directives not be applied, Ireland will face financial sanction at EU-level.

In addition, and significantly, the ECJ has ruled that the temporal effect of its judgment will not be limited. This was in spite of Ireland's submission that to do so would give rise to the risk of 'serious difficulties' which might have 'financial consequences'. As such, it will be open to parties affected by Ireland's failure to apply the European Union Non-Life Insurance Directives to all insurance undertakings on a non-discriminatory basis to issue proceedings against the State in respect of any loss they may have suffered. If they can prove that, on the balance of probabilities, they have suffered such a loss, they will be entitled to damages.

The ECJ Judgement can be accessed at: http://curia.europa.eu/

Central Bank of Ireland

(i) New Fitness and Probity Regime

On 1 September 2011 the Central Bank published its Regulations and Standards of Fitness and Probity, pursuant to its powers under Part 3 of the Central Bank Reform Act 2010, together with Draft Guidance on Fitness and Probity Standards.

The new regime will commence on 1 December 2011 for all existing staff and new staff holding senior positions i.e. Pre-approval Controlled Functions ("PCFs"). In respect of new appointments to less senior positions, i.e. Control Functions ("CFs"), the new regime will commence on 1 March 2012 and from 1 December 2012 for existing staff in CF roles. This phased introduction is aimed at allowing regulated financial service providers ("regulated firms ") time to implement the necessary internal controls and procedures to comply with the new regime.

- *The Regulations*

The Central Bank Reform Act 2010 (Sections 20 and 22) Regulations 2011 (the "Regulations") confirm that the new regime will apply to two distinct groups i.e. persons performing PCFs and CFs. The list of PCFs, set out in Schedule 2 of the Regulations, specifically identify 42 senior positions as PCFs in a regulated firm. The Central Bank's approval is required before a regulated firm can offer to appoint a person to those functions.

The Regulations afford a more generic definition in respect of the 11 categories of CFs, which include a function related to the provision of financial services which is, for example, likely to enable the person responsible for its performance to exercise significant influence over the conduct of the firm's affairs. While the Central Bank's prior approval is not required for persons to be appointed to a CF position, it will be able to investigate, suspend, remove and/or prohibit a person from carrying out such a function in the future.

Regulated firms must identify and maintain a record of persons performing PCFs in their organisations and by 31 December 2011, must submit to the Central Bank a list of persons in a PCF as of 1 December 2011. Written confirmation must also be submitted by the CEO, where appropriate, of regulated firms, that the regulated firm is satisfied that the persons on the list comply with the Standards of Fitness and Probity (the "Standards") and that the firm has obtained written agreement from such persons to abide by the Standards.

While all new persons appointed to a CF role will be required to adhere to the Standards by 1 March 2012, regulated firms must by 1 December 2012, also identify and maintain a record of all persons performing CFs in their organisation and carry out the necessary due diligence to ensure such persons meet with the Standards including obtaining a written statement that such persons will abide by the Standards.

- *The Standards*

The Standards set the conditions which a person must satisfy to perform a PCF or CF and may form the basis for refusing to approve the person's appointment to a PCF or for removing or prohibiting a person from a CF if he/she does not meet those standards. The Standards require a person to be competent and capable; act honestly, ethically and with integrity; and be financially sound. The Standards outline in greater detail what each of these conditions entail.

- *Draft Guidance*

The Draft Guidance on Fitness and Probity Standards (the "Draft Guidance") specifies the due diligence that regulated firms should, at a minimum, carry out to ensure persons are fit and proper to perform PCFs or CFs before proposing them for appointment thereto. The measures considered appropriate to determine a person's fitness require regulated firms, for example, to obtain evidence of requisite qualifications and to retain a record of the application and interview process. Due diligence in respect of probity requires regulated firms to take steps to ensure they are aware of and assess matters which may adversely affect persons' ability to perform the function to a material degree, for instance if the person has been the subject of disciplinary action. Interested parties had until 30 September 2011 to respond to the Draft Guidance.

The Regulations, Standards and Draft Guidance are available on the Central Bank's website: www.centralbank.ie.

(ii) Central Bank Guidelines on Annual Compliance Statements

On 11 August 2011 the Central Bank issued Guidelines to assist industry in preparing the Annual Compliance Statement (the "Statement") as required by section 25 of the Corporate Governance Code for Credit Institutions and Insurance Undertakings (the "Code").

Guidance is provided on various issues, including:-

- The scope of the Annual Compliance Statement – relates to reporting on compliance with Code obligations. The Statement should include reports of material deviations from the Code and details of ad hoc reports of material deviations made to the Central Bank during that period;
- Submission – the Statement should be submitted to the institution's examiner/supervisor in the first instance;
- Timing – the first Statement must be submitted by 30 June 2012 for the calendar year 2011, even if an institution's year end falls before 31 December. If institutions avail of the transitional periods to become compliant (namely the 30 June 2011 to implement systems and structures changes and the 31 December 2011 to implement board changes), this should be reflected in the Statement, while confirming that by the appropriate date they were compliant. Thereafter, reports must be filed annually together with the annual report to the Central Bank. Any potential gap between the period covered by the previous Statement and the institution's annual report year end must be captured in the second and/or subsequent returns. The Central Bank may require more frequent reports;
- Material deviations from the Code – as determined by the Board in the first instance must be reported to the Central Bank. While the Central Bank has not prescribed the form of such reports, they should contain details of the material deviation, its background and remedial action taken or proposed by the institution;
- Use of information by the Central Bank – if an institution reports a material breach of the Code, the Central Bank may use that information for any of its regulatory functions, which may expose the institution and/or persons concerned in its management to, inter alia, financial penalties and other sanctions. If however such a

breach constitutes a criminal offence, the information provided in the Statement may not be used as evidence in criminal proceedings;

- Dis-application of certain obligations under the Code – written consent to dis-apply parts of the Code provided by the Central Bank should be retained by the institution and referred to in the Statement;
- Retention of supporting documentation - in some cases, compliance shall be supported or to some extent demonstrated by certain documents which should be retained by institutions for 6 years and made available to the Central Bank if required. The Guidelines specify certain types of supporting documentation which may be used for this purpose in relation to the board, directors, sub-committees, the institution's policies and procedures and risk appetite; and
- Availability to the Central Bank - the majority of directors must be reasonably available to the Central Bank at "short notice", the meaning of which will depend on the facts of the case and will be influenced, for example, by the urgency of the issue and the reasonable travel time needed by directors and potentially whether contact by telephone or video conference would suffice.

The Guidelines include, at Appendix 1, minimum templates for completion as part of the Annual Compliance Statement.

The Central Bank specified that the Guidelines are not exhaustive and should be read in conjunction with the Frequently Asked Questions on the Code, published on 27 May 2011.

The Guidelines and FAQs are available on the Central Bank's website www.centralbank.ie.

(iii) Corporate Governance Code for Captive Insurance and Captive Reinsurance Undertakings

On 16 August 2011 the Central Bank issued its Corporate Governance Code for Captive Insurance and Captive Reinsurance Undertakings (the "Code"), setting out minimum statutory requirements as to how captives should organise the governance of their institutions to ensure it is strong and effective. It also published its feedback on the responses received to Consultation Paper 53 and a Frequently Asked Questions document on the Code. These documents can be accessed on the Central Bank's website: www.centralbank.ie.

Key provisions of the Code include the following:-

- The board of directors must comprise at least 3 directors;

- Board membership must be reviewed at a minimum every 3 years. The membership of any person who is a member for 9 years or more must also be reviewed and the frequency of the review documented;
- The number of directorships which directors may hold in a captive or non-captive company to ensure that they can properly carry out their role and function within the captive is limited to 25;
- The Chairman, who should not be a director or employee of the captive manager, must be proposed for election or reappointment on an annual basis;
- If a Chief Executive Officer ("CEO"), the definition of which includes a general manager or any executive responsible for the captive regardless of their title, is appointed, the renewal of their contract must be reviewed at least every 5 years;
- The respective roles of the Chairman, CEO, directors and the board in relation to the captive are set out, involving for instance the effective oversight of the captive and the development, execution and scrutiny of strategies;
- The board shall have particular responsibility for appointments and is also required to set the risk appetite for the captive and review it annually;
- Various requirements relating to board meetings are detailed, for instance regarding their chairmanship, attendance, frequency, agenda and minutes; and
- An annual compliance statement must be submitted to the Central Bank.

Contravention of the Code may result in the Central Bank using its regulatory powers, including, for instance, to:-

- impose an administrative sanction under Part IIIC of the Central Bank Act, 1942 (as amended);
- prosecute an offence;
- refuse to appoint a proposed director to any pre-approval controlled function prescribed by it pursuant to Part 3 of the Central Bank Reform Act 2010 ("2010 Act"); and/or
- suspend, remove or prohibit an individual from carrying out a controlled function prescribed by the 2010 Act.

The Code will apply to Irish authorised captive insurance and captive reinsurance undertakings, except foreign incorporated subsidiaries of such Irish captives, however such foreign incorporated subsidiaries are encouraged to adopt equivalent good corporate governance practices. If a captive ceases to comply with the definition of a captive[1] and is

[1] An insurance or reinsurance undertaking, owned by a financial undertaking other than an insurance or reinsurance undertaking or a group of such undertakings or by a non-financial undertaking, the purpose of which is to provide insurance or reinsurance cover exclusively for the risks of the undertaking(s) to which it belongs or of an undertaking(s) of the group of which it is a member.

deemed by the Central Bank to be a non-captive, this Code will cease to apply and the Corporate Governance Code for Credit Institutions and Insurance Undertakings will apply instead. It is also worth noting that the Code will revoke and replace the 2007 Corporate Governance Requirements for Reinsurance Undertakings insofar as they relate to captive reinsurance undertakings.

The Code applies to existing boards and directors from 1 September 2011. However, captives will be given until 31 May 2012 to implement the necessary changes in order to become compliant with the Code. In this regard, the first compliance statement will cover the period from 31 May 2012 until the period ended 31 December 2012 and should be submitted within one month of this date. However, an earlier date may be applicable to the compliance statement if the captive has complied with the Code prior to 31 May 2012 and has notified this date to the Central Bank.

(iv) Updated Requirements for Composite Reinsurance Undertakings

On 21 July 2011 the Central Bank published an updated Requirements for Composite Reinsurance Undertakings Paper (the "Paper"), replacing previous requirements papers, pursuant to its statutory powers under S.I. No. 380 of 2006 which transposed the Reinsurance Directive into Irish law. The Paper contains prudential rules for composite reinsurance undertakings (i.e. reinsurance undertakings carrying on non-life and life reinsurance business) on the following issues:-

- technical provisions – the technical reserves which must be established and maintained pursuant to Regulation 23;
- assets covering technical provisions – how they must comply with Regulation 26 regarding the covering of technical and equalisation reserves by equivalent assets;
- solvency margin – guidance on the determination of the solvency margin and prudential rules of the Central Bank; and
- regulatory returns – the returns to be lodged with the Central Bank including the annual return which consists of the submission of a completed set of forms on the Central Bank's online reporting platform and other items e.g. a Compliance Statement.

It is important that composite reinsurance undertakings are familiar and compliant with the Paper's requirements as failure to comply may result in the imposition of an administrative sanction under Part IIIC of the Central Bank Act 1942 and may constitute an offence in accordance with S.I. No. 380 of 2006.

(v) Central Bank (Supervision and Enforcement) Bill 2011

On 28 July 2011, the Department of Finance published the Central Bank (Supervision and Enforcement) Bill 2011 (the "Bill"). The Bill is aimed at enhancing the supervisory and enforcement powers of the Central Bank so as to ensure the proper and effective regulation of financial services, particularly by increasing its investigative powers and the sanctions it may impose. It represents further reform of financial regulation in Ireland and the introduction of such legislation constitutes a further requirement of the EU-IMF programme of support for Ireland.

If enacted in its current form, the Bill will introduce the following measures:-

- Fines and sanctions – the maximum penalties which could be imposed under the administrative sanction regime will increase from €5m to €10m (or 10% of prior year turnover, whichever is the higher) for corporate bodies and from €0.5m to €1m for natural persons. Regulated financial services providers in breach of financial services legislation could also have their authorisation suspended or revoked;
- Restitution – following an application by the Central Bank, the High Court may order restitution for those who have suffered as a result of a breach of regulatory provisions by a financial service provider;
- Skilled persons reports – financial services providers (or related undertakings) could be required to commission (and bear the cost of) reports by independent experts on matters reasonably required in connection with the exercise of the Central Bank's statutory functions e.g. examination or inquiry into suspected breaches of financial services legislation;
- Directions – if the Central Bank has concerns as to regulated financial services providers' ability to meet their capital requirements, legislative obligations or obligations to creditors or customers, the Central Bank will be able to issue directions, requiring such financial services providers, for instance, to take certain actions or suspend certain activities to address these concerns;
- Regulations – the Central Bank will be able to make regulations on a wide range of issues including risk minimisation; monitoring staff training and qualifications; restricting "cold calling"; and dealings with customers, in terms of suitability of products and resolving complaints. In many instances, this power would relate to matters which are already Central Bank requirements under Codes e.g. consumer protection, related party lending and minimum competency requirements;
- Authorised officers of the Central Bank – the authorised officer regime will be consolidated, replacing some 20 existing regimes. Further, authorised officers may

attend financial services provider meetings to assist the Central Bank in its statutory functions;

- Settlement Agreements - if the Central Bank and a regulated financial services provider enter an agreement to resolve a suspected contravention and the regulated financial services provider does not abide by it, the Central Bank may seek a High Court order compelling compliance therewith;
- Whistle-blowing protections – a whistleblower will be protected from civil liability and penalisation by their employer for making a protected disclosure i.e. one made to appropriate persons (e.g. Central Bank officers/employees) if they have reasonable grounds to believe it will show a prescribed contravention, breach of or offence under financial services legislation is or was being committed or evidence regarding same is being or is likely to be deliberately concealed or destroyed; and
- Mandatory disclosure regime – persons performing pre-approval controlled functions (those in which they may exercise significant influence on the conduct of a regulated financial service provider's affairs) must report a breach of financial services legislation unless this might incriminate them personally. Failing to so disclose could be the basis for an investigation and action under the fitness and probity regime.

The Bill is expected to progress to the second stage in Dáil Éireann during the autumn session. The Bill may be viewed on the Oireachtas website: www.oireachtas.ie.

(vi) Central Bank Issues Consultation Paper 56 ("CP56")

On 11 August 2011 the Central Bank issued a public consultation, CP56, dealing with the protocol to be established between the Central Bank and the Auditors of Regulated Financial Service Providers (the "Auditor Protocol"). It aims to provide a framework which will allow the Central Bank and the auditing profession to exchange relevant information on a timely basis with a view to enhancing both the regulatory and statutory audit processes.

To fulfill its objectives, the draft Auditor Protocol specified that it is necessary for communication channels between the Central Bank and auditors to remain open and an environment that facilitates frank discussions should exist. In this regard it suggested that the following measures should be adopted:

- firms should advise the Central Bank of the contact details of the Lead Partner of its auditor and similarly should advise its auditor of the contact details of the Senior Examiner in the Central Bank; and

- at meetings between the Central Bank and auditors, they should endeavor to share information they believe would lead to higher quality audits or would assist in the exercise of their supervisory functions.

To further pursue the above aims, the consultation highlighted the need to identify and remove barriers to sharing information. As such, it emphasised that the contractual agreements between auditors and firms should not hinder information sharing and provision should be made therein acknowledging that the Central Bank and the firm's auditors can discuss issues relevant to their oversight of the firm and that such communication will not be determined to be a breach of duty by either party.

The proposed framework also provides a structure for bilateral meetings (between the Central Bank and auditors) which are expected to take place twice yearly at the pre- and post-audit stage and trilateral meetings (between the Central Bank, auditors and the audit committee or Independent Non-Executive Director) to be conducted at the planning stage of the audit process.

The Protocol will be subject to annual review and will be updated to reflect changes in legislation, auditing practice and other relevant developments.

The Central Bank indicated that the Auditor Protocol may apply in the first instance to firms rated high impact under its regulatory risk model, PRISM, which is due to be rolled out in 2011/2012. Such categorisation will reflect the firms' relative size and potential to harm the economy, consumers or the wider financial system and will be based on balance sheet size, turnover, client base etc.

Comments were to be submitted on the proposals by 23 September 2011. It is anticipated that the Auditor Protocol will be published later in 2011, whereupon an implementation plan will be agreed with the auditing profession, to commence no later than the beginning of the new audit cycle for relevant firms in 2012.

(vii) New Deputy Governor

On 1 September 2011 Stefan Gerlach took up his position as Deputy Governor of the Central Bank with responsibility for central banking functions. He is one of two deputy governors, the other being Matthew Elderfield who is responsible for financial regulation. Mr. Gerlach succeeds Tony Grimes who retired, having served most recently as Director General, and then Deputy Governor, since 2007.

Prior to his appointment as Deputy Governor, Mr. Gerlach was Professor of Monetary Economics and Managing Director of the Institute for Monetary and Financial Stability at the University of Frankfurt. Before this he worked with the Bank of International Settlements in Basel, most recently as Head of Secretariat of the Committee on the Global Financial System. He has also served as Chief Economist at the Hong Kong Monetary Authority.

Announcing the appointment in July 2011, the Central Bank Governor, Patrick Honohan said: “I am delighted to welcome Stefan Gerlach to the Central Bank of Ireland. He brings exceptional skills to the role. His experience across the monetary and economic spectrum and the qualities he has developed over his career are perfectly suited to the new role he is taking on, at what remains a very challenging time”.

(viii) New Director of Insurance Supervision

On 2 August 2011 Fiona Muldoon assumed her position as Director of Insurance Supervision. This newly created dedicated post for the supervision of over 300 insurance and reinsurance firms will entail the monitoring of risk, solvency and compliance with regulatory standards. Also, as part of her role, Ms. Muldoon, who will report directly to the Deputy Governor (Financial Regulation) Matthew Elderfield, will contribute to the development of policy and best practice in the area.

Ms. Muldoon is an insurance industry specialist with over 25 years’ experience, 17 of which were spent working for the insurance, reinsurance and life operations company XL Group in various capacities, including most recently as Group Treasurer. Prior to this she held accounting and auditing roles at Chase Bank Ireland and Deloitte & Touche. Immediately prior to her appointment as Director of Insurance Supervision, she held the post, since 2010, of Chief Financial Officer with Canada Life Ireland and Canada Life Europe.

(ix) Minimum Competency Code

On 1 September 2011 the Central Bank published the revised Minimum Competency Code (the “Code”) which is aimed at enhancing the minimum professional standards for persons who provide consumers with financial advice and products or undertake certain specified functions (including assisting consumers in making a claim under an insurance policy, adjudicating on a complaint or engaging in reinsurance mediation). The Code will apply from 1 December 2011.

Under existing requirements, regulated firms were not subject to the Minimum Competency Requirements when providing services in other EU/EEA Member States, however under the new Code there is no similar provision. The definition of “consumer” under the new Code does not limit the definition to a consumer in the State and furthermore, the concept of a “controlled function” under Section 20(4) of the Central Bank Reform Act, 2010 states that a controlled function remains a controlled function even if *“(c) it relates to a business of a regulated financial services provider established in the state conducted by that provider outside the State.”*

Other changes arising under the new Code include:-

- an annual requirement of 15 formal hours of CPD for all persons to replace the existing 3 year CPD cycle requirements;
- inclusion of an ethics module in CPD programmes;
- detailed supervision requirements for all new entrants;
- clarification on activities included within the scope of the requirements including amendments to insurance policies and services provided over the internet; and
- restructuring the categories of retail financial products.

Following consideration of the responses to Consultation Paper 45 (“CP45”) and other advice received, the Central Bank decided not to phase out existing grandfathering arrangements in respect of persons who have carried out certain activities for defined lengths of time. Instead regulated firms will have to complete and hold a standard Statement of Grandfathered Status on file setting out the activities in respect of each person who has been grandfathered.

The Code and the responses to CP45 are available on the Central Bank’s website: www.centralbank.ie.

Anti-Money Laundering/Counter-Terrorism Financing

(i) Central Bank Instructions on EU Financial Sanctions

On 24 August 2011 the Central Bank, as the Competent Authority responsible for the administration and enforcement of EU Financial Sanctions, issued Instructions to institutions, requiring them, for example, to:

(v) examine their records and confirm to it on or before 1 November 2011 whether they have any funds or economic resources in the name of any person, group or entity currently the subject of EU restrictive measures;

(vi) provide the Central Bank with details of any funds and economic resources, belonging to, owned or held by such persons which the institutions have frozen;

(vii) bring any name(s), so discovered, to the attention of the Garda Bureau of Fraud Investigation; and

(viii) have adequate systems and controls in place to ensure compliance with their obligations under financial sanctions legislation including (a) screening new clients against current restrictive measures and (b) screening customer databases on an ongoing basis for compliance with prevailing restrictive measures.

Persons who fail to comply with an Instruction issued by the Central Bank are liable on conviction to imprisonment and/or a fine.

All correspondence with the Central Bank in relation to the information requested above should be addressed to:

Financial Sanctions Unit,
Enforcement,
Central Bank of Ireland,
Block D,
Iveagh Court,
Harcourt Road, Dublin 2.

Email: sanctions@centralbank.ie

The Central Bank's Financial Sanctions Notification August 2011, which includes information on outstanding financial sanctions-related Statutory Instruments and EU Regulations, is available on its website: www.centralbank.ie.

(ii) EU Financial Sanctions

In July and August further Council Implementing Regulations No. 611/2011, 755/2011 and 804/2011 were introduced, extending the scope of Council Implementing Regulations No. 442/2011 and 204/2011 in terms of the persons and entities upon whom those Regulations impose restrictive measures and financial sanctions in Syria and Libya respectively.

However, in view of the developments in Libya, Council Implementing Regulations Nos. 572/2011, 573/2011 and in September No. 204/2011, eased the restrictions imposed, for instance by permitting Member States to authorise the release of frozen funds or economic resources of specified persons/entities in Libya for humanitarian purposes and by deleting specified entities to whom Regulation (EU) No 204/2011 apply.

These Regulations may be accessed by visiting the Financial Regulation section of the Central Bank's website: www.centralbank.ie.

(iii) EU Commission Presents Options for Establishing an EU System for Tracking Terrorist Financing

Following the conclusion in June 2010 of the agreement on the processing and transfer of financial messaging data for the purpose of the EU-US Terrorist Financing Tracking Programme ("EU-US TFTP Agreement"), the European Parliament and Council of the European Union requested that the European Commission ("Commission") propose, by 1 August 2011, "a legal and technical framework for the extraction of data on EU territory".

The Commission took an initial step in this regard on 13 July 2011 by adopting a Communication outlining the main options for establishing an EU Terrorist Financing Tracking System ("EU TFTS").

It is considered that a European TFTS should have two main objectives, namely it must contribute to limiting the amount of personal data transferred to the US and it should contribute significantly to efforts to cut off terrorists' access to funding and materials and follow their transactions.

The Communication gives clear indications about the key issues which need to be decided upon before such a system can be established. These include the need to fully respect the fundamental rights of European citizens, data protection and data security issues, the operational scope of the system, as well as costs.

The Communication presents the different options under consideration at this stage, without indicating any preferred one, which the Commission will now discuss with the Council and the Parliament before deciding on further steps on the basis of a thorough impact assessment.

The Communication is available on the Commission's website: http://ec.europa.eu/index_en.htm.

(iv) AML/CTF Equivalent Jurisdictions List

The EU Commission has published an updated list of third countries considered as having equivalent AML/CTF systems to the EU. This common agreed list is not binding on Member States and does not override the need to continue to operate a risk-based approach.

In Ireland, S.I. 343 of 2010 is the current legislative provision which specifies the countries deemed to have AML/CFT equivalence ("white list countries") and only financial institutions from such white list countries can qualify as a "specified customer" (for simplified CDD), a "relevant third party" (for letters of assurance) or an "acceptable institution" (for source of funds as an enhanced due diligence measure).

The current Irish white list now differs in some respects from the agreed EU common list. For instance, on the current Irish list but not the EU list are Argentina and New Zealand, while India and South Korea appear on the EU but not the Irish list. This may result in revisions to the Irish list.

The Commission's updated list is available on its website: www.europa.eu.

(v) Financial Action Task Force ("FATF") – Review of the Standards

The FATF is currently conducting a review of the 40+9 Recommendations, recognised as the international AML/CFT standards to combat the misuse of financial systems and which also form the basis of the EU's AML Directives. To ensure these standards remain relevant and to learn lessons from their implementation, the FATF has prepared a second public consultation paper, outlining a set of policy proposals concerning issues such as: beneficial ownership; data protection and group-wide compliance programmes; wire transfers; targeted financial sanctions; and politically exposed persons.

Interested parties were invited to submit their views on the proposals no later than 16 September 2011. Substantive feedback on the FATF responses to the consultations will be provided when the revised standards are adopted in February 2012. The FATF expects to commence a new round of assessments towards the end of 2013.

The Consultation Paper may be viewed on the FATF website: www.fatf-gafi.org.

Dillon Eustace

This Insurance Quarterly Legal and Regulatory Update is for information purposes only and does not constitute, or purport to represent, legal advice. It has been prepared in respect of the current quarter and, accordingly, may not reflect changes that have occurred subsequent to the start of such period. If you have any queries or would like further information regarding any of the above matters, please refer to your usual contact in Dillon Eustace.

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