Insurance Quarterly Legal and Regulatory Update

Period covered:
1 October to 31 December, 2010

DILLON EUSTACE

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INSURANCE QUARTERLY LEGAL AND REGULATORY UPDATE

Criminal Justice (Money Laundering and Terrorist Financing) Act 2010

The Third Anti-Money Laundering Directive was transposed into Irish law on 5 May 2010 by the Criminal Justice (Money Laundering and Terrorist Financing) Act 2010 (the "CJA Act 2010") and has been effective as of 15 July 2010.

The Central Bank of Ireland (the "Central Bank") is continuing to meet with the various industry representative bodies to review the draft Core Guidance Notes. The topic of reliance on third parties particularly third parties from countries with secrecy laws remains a key issue to be resolved between the Central Bank and the various industry groups. It is now anticipated that the Core Guidance Notes will be finalised in February, 2011. Any changes made in the Core Guidance Notes will then be reflected in the Sectoral Guidance Notes and the Central Bank will engage with the various industry representative bodies to finalise same.

If you would like further information on anti-money laundering requirements Dillon Eustace regularly advises on all aspects thereof and provides training sessions on this topic. Training can be held either at Dillon Eustace's office at 33 Sir John Rogerson's Quay, Dublin 2 or in house training can be provided at a venue of your choosing.

Solvency II Framework Directive - 2009/138/EC

On the 17 December 2009, the definitive text of the Solvency II Directive (2009/138/EC) ("Solvency II") was published in the Official Journal. The Directive aims to strengthen the supervision and prudential regulation of insurance and reinsurance companies, particularly through the imposition of new solvency and governance requirements. It also establishes a new framework for EU regulation through the recasting of 13 insurance directives into a single text.

Solvency II is to be implemented by Member States with an effective date of 1 January 2013.

In Ireland a Solvency II Forum for Independent Non-Executive Directors ("INEDs") took place in the Central Bank on the 21 October 2010. The intention of the forum was to highlight the new responsibilities attaching to INEDs under the impending Solvency II regime. A panel of speakers presented and discussed examples of questions an INED should be asking in relation to Solvency II.

In October 2010 the Central Bank issued the second edition of Solvency II Matters which provides an update on the –

- Quantitative Impact Assessment 5 (QIS5) process;
- Internal Model Pre-Application Process;
- Guidance on Article 4 of the Solvency II Directive; and
- Summary of Industry Survey on Preparations for Solvency II.

Following the survey and review of responses of 280 undertakings the main gaps identified in terms of preparation for Solvency II relate to putting an Own Risk Solvency Assessment ("ORSA ") in place, documentation of procedures and fine tuning risk management and corporate governance processes.

The full copy of Solvency II Matters is available on www.financialregulator.ie.

On the 27 October 2010 the Central Bank issued a letter to undertakings addressing a number of important issues in relation to QIS5. In this letter the Central Bank emphasised that completing the QIS5 is a vital part of the readiness for Solvency II. Where an undertaking finds that its Solvency II requirements are much higher than what is required under Solvency I, then the Central Bank expects the undertaking to be aware of this fact, to understand the reason why and to prepare a plan to deal with the issue.

European Commission Consultation Paper on the Level 2 Implementing Measures for Solvency II

The Commission has recently published a consultation paper on the Level 2 Implementing Measures for Solvency II. The consultation seeks views on the:

- Potential impacts that these policy decisions could have on the pricing, design and availability of insurance products;
- The corresponding effects for consumers; and
- The wider social or economic impacts.

The consultation paper can be found at –

http://ec.europa.eu/internal_market/consultations/2010/solvency-2_en.htm

The deadline for responses is 26th January 2011.

New European Systematic Risk Board

A new European Systemic Risk Board ("ESRB") was established on Thursday 16 December 2010.

It is aimed at contributing to the prevention or reduction of systemic risks to financial stability in the EU that arises from developments within the financial system.

The European Central Bank has commented that the ESRB will also contribute to the smooth functioning of the internal market and is aimed to ensure a sustainable contribution of the financial sector to economic growth.

However, the European Commission has stated that the ESRB will not have any binding powers to impose measures on Member States or national authorities. It has been conceived as a "reputational" body with a high level composition that should influence the actions of policy makers and supervisors by means of its moral authority.

The seat of the ESRB will be in Frankfurt, Germany. The Chair of the ESRB is the President of the European Central Bank, Jean-Claude Trichet, while Mervyn King, Governor of the Bank of England, was elected as first Vice-Chair of the ESRB by the members of the General Council of the European Central Bank.

The General Board of the ESRB will have its inaugural meeting on 20 January 2011.

European Insurance and Occupational Pensions Authority

The European Insurance and Occupational Pensions Authority ("EIOPA") replaces the Committee of European Insurance and Occupational Pensions Supervisors (CEIOPS) with effect from the 1 January 2011.

EIOPA's core responsibilities are to support the stability of the financial system, transparency of markets and financial products as well as the protection of insurance policyholders, pension scheme members and beneficiaries.

EIOPA is part of the European System of Financial Supervision consisting of three European Supervisory Authorities and the European Systemic Risk Board. It is an independent advisory body to the European Parliament, the Council of the European Union and the European Commission.

European Communities (Statutory Audits) (Directive 2006/43/EC) Regulations, 2010

In late May, 2010 Directive 2006/43/EC (the "8th Company Law Directive") was transposed into Irish Law by Statutory Instrument Number 220 of 2010 entitled the European Communities (Statutory Audits) (Directive 2006/43/EC) Regulations, 2010 (the "Regulations").

Regulation 91 of the Regulations states that "public-interest entities" shall, within 6 months of the Regulations being made (i.e. by 20 November, 2010), establish an audit committee in respect of it.

Public-interest entities are defined as in the Regulations as –

- Companies or other corporate bodies governed by the law of a Member State whose transferable securities are admitted to trading on a regulated market of any Member State;
- Credit institutions; or
- Insurance undertakings.

Exemptions to the Regulations are set out in Regulation 91 thereof. For example, a subsidiary undertaking can be exempt from the Regulations where the parent undertaking has established an Audit Committee in accordance with the Regulations. To avail of an exemption, it may be necessary to insert appropriate wording in the annual report.

Irish Stock Exchange adopts New Rules in relation to Corporate Governance

On the 17 December 2010, the Irish Stock Exchange ("the ISE") published the new Listing Rules ("the Rules") which require Irish listed companies to comply or explain against additional corporate governance provisions which arise from the recommendations

contained in the report on Compliance with the Combined Code on Corporate Governance by Irish listed companies ("the ISE/IAIM Commissioned Report"). These Rules, contained in a new Irish Corporate Governance Annex, supplement the existing provisions which require Irish listed companies to comply or explain against the requirements of the UK Corporate Governance Code.

The new Rules are effective immediately, therefore Irish listed companies with accounting periods commencing on or after the 18 December 2010, will be required to comply or explain against the Irish specific corporate governance provisions.

The requirement to comply with the UK Corporate Code is already in place, having applied to Irish listed companies with accounting periods beginning on or after 30 September 2010.

Extension of the short term guarantee

The Minister for Finance, Mr Brian Lenihan, TD announced on the 10 November 2010 that the EU has approved the extension of the Government guarantee for short term bank liabilities, including corporate and interbank deposits as well as debt securities to the 30 June 2011.

This announcement does not affect retail deposits of up to €100,000 as these deposits continue to be guaranteed under the ordinary Deposit Guarantee Scheme and that Scheme is not time limited.

The Central Bank of Ireland

(i) Change of Name

Following the commencement of the Central Bank Reform Act 2010, the Irish Financial Services Regulatory Authority has been renamed the "Central Bank of Ireland" with effect from 1 October, 2010.

The Central Bank has confirmed that it does not require approved documents or contracts to be updated immediately in order to reflect this change in name. Such updates can be implemented when documents next come up for review.

(ii) Consultation Paper 45 – amendments to the Minimum Competency Requirements ("CP45")

During the second quarter, the Central Bank published CP45 regarding the Minimum Competency Requirements and sought industry views on the proposals by the 13 August 2010. The Central Bank was expected to publish their findings in the final quarter of this year but it is more likely to be in the New Year. In summary, CP45 proposes the following:

- Changing the 3 year CPD cycle to an annual 15 formal hour requirement;
- Phasing out 'grandfathering arrangements' over a 4 year period whereby a recognised qualification must be achieved by 2015;
- Amendment to making public the register of accredited individuals on request; and
- Detailed requirements are proposed regarding records to be maintained to demonstrate compliance with the Requirements.

The Central Bank is aiming at introducing the new requirements in the second quarter of 2011.

(iii) New Chairperson of Takeover Panel

On the 19 October, Mr Denis McDonald, S.C. was announced, as the Chairperson of the Irish Takeover Panel for a three year period.

The Irish Takeover Panel is the statutory body responsible for monitoring and supervising takeovers and other relevant transactions in relevant companies in Ireland.

Mr McDonald was called to the Bar in July 1986 and called to the Inner Bar in October 2000. He practices primarily in commercial law.

(iv) Inspection Findings on Compliance with Minimum Competency Requirements

On the 22 October 2010, the Central Bank of Ireland published its findings following a themed inspection of intermediaries to check their compliance with the provisions of the Minimum Competency Requirements (MCR).

Under the MCR, which came into effect on 1 January 2007, firms must ensure that individuals who provide advice on or sell retail financial products or undertake certain

specified activities meet a minimum required competency standard, either through holding a recognised qualification or working in the industry for a specified period of time.

In addition, individuals are required to undertake a programme of Continuing Professional Development (CPD) on an ongoing basis and firms are required to ensure that these individuals comply with these requirements.

Of the twenty firms inspected, only 25% were found to be fully compliant with the MCR. For the remaining firms, the majority of the breaches found were in relation to a lack of documentation. The findings and recommendations from the theme are as follows:

- A number of firms were found not to have correctly certified grandfathered individuals. Firms must have procedures in place to ensure that grandfathered individuals who are recruited from another firm in the financial services industry have experience that is relevant to the role they will carry out in the firm. The verification of this must be documented and recorded;
- A number of firms were not monitoring staff compliance with the CPD requirements. Firms must ensure that all staff who are required to meet CPD requirements are monitored on an ongoing basis to ensure that the required amount of CPD is completed and that the CPD is relevant to the staff member;
- Some firms did not retain full documentation of courses attended or logs of CPD hours completed. Firms must ensure that their records are kept up to date and where anomalies exist in CPD records, these must be investigated and addressed as a matter of urgency; and
- In a number of firms the Staff Register was found to be incomplete or out of date. Firms must implement procedures to ensure that the register of accredited individuals is kept up to date on an ongoing basis to ensure that consumers are not provided with out of date information.

(v) Consultation paper 47 – Review of Consumer Protection Code (“CP47”)

In late October, the Central Bank issued a consultation paper on amendments to the Consumer Protection Code. The consultation paper proposes among other matters new definitions of vulnerable customers, more rigorous suitability requirements on firms, the imposition of strict time limits in dealing with overcharging errors and extending disclosure requirements on commission.

The closing date for submissions is 10 January, 2011 and full details of CP47 can be found on www.financialregulator.ie.

(vi) Draft Directive Deposit Guarantee Scheme

In November 2010, the Head of Payments and Securities Settlements in the Central Bank (Paul Molumby) welcomed the proposals set out in the draft recast Deposit Guarantee Schemes Directive.

The proposal is a comprehensive reform of EU Deposit Guarantee Schemes and follows on from the EU "emergency measures" taken in 2009, through Directive 2009/14/EC, which principally dealt with increasing the level of coverage to €100,000 for all schemes.

The four key elements of the draft directive are:

1. The simplification and harmonisation of the scope of coverage;
2. Faster payout times;
3. Revisions to funding arrangements; and
4. Enhanced cooperation between deposit guarantee schemes across Europe.

The proposals are beneficial from a depositor's perspective and give confidence that Deposit Guarantee Schemes can assist in maintaining financial stability. In particular, depositors would receive compensation quicker than was previously the case.

While payout times will be reduced from three months to 20 working days with effect from the 1 January 2011 under Directive 2009/14/EC, the draft directive proposes reducing this to seven calendar days by the end of 2013.

This is a draft directive, and certain aspects may be clarified or changed as it progresses through the EU approval process. The Central Bank continue to closely monitor developments.

(vii) Corporate Governance Code for Banks and Insurers

On the 8 November 2010, the Central Bank issued the Corporate Governance Code for Credit Institutions and Insurance firms ("the Code"). The Code sets out minimum statutory requirements on how banks and insurance companies should organise the governance of their institutions. The purpose of these new rules is to ensure that robust governance arrangements are in place so that appropriate oversight exists to avoid or minimise the risk

of a future crisis. The Code includes provisions on the membership of the Board of Directors, the role and responsibilities of the Chairman and other directors and the operation of various board committees. It will apply to existing directors and boards from 1 January 2011.

The Code adopts a two tier approach by imposing minimum core standards upon the boards of directors of banks and insurers in general with additional requirements defined for firms that the Central Bank designates as major institutions. The Central Bank will notify those firms it designates as major institutions.

The Code imposes the following minimum requirements on non-major institutions:

- Boards must have a minimum of five directors;
- The majority of the board shall be independent non-executive directors (this may include the Chairman). However in the case of institutions that are subsidiaries of groups the majority of the board may be group non-executive directors provided that the subsidiary has at least two independent non-executives or such greater number specified by the Central Bank;
- The Chairman shall be an independent non-executive director except in the case of a subsidiary where the Chairman may be a group director;
- Criteria for director independence and consideration of conflicts of interest;
- Limits on the number of directorships which directors may hold in financial and non financial companies to ensure they can comply with the expected demands of board membership of a credit institution or insurance company;
- Clear separation of the roles of Chairman and CEO;
- A prohibition on an individual who has been a CEO, director or senior manager during the previous five years from becoming Chairman of that institution;
- The board should meet at least on a quarterly basis;
- A requirement that board membership is reviewed at a minimum every three years;
- A requirement that boards set the risk appetite for the institution and monitor adherence to this on an ongoing basis;

- Minimum requirements for board committees including audit and risk committees, however where an institution is part of a wider group which has a Group Audit Committee and a Group Risk Committee, it may rely on those committee provided that the board is satisfied that they are appropriate to the specific circumstances of the institution; and

- A requirement for an annual confirmation of compliance to be submitted to the Central Bank.

The new requirements will apply generally to all credit institutions and insurers based in Ireland (including re-insurance firms but excluding captives). Differentiated standards apply to Irish subsidiaries of foreign regulated firms in a number of areas.

The Code will apply to existing directors and boards with effect from 1 January 2011. Those institutions which may need time to implement changes to systems and structures to become compliant will be given until 30 June 2011 to do so. Where changes to the Board are necessary, this period will be extended to 31 December 2011 to identify and assess suitable candidates with appropriate experience and diversities.

Failure to comply with the requirements may be subject to supervisory action and disciplinary procedures by the Central Bank, including sanction under the Administrative Sanctions Framework, criminal prosecution or the Central Bank using its new regulatory powers to refuse to appoint directors, or to suspend, remove or prohibit directors under the Central Bank Reform Act 2010.

(viii) Settlement Agreement between the Central Bank and the Endowment Policy Purchasing Company

On the 9 November 2010 the Central Bank entered into a Settlement Agreement with The Endowment Policy Purchasing Company Limited ("the firm"), a regulated financial services provider, in relation to breaches of regulatory requirements contained in the Investment Intermediaries Act, 1995 ("IIA"), the Client Asset Requirements ("CAR") and the Handbook for Authorised Endowment Policy Traders ("Handbook").

The breaches identified comprised of the firm failing to maintain adequate controls and accounting systems to facilitate effective management and to ensure it was in a position to satisfy supervisory and reporting requirements. These breaches were detected by the Central Bank during the course of an inspection. Once informed of the breaches, the firm undertook immediate remedial steps.

The firm confirms that the breaches did not result in financial loss to any clients.
The Central Bank reprimanded the firm and required it to pay a penalty of €23,500. The penalties imposed in this case reflect the cooperation of the firm during the course of the investigation and in settling at an early stage in the administrative sanctions procedure. The matter is now closed.

(ix) Motor Insurance Claims Handling

Following a series of onsite inspections of ten insurance firms between May and June 2010, the Central Bank issued its findings in November 2010. The inspection focused on third party claim files and was carried out to establish if firms had put appropriate practices and procedures in place in line with the claims processing provisions of the Consumer Protection Code ("the Code").

The inspection focused on a firms' interaction with the claimant, from the initial notification of a claim through to when the claim was rectified either through repairs or a financial settlement being made. Overall, it was found that there is a high level of compliance by firms with the claims processing requirements of the Code. The inspection found that firms do not treat third party claimants differently to their own policyholders.

In general, it was noted that firms provided a reasonable level of assistance to third party motor insurance claimants and endeavoured to pay claims with a minimum of delay once liability for the claim had been accepted.

(x) Enforcement Strategy and Risk Based Supervision

On the 21 December 2010, the Central Bank published its Enforcement Strategy which sets out the enforcement regime of the newly established Enforcement Directorate for 2011-2012.

The key objectives of the Enforcement Strategy include:

- Improving effective compliance through the robust application of the enforcement powers of the Central Bank;
- Enforcement activity prioritised in accordance with the risk profile of the financial institution to ensure that enforcement resources will be directed to those areas where it is perceived that the greatest risks lie; and

- An increased focus on the actions of persons involved in the management of financial institutions.

On the 22 December 2010, the Central Bank published its Consultation Paper on Impact Metrics for the Risk Based Supervision of Financial Firms by the Central Bank.

Interested parties are invited by this Consultation Paper to submit proposals as to what indicators the Central Bank should use to calibrate the impact of the circa 15,000 firms that it regulates. The result of this consultation will be used alongside the Central Bank's own analysis of the most pertinent indicators to determine the metrics which will be used in its approach to supervision of different entities as well as the fees' blocks into which different institutions should fall.

The consultation will run from 22 December until 24 February 2011. Responses should be sent to Risk@centralbank.ie or by post to Miss Helen Guinane, Risk Division, Central Bank of Ireland, PO Box No. 559, Dame Street, Dublin 2.

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