

Central Bank
(Supervision
and
Enforcement)
Bill 2011

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Central Bank (Supervision and Enforcement) Bill 2011

Introduction

The Central Bank (Supervision and Enforcement) Bill, 2011 (the “**Bill**”) was initiated on 28 July, 2011. While only at the initial stage in the Oireachtas, when enacted the Bill will provide the Central Bank of Ireland (the “**Central Bank**”) with significantly enhanced powers regarding the supervision of regulated financial service providers and the enforcement of financial services legislation. In doing so, it will provide welcome protection to persons who act as “whistleblowers” in respect of regulated financial service providers. However, the Bill in its current form is not without its controversies.

In this article we set out the main provisions of the Bill, explore any potential overlap it may have with the Criminal Justice Act, 2011 (which came into force on 9 August 2011) and highlight some concerns over certain provisions of the Bill in its current form.

Overview of the Bill’s Provisions

The Bill addresses some of the concerns raised by the Central Bank in its Enforcement Strategy 2011–2012 regarding the extent of its investigative powers and the sanctions it may impose in respect of breaches of financial services legislation by regulated financial service providers. It proposes to introduce, for example:

- (i) a significant increase in the extent of financial penalties that may be levied against individuals and regulated financial service providers;
- (ii) turnover-based financial penalties for a body corporate or an unincorporated body;
- (iii) the power to restrict an entity’s activities;
- (iv) the power to suspend or revoke an authorisation;
- (v) augmented powers for authorised officers, while consolidating the various legislative provisions relating to authorised officers; and
- (vi) whistleblower protection.

Details of these proposed changes are set out below.

Increase in extent of financial penalties

It is proposed that the maximum financial penalties which may be imposed by the Central Bank for a prescribed contravention of financial services legislation be doubled, at a minimum, as follows:

- (i) a natural person could be fined an amount of up to €1,000,000 (increased from €500,000); and
- (ii) a body corporate or an unincorporated body could be fined an amount up to the greater of €10,000,000 or 10 per cent. of the entity's previous year's turnover (increased from €5,000,000).

Increased powers

Power to require the provision of a report by an appropriately skilled third party

Under Part 2 of the Bill, the Central Bank will have the power to require a regulated financial services provider or, significantly, a related undertaking thereto (the “**reviewee**”) to commission a report by an appropriately skilled third party who is acceptable to the Central Bank (the “**reviewer**”) on any matter which the Central Bank has specified in the notice to the reviewee. A reviewer can be an auditor, accountant, lawyer or any other person with relevant business, technical or technological skill.

This can extend to the provision of information or the production of documents under any provision of financial services legislation.

In the notice issued to the reviewee, the Central Bank must state:

- (i) the date on which the notice was given;
- (ii) the period within which the reviewee shall nominate a person to the Central Bank for approval as a reviewer;
- (iii) the purpose of the report;
- (iv) the scope of the report;
- (v) the timetable for completion of the report;
- (vi) the matters required to be reported on;
- (vii) whether the report is to include recommendations;
- (viii) the form of the report;
- (ix) where appropriate, the methodology to be used in the preparation of the report; and
- (x) such other matters relating to the report as the Central Bank considers appropriate.

Before giving such a notice, the Central Bank must have regard to the cost implications for the reviewee (the cost of the report will be borne by the reviewee), the relevant knowledge and expertise available to the reviewee and whether it would be more appropriate for the Central Bank to utilise other powers available to it in the circumstances.

The contract for the completion of the report will be between the reviewee and the reviewer. The reviewer is expected to act objectively and without conflict of interest. Despite not being party to the contract, the Central Bank will have the right to enforce those provisions included in the contract which also appear in the notice as listed above. Furthermore, the contract may not be amended without the Central Bank's consent.

The contract between the reviewee and the reviewer must incorporate the contents of the notice provided to the reviewee by the Central Bank. However, the Bill does not state that these are the only terms which may be included in the contract. As such, it may be open to the reviewee and reviewer to negotiate other key terms such as liability and accountability.

Section 12(2)(b) of the Bill provides that any duty owed by the reviewer to the reviewee which might limit the provision of information or opinion by the reviewee to the reviewer in preparing a report will be waived. It is evident that the primary purpose of this section is to ensure the provision of information and opinion by the reviewee. However, it would also appear that the reviewee may be obliged to waive otherwise standard contractual rights. For example, this clause may limit the reviewee's right to ensure that any information it provides to the reviewer is not used to defame a person or breach another's intellectual property rights. This could have broad and significant consequences for the reviewee. It may be that this section should be limited so that any waiver of duties shall not be allowed to infringe the legal rights of the reviewer, the reviewee or any third party.

One issue which may arise under Part 2 is whether or not the reviewee will be obliged to provide legally privileged documentation to the reviewer. Section 28 of the Bill provides that nothing in Part 3 (Authorised Officers) of the Bill will infringe on the rights of legal professional privilege. Such a statement is not to be found in Part 2, which raises the question as to whether the Bill is seeking to limit such a right under that part.

It is noteworthy that section 12(2)(c)(iv) sets out that where the reviewer provides copies of any draft reports to the reviewee, the Central Bank may request copies of same. This may be interpreted as giving the reviewee an entitlement to receive drafts of the report from the reviewer throughout the report process, thereby giving the reviewee an opportunity to assess the accuracy of the reviewer's report and to ensure that its contents comply with the scope of the notice given by the Central Bank. However, there does not appear to be any obligation

on the reviewer to take account of any comments made by the reviewee as regards the report's accuracy. Further, the provision of draft reports to the Central Bank may lead to a prejudicial interpretation of the final report.

It is also noteworthy that under section 12(2)(c)(iii), the Central Bank can request the reviewer to provide it with copies of all documents and working papers relating to the report. This could lead to information being provided to the Central Bank which is outside the scope of the immediate report and/or, once again, lead to a prejudicial interpretation of the final report.

The reviewee is obliged to assist the reviewer in as much as the reviewer may reasonably require for the purposes of the completion of the report. This obligation is extended to any person who provided services to the reviewee in relation to any matter on which the report is based. The Central Bank may apply to the High Court for an order enforcing the obligations of any person in respect of the report. The term "services" is not defined in the Bill and as such the scope of this obligation is not clear. It is possible that it might extend to former employees of the reviewee. It may also include legal advisers who have provided legal services to the reviewee.

A person who obstructs or impedes the reviewer in their completion of the report or who knowingly gives information that is false in a material respect may be committing an offence and may be liable on indictment to a fine of up to €250,000 and/or a term of imprisonment of up to 5 years. No guidance is given in the Bill as to what constitutes "obstructing" or "impeding". If interpreted broadly, it may mean that any person who fails to answer questions by the reviewer will be committing an offence. However, bearing in mind a person's right to silence and the privilege against self-incrimination, answers required under statute may not be used in evidence against that person in any criminal trial.

Once the report has been completed, the Central Bank may use it in the performance of its functions under financial services legislation including the Administrative Sanctions Regime (i.e. as the basis for an examination or inquiry into a suspected breach of such legislation).

Earlier, we noted that the definition of "reviewee" under the Bill includes, in addition to a regulated financial service provider, a "related undertaking" of such an entity. "Related undertaking" is broadly defined and could include both regulated and unregulated entities regardless of location. This could imply that the Central Bank has authority to request such entities to prepare a report. However it is important to note that the Central Bank may only require the provision of a report on those matters to which it is entitled to under Irish financial services legislation. The Central Bank's jurisdiction over foreign registered companies may be called into question.

Power to give directions

Where the Central Bank:

- (i) has a concern as to the ability of a regulated financial services provider or related undertaking thereto to meet its capital requirements, obligations to creditors or customers or its obligations under financial services legislation; or
- (ii) has a concern that a customer may be prejudiced by the actions of the financial services provider or related undertaking; or
- (iii) believes there are grounds for revoking or not renewing its authorisation,

the Central Bank may direct the financial services provider or related undertaking to restrict its operations in certain areas for a period of up to 12 months and/or to take certain actions so as to diminish the Central Bank's concern. Such actions may include raising additional capital, the modification of systems and controls or an obligation to comply with a specific legislative requirement. The Central Bank may apply to the High Court for an order requiring compliance with such a direction.

The Central Bank's authority to give directions to a "related undertaking" over which it holds no regulatory authority may be called into question.

Power to seek High Court order for restitution

Section 45 of the Bill proposes a mechanism whereby the Central Bank may seek restitution through the High Court for those who suffered as a result of a breach of regulatory provisions by a regulated financial services provider.

Extension of power to take evidence

Section 51 of the Bill proposes a new offence for those who in any way obstruct the Central Bank's power to summon witnesses and take evidence. A person who so obstructs may be liable on summary conviction to a fine of up to €5,000 and/or a term of imprisonment of up to 12 months. In addition, the Central Bank will be given the same powers as a judge of the High Court with respect to the examination of witnesses.

Power to make regulations

Under section 40 of the Bill it is proposed that the Central Bank will have the power to make regulations covering a wide range of issues with a view to assisting in the proper and effective regulation of regulated financial service providers. These issues include:

- (i) risk minimisation;
- (ii) monitoring staff training and qualifications;
- (iii) the level of information to be given to customers;
- (iv) the restriction of “cold calling”;
- (v) the processes and procedures to be adopted when processing rebates and refunds to customers;
- (vi) resolution procedures concerning disputes with customers;
- (vii) order execution; and
- (viii) the ways in which errors made by regulated financial service providers are corrected.

Before making such regulations, the Central Bank must consult with the Minister and may consult with any other person whom the Central Bank considers appropriate.

Power to seek a High Court order for enforcement of a settlement agreement

Where the Central Bank and a regulated financial services provider have entered into an agreement in resolution of a suspected contravention and the regulated financial services provider has not abided by that agreement, the Central Bank may apply to the High Court for an order requiring the regulated financial services provider to comply with the terms of the agreement.

Increased powers of “authorised officers” of the Central Bank

Part 3 of the Bill proposes to consolidate the various pieces of legislation concerning authorised officers of the Central Bank (i.e. under the Insurance Act, 1989, the Investment Intermediaries Act, 1995 and the Building Societies Act, 1989) and to provide authorised officers with increased powers.

It should be noted that section 21 of the Bill extends the provisions of Part 3 to persons outside of the State, thereby giving the Central Bank extra-territorial powers. It is not clear how such a power might be enforced by the Central Bank.

Under section 24 of the Bill, an authorised officer will be entitled to enter premises for the purposes of information gathering (either under warrant or by consent) which the authorised officer reasonably believes were used by:

- (i) a current or past financial services provider;
- (ii) a person who made an application to be a financial services provider; or
- (iii) a related party in respect of (i) or (ii).

Under section 25(1)(h) an authorised officer may require any person to answer questions and to make a declaration as to the truth of the answers to those questions. However, as alluded to above, a person's right to silence and the privilege against self-incrimination must be borne in mind. As such, answers to the questions required under section 25(1)(h) may not be used in evidence against that person in any criminal trial.

The Bill will empower authorised officers to access and inspect all records found during the course of the inspection. While it is noted that the Central Bank will appoint authorised officers for the purposes of obtaining any information necessary for the performance by the Central Bank of its functions, the Bill does not limit the scope of the records which an authorised officer may inspect in any way.

Under section 27 of the Bill an authorised officer will be entitled to attend any meeting relating to the business of a regulated financial service provider where it is deemed necessary to assist the Central Bank in its functions under financial services legislation.

In addition, section 31 of the Bill proposes to introduce the offence of obstructing or impeding an authorised officer in the exercise of their powers under Part 3 of the Bill, failing to comply with a requirement of an authorised officer without reasonable excuse or knowingly providing information which is false or misleading in a material respect. The term "material respect" is not defined. A person who commits an offence under this section may be liable on indictment to a fine of up to €250,000 or imprisonment for a term of up to 5 years or both. As discussed above, no guidance is given in the Bill as to what constitutes "obstructing" or "impeding", with the same issues therefore arising.

Whistleblower protection

The Bill proposes to introduce increased protection for whistleblowers within regulated financial service providers, namely protection from civil liability and penalisation.

Protection from civil liability

A person who makes a "protected disclosure" will not be liable in damages in respect of the making of such a disclosure unless it was made in the knowledge that the information being disclosed is false or misleading.

A protected disclosure is a disclosure made by a person in good faith to the Central Bank, a Central Bank employee or an authorised officer of the Central Bank where that person has reasonable grounds for believing that the disclosure will show:

- (i) that an offence was or is being committed under financial services legislation;
- (ii) that a prescribed contravention (as defined in the Bill) was or is being committed;
- (iii) any provision of financial services legislation was or is being contravened; or
- (iv) that evidence in respect of the above is being or is likely to be deliberately concealed or destroyed.

It is important to note that a disclosure made anonymously will not qualify as a protected disclosure. However, the identity of a person who makes a protected disclosure will not be divulged by the Central Bank without that person's consent.

Protection from penalisation

An employer who penalises or threatens to penalise a person (or causes or permits another to do so) for:

- (i) making a protected disclosure;
- (ii) giving evidence in any proceedings under financial services legislation; or
- (iii) giving notice of their intention to do either of the above

may be guilty of an offence and may be liable on indictment to a fine of up to €250,000 and/or a term of imprisonment term of up to 2 years.

Tortious liability for victimisation

Where a person is victimised because they or any other person:

- (i) honestly made a protected disclosure;
- (ii) gave evidence in any proceedings under financial services legislation; or
- (iii) gave notice of their intention to do either of the above,

that person will have a right of action in tort against the person who victimised them.

Examples of victimisation given in the Bill include harassment, intimidation, discrimination, injury and the treat of reprisal, among others.

Obligation to report a breach of financial services legislation

Under section 33(2)(a), an obligation will be placed on a person who performs a pre-approval controlled function (a function in which a person may exercise significant influence on the conduct of a regulated financial service provider's affairs, such as a director of that financial service provider) to report a breach of financial services legislation as soon as practicable where he/she believes it might be of material assistance to the Central Bank.

A person will be excused from this obligation if the disclosure might incriminate them personally. This might include, for example, a director who will be excused from making a disclosure where he/she might be prosecuted on the basis of its contents.

Further points to note and potential issues

Reporting obligations under the Bill and the Criminal Justice Act 2011

Under the Criminal Justice Act 2011 (the "**Act**"), a person who fails without reasonable excuse to report information which could be of material assistance regarding a relevant offence (as defined in the Act) or suspected relevant offence to the Garda Síochána will themselves be guilty of an offence.

By way of example, the list of relevant offences under the Act includes the obligation under section 42 of the Criminal Justice (Money Laundering and Terrorist Financing) Act, 2010 whereby a designated person is required to report a suspicious transaction relating to money laundering or terrorist financing.

Under the Act, if a person believes that a designated person is not reporting suspicious transactions to the Garda Síochána, then that person would be required to notify the Garda Síochána accordingly. The expression "person" is not defined in the Act. Therefore this obligation could extend to all employees.

When the Bill comes into force, a person in a pre-approval controlled function will be required to report a breach of financial services legislation as soon as practicable when he/she believes it might be of material assistance to the Central Bank. This list of financial services legislation includes the Criminal Justice (Money Laundering and Terrorist Financing) Act, 2010. Therefore, under the Bill, if a person in a pre-approval controlled function suspects that a designated person is not reporting suspicious transactions under section 42, then that person would be required to notify the Central Bank accordingly.

While a person who makes a report under the Act/Bill will receive whistleblower protection under the Act/Bill respectively, it is not yet clear how the reporting obligations under the Act/Bill will operate in terms of timing. For example, will reports have to be made to the Garda Síochána and the Central Bank simultaneously? In addition it is also not clear what due process should take place internally in an organisation, if any, before a person makes such a report.

There appears also to be some inconsistency between the Act and the Bill in that the duty to report appears to extend to all employees under the Act and only to persons in pre-approval controlled functions under the Bill.

Overlap with Corporate Governance Codes

It is as yet unclear as to how the Act and the Bill will interplay with the Corporate Governance Code for Credit Institutions and Insurance Undertakings and the Corporate Governance Code for Captive Insurance and Captive Reinsurance Undertakings (the “Codes”). For example, under section 6.7 of each of the Codes, a director who has a material concern about the overall corporate governance of an institution is obliged to report the concern without delay to the board in the first instance. Where that director’s concern is not satisfactorily addressed by the board within 5 business days, the director must then report the concern directly to the Central Bank.

If the subject of the concern also triggers a reporting obligation under the Act and/or the Bill, is the director to inform the board of directors and the Garda Síochána/Central Bank (as appropriate) simultaneously?

Conclusion

The Bill is designed to give the Central Bank much greater powers of supervision and enforcement. In doing so, however, it raises several unanswered questions as to the scope of such powers in terms of the protection of an individual’s rights and the extension of the provisions to individuals and/or entities located outside of the State. The Bill is designed to apply to a broad category of entities including undertakings related to regulated financial service providers. It remains to be seen how such powers will be applied in practice.

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