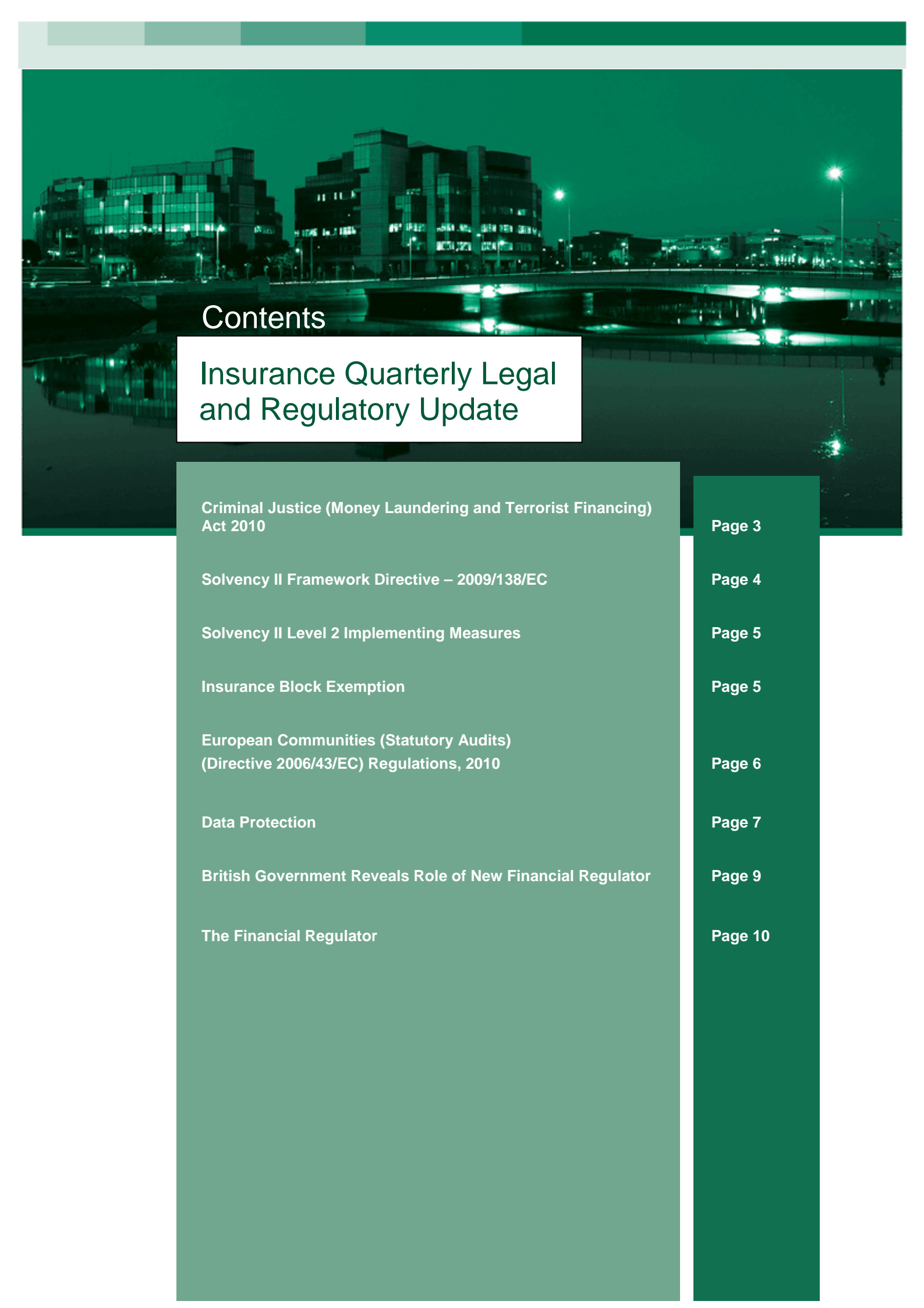


Insurance Quarterly Legal and Regulatory Update

Period covered:
1 April to 30 June, 2010

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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”).

The Department of Justice and Law Reform has confirmed that the commencement date for the CJA Act 2010 will be 15 July 2010, except for Chapter 9 of Part 4 (Authorisation of Trust and Company Service Providers). This leaves a very short time frame for all designated persons to comply with the new requirements.

The CJA Act 2010 introduces the following important changes for designated persons:

- the definition of money laundering has widened to include the proceeds of any criminal conduct, however minor;
- the terminology of “Know Your Customer” has been replaced by “Customer Due Diligence” (“CDD”);
- the level of CDD required will be determined using a risk based approach. This can range from “simplified” where there is a low risk of money laundering or terrorist financing to “enhanced” where there is high risk of money laundering or terrorist financing;
- there are enhanced obligations to identify the “beneficial owner” whereby the designated person must ensure that they take reasonable measures to understand the ownership and control structure of the client;
- there is a new requirement to identify non domestic politically exposed persons (“PEPs”) i.e. those persons in a prominent public position and their families or close associates;
- those persons who meet the definition of “trust and company services provider” will need to be authorised;
- a guard at superintendant level or higher and/or a District Court judge has the power to direct a designated person not to carry out a specified service for a specific timeframe where a customer is subject to investigation;

- ▣ the number of offences that can arise under the CJA Act 2010 are significantly greater than under the old legislation;
- ▣ the Minister for Justice and Law Reform, in conjunction with the Minister for Finance, can approve the Guidance Notes to be used by designated persons. A Court can have regard to these Notes when determining if a designated person took all the appropriate measures.

Core Guidance Notes and sector specific Guidance Notes for the insurance sector are currently under public consultation and are available on the Financial Regulator's website. The closing date for comments on the draft Core Guidance Notes is the 2 July 2010, while the closing date for comments on the insurance sector specific Guidance Notes is Friday 9 July 2010.

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 by 31 October 2012, although the European Commission is considering postponing the implementation date to 1 January 2013 in order to better reflect the year end dates of the majority of insurance undertakings and to enable a smoother transition from the old to the new regime.

In April 2010 the Financial Regulator wrote to those firms that had indicated their intention to seek internal model approval recommending that such firms participate in a pre-application process by completing a questionnaire entitled "Pre Application Readiness Assessment Process".

The Financial Regulator held a number of workshops in May 2010 to discuss the questionnaire with those companies that expressed an interest in entering the Pre

Application Process. The Financial Regulator has since published a document entitled “Pre-application Readiness Assessment Process incl. Questions from Workshops”, which is available on the Financial Regulator’s website.

On the 11 May 2010, the Financial Regulator held a forum on Solvency II, with an open invitation to the insurance industry. Matters covered included an overview of Solvency II requirements along with more detailed presentations on the reporting and disclosure requirements and the new system of governance that will be required under Solvency II. A panel discussion took place with representatives from the insurance sector, advisors to the sector and representative bodies. This forum was very well attended by the industry. The relevant documentation from the forum is available on the Financial Regulator’s website.

On the 24 June 2010, the Financial Regulator held another forum on Solvency II specifically aimed at independent Non Executive Directors and Directors with responsibility for Solvency II. Notes summarising some key questions and considerations for Non Executive Directors and Directors are available on the Financial Regulator’s website.

Solvency II Level 2 Implementing Measures

On the 1 April 2010, the Committee of European Insurance and Occupational Pensions Supervisors (CEIOPS) published its final advice to the European Commission (Commission) on the Level 2 implementing measures on the general criteria to be used to assess third country (i.e. non-EU member state) equivalence under Solvency II in the areas of reinsurance, group solvency and group supervision.

The Commission has now asked CEIOPS to identify the third countries that should be included in the first wave of equivalence assessments. CEIOPS is required to revert to the Commission on this matter by the end of August 2010.

Following the decision by the Commission on the first wave third countries, CEIOPS will then be required to produce final advice by the end of July 2011 analyzing whether these first wave third countries satisfy the general criteria for assessing third country equivalence.

Insurance Block Exemption

The European Commission has adopted a new insurance block exemption regulation (“BER”) which comes into force on 1 April 2010 and will remain in force until 31 March 2017. This replaces a previous exemption adopted in 2003.

The BER exempts certain agreements between companies in the insurance sector from the ban on restrictive business practices provided for by European competition law rules.

The new BER has renewed two of the four categories of agreements exempted under the old regime, namely information exchanges and insurance pools, with certain amendments. Two other types of agreement covered by the previous BER - standard policy conditions and agreements on security devices - have been excluded from the new BER, as the Commission considers that they do not require a sector-specific exemption. Companies engaging in such agreements, or in agreements which do not meet the conditions set out in the BER, must conduct their own analysis to determine whether the arrangements are permissible or not.

The exemption of co-insurance and co-reinsurance pools (up to market share thresholds of 20% and 25% respectively) has been preserved in the new BER, but narrowed in scope. The market share is no longer based solely on the gross premium income of members within the pool, but takes account of members' income earned outside the pool.

New arrangements must be assessed for compliance with the BER as of 1 April 2010. Insurance agreements in force before 1 April 2010 remain covered by the previous BER until 30 September 2010, however insurers are advised to review existing arrangements for compliance with the new BER well in advance of that date to ensure any necessary changes are implemented in time.

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").

These Regulations give effect to the 8th Company Law Directive on statutory audits of annual accounts and consolidated accounts, amending Council Directive 78/660/EEC on the annual accounts of certain types of companies and Council Directive 83/349/EEC on consolidated accounts and repeals Council Directive 84/253/EEC on the approval of persons responsible for carrying out the statutory audits of accounting documents.

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.

Please contact the author or your usual contact in Dillon Eustace should you require further information on the Regulations.

Data Protection

Data Protection - New Standard Contractual Clauses

The European Commission has approved new standard contractual clauses on the transfer of data to data processors established in third countries. The difference between the new clauses and the previous clauses is that the new clauses include provision for the onward appointment of sub-processors being appointed by data processors in Third Countries. This is a welcomed development in the area of data protection. The new clauses came into force on 15 May, 2010.

For further details please contact David Nolan in Dillon Eustace.

Data Protection Commissioner’s Annual Report - 2009

On 8 April, 2010 the Data Protection Commissioner (“Commissioner”) launched his report for 2009. The report focused on the responsibility of private and public sector organisations with respect to handling their customers’ personal information.

During 2009 the Office of the Data Protection Commissioner opened for investigation 914 complaints. This slight decrease on the figure for 2008 (1031) can be accounted for in some respects by a drop in the last two years in complaints about unsolicited direct marketing text messages, phone calls, fax messages and emails. The report states that this is attributable in part to a series of prosecutions against a number of companies operating in the premium rate text messaging sector.

The Commissioner considers that the message from his Office should now be clear - entities that continue to commit offences in relation to electronic marketing face prosecution. The Commissioner also reports on efforts to minimise the number and impact of personal data security breaches and, when such breaches occur, to encourage organisations to voluntarily report the incidents to his Office. 119 data security breach incidents were reported to the Office in 2009, which is nearly 50% more than in 2008.

The Commissioner also highlighted his concerns about the current inability of his Office to investigate the sending of unsolicited text messages, emails or the making of unsolicited phone calls by candidates for election or political parties.

The Report also outlines views conveyed by the Commissioner on the DNA Bill, the Communications (Retention of Data) Bill, the Spent Convictions Bill and Google Streetview in Ireland.

Consultation on Development of a Data Security breach Code of Practice

The Data Protection Review Group (the "Review group") established by the Minister for Justice and Law Reform considered, amongst other things, how to ensure that the reporting obligations of organisations in relation to data security breaches are sufficiently robust to protect the rights of underlying data subjects. Following a period of public consultation, the Review Group issued a report recommending that:

"The reporting obligations of data controllers in relation to data breaches should be set out in a statutory Code of Practice as provided for under the Data Protection Acts. The Code, broadly based on the current guidelines from the DPC, should set out the circumstances in which disclosure of data breaches is mandatory. Failure to comply with the disclosure obligations of the Code could lead to prosecution by the DPC."

A draft Code of Practice (“the Code”) has been prepared in response to this recommendation and is available on the Commissioner’s website. In summary the Code states that where there is a loss of control of personal data by a data controller it must be reported to the Commissioner within **two working days** of the data controller becoming aware of the incident, except in a limited number of circumstances.

The exceptional circumstances include –

- ▣ where the data has been securely encrypted;
- ▣ the incident has been reported without delay to the affected data subject;
- ▣ the loss of personal data affects less than 100 data subjects and does not include sensitive personal data or personal financial data that could be used to carry out identity theft.

Data controllers, subject to the reporting requirements, must provide a detailed report of the incident setting out:

- ▣ the amount and nature of the personal data that has been compromised;
- ▣ what action is being taken to secure and / or recover the personal data that has been compromised;
- ▣ what actions are being taken to inform those affected by the incident or reasons for the decision not to do so;
- ▣ what actions (if any) are being taken to limit damage or distress to those affected by the incident;
- ▣ a chronology of the events leading up to the disclosure and
- ▣ details of the measures being undertaken to prevent repetition of the incident.

British Government Reveals Role of New Financial Regulator

In June, 2010 the Finance Minister George Osborne announced radical changes in the way banks and financial institutions will be regulated. Mr Osborne and the new coalition government feel that the structure of regulation was partly to blame for the severe impact the financial crisis had on the British banking sector and he wants to reform it so that it will not happen again.

Mr Osborne has announced that the current Financial Services Authority (“FSA”) will be wound up by 2012 and its functions will be taken over by the Bank of England (“BoE”).

A new committee called the Financial Policy Committee (“FPC”) will be established by the BoE, which will be responsible for overseeing macro- economic and financial issues that could threaten stability in the future.

In addition a new Prudential Regulation Authority will be set up as a subsidiary of the BOE, and carry out its orders. It will regulate retail and investment banks, building societies and insurance companies.

The third part of the reform is the creation of a new Consumer Protection and Markets Authority, which will regulate the conduct of all authorized financial firms providing services to consumers.

It is expected that Hector Sant who is the current chief executive of the FSA will become the first chief executive of the Prudential Authority and a deputy governor of the BoE.

The Financial Regulator

Settlement Agreement

On the 21 April 2010 the Financial Regulator modified the direction issued to Quinn Insurance Limited ‘QIL’ (under administration) on 30th March 2010 to permit the company to write motor insurance cover for provisional driver licence holders in the United Kingdom (including Northern Ireland). On the 29 April the Financial Regulator permitted QIL UK to re-open the private motor business (new and renewals).

The Financial Regulator consulted closely with the United Kingdom’s Financial Services Authority prior to making these decisions and continues to work closely with the administrators of QIL in relation to their obligations to restore the company to a sound commercial and financial footing.

Consultation Paper 41– Corporate Governance Requirements for Credit Institutions and Insurance Undertakings (“CP 41”)

On the 27 April, 2010 the Financial Regulator published CP 41, which proposes an enhanced corporate governance regime for credit institutions and insurance undertakings.

The Financial Regulator's proposals as set out in CP41 include:

- ▣ imposing requirements in terms of the minimum number of directors on the board;
- ▣ limiting the number of directorships which directors may hold so as to ensure they can comply with the expected demands of board membership of an institution;
- ▣ requiring that board membership is reviewed at a minimum every 3 years;
- ▣ requiring clear separation of the roles of Chairman and CEO and precluding an individual who has been CEO, director or senior manager during the previous five years from becoming Chairman of that institution;
- ▣ setting out clearly the role of the independent non-executive directors;
- ▣ requiring the board to set the risk appetite for the institution and to monitor adherence to this on an ongoing basis;
- ▣ setting out the minimum requirements for board committees; and
- ▣ requiring annual confirmation of compliance to the Financial Regulator.

CP 41 proposes that the requirements will apply to all credit institutions and to insurers licensed by the Financial Regulator, including Irish licensed and authorised subsidiaries of international financial services groups. The proposed new requirements will not apply to foreign incorporated subsidiaries of an Irish entity. However those institutions are encouraged to adopt equivalent good corporate governance practices in their foreign incorporated subsidiaries.

While there is an acknowledgement of proportionality when implementing these measures, there is, nevertheless, a very clear emphasis on the need for good corporate governance aligned with robust regulation to secure the long term interests of the banking and insurance sectors.

The closing date for submissions was the 30 June, 2010.

Consultation Paper CP42 on Investment Guarantees – Guidance on Reserving and Risk Governance (“CP42”)

On the 11 May, 2010 the Financial Regulator issued a public consultation on CP42 , which follows a discussion document on reserving for Variable Annuities (VAs) published in August 2009. Submissions received in response to the discussion paper outlined the difficulty in defining VAs and has led to the expansion of the scope of this Consultation Paper to cover all Investment Guarantees, except for certain and well defined classes.

The Consultation Paper proposes new standards for insurers who write VA business in Ireland including:

- ▣ Submission of a Financial Risk Analysis annually with regulatory returns;
- ▣ Adherence to Minimum Capital and Reserves Standards;
- ▣ Follow the Risk Volume Capital Process; and
- ▣ Subject the Financial Risk Analysis and Risk Volume Capital to independent oversight.

Interested parties were asked to comment on the proposals by 30 June 2010.

Introductory Statement by the Head of Financial Regulation to the Public Accounts Committee

On the 13 May 2010, the Head of Financial Regulation, Mr. Matthew Elderfield, addressed the Public Accounts Committee where he briefly outlined the changes the Financial Regulator has made to date and the proposed changes to be made in the supervision of financial institutions. He also commented on the main regulatory issues highlighted in the Comptroller and Auditor General's Special Report 72 and finally he set out the changes proposed for credit institutions in the area of related party lending.

The Irish Banking Crisis, Regulatory and Financial Stability Policy 2003 – 2008 and the new Strategic approach to Banking Supervision

On the 9 June, 2010 the Governor of the Central Bank issued his report to the Minister for Finance on the Irish Banking Crisis, while on the 21 June, the Central Bank published their new strategy on banking supervision in Ireland, which outlines the new approach to the regulation for retail, wholesale and international banks in Ireland.

Both reports are available on the Financial Regulator's website.

Settlement Agreement between the Financial Regulator and Culleton Insurances Limited

Following suspected breaches of regulatory requirements, the Financial Regulator entered into a Settlement Agreement with effect from 15 June 2010 with Culleton Insurances Limited (the 'firm') of Selskar Court, Wexford Town, Co. Wexford, a regulated financial service provider.

The breaches, which were discovered during the course of the Financial Regulator's Themed Inspections into 'Charges and Premium Rebates in the Insurance Intermediary Sector', relate to the firm failing to act professionally in the best interests of its customers during the period 1 August 2004 to 31 October 2007. The issue relate to the firm inadvertently applying broker fees to the policies of some customers which were in excess of the maximum fees advised on the firm's terms of business document resulting in those customers being overcharged; and failing to have adequate systems and controls in place to ensure compliance with the requirements of the Consumer Protection Code and Handbooks.

The Financial Regulator imposed a fine of €27,000 on the firm and agreed a schedule of repayments to affected customers or charity.

In the Settlement Agreement, the Financial Regulator sought to remind all regulated firms that the Financial Regulator will not accept a situation whereby any customer is charged any amount in excess of that stated in the firm's Terms of Business.

Issues identified in themed inspections into mortgage referrals, home insurance claims and motor insurance renewals

On the 22 June 2010, the Financial Regulator published the findings of three themed inspections of intermediary and insurance firms, which commenced in 2009 and focused on compliance by firms with the requirements of the Consumer Protection Code ("the Code") under each of the following areas.

(i) Review of mortgages referred to specialist lenders by mortgage intermediaries

The review focused on mortgages applied for through intermediary channels which were referred to non-bank/specialist lenders. Twenty mortgage intermediaries were chosen for inspection based on the volume of business they had placed with specialist lenders. The main findings from the inspection are:

- ▣ Suitability statement/'reasons why' letter – A number of firms were found to be producing statements of suitability that were lacking in detail and contained vague generic statements. Instead, the statement must set out why the product is considered suitable, or most suitable, as appropriate.
- ▣ Affordability – In a number of cases firms did not appear to be conducting sufficient research into the consumer's ability to repay.

- ▣ Appropriate documentation – researching and client information gathering is critical to ascertain whether a product is the most suitable. In order to demonstrate compliance, appropriate documentation must be maintained on client files.
- ▣ Areas of responsibility – There was a perception in a number of firms that it was the lenders and not the intermediaries' responsibility to comply with certain sections of the Code, e.g. Chapter 4 (14) relating to declarations of sight of original documentation. In some cases if the lender had not requested a declaration from the intermediary, it had not been forwarded to the lender. Intermediary firms must remain aware that they are a regulated entity and must satisfy themselves that they are in compliance with the Code.

(ii) Home Insurance Claims

The Financial Regulator inspected the eight largest firms in terms of the number of claims processed for the inspection into home insurance claims. The firms chosen were responsible for over 98% of the claims processed during the review period.

The main finding of the home insurance inspection was that while the majority of claims are processed in line with the requirements of the Code, there were a small number of cases where claims cheques were not issued to claimants within 10 business days. The Code requires that firms pay all claims to the claimant within 10 business days of an agreed settlement as it is important for consumers to receive prompt payment of claims.

It was also found that some firms are moving to a process where claims can only be settled using the firms' approved repairers. Firms are expected to satisfy themselves that their use of approved repairers is consistent with the Code and where firms intend using approved repairers, they must ensure that consumers are aware of this at the time of entering into an insurance contract.

The Financial Regulator has also recommended that firms write to claimants when a payment is made to builders or other similar third parties, to inform claimants of the amount paid in respect of their claim, as this could impact on their future premiums.

(iii) Motor Insurance Renewals

The Financial Regulator inspected nine firms, representing the largest firms in terms of motor insurance renewals. In the majority of cases it was found that firms are processing motor insurance renewal documentation in line with regulatory requirements. However there were a very small number of cases where the 15 day rule for issuing renewals had been

breached and in some cases it was found that actual renewal documentation issued did not contain some information required by the regulations.

Central Bank Announces New Senior Appointments

The Central Bank has made five new appointments at Assistant Director General (ADG) level. The appointments are to new directorates in the restructured Central Bank. Peter Oakes has been appointed ADG for Enforcement, Gareth Murphy ADG for Markets Supervision, Patrick Brady ADG for Policy and Risk, Bernard Sheridan ADG for Consumer Protection. Gerry Quinn has been appointed Chief Information Officer and will head up the Information Technology Division.

Consultation Paper 45 – amendments to the Minimum Competency Requirements (“CP45”)

On 30 June, 2010 the Financial Regulator published CP 45 regarding the Minimum Competency Requirements. They are seeking views by 13 August, 2010 on the following proposals:

- ▣ 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 Financial Regulator is aiming at introducing the new requirements in the second quarter of 2011.

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