

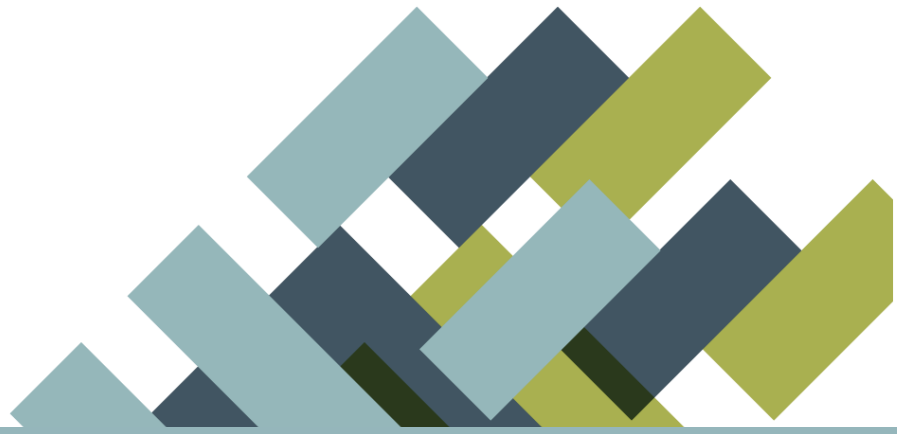
WILLIAM FRY III

PRESENTATION

“Is there an Increasing Personal Liability for
Directors of Insurance Companies?”

to
the
Directors' Interest Group
Society of Actuaries in Ireland

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1. Background

- Global financial crisis of 07/08 exposed significant shortcomings in the corporate governance and risk management of companies operating in the financial services sector
- These weaknesses most evident in banks and investment banks, but other financial services companies, such as insurance companies were also affected
- Since the crash, steps have been taken to bolster the corporate governance and risk structures in place, at national and EU level
- **At EU level:** Solvency II Directive, IDD, PRIIPs
- **At national level:** Central Bank Acts, amended Corporate Governance Codes, and the Companies Act 2014
- As regulator, the CBI has and will avail of the relevant legislation to pursue not only regulated entities but also directors/persons concerned in the management of regulated entities
- This presentation provides an overview of the increased obligations and potential liability for directors of insurance companies

1. Background

- **Codification of Directors' Fiduciary Duties**
Section 228, Companies Act 2014

Act in good faith in interests of Company

Act honestly, responsibly in conduct of company's affairs

Act in accordance with company's constitution and the law

Not use company's property, information or opportunities for own/other third party benefit

Do not restrict director's power to exercise independent judgment

Avoid any conflict between director's duties and own interests

Exercise the care, skill & diligence that would be exercised by reasonable person with knowledge & experience a director expected to have and that director actually has

Have regard to interests of members, in addition to general duty to employees

1. Background

- Does not significantly increase director duties under company law
- “Makes it easier to understand and difficult to deny” *(Minister Richard Bruton T.D.)*
- More will be expected of directors in execution of duties
- Expect more rigorous enforcement by courts & regulators
- Company law obligations are the foundation on which financial services obligations are built



1. Background

Solvency II Directive

- Article 40 - *"Member States shall ensure that the administrative, management or supervisory body of the insurance or reinsurance undertaking has the ultimate responsibility for the compliance, by the undertaking concerned, with the laws, regulations and administrative provisions adopted pursuant to this Directive"*.
- Article 34(2) - *"The supervisory authorities shall have the power to take any necessary measures, including where appropriate, those of an administrative or financial nature, with regard to insurance or reinsurance undertakings, and the members of their administrative, management or supervisory body"*.

European Union (Insurance and Reinsurance) Regulations 2015

- Regulation 303: Liability of officers of undertaking for offences committed by undertaking
- *"(1) Where an offence under these Regulations is committed by a body corporate and it is proved that the offence was committed with the consent or connivance, or was attributable to any wilful neglect, of a person who was a director, manager, secretary or other officer of the body corporate, or a person purporting to act in that capacity, that person, as well as the body corporate, shall be guilty of an offence and may be proceeded against and punished as if he or she were guilty of the first-mentioned offence.*
- *(2) Where the affairs of a body corporate are managed by its members, paragraph (1) applies in relation to the acts and defaults of a member in connection with his or her functions of management as if he or she were a director or manager of the body corporate."*

1. Background

- What type of damage might a **Director** suffer?
 - Reputational
 - Regulatory (- challenged under F&P)
 - Fined by CBI under ASP
 - Civil Liability
 - Criminal Sanction
- What type of damage might the **Company** suffer?
 - Reputational
 - Regulatory (- enhanced supervision)
 - Fined by CBI under ASP
 - Civil Liability
 - Criminal Sanction

2. EU Regulatory Developments

- Packaged Retail and Insurance-based Investment Products (“**PRIIPs**”)
- Insurance Distribution Directive (“**IDD**”)

2. EU Regulatory Developments

PRIIPS – Packed Retail and Insurance based Investment Products

- European-wide Regulation aimed at improving comparability of investment products and reducing the risk of retail investors buying products that do not meet their needs. (no local transposition required for an EU Regulation).
- *14 September 2016* – the European Parliament rejected the Level 2 implementing technical standards (“**ITS**”).
- *9 November 2016* – 12 month delay proposed by the Commission. The delay gives issuers and distributors of PRIIPs products until 1 January 2018 to comply with the provisions of the Regulation.

2. EU Regulatory Developments

Administrative Sanction & Other Measures

- Chapter V of the PRIIPs Regulation deals with administrative sanctions and other measures for failure to comply with the Regulations.
- Fines can be imposed on “natural persons” (this might include directors and managers) as well as on legal entities.
- Member States must put in place “*effective, proportionate and dissuasive*” sanctions for breach of PRIIPs terms.
- Member States have power to impose:
 - an order prohibiting or suspending the marketing of a PRIIP;
 - a public warning indicating the person responsible for the infringement;
 - an order prohibiting the provision of a KID which does not meet specific requirements.
 - administrative fines of “at least” up to €5m for a legal entity and €700,000 for an individual (Member States can imposed higher fines) and any other additional sanctions or measures.
 - Matters concerning the civil liability of a PRIIP manufacturer not covered by the Regulation should be governed by the applicable national law i.e. the ASP.

2. EU Regulatory Developments

- Circumstances to be taken into account by competent authorities when imposing administrative sanctions and measures are set out in a non-exhaustive list in Article 25 of the PRIIPs Regulation:
 - The gravity and the duration of the infringement;
 - The degree of responsibility of the person responsible for the infringement;
 - The impact of the infringement on retail investors' interests;
 - The cooperative behaviour of the person responsible for the infringement;
 - Any previous infringements by the person responsible for the infringement;
 - Measures taken after the infringement by the person responsible for the infringement to prevent its repetition.

2. EU Regulatory Developments

Insurance Distribution Directive (“IDD”)

- IDD – a more harmonised regulatory framework for distribution of insurance products across the EU (“distributors” includes direct writers)
- Transposition Deadline = 23 February 2018 (existing intermediaries – 1 year transition period)

Product Oversight and Governance

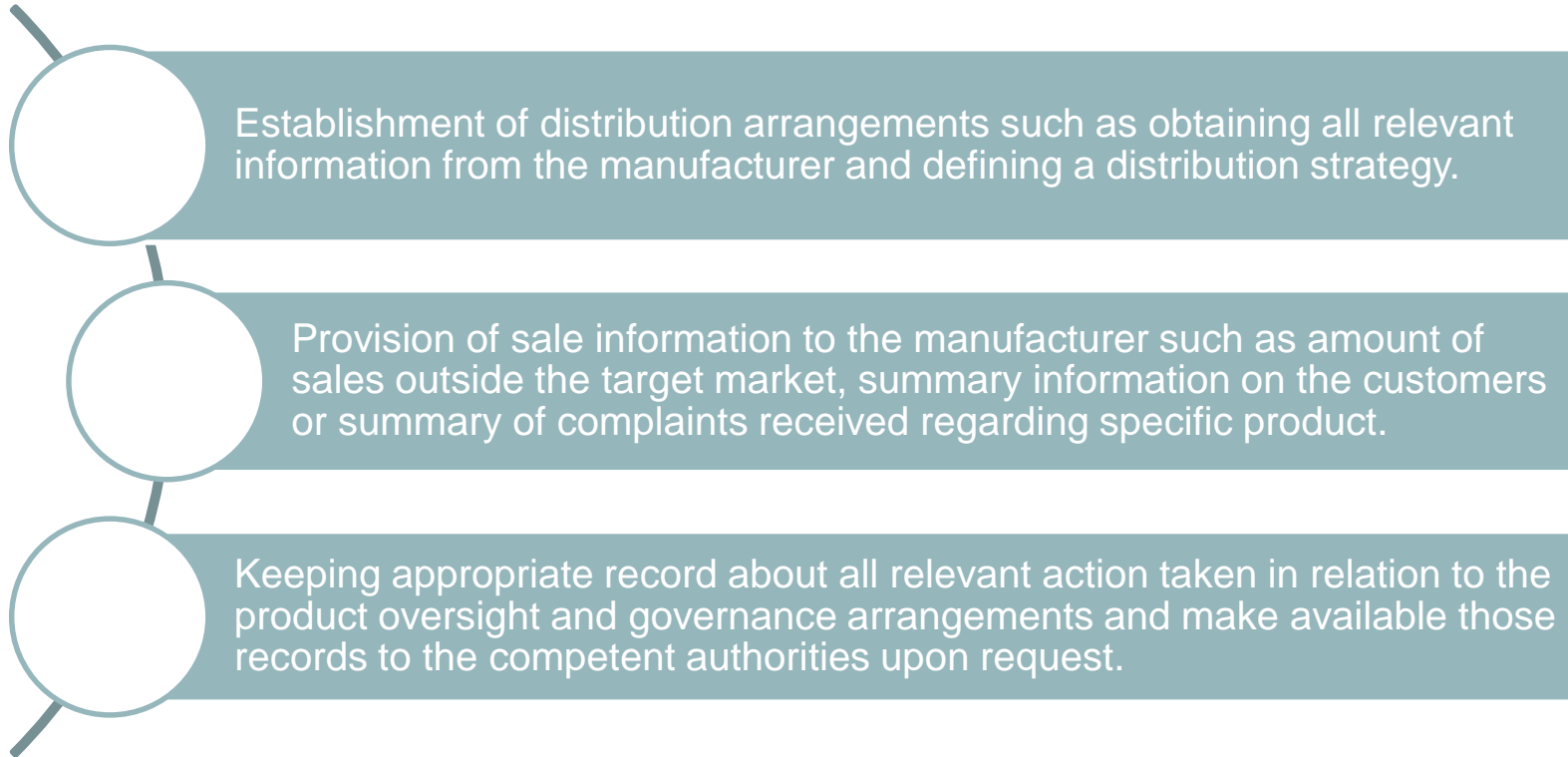
- Article 25 requires insurers and intermediaries to maintain, operate and review an approval process 1) pre-launch and 2) pre-significant adaptations of products
- The product approval process must be proportionate and appropriate to the product
- Chapter VII of the IDD deals with sanctions and other measures for failure to comply with the requirements of the Directive.
- Fines can also be imposed on “natural persons” (this might include directors and managers) as well as legal entities.
- The Commission will adopt a Delegated Act relating to Article 25 – this will flesh out the detail.

2. EU Regulatory Developments

- EIOPA Preparatory Guidelines on Product Oversight and Governance (“**POG**”) arrangements by insurance undertakings and insurance distributors.
- POG Guidelines introduce explicit processes and measures relating to design, development and monitoring of new insurance products.
- Product Oversight and Governance (“**POG**”) Preparatory Guidelines – Role of the manufacturer’s board:
 - The Board of the manufacturer is ultimately responsible for the **establishment**, subsequent **reviews** and continued **compliance** of the product oversight and governance arrangements. The Board also ensures that the product oversight and governance arrangements are **appropriately designed and implemented** into the governing structures of the manufacturer.
 - The product oversight and governance arrangements, as well as any material changes to those arrangements, are subject to **prior approval by the Board**.

2. EU Regulatory Developments

- POG Preparatory Guidelines
 - Distributor's requirements



Insurance Distribution Directive (“IDD”) Cotd.

- Commission and EIOPA regard POG as playing a key role in consumer protection – 1) ensure products meet target market needs and 2) mitigate risk of mis-selling

Administrative Sanctions & Other Measures

- Article 33(1) of IDD – provides for “*effective, proportionate and dissuasive*” sanctions / measures to be introduced by Member-States
- Article 35(1) of IDD – effective mechanisms for ‘whistle-blowing’ required
- Irish approach to transposition of IDD awaited!

3. Compliance Statements

- The emerging practice of requiring directors to provide annual compliance and accuracy certificates creates greater risks for directors
- This makes it more difficult for directors to deny responsibility, and therefore liability, because generally some or all of the directors will have signed the compliance statement
- Important that directors recognise and manage those risks
- Need for greater reliance on appropriate systems and arrangements that are designed to secure material compliance
- Directors could consider receiving appropriate confirmations from management and service providers

3. Compliance Statements

- Central Bank Act, 1997 – Section 25 Compliance Statement
- Corporate Governance Requirements for Insurance Undertakings 2015
- EU(Insurance and Reinsurance) Regulations 2015 – Directors' Accuracy Certifications
- Section 225, Companies Act 2014

3. Compliance Statements

Section 25, Central Bank Act 1997

- Empowers CBI to require RFSPs to comply with “*relevant obligations*” or with as much of them as are specified in the notice.
- Section 25(4) requires RFSPs to provide a compliance certificate
- “*Relevant obligations*” comprise:
 - All designated enactments and all designated statutory instruments that apply to RFSPs
 - All codes, guidelines and notices issued by the CBI that apply to RFSP
 - All other enactments and S.I.s with which it must comply
- Note: CBI can select which “*relevant obligations*” are the subject of the Compliance Statement

3. Compliance Statements

- Note that this power to request a Compliance Statement applies to all regulated financial service providers (not just (re)insurers)
- CBI has power to extend the scope of the Directors' Compliance Statement requirement to include other codes and legislation (e.g. CPC and Data Protection Acts)
- Section 27(A)(1), CBA 1997 empowers the CBI to issue guidelines with which a compliance certificate must comply

3. Compliance Statements

Corporate Governance Requirements for Insurance Undertakings 2015

- Compliance Certificate requirement – Section 26 of the Requirements – to be issued “*in accordance with any relevant guidelines issued by the Bank*”
- To be issued annually “*or with such other frequency*” as the CBI may notify the (re)insurer from time to time (e.g. following an ASP)
- Requirement is that of the (re)insurer – yet the template requires all of the directors to sign

3. Compliance Statements

CBI Guidelines for Solvency II (re)insurers on Directors' Certifications

- Scope of these guidelines is narrower than Section 25 of the Central Bank Act, 1997
 - “Insurance Acts” (as defined in the EU (Insurance & Reinsurance) Regulations 2015
 - EU (Insurance and Reinsurance) Regulations 2015
 - Applicable EU Delegated Regulations and Implementing Regulations where designated as designated enactments by S2(2A) of CB Act 1942
 - Respective Corporate Governance Requirements for (re)insurers 2015 and for captives

3. Compliance Statements

- Directors must certify “*material*” compliance with relevant obligations
- Directors accuracy certificate (Regulation 36 of the 2015 Regulations) – “*attesting the accuracy of the information submitted*”
- No materiality qualification included in Reg 36
- **New Conditions of Authorisation**
 - New condition imposed requiring that a (re)insurer shall not in any circumstances provide the CBI with:
 - a) False or misleading statements concerning its operation; or
 - b) Information which it knows or ought reasonably to know to be false or misleading.

3. Compliance Statements

Section 225, Companies Act 2014

- Applies to all plcs and large private companies (ie gross assets exceeding €12.5m and turnover exceeding €25m for the year)
- Directors' Compliance Statement (forms part of the annual report)
- Directors **acknowledge** that they are **responsible** for **securing compliance** with the company's "relevant obligations"

3. Compliance Statements

- “Relevant obligations” for this purpose are:
 - All tax laws
 - Serious market abuse, transparency and prospectus provisions
 - Breaches of CA 2014 constituting a category 1 (fines up to €500k) or category 2 (fines up to €50k) offence
- Compliance Statement must also confirm that the Company:
 - has a compliance policy statement
 - appropriate arrangements or structures that, in the directors’ opinion are designed to secure **material compliance** with the Company’s “relevant obligations”
 - has reviewed those arrangements **during** the financial year

3. Compliance Statements

- Appropriate arrangements or structures may include reliance on the advice of employees and advisers with the relevant experience.
- Comply or Explain philosophy.

4. Central Bank's Fitness and Probity Regime

- Central Bank Fitness and Probity Regime (“**F&P Regime**”) arose from Part 3 of the Central Bank Reform Act 2010 and related regulations and came into effect in 2011 for all regulated financial services providers
- Currently, 46 senior positions prescribed as PCFs requiring prior approval
- Includes Directors, Non-Executive Directors, Chairman, CEO and a range of other senior management positions
- Central Bank Fitness and Probity Standards 2011 sets out the key standards required of all PCFs / Directors, as follows:
 - Competent and capable;
 - Honest, ethical and to act with integrity; and
 - Financially sound.
- *Remember* – **ongoing** compliance with Standards is essential and annual reporting requirements must be adhered to.
- F&P Regime represents a constant challenge and risk to all Directors.

4. Fitness & Probity Regime – Case Studies

- **October 2016** - the Irish Financial Services Appeals Tribunal upheld the Central Bank's decision to refuse a retail intermediary's application for authorisation on the basis that the Applicant failed to satisfy the fitness and probity requirements.
- Key failings identified were as follows:
 - Applicant failed to satisfy the Central Bank as to his knowledge of the business of a retail intermediary and the legal and regulatory requirements that apply;
 - Applicant's **former** firm failed to comply with the F&P regime (and with reporting of regulatory returns);
 - Applicant failed to investigate and take action in relation to allegations that he had made of irregular conduct by a co-director (forging of signatures);
 - Former firm (of which Applicant a director) was convicted in the District Court for failing to file an annual return with the CRO under **company law**.
- **May 2016** - Central Bank issued Prohibition Notice against Mr Darren Gleeson, a director of a retail intermediary firm, prohibiting him from carrying out **any CF or PCF role** in any regulated financial services provider for an **indefinite period**.

4. Central Bank's Fitness and Probity Regime

- **Protected disclosure obligation on PCFs**
 - Section 38(2) of the Central Bank (Supervision and Enforcement) Act, 2013.
 - Obligation on PCF-holders to disclose to the Central Bank, as soon as practicable, information which PCF believes will be of material assistance to CBI related to specified matters = protected disclosure.
 - Industry letter dated 5 November 2014 from Central Bank drawing attention to certain provisions around protected disclosures specifically:
 - Highlighting the aim of the Central Bank (Supervision and Enforcement) Act, 2013 is to encourage persons to make protected disclosures to the Central Bank and that the person's name will not be made public without consent.
 - reiterating the obligation on PCFs to disclose alleged breaches **as soon as it is practicable**.
 - The Protected Disclosures Act 2014 now provides protections to workers in all sectors, not just PCFs.

5. Enforcement

- Outline of Administrative Sanctions Procedure (“**ASP**”)
- Settlement Agreements – lessons and deterrents
- Sanctions
- Referral to prosecuting or disciplinary bodies
- *Appendix* – Process for Investigations and Inquiries

5. Outline of the Administrative Sanctions Procedure

- Enforcement power of the CBI, deriving from the Central Bank and Financial Services Authority of Ireland Act, 2004 and strengthened by the Central Bank (Supervision and Enforcement) Act, 2013.
- The power to administer sanctions in respect of “prescribed contraventions” by “regulated financial services providers”.
- The definition of a “prescribed contravention” in the Central Bank Act 1942 is extremely broad and includes:
 - contravention of a designated enactment or a designated statutory instrument; or
 - a code made or a direction given under such a provision; or
 - any condition or requirement imposed under a provision of a designated enactment, designated statutory instrument, code or direction; or
 - Any obligation imposed on any person by Part IIIC of the Central Bank Act 1942 or imposed by the CBI pursuant to a power exercised under that Part.
- The ASP applies to a regulated financial service provider and persons concerned in the management of a RFSP.
 - Very broad definition of person concerned in management; includes any person “*in any way involved in directing, managing or administering the affairs of the body or firm*” – not just directors.
 - Focus more likely on individuals if management failures instrumental

5. Outline of the Administrative Sanctions Procedure

- Where concern arises that a prescribed contravention has been or is being committed, the CBI's Enforcement Directorate may investigate.
- The ASP is an umbrella term comprising several stages:
 - Investigation;
 - Inquiry (following an investigation the CBI may hold an Inquiry where there are reasonable grounds to suspect that prescribed contravention has been or is being committed);
 - Sanctions;
 - Appeal to the Irish Financial Services Appeals Tribunal;
 - Appeal to the High Court.
- At any stage up to the imposition of a sanction, the CBI and the regulated entity/person concerned may resolve the matter by entering into a written, binding settlement agreement.
- The terms of the settlement agreement may contain sanctions referred to in Section 33AQ of the Central Bank Act, 1942 and will invariably stipulate that a public statement containing details of the settlement agreement will be published.

5. Settlement Agreements

- Since the commencement of the ASP in 2006 there have been 103 published settlement agreements.
- Entry into a settlement agreement will be conditional upon all relevant facts known to the regulated entity having been openly disclosed by the regulated entity.
- There is no obligation on the CBI to enter into a settlement agreement.
- Settlement Agreements are possible up to the conclusion of an Inquiry.
- All negotiations are conducted on a “*without prejudice*” basis.
- Where a regulated entity settles a matter at an early stage with the Central Bank, a discount may be applied to the sanction, which can be up to 30%.
- Both parties must adhere to the terms of the settlement agreement. If the regulated entity fails to do so, the CBI may apply to the High Court for an order requiring compliance and/or monetary penalty.
- If further material information emerges after the conclusion of a settlement agreement, the CBI is not precluded from re-opening an investigation.

5. Settlement Agreements

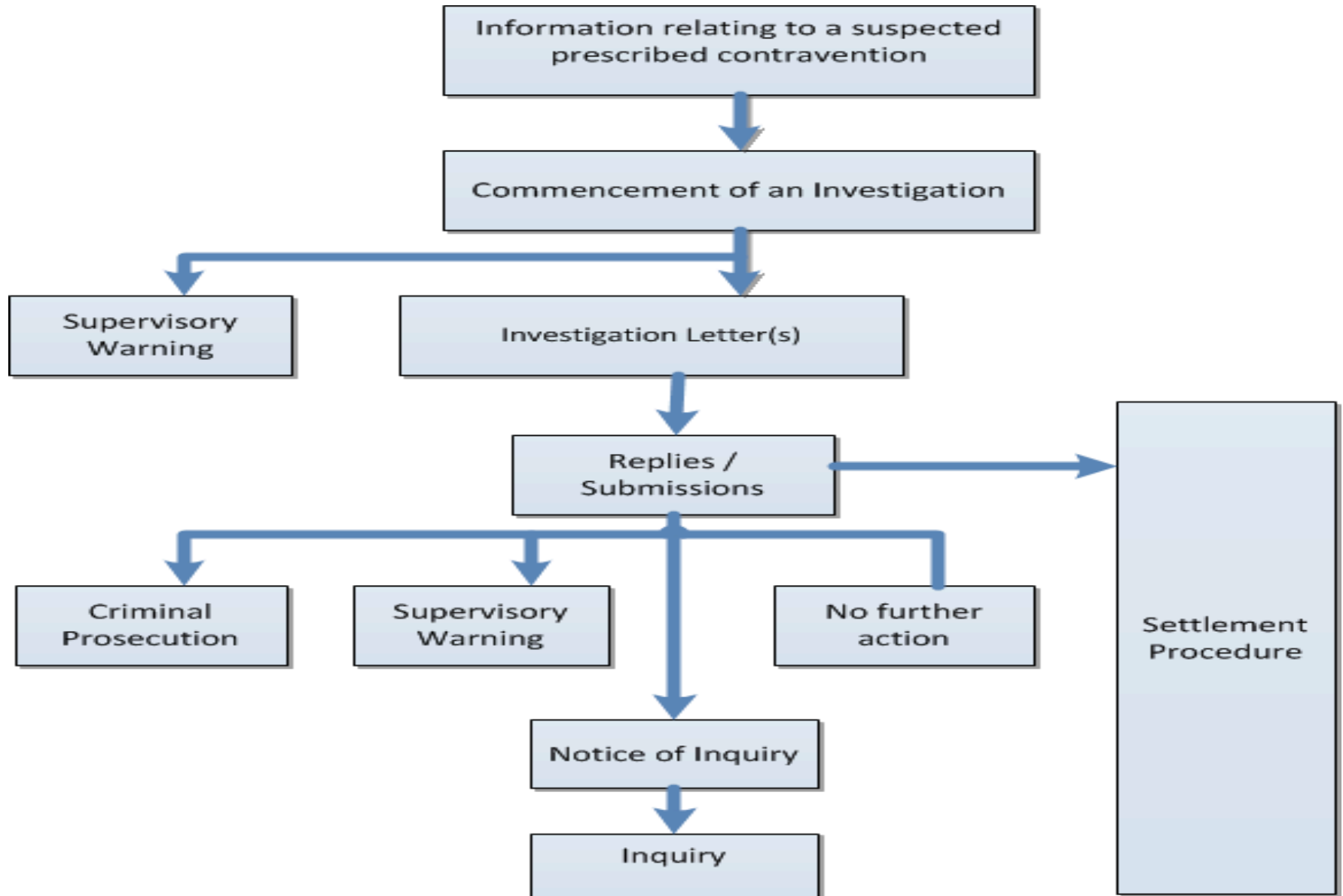
- Settlement agreement between Quinn Insurance Limited (“**QIL**”), Mr Sean Quinn Senior and the CBI dated 24 October 2008.
 - Example of imposition of liability on a director
 - There were suspected breaches of regulatory requirements related to contraventions by QIL of its obligations under the Insurance Acts and Regulations, including failing to notify the Financial Regulator prior to providing loans to related companies. Both the regulated entity and Mr Quinn as a “person involved in management of the regulated financial service provider” were pursued.
 - QIL was required to pay €3,250,000.
 - Mr Quinn was required to pay €200,000 (the maximum fine at the time was €500,000).
 - Mr Quinn stood down as Chairman and as Director.
 - QIL confirmed that no consequences has arisen for any of its policyholders as a result of suspected breaches.

- Settlement agreement between Smyths Insurance Brokers Ltd & Raymond Smyth dated 10 September 2013
 - Specific reference to responsibility of the director
 - There were breaches of the Consumer Protection Code 2006 and wrongful debits were made from the client premium account to the office account.
 - The CBI reprimanded Mr Smyth and disqualified him from being a person concerned in the management of a regulated financial services provider for 3 years.
 - The insurance intermediary firm was reprimanded and fined €12,000.
 - As regards Mr Smyth, the CBI deemed him to have acted deliberately and it was his actions that caused the firm to breach provisions of the Consumer Protection Code 2006.

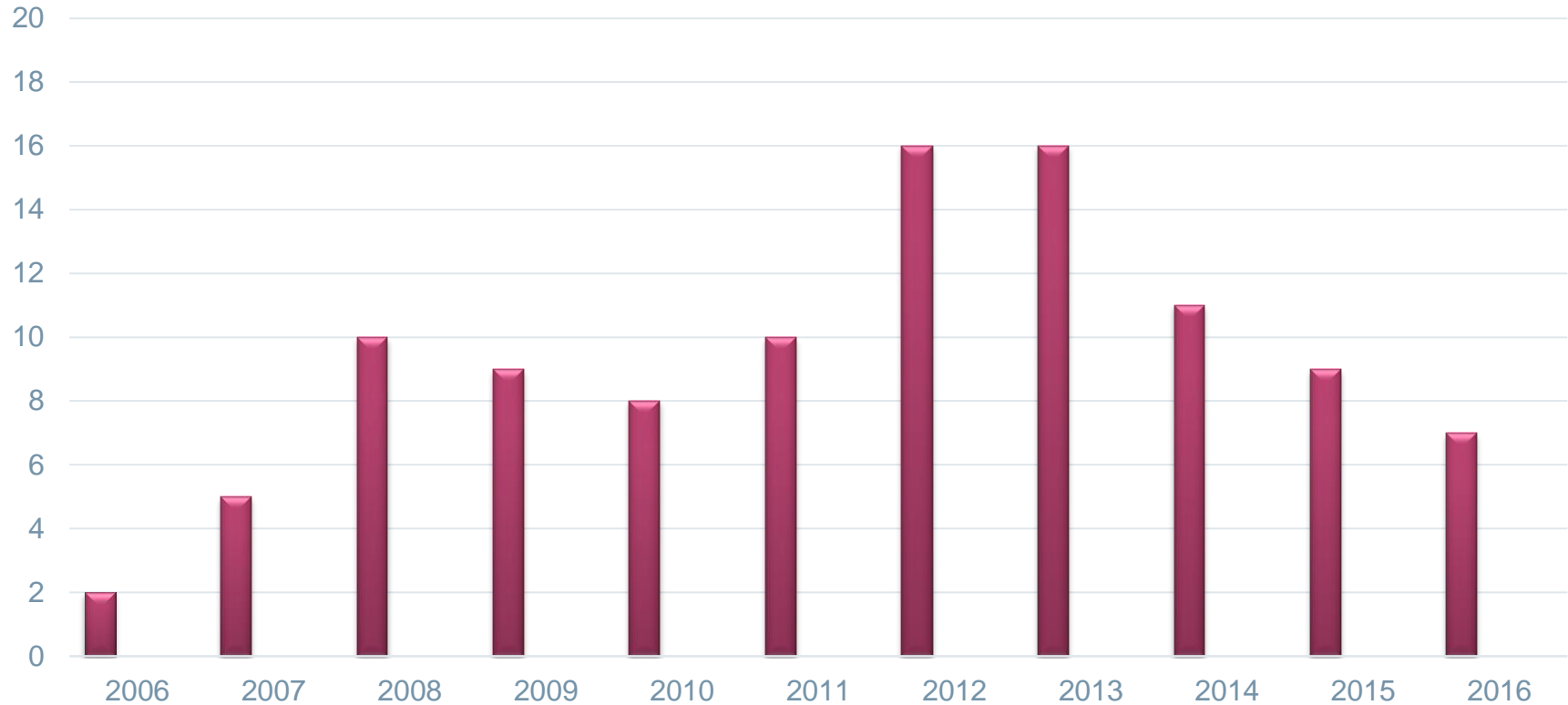
5. Settlement Agreements

- Settlement agreement between Arch Reinsurance Europe Underwriting DAC and the CBI dated 15 March 2016
 - Example of the importance of complying with Codes as well as legislation
 - The firm breaches the Corporate Governance Code for Credit Institutions and Insurance Undertakings 2010. The firm failed to comply with the standards contained therein because 1) some of its internal controls were not sufficiently robust, 2) its Risk Committee was not sufficiently effective and 3) it failed to adequately oversee its subsidiary.
 - The CBI issued a fine of €275,000 and a reprimand to the firm.
- A key negative aspect of the Administrative Sanctions Procedure and the Settlement Agreements is that the CBI will publish the material findings on its website. This obviously has serious reputational effects on the firm and individuals concerned.

5. Settlement Agreements – Process Flow Chart



5. Settlement Agreements



WF-18028787-v1

Source: Central Bank of Ireland website

5. Sanctions

- The types of sanctions that can be imposed are set out in the Central Bank Act 1942 (as amended) and include:
 - caution or reprimand;
 - Fines
 - Up to €10m (or 10% of turnover) for firms;
 - Up to €1m for natural persons i.e. directors.
 - Direction disqualifying a person from being concerned in the management of a regulated financial service provider;
 - Suspension of the authorisation of the regulated entity;
 - revocation of the regulated entity's authorisation;
 - Direction to cease a contravention, if it is found that the contravention is continuing; and
 - Direction to pay to the Central Bank all or a specified part of the costs incurred by the Central Bank.
- Sanctioning factors
 - The nature and seriousness of the contravention;
 - The conduct of the regulated entity after the contravention;
 - The previous record of the regulated entity;
 - Other general considerations.

5. Referral to prosecuting or disciplinary bodies

- During the course of the ASP, the CBI has various reporting obligations in circumstances where information obtained gives rise to a suspicion of a criminal offence, a breach of company law, or a breach of competition law.
- Relevant authorities include An Garda Síochána, the Revenue Commissioners, the Directors of Corporate Enforcement, the Competition Authority and the Competition and Consumer Protection Commission.
- Where both the ASP and summary criminal prosecution are available, the CBI has discretion to choose having regard to the DPP's "Guideline for Prosecutors".
- No criminal prosecution may be brought if the prescribed contravention is dealt with by way of the ASP and resulted in a monetary sanction.

6. Minimising Risk Exposure – Key Points!

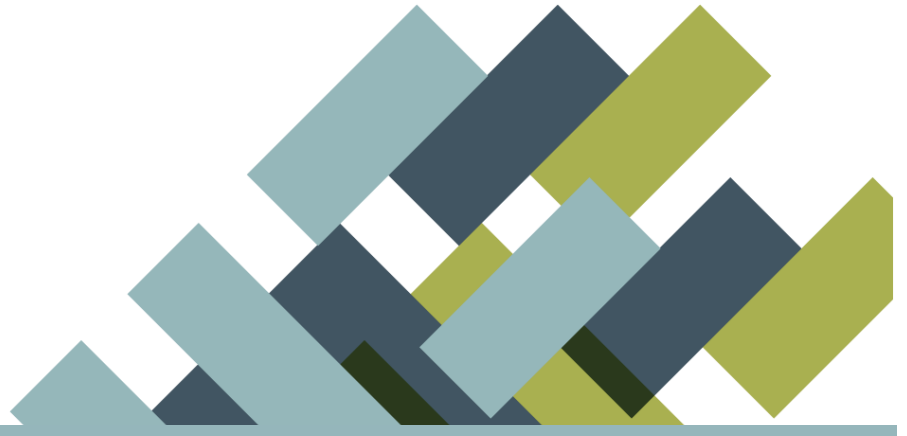
- Due diligence before accepting appointment on:
 - group\company
 - existing board members
 - prior regulatory\compliance record
 - extent of commitment required
 - how will communication\engagement occur
 - check out D & O policy
- If it does not seem right, do not do it!
- Comply with fiduciary duties as per S.228 CA 2014
- Ensure your company is monitoring what issues are trending with CBI (eg cyber security, AML, outsourcing of CIFAs, embedding risk culture in organisation, etc)
- Rely on management / service providers only where appropriate.
- Objectively appraise persons proposed for PCF and CF roles – do they satisfy the fitness and probity tests?

6. Minimising Risk Exposure – Key Points!

- Keep up-to-date with legal and regulatory developments
- Ensure that your company has fully transitioned to SII
- Where appropriate constructively challenge management views - ensure that minutes reflect this challenge and follow-up is important
- Ensure company complies with adopted policies and procedures
- Company must also review policies and procedures for continued relevance (possibly annually)
- Directors should not be reluctant to seek professional advice where necessary.

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Questions & Answers



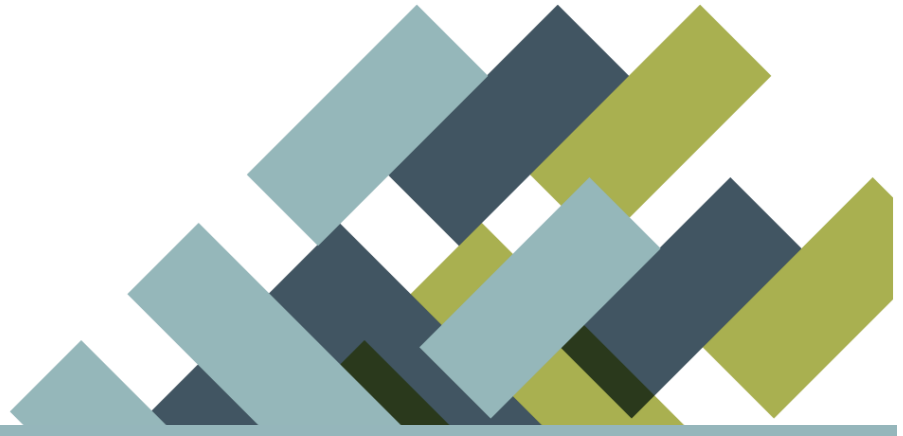
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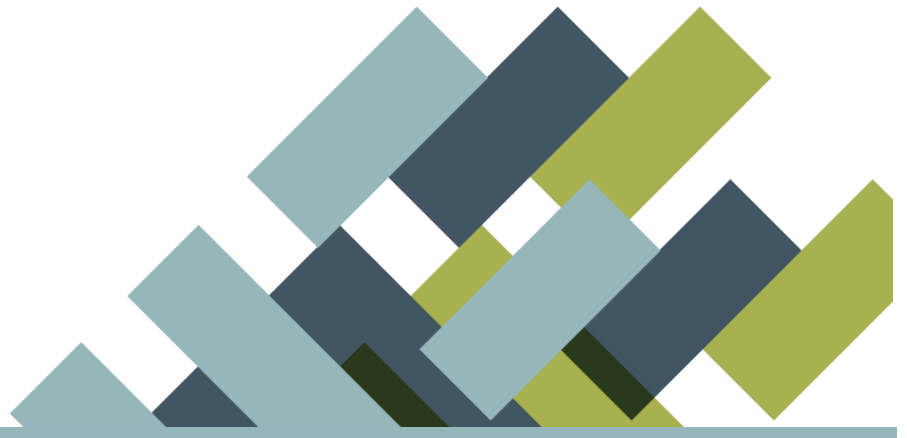
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Appendix

Process for Investigations and Inquiries



Appendix: Investigation / Inquiry Process

	Process (Investigation)
↓	Investigation Letter – will outline suspected prescribed contravention and call for a response from the RFSP
↓	Responses received and RFSP will justify and explain its circumstances - must be open and truthful
↓	CBI will continue gathering evidence, possibly through interview
↓	Interviewees may have recourse to own legal advice
↓	CBI may be obliged to report matters to other authorities, if, during the course of its investigations, it suspects a breach of another law (eg the ODCE; the DPC or CCPC)
↓	If both ASP and summary criminal protection are available, CBI will decide which to pursue – both are not an option
↓	Once investigation is concluded, CBI will either (i) take no further action (ii) issue a supervisory warning (iii) take a supervisory action (iv) agree a settlement; (v) refer the case to Inquiry for determination and sanction, (vi) initiate summary criminal prosecution; or (vii) refer the case to another authority or the Garda Síochána.

Appendix: Investigation / Inquiry Process

Process (Inquiry)

Investigation concludes with reasonable grounds to suspect that prescribed contravention has been or is being committed

CBI's Enforcement Directorate will prepare an Investigation Report for the CBI's Regulatory Decisions Unit.

One or more Inquiry Members will be appointed from a panel.

The regulated entity/person concerned will be sent a Notice of Inquiry, the Investigation Report and an Inquiry Management Questionnaire dealing with issues such as scheduling, legal representation, witnesses, experts.

There will likely be one or more Inquiry Management Meetings to decide procedural matters and preliminary applications (such as applications for private hearings, documents) before the hearing of the Inquiry proper.

Hearing of Inquiry proper.

Inquiry Members deliver written findings.

Appendix: Inquiry – key process issues

- Inquiry Members are “agents” of the CBI.
 - quasi-independent of the Central Bank.
 - can be employees of the Central Bank or other individuals.
 - current panel of potential members includes financial services professionals, retired High Court judges.
- Inquiries will normally be held in public, absent unfair prejudice to reputation, or the potential to hear evidence that is confidential or relates to the commission of a criminal offence.
- Inquiry Members appoint their own legal team to advise it during the course of the Inquiry.
- Considered to be inquisitorial, rather than adversarial.
- Inquiry Members have the power to summon witnesses to give evidence under oath.
- Standard of proof is the civil standard – the balance of probabilities.
- No ability to recover legal costs, win or lose.

Appendix: Inquiry

- Three Inquiries underway:
 1. Irish Nationwide Building Society and certain persons concerned in its management (*9 July 2015 – alleged failures in lending practices*)
 2. Persons concerned in the management of Quinn Insurance Limited (Under Administration) (*11 November 2015 – alleged breach of European Communities (Non-Life Insurance) Framework Regulations 1994*)
 3. Unknown Insurance Intermediary (*10 February 2016 – alleged failure to hold satisfactory professional indemnity insurance*)
- Constitutional challenges to ASP powers ongoing through courts. The High Court has said powers are constitutional, but expectation is the issue will ultimately be decided by the Supreme Court in the coming years.