Settlement Agreement between the Central Bank of Ireland and Quinn Insurance Limited (Under Administration)

The Central Bank of Ireland ("the Central Bank") has entered into a Settlement Agreement with effect from 18 February 2013 with Quinn Insurance Limited (Under Administration) ("the firm"), a regulated financial services provider, in relation to breaches of article 10(3) and article 13(1)(b) of the European Communities (Non-Life Insurance) Framework Regulations 1994, as amended ("the 1994 Regulations").

Reprimand and Monetary Penalty

The Central Bank reprimanded the firm.

The Central Bank considers that the contraventions committed by the firm merit the maximum monetary penalty that can be levied by the Central Bank on a regulated financial services provider, namely €5 million.

However, the firm is under administration and is entirely reliant on funding from the Insurance Compensation Fund. In these wholly exceptional circumstances, the Central Bank has decided that it is in the public interest to waive the monetary penalty in its entirety.

Breaches

The breaches identified are:

1. Between 6 October 2005 and 29 March 2010 inclusive, prior to the administration, the firm had no adequate procedures or

controls to manage assets representing its technical reserves in contravention of article 10(3) of the 1994 Regulations which requires every insurance undertaking to have administrative and accounting procedures and internal control mechanisms which are sound and adequate. The board of the firm was unaware that its subsidiaries had guaranteed Quinn group debt up to €1.2 billion. These guarantees were effected with no consultation with the firm's full board or investment committee; and

2. The firm failed to maintain an adequate solvency margin in contravention of article 13(1)(b) of the 1994 Regulations which requires all firms to maintain a minimum solvency margin. As at 31 December 2009, the firm had a solvency margin of minus 250%, namely a shortfall of €830 million in its assets, as evidenced in its 2009 regulatory return.

Background

Following an application by the Central Bank to the High Court, provisional Joint Administrators were appointed to the firm on 30 March 2010. On 15 April 2010 the High Court ordered that the firm be placed into administration and confirmed the appointment of Paul McCann and Michael McAteer of Grant Thornton as Joint Administrators. The firm consented to the administration.

The Central Bank brought the application on account of various facts coming to its attention. Thirty five subsidiaries of Quinn Group Limited ("QGL") (the firm's ultimate parent company) had provided guarantees in respect of borrowings by QGL of up to €1.2 billion under various financing agreements entered into by QGL ("the Guarantees"). Under

the terms of the Guarantees, the guarantors were jointly and severally liable, leaving each guarantor potentially liable for the full guaranteed amount of approximately €1.2 billion. Eight of the guarantor subsidiaries were directly or indirectly owned by the firm[1].

By virtue of article 13(1)(a) of the 1994 Regulations, each non-life insurance undertaking is required to maintain technical reserves in respect of all underwriting liabilities assumed by it. Between the 6 October 2005 and 29 March 2010 the assets of the firm's subsidiaries formed part of the firm's technical reserves.

Shortly after the appointment of the Joint Administrators, the Central Bank commenced an Examination into the circumstances surrounding the giving of the Guarantees by the firm's subsidiaries, in accordance with the Administrative Sanctions Procedure.

A lengthy and detailed Examination against the firm then ensued culminating in the settlement agreement with the firm dated 18 February 2013. The breaches described below, all of which pre-dated the administration, have been admitted by the firm.

Breach of article 10(3) of the 1994 Regulations

The breach of article 10(3) concern the firm's failure to have in place adequate administrative procedures or internal control mechanisms in relation to the management and monitoring of the assets of the firm's subsidiaries. Such procedures were required because the assets of

[1] The 8 guarantors were Quinn Property Holdings Limited, Shamrock Public Houses Limited, Quinn Public Houses Limited, Quinn Hotels Limited, Mantlin Limited, Quinn Investment Holding AG, Compagnie Des Hotels De Luxe S.A., and Wawel Hotel Development SP ZOO. Of these 8 subsidaries, QPH is 100% owned by the firm and the other 7 are QPH subsidiaries.

the firm's subsidiaries covered a significant part of the firm's technical reserves.

The business and certain financial functions of the firm's subsidiaries were managed by QGL rather than by the firm. The firm was obliged to ensure that assets were properly supervised and that any material decisions concerning them were entered into only in accordance with the firm's approved policies and procedures. The only procedures which were introduced by the firm for this purpose were two resolutions which were passed by the firm's board on 4 December 2001 and 28 March 2008 respectively.

On 4 December 2001 the firm's board resolved that "*...any material changes in relation to subsidiary companies should be brought to the attention of the board in advance via its Investment Committee.*" ("the 2001 resolution").

Following certain regulatory concerns coming to the attention of the Central Bank, the firm's board resolved on 28 March 2008 that:

> *"In the context of QIL being in the unusual position of being a privately owned company whose shareholders hold senior executive positions in a regulated entity a resolution was proposed and agreed by the board stating:*
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> *All decisions that, in the opinion of one or more board members, could have a material impact on the company fulfilling its regulatory requirements, the company's reputation or its financial position are made at board meetings and minuted as such...".*

On this date, the firm's board also agreed that in the event of any such decision not being made through the board, then all directors would have a duty to report any such breach of this resolution to the firm's board and to the Central Bank, to the extent that the decision breached any standing arrangements with the Central Bank or any statutory requirements ("the 2008 resolution").

While these resolutions required material developments in relation to the firm's subsidiaries to be brought to the attention of, and voted on, by the firm's board, the firm established no further procedure to ensure the implementation of, or compliance, with either resolution.

As a result, the terms of the 2001 resolution were subsequently breached on three separate occasions when steps were taken which allowed certain of the firm's subsidiaries, without consulting the firm, to guarantee the borrowings of QGL pursuant to various financing agreements entered into by QGL between October 2005 and April 2007.

It was only in April 2009, at a point after the common directors of the firm and the subsidiaries had stepped down from the firm's board, that the firm introduced a compliance procedure in relation to its subsidiaries. This procedure required the subsidiaries to confirm that matters reserved for approval by the firm's board of directors would be reported to the firm, by the subsidiaries, in an appropriate and timely manner.

Pursuant to the Guarantees, certain of the firm's subsidiaries (along with various other companies) were jointly and severally liable for the full amount of up to €1.2 billion advanced to QGL under the various financing arrangements. The provision of the Guarantees was a

material change in relation to the firm's subsidiaries which was required by the 2001 resolution to be brought to the attention of the full board of the firm via its Investment Committee. This did not occur.

Instead, two of the directors of the firm purportedly held board meetings of the firm on 6 October 2005, 18 April 2006 and 28 March 2007, at which the firm purportedly authorised Quinn Property Holdings Limited ("QPHL") to provide Guarantees in respect of the financing agreements. QPHL was the holding company of the firm's other guarantor subsidiaries and therefore capable of authorising their subsequent entry into the Guarantees.

No notice was given to the full board of the firm or to its Investment Committee of the decisions which were proposed to be made at each of the purported board meetings. Furthermore, despite the 2008 resolution, the Central Bank was not informed of the Guarantees until 24 March 2010 and the firm's full board was not made aware of the Guarantees existence until in or around 26 March 2010.

In addition to a failure to comply with the 2001 resolution, the purported board meetings did not comply with the firm's Articles of Association. No notice was given to the firm's full board of directors in advance of these meetings being convened and the purported board meetings which were held on 18 April 2006 and 28 March 2007 did not have a sufficient quorum for a valid board meeting.

Breach of article 13(1)(b) of the 1994 Regulations

As at 31 December 2009, the firm failed to maintain the required solvency margin, which in the firm's case was €236 million. Instead,

the firm had an asset shortfall of approximately €830 million, as evidenced by its 2009 regulatory return. Accordingly, the firm was insolvent at this date.

Penalty Decision Factors

The Central Bank is of the view that the firm's conduct merits the highest monetary penalty of €5 million. The penalty decision factors are as follows:

1. The firm failed to comply with its minimum solvency requirement. This is a breach of the most fundamental regulatory requirement for a non-life insurance undertaking namely the obligation to ensure it is sufficiently solvent to meet its liabilities to policyholders.

2. The scale of the breach of the required solvency margin was unprecedented for an insurance company regulated by the Central Bank, being minus 250% of its minimum required solvency margin. This was a shortfall in its assets of €830 million, as evidenced by its 2009 regulatory return.

3. The assets of the firm's subsidiaries were used by the firm to cover its technical reserves but many were managed outside the firm by its unregulated parent. The firm's systems and controls for the management and monitoring of the activities of these subsidiary companies were inadequate.

4. The decision to enter into the Guarantees was a very significant one with potentially far reaching consequences for the firm's assets and its ability to meet policyholder liabilities. As such, it

merited serious consideration by the firm's board and Investment Committee. Instead, the Guarantees were effected contrary to the clear directions of the board as recorded in the 2001 resolution. As a result, the firm's board was not aware of the Guarantees.

5. The firm's failures as described above contributed substantially to the firm entering into administration.

6. In reporting to the High Court, the Joint Administrators have estimated that a call on the Insurance Compensation Fund could be in the region of €1.65 billion. They determined that an application to the Insurance Compensation Fund was necessary to ensure that all of the firm's liabilities would be discharged. The failures described above also contributed to the necessity for this call to be made on the Insurance Compensation Fund.

7. The firm is substantially reliant on the Insurance Compensation Fund for financial support and therefore public funds have been expended in order to deal with some of the consequences of the conduct.

A serious aggravating feature of this case is that this is the second time that enforcement action has been taken against the firm. On 24 October 2008 and following an investigation which commenced in February 2008, the Central Bank entered into a Settlement Agreement with the firm and required it to pay a monetary penalty of €3.25 million in respect of breaches by the firm of its obligations under the Insurance Acts and regulations, including failure to notify the Central Bank prior to providing loans to related companies. At that time, this was the highest monetary penalty to have been imposed by the

Central Bank on a regulated financial services provider. There are material similarities with this case, in that both concern the unauthorised use of the regulated firm's assets for the benefit of other companies within the wider group.

Additionally, this has been a complex and lengthy investigation involving the commission of significant resources by the Central Bank. In such investigations, the Central Bank considers it appropriate that the costs of the investigation are recouped from the sanctioned firm or individuals.

Despite the penalty decision factors listed above, the Central Bank recognises that there are exceptional and unprecedented circumstances in this case, including a need to act in the wider public interest.

The firm is currently under administration and does not have the resources to pay the proposed monetary penalty or indeed, any monetary penalty. Further, any monetary penalty imposed would ultimately be financed from the Insurance Compensation Fund and therefore, indirectly through contributions made by non-life insurers and the levy imposed on all Irish motor and home policyholders.

In recognition of these factors and so as to ensure there is no further draw on the Insurance Compensation Fund and in turn the Irish public, the Central Bank has waived the monetary penalty it would otherwise have required the firm to pay and has not sought to recoup investigative costs from the firm.

The Central Bank recognises the co-operation provided by the firm's Joint Administrators during the course of this Examination.

The Central Bank confirms that its investigations against the firm are now closed. Other investigations by the Central Bank remain ongoing.

- End -

The Central Bank of Ireland has entered into a Settlement Agreement on 18 February 2013 with Quinn Insurance Limited (Under Administration) ("Quinn Insurance"), a regulated financial services provider, in relation to breaches of the European Communities (Non-Life Insurance) Framework Regulations 1994.

The Central Bank of Ireland also issued a comment by Derville Rowland, Head of its Enforcement 1 Division:

"The facts of this case contributed to the failure of one of the State's largest insurers, an event which has had severe financial consequences for Ireland's insurance industry and the Irish taxpayer.

Prior to Quinn Insurance being placed into administration, it failed to ensure proper oversight of its subsidiaries. Certain of these subsidiaries, on which Quinn Insurance was dependant for its technical reserves, entered into significant financial guarantees. Quinn Insurance was blind to these guarantees; its board never had opportunity to consider them or their implications. The controls to manage the firm's subsidiaries were evidently deficient.

This is a repeat offence which is a significant aggravating factor. The firm had a monetary penalty of €3.25 million imposed in October 2008 for similar breaches.

This case therefore warrants the maximum monetary penalty which the Central Bank can impose, namely €5 million. The penalty has been waived for public interest reasons linked to the exceptional financial circumstances of the firm which is now dependent on the Insurance Compensation Fund.

While this enforcement action came too late to prevent the failure of the firm, there are important lessons to be taken from it. First, firms should never underestimate the importance of good governance and robust controls in running their business. It must be a priority for every firm to monitor compliance with its procedures and internal mandates. If there are issues with non-compliance, firms must take immediate action to strengthen internal controls. Second, firms must regularly review the adequacy of their controls to ensure that that they are sufficiently aligned with the firm's business risks. It is no excuse for a firm to underestimate these risks and ultimate responsibility rests with the board of directors.

We know from recent experience that weak controls can cause firms to fail and result in systemic harm. For this reason, the Central Bank will not tolerate weak controls or governance within a firm and will take enforcement action against the firm or responsible senior management when problems arise. The Central Bank will not hesitate to impose serious penalties on firms and individuals in order to deter others from similar poor behaviour.

Finally, firms and individuals must expect full public disclosure of all relevant facts in successful enforcement action. There is a powerful deterrent impact from such disclosure. We also owe it to consumers and investors so that their confidence, so damaged in recent years, is restored in Ireland's financial services sector."

The Director of Credit Institutions & Insurance Supervision, Fiona Muldoon, has an important message for the insurance market:

"Insurers must understand that their most fundamental obligation is to ensure that their business is managed not only to maximise their profits, but also so that they are always in a position to meet their liabilities to their policyholders. Therefore insurers must hold assets to adequately cover both their technical provisions and their required solvency margin and these assets must be managed in a sound and prudent manner.

Technical reserves are held to cover the payment of future claims and should be invested in safe, appropriate, diversified and marketable investments. This requirement is the cornerstone of any insurance company's ability to meet the future claims of policyholders.

Consequently, undertakings are required to monitor, measure, report and control investment risks. In this instance, it is a matter of grave concern that the firm was unaware that certain of its subsidiaries, whose assets were being counted towards the firm's technical reserves, were jointly and severally liable on foot of guarantees to the sum of up to €1.2 billion.

Over and above technical reserves, insurance companies must also possess a supplementary reserve, known as the solvency margin – this acts as a buffer against adverse business fluctuations. The solvency margin is the key element of prudential supervision for the protection of insured persons and policyholders.

Insurers should be aware that any breach of an insurer's solvency margin, regardless of scale or excuse, is completely unacceptable. In

such circumstances, the Central Bank will take whatever action is necessary to protect policyholders."