

September 27, 2017

## U.S. and EU Sign Covered Agreement

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### Covered Agreement Between the United States and the European Union on Insurance and Reinsurance Prudential Measures Is Signed

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#### SUMMARY

On September 22, 2017, the United States and the European Union (“EU”) jointly announced the signing of the “Bilateral Agreement between the European Union and the United States of America on Prudential Measures Regarding Insurance and Reinsurance” (the “Covered Agreement”).<sup>1</sup> U.S. and EU representatives completed negotiation of the Covered Agreement on January 13, 2017, on which date the text of the Covered Agreement was submitted to Congress by the Secretary of the U.S. Department of the Treasury (“Treasury”) and the Office of the U.S. Trade Representative (“USTR”) to begin a statutorily required 90-day review period. The text of the Covered Agreement signed on September 22, 2017 is identical to the text submitted to Congress in January 2017.

Treasury and the USTR also jointly issued a policy statement (the “Policy Statement”) on September 22, 2017 clarifying how the United States views implementation of certain provisions of the Covered Agreement.<sup>2</sup> According to the joint statement issued by the United States and the EU in anticipation of the signing of the Covered Agreement, the United States and EU “will now move forward to provisional application in accordance with the [Covered] Agreement.” The EU will also take the necessary steps, involving the Council of the EU and the European Parliament pursuant to the Treaty on the Functioning of the European Union, to formally conclude the Covered Agreement.<sup>3</sup>

As detailed in our January 16, 2017 [Memorandum to Clients](#), the Covered Agreement addresses three areas of prudential insurance and reinsurance supervision:

- **Reinsurance:** Subject to certain conditions, the Covered Agreement eliminates local presence and collateral requirements as a condition for entering into reinsurance agreements or obtaining credit for reinsurance for regulatory purposes. These requirements are to be eliminated for U.S. reinsurers operating in the EU market and for EU reinsurers operating in the U.S. market. The Covered

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Agreement establishes financial strength and market conduct conditions that EU and U.S. reinsurers must meet in order to be exempt from local presence or collateral requirements (e.g., maintaining minimum capital and solvency standards and a record of prompt claims payments to ceding insurers).

- **Group Supervision:** Subject to the fulfillment of certain conditions, U.S. insurance groups operating in the EU will be subject to worldwide group-level insurance prudential supervision (including group governance, solvency, capital and reporting requirements) only by the relevant U.S. insurance regulators. Likewise, EU insurance groups operating in the United States will be supervised at the worldwide group level only by the relevant EU insurance supervisors. Under the EU's Solvency II Directive (2009/138/EEC) and related regulations ("Solvency II"), EU supervisors have the ability to apply solvency and capital requirements to the worldwide operations of any U.S. insurance group operating in the EU. The group supervision provisions of the Covered Agreement are intended to preclude EU insurance supervisors from applying Solvency II group-level solvency and capital standards to U.S. insurance groups (the EU operations of U.S. insurers will, however, continue to be subject to applicable Solvency II standards). U.S. and EU supervisors will, nevertheless, preserve the ability to request and obtain information about worldwide activities if deemed necessary to protect against serious harm to policyholders, serious threat to financial stability or a serious impact on the ability of an insurer to pay claims in their respective territories.
- **Exchange of Information:** The Covered Agreement encourages insurance supervisors in the United States and the EU to exchange supervisory information. An annex to the Covered Agreement includes model provisions for a memorandum of understanding on information exchange that insurance supervisors are encouraged to adopt.

As discussed in our January 16, 2017 Memorandum to Clients, the Covered Agreement includes provisions to ensure adherence to its terms and the establishment of a Joint Committee for the parties to consult one another as needed, and sets forth, on a provision-by-provision basis, specific timelines for application and implementation of the agreement.<sup>4</sup> Following mandatory consultation, either party may terminate the Covered Agreement at any time by giving written notice to the other party.

In particular, the implementation and application timelines include:

- **Reinsurance collateral reform:** U.S. states will have 60 months (five years) from signature of the agreement to adopt reinsurance reforms removing collateral requirements for EU reinsurers that meet the prescribed conditions in the Covered Agreement. The Federal Insurance Office ("FIO") will begin the process of making potential preemption determinations of state laws that are inconsistent with the Covered Agreement after 42 months following signature of the agreement, with any preemption determination required to be completed by the end of the 60-month period.
- **EU local presence requirements:** Within 24 months from signing of the Covered Agreement, EU member states are to revise existing laws so that U.S. reinsurers can operate in the EU without establishing a branch or subsidiary.
- **Group supervision:** The EU member states will apply the group supervision measures of the Covered Agreement following signature of the agreement and completion of the EU's internal approvals for "provisional application" of the agreement. The Covered Agreement also provides that, for 60 months after the date of provisional application of the agreement, supervisory authorities in the EU shall not impose a group capital requirement at the level of the worldwide parent with regard to a U.S. insurance group with operations in the EU. After the end of such 60-month period, however, EU insurance supervisors would be able to impose a group-level capital assessment or requirement at the level of the U.S.-based worldwide parent if the U.S. insurance group is not at such time subject to a group capital assessment that includes a worldwide group capital calculation capturing risk at the level of the entire group. As discussed below, the Policy Statement affirms that development of a group capital standard or group capital requirement in the United States is not required and clarifies

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that the existing authority of state insurance regulators to apply capital measures at the insurance entity level is consistent with the terms of the Covered Agreement.

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### BACKGROUND

Under Title V of the Dodd-Frank Wall Street Reform and Consumer Protection Act (“Dodd-Frank”), the Secretary of the Treasury, acting through FIO, and the USTR are authorized to jointly negotiate covered agreements, defined under Dodd-Frank as written bilateral or multilateral agreements between the United States and one or more foreign governments, authorities or regulators regarding prudential measures with respect to insurance or reinsurance. As a condition of any such agreement, Dodd-Frank also mandates that the prudential measures subject to a covered agreement achieve a level of protection for insurance or reinsurance consumers that is “substantially equivalent” to the level of protection achieved under U.S. state insurance laws.

In November 2015, as required by Dodd-Frank, Treasury and the USTR announced to certain committees of Congress their intention to begin negotiating a covered agreement with the EU. The talks began in February 2016 and concluded in January 2017. On January 13, 2017, Treasury and the USTR submitted the text of the negotiated Covered Agreement to the Congressional committees. The Council of the EU authorized the signing of the agreement in May 2017.

Response to the Covered Agreement by U.S. stakeholders and regulators was divided following the publication of the agreement in January 2017. On the one hand, FIO, Treasury and the USTR have supported signing the agreement, as have several major U.S. insurance organizations, including the American Insurance Association (AIA), the American Council of Life Insurers (ACLI) and the Reinsurance Association of America (RAA). On the other hand, the National Association of Insurance Commissioners (“NAIC”), the National Association of Mutual Insurance Companies (NAMIC) and the National Conference of Insurance Legislators (NCOIL) have expressed concerns regarding the agreement, initially advocating that the United States reopen negotiations with the EU.

A hearing to assess the Covered Agreement was held before the House Financial Services Committee Subcommittee on Housing and Insurance on February 16, 2017, which included testimony from some of the proponents and opponents of the agreement. A similar hearing was held before the Senate Committee on Banking, Housing and Urban Affairs on May 2, 2017. In April 2017, the NAIC and certain members of Congress separately submitted to Treasury and the USTR a list of provisions in the Covered Agreement that were considered ambiguous or unclear, seeking formal clarification with respect to those provisions prior to signing and implementation of the Covered Agreement.

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### THE POLICY STATEMENT

The Policy Statement jointly issued by Treasury and the USTR addresses many of the provisions that were identified by the NAIC and others as ambiguous or unclear.<sup>5</sup> According to the Policy Statement, the

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statement is intended “to provide additional clarity for U.S. insurance regulators and industry participants with respect to the implementation of the [Covered] Agreement.”<sup>6</sup> The Policy Statement further states that the Covered Agreement “affirms the U.S. system of insurance regulation, including the role of state insurance regulators as the primary supervisors of the business of insurance.”

The Policy Statement addresses the following key areas for which clarification had been sought by the NAIC and others:

- **Application of collateral requirements:** According to the Policy Statement, the collateral elimination requirements of the Covered Agreement do not apply to reinsurance agreements entered into before the Covered Agreement’s application, or to losses incurred or reserves posted before the agreement’s application.<sup>7</sup> The Policy Statement also confirms that the Covered Agreement does not limit the ability of parties to a reinsurance agreement to renegotiate such agreement or contractually agree to collateral requirements in excess of those required by law.
- **Non-collateral requirements:** According to the Policy Statement, Article 3 of the Covered Agreement “clarifies that the Agreement does not prevent a state insurance regulator from imposing non-collateral requirements that do not have substantially the same regulatory impact as collateral requirements as conditions for ceding companies to enter into reinsurance agreements with EU reinsurers or to allow credit for such reinsurance, if the state insurance regulator applies the same requirements in the case of reinsurance agreements with U.S. reinsurers domiciled in that state.”
- **Group capital assessment:** The Policy Statement affirms that the Covered Agreement does not require development of a group capital standard or group capital requirement in the United States. The NAIC and other stakeholders in the United States have expressed concern that Article 4(h) of the Covered Agreement could be interpreted as permitting EU supervisors to apply Solvency II group capital requirements if state insurance regulators do not develop and adopt group capital requirements within five years from the signing of the Covered Agreement. Article 4(h) provides that a “host supervisor” (i.e., a supervisory authority from the territory in which an insurance group has operations but which is not the territory where the worldwide parent is domiciled or headquartered) may not impose a group capital assessment or requirement at the level of the worldwide parent, but only if the insurance group is subject to a group capital assessment imposed by its applicable supervisor in the jurisdiction where the worldwide parent of the group is domiciled or headquartered (the “home supervisor”). Article 4(h) further provides that the group capital assessment must include a worldwide group capital calculation capturing risk at the level of the entire group, and the home supervisor must “have the authority to impose preventive, corrective, or otherwise responsive measures on the basis of the assessment, including requiring, where appropriate, capital measures.”

The NAIC has been in the process of developing a group capital calculation intended to serve as an analytical tool for evaluating an insurer’s capital position at the group level, but which is not intended to be applied as a group-level capital requirement or standard. The Policy Statement provides that “[t]he United States expects that the NAIC’s group capital calculation will satisfy the ‘group capital assessment’ condition of Article 4(h), provided that the work is completed and implemented within five years of the date on which the [Covered] Agreement is signed.”<sup>8</sup> With respect to the language in the Covered Agreement requiring that home supervisors have the authority to impose preventive measures (including capital measures) on the basis of the group capital assessment, the Policy Statement states that the authority of state insurance regulators to apply capital measures at the insurance entity level (as opposed to the worldwide parent level) as a means of imposing “preventive, corrective or otherwise responsive measures” is consistent with the terms of Article 4.

- **Group-level reporting:** The Covered Agreement permits state insurance regulators to obtain information about the EU parent of insurers active in the United States if the information is deemed necessary “to protect against serious harm to policyholders or serious threat to financial stability or a serious impact on the ability of an insurer or reinsurer to pay its claims” in the United States. Likewise, the Covered Agreement provides that prudential group supervision reporting requirements

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imposed by host supervisors cannot apply at the worldwide parent level unless they “directly relate to the risk of a serious impact” on the ability of the insurer to pay claims in the territory of the host supervisor. State insurance regulators currently require certain information about, and reports from, the worldwide parent of insurance companies domiciled in their state, pursuant to each state’s insurance holding company laws. There has been concern that the Covered Agreement’s conditions for requesting information or reports from the EU parent of a U.S. insurer (e.g., only to protect against serious harm to U.S. policyholders or serious impact on claims-paying ability in the United States) could impede the collection of group-level information and reports that state insurance regulators have historically received under their state insurance holding company laws.

According to the Policy Statement, “[t]he United States does not see a basis to expect that state insurance regulators, in adhering to Article 4 reporting provisions, will encounter conflicts with state law based on the NAIC’s Insurance Holding Company System Model Regulatory Act.” State insurance holding company laws are generally based on the NAIC’s model holding company act.

- **Joint Committee:** The Covered Agreement establishes a Joint Committee, composed of representatives of the United States and EU, as a forum for consultation and to exchange information on the administration and implementation of the agreement. The Covered Agreement does not address who will represent the United States in the Joint Committee. The Policy Statement clarifies that, because state insurance regulators will be largely responsible for implementing the Covered Agreement, “the United States is committed to the direct involvement of state insurance regulators, including their staff, in the work of the Joint Committee. To this end, the United States will consult with state insurance regulators, and will establish a robust consultative process to ensure that discussions in the Joint Committee will be well-informed of the views and interests of state insurance regulators.”

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## ENDNOTES

- <sup>1</sup> *Joint Statement on Upcoming Signature of the Bilateral Agreement between the European Union and the United States of America on Prudential Measures Regarding Insurance and Reinsurance*, September 22, 2017, available at [https://ec.europa.eu/info/sites/info/files/170922-eu-us-joint-financial-regulatory-forum-joint-statement\\_en.pdf](https://ec.europa.eu/info/sites/info/files/170922-eu-us-joint-financial-regulatory-forum-joint-statement_en.pdf). See also U.S. Department of the Treasury, Press Release: *Treasury, USTR Sign Covered Agreement on Prudential Insurance and Reinsurance Measures with the European Union* (September 22, 2017), available at <https://www.treasury.gov/press-center/press-releases/Pages/sm0164.aspx>. The final legal text of the Covered Agreement is available at [https://www.treasury.gov/initiatives/fio/reports-and-notices/Documents/US\\_EU\\_Covered\\_Agreement\\_Signed\\_September\\_17.pdf](https://www.treasury.gov/initiatives/fio/reports-and-notices/Documents/US_EU_Covered_Agreement_Signed_September_17.pdf).
- <sup>2</sup> *Statement of the United States on the Covered Agreement with the European Union*, September 22, 2017, available at [https://www.treasury.gov/initiatives/fio/reports-and-notices/Documents/US\\_Covered\\_Agreement\\_Policy\\_Statement\\_Issued\\_September\\_2017.pdf](https://www.treasury.gov/initiatives/fio/reports-and-notices/Documents/US_Covered_Agreement_Policy_Statement_Issued_September_2017.pdf).
- <sup>3</sup> *Joint Statement on Upcoming Signature of the Bilateral Agreement between the European Union and the United States of America on Prudential Measures Regarding Insurance and Reinsurance*, September 22, 2017. According to the European Commission press release on the signing of the Covered Agreement, the European Parliament and the Council of the EU still need to approve the conclusion of the agreement, although signature allows parts of the agreement to become immediately applicable on a provisional basis. European Commission, Press Release: *EU and US sign bilateral agreement on insurance and reinsurance*, September 22, 2017, available at [http://europa.eu/rapid/press-release\\_MEX-17-3424\\_en.htm](http://europa.eu/rapid/press-release_MEX-17-3424_en.htm).
- <sup>4</sup> The Covered Agreement also establishes cross-conditionality between provisions. For example, the United States would not be required to implement the elimination of reinsurance collateral requirements if the EU fails to comply with terms of the agreement relating to group supervision or the elimination of local presence requirements for U.S. reinsurers. Likewise, the EU would be able to reapply Solvency II to worldwide group-level prudential supervision of U.S. insurance groups if the United States does not complete the necessary reinsurance reforms within the five-year period required under the Covered Agreement.
- <sup>5</sup> NAIC President and Wisconsin Insurance Commissioner Ted Nickel issued a statement following the signing of the Covered Agreement, stating that the NAIC is “pleased to see Treasury and USTR clarify their interpretation of the Covered Agreement ... in key areas like capital, group supervision, reinsurance and the Joint Committee.”
- <sup>6</sup> The European Commission published a short Fact Sheet on September 22, 2017 regarding the Covered Agreement, which includes some policy statements from the perspective of the EU, available at [http://europa.eu/rapid/press-release\\_MEMO-17-3426\\_en.htm](http://europa.eu/rapid/press-release_MEMO-17-3426_en.htm). The Fact Sheet confirms that U.S. groups active in the EU will not be subject to Solvency II requirements at the level of the ultimate parent undertaking for their non-European activities. In addition, the Fact Sheet states that “... EU groups will have to submit only one group-level Own Risk and Solvency Assessment (ORSA), to their group supervisor in the EU. The U.S. supervisors will use it and not require a local ORSA from this group.”
- <sup>7</sup> Article 3(8) of the Covered Agreement provides that the Covered Agreement will only apply to reinsurance agreements entered into, amended or renewed on or after the date on which an insurance law or regulation reducing the collateral in accordance with the Covered Agreement takes effect in the applicable jurisdiction, and only with respect to losses incurred and reserves reported from and after the later of (1) the date of such insurance law or regulation or (2) the effective date of the new reinsurance agreement, amendment or renewal.
- <sup>8</sup> The Policy Statement also makes clear that the Covered Agreement does not require a group capital assessment with respect to U.S. insurance groups without operations in the EU.

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