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Testimony of  
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Tennessee Department of Commerce and Insurance  
On Behalf of the National Association of Insurance  
Commissioners

Before the  
U.S. Senate Committee on Banking, Housing & Urban Affairs

Regarding:  
Examining the United States-European Union Covered  
Agreement

Thank you Chairman Crapo, Ranking Member Brown, and members of the committee. My name is Julie Mix McPeak. I serve as the commissioner for Commerce and Insurance for the state of Tennessee and current President-Elect of the National Association of Insurance Commissioners (NAIC). I greatly appreciate your invitation to testify before you regarding the covered agreement between the European Union and the United States.

The NAIC is well aware of the disparate regulatory treatment some European Union (EU) jurisdictions are imposing on certain U.S. insurers doing business in the EU and are committed to working with Congress and the administration to address this important issue for our sector. While a covered agreement is one way to do so, we have serious concerns with the text of the current agreement. It is ambiguous in several respects making it difficult to evaluate the benefits to the U.S. insurance sector and more importantly, making it difficult to implement. We therefore urge the administration to clarify or confirm certain provisions prior to moving forward with this agreement and asking the states to take on the significant undertaking related to any implementation.

## **Background**

Under the EU's new Solvency II regime, which went into effect on January 1, 2017, an assessment is required to determine whether another country's regulatory system is equivalent to elements of their new regime, and then penalizes that non-equivalent country's insurers with additional regulatory requirements. This has the effect of either imposing the EU approach on the rest of the world, or placing companies from those jurisdictions at a competitive disadvantage when operating within the EU. Last year, certain EU member countries such as Germany and the U.K. began imposing additional regulatory requirements on U.S. companies as they implement Solvency II. Though the materiality of the impact to the U.S. insurance sector does not appear extensive, this is troubling.

The EU may argue that serving as judge and jury of other countries' regulatory systems is an important tool for ensuring emerging markets are safe for EU investment. But the U.S. is the largest market in the world and has proven to be as effective as the best aspirations of Solvency II. Keep in mind, Europe's new system won't be fully implemented for another decade, may undergo further revisions, and has been deemed inappropriate for the U.S. insurance sector by state insurance regulators and the Federal Reserve. We are already subject to assessment and scrutiny by governors' offices, state legislatures, Congress, government watchdogs, and international standard setters, and our track record of ensuring a competitive and fair market for more than 145 years speaks for itself.

That's not to say U.S. insurance regulators are unwilling to work with our colleagues overseas to address regulatory cooperation and areas of convergence. For several years, we have engaged our EU counterparts on regulatory issues, and to coordinate the oversight of global market players. As part of the U.S./EU dialogue project with Treasury and the EU, we have explored both our regulatory regimes in depth and discovered that despite our structural differences, we have much in common. On the heels of the project, the EU granted provisional equivalence to

the United States' group solvency regime – which largely benefited EU insurers – and acknowledged our system's substantial confidentiality protections; all without a covered agreement.

Nevertheless, on November 20, 2015, the previous administration's Treasury Department and the Office United States Trade Representative (USTR) notified Congress they intended to initiate negotiations to enter into a covered agreement with the European Union to address the disparate treatment of US firms operating in the EU.<sup>1</sup> They made it clear they would not enter into a covered agreement unless terms of the agreement were beneficial to the United States. State insurance regulators were also promised a meaningful role during the covered agreement process. In that notification, the Treasury Department and USTR set out the following negotiating objectives:

- 1) "treatment of the U.S. insurance regulatory system by the EU as 'equivalent'" under Solvency II "to allow for a level playing field for U.S insurers and reinsurers operating in the EU;"
- 2) "recognition" by the EU of the U.S. insurance regulatory system, including with respect to group supervision;
- 3) "Facilitat[ion of the] the exchange of confidential regulatory information between lead supervisors across national borders;"<sup>2</sup>
- 4) "nationally uniform treatment of EU-based reinsurers operating in the United States, including with respect to collateral requirements;" and
- 5) "permanent equivalent treatment of the solvency regime in the United States and applicable to insurance and reinsurance undertakings."

Following notification to Congress, the Treasury Department and USTR negotiated for over a year behind closed doors. Unlike a trade agreement, which is subject to established procedures for consultation, input from the states and a vote by the Congress, there was no formal consultation with a broader group of U.S. stakeholders including industry and consumer participants. State regulators were assured we would have direct and meaningful participation in this covered agreement process, but the few of us involved in the process were subject to strict confidentiality with no ability to consult our staff and fellow regulators, and with little ability to impact the outcome. In fact, even here testifying before this committee, I cannot identify specific concerns or disagreements that may have occurred during the negotiation. The process was also skewed in favor of the EU from the beginning by the fact that it retained the ability to approve the agreement by the European Parliament and the European Council, whereas the U.S. retained virtually no congressional vetting authority prior to possible preemption of U.S. insurance regulations. Negotiations were completed in January and the Agreement was submitted to Congress on January 13 for the layover period mandated by the Dodd-Frank Act.

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<sup>1</sup> Wall, Anne. Harney, Michael. Letter to Congress Re: Initiation of Covered Agreement Negotiations, 20 Nov. 2015.

<sup>2</sup> The agreement encourages, but does not require, supervisory authorities to cooperate in exchanging information while respecting a high standard of confidentiality protection. It appears to do little of substance in relation to laws or procedures related to information exchange.

## **An Ambiguous Agreement is not an Agreement**

Based on a plain reading of the text, we believe the previous administration's Treasury Department and USTR failed to meet several of their objectives. While we recognize the agreement appears to provide some benefit to certain U.S. insurers operating in the EU by eliminating EU local presence requirements over time, this agreement does not require the EU to grant the U.S. permanent equivalence (or comparable treatment), and in fact, the word "equivalence" is nowhere to be found in the document. This means, even post covered agreement, insurers based in Bermuda or Switzerland, for example, (which have received equivalence) receive greater benefits from the EU than U.S. insurers. Yet, under this agreement, the United States, one of the most sophisticated and well-regulated insurance marketplaces on the globe, continues to be treated by Europe with unjustifiable skepticism. We remain under suspicion, we continue to be monitored, and whatever freedoms afforded by this agreement can be revoked. Similarly, this agreement also fails to grant full "recognition" by the EU of the U.S. insurance regulatory system, including with respect to group supervision. While this agreement appears to prevent the EU from imposing its requirements on the "worldwide parent" located in the United States, it does not provide promised "recognition" or require the EU to recognize the U.S. as equivalent.

While there is little that can be done about the process issues involved in reaching this agreement, this administration still has an opportunity to address the substantive issues raised by the agreement itself, notably the myriad of ambiguities that exist. Much has been made by former administration officials about how this is a great deal for the U.S. We would welcome an outcome that benefits the U.S. market and resolves the outstanding issues with finality but in looking at the four corners of the document, it is impossible to know whether we have such an outcome without confirmation from those interpreting it on both sides of the Atlantic. Thus we support the bipartisan requests coming from Congress requesting that the Treasury Department and USTR find some mechanism to resolve these important issues before states are asked to engage in the resource intensive efforts surrounding implementation. Let me provide just some specific examples of a few of the key areas of ambiguity

Overall the language of the agreement is ambiguous as to the obligations of the parties and the entities to which it applies (e.g., the insurance group, the insurance and non-insurance group, the legal entities, or a combination). The agreement also appears to supersede existing authority of regulators to obtain information or take certain actions currently authorized under state laws. Indeed, there are potential conflicts between provisions and limitations in this agreement and existing state reporting processes as well as critical examination and hazardous financial condition authority. In addition, many key terms describing the circumstances which would prompt action by regulators to comply with this agreement are undefined or ambiguous. For example, the agreement acknowledges a need for a group capital requirement or assessment, but it also requires "the authority to impose preventive, corrective, or otherwise responsive measures on the basis of the assessment, including requiring, where appropriate, capital measures."<sup>3</sup> The

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<sup>3</sup> *Bilateral Agreement between the European Union and the United States of America on Prudential Measures Regarding Insurance and Reinsurance*, January 13, 2017, p. 12.

provision implies state insurance regulators are effectively required to develop and adopt a group capital requirement, and also includes language suggesting the EU could apply its own group capital requirements and re-impose local presence requirements if states choose not to act. In other words, this agreement seems to compel states to subject a broad group of insurers to additional regulation with no guarantee the EU ultimately would not apply its own layer of requirements if it finds the U.S. approach to be unsatisfactory.

As currently structured, these ambiguities would have to be resolved by an undefined “Joint Committee” composed of representatives of the U.S. and EU. This agreement does not set forth how many representatives will compose the Joint Committee or indicate which persons or bodies will be represented. Importantly, there is no mention of a role for state insurance regulators, who are charged with implementing much of this agreement and whose laws and regulations may be directly impacted or preempted. If resolution cannot be reached on these ambiguities, this agreement may be voided. Under its terms, the agreement is cross-conditional—if any single provision of this agreement is violated, the other party is not obligated to follow other provisions of this agreement. This framework inevitably will lead to perpetual renegotiation through the Joint Committee and uncertainty for U.S. industry, policyholders, and regulators.

### **EU Market Access at the expense of reduced reinsurance collateral**

As Congress and the administration weigh the merits of the agreement, the focus from supporters has been on the perceived benefits of the agreement for the subset of U.S. firms doing business in the EU, but consideration must also be given to what is being given up to achieve that benefit. The one objective met was a key negotiating priority for the EU, total elimination of reinsurance collateral requirements. In fairness, this covered agreement retains a few of the elements from the NAIC’s Credit for Reinsurance model laws, including requirements with respect to enforcement of final U.S. judgments, service of process, financial reporting requirements, prompt payment of claims, and solvent schemes of arrangement. These requirements are also applicable to U.S. reinsurers doing business in the EU, and collateral may be imposed if these requirements are not met under a process established in this agreement. However, this agreement does not include a fulsome evaluation of a reinsurer’s creditworthiness and despite the Treasury Department having verbally committed it would never accept an agreement which totally eliminates reinsurance collateral, it did exactly that.

Existence of reinsurance collateral provides strong incentives for reinsurers to perform on their obligations and regulatory requirements to protect all insurers, particularly smaller insurers that may not have the leverage to renegotiate and require it contractually from reinsurers with whom they do business. Though we believe it is necessary for counterparties to have “skin in the game” (a lesson the financial system was reminded of during the financial crisis with respect to other financial instruments), we have nevertheless attempted to be responsive to the European insurance industry and governments who have sought reduction of such requirements. We have worked tirelessly to reduce collateral requirements by amending NAIC’s Credit for Reinsurance Model Act to allow for reduction in collateral based on the strength of the insurer and its regulatory regime. The amendments have already been adopted by 39 states representing approximately 70 percent of direct written premium and will become an NAIC Accreditation requirement on January 1, 2019, leading to further adoption by states. Interestingly, even though

certified reinsurers will likely have reduced collateral requirements, of the 215 EU reinsurers that we are aware of, only 6 have sought and received certification—the remaining reinsurers have not even filed an application.<sup>4</sup> Under the terms of the Agreement, all EU reinsurers, even those that have not applied for certified reinsurer status, will be eligible for zero collateral even though they may not meet existing financial strength and other regulatory requirements. When you consider even significantly reduced collateral protections represent commitments to policyholders and a leverage point for regulators, wiping them out entirely will force regulators to find other mechanisms with which to protect insurers and their policyholders from the risks posed by reinsurance counterparties. This could possibly include additional capital charges or restrictions imposed on ceding insurers. This covered agreement essentially transfers the credit risk of foreign reinsurers to their customers: U.S. insurance companies, and by extension, U.S. policyholders.

In sum, the issues addressed by this covered agreement are a creation of the EU’s policy making decisions but they are being solved entirely at the expense of state insurance regulation, U.S. industry, and consumers and regulators. Nonetheless, state regulators are firmly committed to resolving these issues so U.S. firms are not put at a competitive disadvantage when operating in the EU.

### **Confusion Surrounding the Agreement’s Terms**

Earlier this year, my colleague and NAIC President Wisconsin Commissioner Ted Nickel testified before the House Financial Services Subcommittee on Housing and Insurance, and detailed our concerns.<sup>5</sup> At that time, given the seriousness of these concerns, we urged renegotiation of the agreement. At the same hearing, former FIO Director Michael McRaith, one of the chief negotiators of this Agreement, testified to what he believed the agreement accomplished, specifically that “the Agreement affirms that the U.S. supervises its insurance sector as the U.S. deems appropriate.” He noted it only required states to address collateral requirements in a manner that was supportive of state regulator efforts to implement changes to their credit for reinsurance laws and regulations that would reduce reinsurance collateral, finish our ongoing work on a group capital calculation, and for purposes of group supervision, treat EU-based insurance companies operating in the U.S. as they are treated today. He asserted that the Agreement recognizes the current U.S. insurance group supervision practices, prohibits Europe from extraterritorial application of its requirements on U.S. based holding companies or legal entities, and requires certain EU jurisdictions to immediately lift their requirements that US reinsurers maintain a local presence as a condition of doing business.

Candidly, we were surprised. Mr. McRaith’s characterization of the Agreement, if shared by the present Treasury Department and importantly by the EU, is more promising than a plain reading of the text suggests. As such, the focus of our requests to Congress, Treasury, and the USTR has evolved to urge confirmation of some of these key assertions. We want to ensure that all parties

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<sup>4</sup> The States and NAIC has certified 32 reinsurers in total, most of which are Bermuda based.

<sup>5</sup> United States. Cong. House. Financial Services Subcommittee on Housing and Insurance. *Hearing Regarding Assessing the U.S.-EU Covered Agreement*. February 16, 2017. 115th Cong. 1<sup>st</sup> sess. Washington: GPO, 2017 (statement of Ted Nickel, Wisconsin Insurance Commissioner)

agree that we have the deal we've been told we have. We believe that confirmation may be achieved without renegotiation and without undue delay. Critically, however, we believe that these ambiguities must be resolved at the outset of the agreement rather than at some later date through the opaque process afforded by the Joint Committee. It is entirely unacceptable to ask 50 state Governors, legislatures, and regulators to revise some of the fundamental elements of their system based on the informal interpretations of the agreement by a former Treasury official no longer involved in its implementation or interpretation. We have confidence that through the bipartisan efforts of this Congress as well as the commitment of this Administration to ensure the U.S. obtains the best deal possible for our citizens, we can resolve these ambiguities and find a way forward.

### **The Path Forward**

Last week, the NAIC submitted a list of provisions to the Treasury Department, the USTR, and the Congressional Committees of Jurisdiction that we would like clarified before the United States moves forward with implementation of the Agreement. Among those included on the list are:

- 1) Clarifying that insurance regulators can impose regulatory requirements, other than collateral, to address reinsurance counterparty risk;
- 2) Clarifying that existing group supervisory reporting requirements under state law continue to apply to EU affiliates of US companies;
- 3) Clarifying that the NAIC's group capital calculation work would meet the terms of the group capital assessment provisions of the agreement;
- 4) Clarifying that collateral requirement for current reinsurance contracts will be unaffected and confirmation as to how losses treated prior to a new reinsurance agreement will be treated;
- 5) Clarify how reinsurance collateral requirements should be addressed prior to the conclusion of the 5 year period for full elimination of requirements.

We urge the administration, with the direct involvement of the states, to expeditiously provide the needed clarity and comfort now rather than taking an imprudent leap of faith that such clarifications will be "worked out" at a later date through a Joint Committee process. Absent such clarifications, we cannot be assured that state implementation will meet the terms of the agreement and satisfy the current administration or the EU, potentially putting us in a position of perpetual renegotiations or worse yet, having made changes to state laws and regulations only to have the EU challenge those at later date and revert to treating our companies unfairly. Under these circumstances, it is hard to see how our sector can achieve certainty and finality regarding their concerns. Finally, we request that the administration confirm state insurance regulators will be included in any Joint Committee and that insurance regulators from all the states will be consulted on all issues that the committee discusses. As the states are the primary regulators of the insurance sector and would have to implement the provisions of any agreement, our involvement and buy-in is essential to its success.

## Conclusion

We remain deeply concerned with the treatment of certain insurers by the EU and we remain committed to resolving these issues. However, it is not in the best interest of the United States insurance sector and policyholders to proceed with implementation of the Agreement without clarification of its ambiguous terms and a clear understanding shared on both sides of the Atlantic. Such confirmation of intent will ensure the EU will not be able to use the agreement's lack of clarity as a means of imposing their regulatory system and ultimately their will on our insurance sector to the detriment of US insurance companies and policyholders. Working together with the administration and Congress, we believe we can obtain a level of comfort and clarity that will achieve finality and certainty for our sector without sacrificing consumer protections. Thank you for this opportunity to testify today and I would be pleased to take your questions.