EMBARGOED FOR DELIVERY

Written Testimony of Michael T. McRaith

U.S. Senate Committee on Banking, Housing and Urban Affairs

"Examining the U.S. - EU Covered Agreement"

May 2, 2017

Chairman Crapo, Ranking Member Brown, members of the Committee, thank you for inviting me to testify in this hearing "Examining the U.S. - EU Covered Agreement."

I previously served as the Illinois Director of Insurance from 2005- 2011, and as the Director of the Federal Insurance Office (FIO) at the U.S. Department of the Treasury from 2011 until January 20, 2017.

While serving as the FIO Director, among other things, I coordinated and developed Federal policy on prudential aspects of international insurance matters and served as Treasury's lead negotiator for the "Bilateral Agreement Between the European Union and the United States of America on Prudential Measures Regarding Insurance and Reinsurance" (Covered Agreement).

The Covered Agreement will open the entire European Union (EU) reinsurance market to U.S. reinsurers, spare U.S. industry potentially billions of dollars in compliance costs, and embrace the U.S. state regulatory approach to insurance group supervision.

I first testified before Congress on June 20, 2006, on behalf of the National Association of Insurance Commissioners (NAIC) in the U.S. Senate Committee on the Judiciary, and offered testimony in support of the limited anti-trust exemption in the McCarran-Ferguson Act. As in that first hearing, and in every hearing since, I reiterate today my support for the U.S. integrated system of insurance oversight wherein the states remain the primary regulators of the business of insurance.

Most states have diverse insurance markets in which multi-national insurers of great size, scale and complexity compete against insurers that operate only in one state, or in only one region of one state. As the Director of Insurance in Illinois, I witnessed firsthand the importance of all aspects of the insurance industry to consumers, to local and state economies, to employees, and to our national interests. Insurance agents, brokers, and companies are an essential feature of every American community.

Insurance is a necessary component of America's promise of economic fairness and opportunity. Competitive insurance markets benefit America's working families and small businesses. Products and services offered by America's insurers allow families to protect and accumulate property, to transfer wealth between generations, and to support a financially secure retirement.

Indeed, FIO's Covered Agreement authority recognizes the global interests of the U.S. insurance sector and the implications of those interests for the American insurance industry and consumers. For these reasons, among others, Treasury and the United States Trade Representative (USTR) jointly negotiated and agreed upon the Covered Agreement with the EU.

On February 16, 2017, the U.S. House of Representatives Committee on Financial Services held a hearing entitled "Assessing the U.S. - EU Covered Agreement." Annex A to this written testimony contains replies to Questions for the Record that followed that hearing. In particular, the reply to the first QFR provides a paragraph-by-paragraph description of the legal benefits of the Covered Agreement for the United States.

To highlight a few key points:

1. "Equivalence," as defined by the EU, would require the United States to implement a global group capital requirement. The Covered Agreement will preserve the independence of the U.S. approach to insurance group supervision.

2. Reinsurance collateral reforms, drawn from the approach that state insurance regulators have adopted as a requirement for every state, do not have retroactive effect and cannot change existing reinsurance agreements.

3. The entire Covered Agreement is cross-conditional. Both the United States and the EU must provide the benefits in order to receive the benefits. Any unilateral action adverse to the other could result in the loss of the benefits of the Covered Agreement.

Background

The prudential insurance matters addressed by the Covered Agreement are neither new nor surprising. Reform of the U.S. state reinsurance laws was first debated by state regulators in 1999, if not earlier, well more than a decade before state regulators unanimously adopted modernized model laws and regulations in November 2011.

However, despite energetic efforts by state regulators through the NAIC, only 32 states have adopted some version of reinsurance reforms. Both the content and the implementation of that reform varies across those 32 states. For this reason, among others, state regulators, through the NAIC, opted in 2016 to establish reinsurance reforms as an NAIC accreditation standard, effective January 1, 2019. By virtue of this NAIC decision, all states must adopt a law or regulation substantially similar to the NAIC model law and regulation by January 1, 2019.

While the NAIC spent years working through alternative approaches to reforms of state-based credit for reinsurance laws, the EU spent years developing its Solvency II insurance supervisory regime. Solvency II was first previewed and anticipated more than 10 years before its implementation on January 1, 2016. The EU and its member states should be congratulated on

the successful technical development and implementation of Solvency II, an EU-wide system of insurance oversight that reflects a high level of professional and political accomplishment.

Almost from the earliest days of the development of Solvency II, U.S. insurance sector stakeholders, including state regulators, were aware that Solvency II could require the EU to evaluate whether non-EU insurers and reinsurers operating in the EU market were domiciled in "equivalent" jurisdictions. An "equivalent" jurisdiction is one, such as Switzerland, which supervises its insurers consistent with Solvency II practices and standards, i.e. global group capital, reporting and governance.

Among other reasons, Solvency II and its supervisory approach matter to the United States because, in terms of premium volume, the EU's consolidated insurance market is the largest in the world. Also, EU insurers and reinsurers operating in the United States provide insurance and annuity products to millions of American families and businesses, employ tens of thousands of Americans in states around our country, and provide essential capital following a disaster, including 9/11, Hurricanes Katrina, Rita, and Wilma, and Superstorm Sandy.

As the world's largest single nation insurance market, U.S. insurance authorities have repeatedly refused submission to the formal EU Solvency II equivalence process. The United States has long-held that the United States substantively and structurally regulates its insurance sector as the United States determines appropriate, just as the EU determines how to supervise the insurance sector within the EU. The Covered Agreement affirms this independence.

Nevertheless, U.S. insurance stakeholders have known that failure to resolve the Solvency II "equivalence" issue could result in: (1) U.S. reinsurers losing opportunities in the EU reinsurance market, and (2) U.S. primary insurers being forced to satisfy Solvency II global group capital, reporting and governance criteria that are far different, and far more costly, than current U.S. regulatory practices.

As the EU moved to implement Solvency II on January 1, 2016, U.S. insurance stakeholders learned more about the potential negative impact on U.S. reinsurers and insurers. At the same time, U.S. state insurance regulators continued the massive (albeit piecemeal) effort to reform reinsurance oversight. Nevertheless, in exchange for this reform, state regulators received nothing of benefit for U.S.-based insurers and reinsurers operating in the EU. Nothing.

Following often difficult and contentious negotiations that began in early 2016, the Covered Agreement will resolve these long-standing issues. The Covered Agreement will remove excessive unnecessary regulation of the global reinsurance industry in both markets, open the EU reinsurance market to U.S. reinsurers, and relieve U.S. primary insurers of potentially billions of dollars in Solvency II compliance costs.

While providing an equally meaningful outcome for the EU, the Covered Agreement puts America's interests first. U.S. insurance consumers, industry and the U.S. national economy will benefit from the Covered Agreement.

Covered Agreement Negotiations — Process and Transparency

U.S. state regulators, most of whom are appointed and serve at the will of a state Governor, have never before been directly included in the negotiating delegation for a U.S. international agreement. However, in recognition of the unique role of the states in insurance sector oversight, and even though not required by law, the Covered Agreement negotiation process created an unprecedented mechanism for state regulator participation.

Treasury and USTR asked the state regulators to establish a small covered agreement task force of commissioners, and allowed the state regulators to determine the size and membership of the task force.

State regulators were invited to, and did, participate in every Covered Agreement negotiating session.

State regulators were invited to, and did, share perspectives, technical insights, and ask questions during U.S. delegation preparations in advance of any Covered Agreement negotiating session.

State regulators were consulted throughout the Covered Agreement negotiation process, including during any Covered Agreement negotiating session.

During the Covered Agreement negotiations, a state regulator sat at the table with the U.S. delegation and frequently provided technical insights.

Through a confidential web portal established solely for purposes of sharing confidential Covered Agreement documents with the state regulator task force, state regulators received all documents offered by the EU shortly after those documents were received by Treasury and USTR.

Through the same confidential web portal, state regulators received all U.S. Covered Agreement documents before those documents were provided to the EU.

Before any U.S. Covered Agreement document was provided to the EU, state regulators were invited to, and did, participate in a telephone call with Treasury and USTR to provide state regulator feedback and insight, and to ask questions. These telephone calls frequently resulted in important insights and perspectives that were incorporated into, or addressed in, the U.S. Covered Agreement document before that document was provided to the EU.

Prior to my departure from Treasury, both Treasury and USTR expressed appreciation to Tennessee Commissioner McPeak and her colleagues from California, Texas, Missouri, Florida,

Vermont, Wisconsin, Kentucky, Maine and Montana for their constructive input and insights provided throughout the Covered Agreement negotiation.

U.S. state regulators made important contributions that improved the outcome of the Covered Agreement. These regulators, including Commissioner McPeak, should be commended for contributing substantial time and energy to the Covered Agreement negotiations even while tending to the business of insurance in their home states and to the various NAIC activities in which they are engaged.

In addition, throughout the Covered Agreement negotiations, Treasury and USTR consulted extensively with the four Committees of jurisdiction in Congress. These consultations occurred in person and by telephone, and occurred before negotiations began, before and after each negotiating session, and before the negotiations and the Covered Agreement were finalized.

Treasury and USTR also extensively consulted with private sector stakeholders, particularly those U.S. insurers and reinsurers with operations in the EU.

Treasury and USTR also worked closely with the entire U.S. Covered Agreement negotiating delegation which, in addition to Treasury and USTR and the state insurance regulators, also included the Departments of Commerce and State, and the Board of Governors of the Federal Reserve System.

This extensive transparency and stakeholder engagement supported and informed Treasury and USTR's work throughout the Covered Agreement negotiating process.

Credit for Reinsurance Reform — Removing Excessive Regulation of a Global Industry

The reinsurance industry largely manages risk on a global basis. The reason is obvious: in order to avoid concentration of risk from natural catastrophes, or from a mass epidemic, reinsurers spread capital to different areas and continents. Insurance supervisors support this approach in order to promote affordable and reliable reinsurance markets and, in turn, promote the affordability and accessibility of insurance products to working families and small businesses throughout the United States.

The Covered Agreement supports the U.S. state-based initiative to reform reinsurance regulation. In fact, the 32 U.S. states that have already adopted reinsurance collateral reform have, as of early 2017, provided collateral relief to 31 non-U.S. reinsurance entities. Of those 31, 30 now hold 10% or 20% of the collateral required under prior state laws.

The state regulators' adoption of reinsurance collateral reform as an accreditation standard, effective January 1, 2019, means that all states would be expected to adopt a substantially similar reform by that date. In other words, within the next two years, as a matter of state law, every non-U.S. reinsurer could be posting as little as 10%-20% of the collateral formerly required by the states.

If domiciled in a non-equivalent country, a reinsurer operating in the EU could be subject to EU member state laws that require collateral, a local presence, or other prohibitive regulatory requirements. Beginning in mid-2016, U.S. reinsurers were losing existing EU clients and missing new opportunities in the EU. Before the Covered Agreement was provided to Congress on January 13, 2017, U.S. reinsurers were experiencing this burden in full force: at least two EU member states, with more in process, required that U.S. reinsurers either establish a subsidiary or operate in the EU member state only without the use of brokers.

The Covered Agreement eliminates collateral and local presence requirements for EU reinsurers operating in the United States and U.S. reinsurers operating in the EU. The Covered Agreement eliminates excessive reinsurance regulation in the United States and the EU, and establishes a new global paradigm for oversight of this essential global industry.

If the Covered Agreement conditions are met, current collateral requirements for EU-based reinsurers will be eliminated within 60 months from the date the Covered Agreement enters into force or, perhaps, as early as mid-2023. States, therefore, have sufficient time beyond the NAIC's existing plan for accreditation (January 1, 2019) to conform all state law and regulation to the terms of the Covered Agreement.

In addition, if the Covered Agreement conditions are met, current local presence requirements for U.S. reinsurers in the EU (or EU reinsurers in the United States) will be eliminated within two years from the date of signature. Due to the success of the Covered Agreement negotiations, EU member states that were imposing local presence requirements on U.S. reinsurers are already forbearing from enforcement of local presence requirements.

By combining meaningful reporting requirements with the potential for re-imposition of local presence or collateral requirements, the Covered Agreement enhances the protections available to primary insurers and consumers in both the EU and the United States. For example, a reinsurer must confirm in writing that it consents to the jurisdiction of the courts where the primary insurer is domiciled, and must consent in writing to pay all final and enforceable judgments wherever enforcement of that judgment is sought. Also, reinsurers must maintain a practice of prompt payment, and could be required to report to the ceding insurer's supervisor semi-annually with an updated list of all disputed and overdue reinsurance claims that have been outstanding for 90 days or more.

These protections, and the myriad others contained in the Covered Agreement, apply to U.S. reinsurers operating in the EU and to EU reinsurers operating in the United States.

In exchange for these enhanced consumer protections, the EU and U.S. reinsurance markets will be open to non-domestic competition in an unprecedented manner, thereby providing free market opportunities that will meaningfully benefit ceding insurers and insurance consumers.

Finally, and importantly, the Covered Agreement provides that U.S. state law and regulation (and EU law and regulation) can revert to its prior form if the Covered Agreement is terminated. Termination of the Covered Agreement will allow for the "snap back" of collateral or local presence requirements, precluding the prospect that the EU or United States could benefit from the Covered Agreement despite failing to provide the benefits.

Group Supervision — Mutual Respect Finalized

In Article 4, the Covered Agreement describes insurance group supervision practices in a manner that accommodates the distinctly different approaches of both the United States and the EU. Annex A includes a description of the legal benefits of each paragraph of the Covered Agreement, including Article 4.

Notably, the group supervision practices of the Covered Agreement (Article 4) apply *only* to those insurers operating in both the EU and the United States.

For purposes of defining the scope of the group, the Covered Agreement retains flexibility for the United States and the EU to move forward as each deems appropriate. The scope of the group is understood to be consistent with Insurance Core Principle (ICP) 23 developed by the International Association of Insurance Supervisors and in effect in early 2017.

Through the Covered Agreement, the EU and the United States agree that supervisors of the jurisdiction in which the insurer (or reinsurer) is domiciled are the only supervisors with authority to supervise the insurers at the global group level.

The Covered Agreement group supervision practices memorialize the mutual respect shared by the EU and the United States, and comprise explicit recognition that neither the EU nor the United States will change insurance regulatory systems and structures just because of the other. As a factual matter, supervisors in both jurisdictions have adopted, or pursued, practices that originated with the other. For example, U.S. state regulators began development of an Own Risk Solvency Assessment (ORSA) based on the idea as it originated with the EU. Over time, U.S. state regulators adopted the ORSA but in a U.S.-specific way. At the same time, EU supervisors have studied the U.S. state regulators' approach to the collection, compilation and publication of insurance industry data, and are developing a system of insurer reporting that, while different from the U.S. state approach, is based on ideas as originated in the United States.

Beginning in 2014, U.S. state insurance regulators, through the NAIC, began development of a group capital calculation for U.S. insurers and reinsurers. This initiative reflects a growing awareness among international insurance supervisors that a common group capital standard for multi-national insurers will allow for non-domestic insurance regulators to protect consumers and promote financial stability within their jurisdictions. Although the NAIC group capital initiative has been under development for over two years, it remains in the early phases as state

regulators evaluate alternative approaches both to the scope and the technique for the calculation.

It is clear, however, that the NAIC's group capital calculation will not be a group capital requirement, and will not require capital to be held by U.S.-based insurers and reinsurers in any place other than the insurance legal entities over which state regulators have authority. The Covered Agreement confirms these two facts, and provides U.S. state regulators with flexibility to build the U.S. group capital calculation on specifications that they determine appropriate. To repeat for clarity, the Covered Agreement only requires that U.S. state regulators proceed with group capital work already underway through the NAIC and does not specify how that work should proceed or conclude.

To be abundantly clear, the Covered Agreement will not require that U.S. state regulators develop an approach that requires capital to be held outside of an insurance legal entity, and the reference to "corrective, preventive, or otherwise responsive measures" merely restates existing state-based insurance holding company laws. Indeed, to repeat again for clarity, the Covered Agreement further limits the application of the state regulators' group capital calculation to a much smaller group of U.S. insurers and reinsurers (i.e. only those operating in the EU) than presently contemplated by the state regulators.

Importantly, just as the United States sought respect for the U.S. approach to its group capital calculation, the Covered Agreement is also drafted in a manner that accommodates and expresses respect for the EU approach to a global group capital requirement. Although different from the U.S. approach, Solvency II has formed the basis for insurance regulatory reforms around the world, including in Mexico, South Africa, Bermuda, Brazil, and China.

The Covered Agreement limits the application of the EU's Solvency II global group supervision practices to the operations and activities of U.S. insurers that occur in or originate from the EU. While the same limitation of U.S. law and regulation also applies to EU insurers operating in the U.S. market, the limitation on the application of Solvency II saves U.S. insurers potentially billions of dollars in additional compliance costs.

The Covered Agreement will benefit U.S. insurance consumers through increased affordability, increased insurer investment in the U.S., and more efficient use of the capital that would otherwise be tied to Solvency II compliance. The Covered Agreement provides U.S. insurers operating in the EU with the strategic flexibility necessary for continued domestic and global growth.

The Covered Agreement will provide insurers and reinsurers that operate in both the United States and the EU the long-sought clarity and certainty with respect to the relationship between the two different supervisory approaches. The Covered Agreement incorporates, and memorializes, shared mutual respect between the EU and the United States.

The Covered Agreement Resolves Reinsurance and Group Supervision with Finality

Neither the United States nor the EU can benefit from the terms of the Covered Agreement without also providing to the other the benefits of the Covered Agreement. In other words, the provisions of the Covered Agreement are cross-conditional.

If the United States fails to perform on the reinsurance reforms, then the EU need not comply with the group supervision practices. If the EU does not comply with the group supervision practices, then the United States need not comply with the reinsurance reforms. The cross-conditional nature of the Covered Agreement incentivizes compliance by supervisors in both the EU and the United States.

The Covered Agreement need not be clarified with further written materials. The Covered Agreement terms, painstakingly negotiated, are abundantly clear even if not written to resolve every stakeholder's nuanced fantasies.

For example, if a stakeholder were to complain about the uncertainty of five years hence, one might ask that stakeholder to explain whether that same question can be raised about every agreement or, for that matter, every facet of life, or, in fact, any subsequent written material that stakeholder may claim to be essential. For this reason, the cross-conditional nature of the Covered Agreement allows for the United States to provide the benefits of the Covered Agreement only insofar as the EU also provides the benefits. Both sides are disciplined into compliance with the Covered Agreement.

To the extent that the EU and the United States have questions about interpretation or implementation in the coming years, the Covered Agreement establishes a Joint Committee to address and resolve any ambiguity. This Joint Committee mechanism, not unlike those established to implement other international agreements, would allow for both broad and targeted subjects to be addressed in a collaborative manner.

Finally, if both the EU and the United States have complied with the Covered Agreement conditions, then the terms of the Covered Agreement become permanent and final. *See* Article 10, paragraph 1.

Federal Insurance Office

After the devastation wrought by the financial crisis, Title V of the Dodd-Frank Consumer Protection and Wall Street Reform Act established FIO to complement the work of the states with respect to the U.S. insurance regulatory system. Among other authorities, FIO has statutory authority to represent the United States on prudential aspects of international matters. In doing so, FIO has worked closely with the insurance professionals at the Board of Governors of the Federal Reserve System, state regulators, and staff at the NAIC. In addition, working with our

international counterparts, FIO supported international consensus that accommodates the substance and structure of the U.S. insurance regulatory system.

Make no mistake — U.S. leadership in the global insurance sector is more important now than ever before. Developing economies around the world seek private capital and insurance products to provide the same benefits to their populations that the industry provides to families and businesses in the United States.

Where the United States does not engage, or lead, then the United States cedes the development of regulatory concepts to other jurisdictions. The global insurance community will not wait for the United States if we repeatedly re-hash the currently unchallenged merits of the McCarran-Ferguson Act.

The U.S. insurance industry, in all of its diversity, deserves prominent U.S. Federal leadership on important global insurance matters. For those who would argue that only a state (which state?) should have this role, the actual salient question is whether the United States prefers to lead or to follow.

As an industry of $8.5 trillion in assets (2015 total) in the United States, and a critical tool for all aspects of American personal and commercial activity, the U.S. insurance sector deserves a heightened prominence in the U.S. Department of the Treasury. Recent proposals, including by the Bipartisan Policy Council, affirm the increasing awareness of the U.S. insurance sector's national and global importance.

Industry and consumers have a shared interest in efficient, well-regulated and competitive markets. FIO has published 16 reports, including on topics relating to insurance consumer matters and the development of an affordability index of personal auto insurance. This work highlights the state-by-state differences and the impact of those differences on the insurance industry and the American people.

FIO has engaged domestically in, or led U.S. engagement in, a broad range of matters, including retirement security, resilience to severe weather events, cyber-security, implementation and interpretation of the 2015 terrorism risk insurance program, as well as nuts and bolts insurance projects such as flood insurance and long-term care insurance. This engagement has assured that insurance matters of national interest and concern are identified, recognized, understood, and appreciated at the highest levels of the Federal government.

As one of the most highly regulated and quickly evolving financial services, the U.S. insurance sector – consumers and industry – deserves strong national and global representation and leadership. Federal leadership, including through Congress, will be increasingly necessary to address important insurance issues of national interest.

Conclusion

Treasury and USTR pursued a Covered Agreement that would memorialize the obvious prerogative of the United States to determine the substance and structure of U.S. insurance oversight. In addition, Treasury and USTR sought a Covered Agreement that would provide meaningful benefits for U.S. insurers, reinsurers, consumers, and for the U.S. economy. While providing equally meaningful benefits for the EU, this Covered Agreement achieves all objectives sought by the United States.

At every point in the Covered Agreement negotiation, Treasury and USTR prioritized the best interests of U.S. consumers, U.S. insurers and the U.S. economy.

Chairman Crapo, Ranking Member Brown, thank you for the opportunity to speak with you today. I look forward to your questions.

ANNEX A

McRaith Replies to Questions for the Record

U.S. House Financial Services Committee

Subcommittee on Housing and Insurance

"Assessing the U.S. – EU Covered Agreement"

February 16, 2017

U.S. House of Representatives Financial Services Committee
Hearing: "Assessing the U.S. – EU Covered Agreement"
February 16, 2017
Michael T. McRaith
Replies to Questions for the Record

Chairman Duffy

Question Number One

The Covered Agreement (Agreement) opened the entire EU reinsurance market to U.S. reinsurers, spared U.S. industry operating in the EU potentially billions of dollars in compliance costs, and embraced the U.S. state regulatory approach to insurance group supervision.

The Agreement applies only to, and provides clarity for, U.S. and EU insurers that operate in both jurisdictions. Notably, the benefits are not mutually exclusive in that a positive outcome for EU industry stakeholders can also benefit U.S. interests.

EU insurers and reinsurers insure millions of American families and businesses and employ tens of thousands of Americans in states around our country. EU-based holding companies own high profile U.S. property and life insurers. EU-headquartered insurers and reinsurers pay billions to assist the United States in post-disaster recovery. For example:

- EU insurers and reinsurers paid more than $12.2 billion in claims following the terrorist attacks of September 11, 2001, an event for which 64% of all claims were paid by reinsurers. Lloyd's paid more than 11% of all 9/11 claims.
- Following the devastation of Hurricanes Katrina, Rita and Wilma, more than 22% of all claims were paid by EU insurers and reinsurers, with Lloyd's paying nearly 10% of the total.
- Of the total insured claims of $18.715 billion from Superstorm Sandy, $5.3 billion was paid by EU-headquartered insurers and reinsurers, and approximately $2.5 billion was paid by Lloyd's.

This reply identifies only the legal benefits conferred upon the United States and its stakeholders (consumers and industry), and does not describe the financial and commercial benefits for those stakeholders.

The Agreement is drafted in language, and provides benefits, that apply equally to the United States and the EU. The following list of legal benefits conferred on the United States by the Agreement cites directly to the relevant Article and Paragraph:

a. Preamble: the Preamble reflects the understandings and acknowledgements of the United States and the EU with respect to the Agreement. While each is an important statement, three warrant specific mention:

> "Sharing the goal of protecting insurance and reinsurance policyholders and other consumers, while respecting each Party's system for insurance and reinsurance supervision and regulation";
>
> "Taking into account information exchanged on each Party's regulatory frameworks and after careful consideration of these frameworks";
>
> "Acknowledging the need for a group capital requirement or assessment for insurers and reinsurers forming part of a group that operates in the territory of both Parties, and that a group capital requirement or assessment at the level of the worldwide parent undertaking can be based on the approach of the Home Party[.]"

b. Article 1 – Objectives

While Article 1 does not, in itself, confer any legal benefits for U.S. stakeholders, the Objectives articulate the goals of the Agreement. While each is important and are addressed in the following substantive Articles, these goals describe the outcome of the Agreement:

> (a) Elimination of local presence requirements for U.S. and EU reinsurers operating in the other jurisdiction.
>
> (b) Elimination of collateral requirements for U.S. and EU reinsurers operating in the other jurisdiction.
>
> (c) Prohibit the application of group supervision by an EU regulatory authority except to the extent that the U.S. insurer has operations or activities occurring in or originating from the EU, including with respect to solvency and capital, governance and reporting.

c. Article 2 — Definitions

d. Article 3 — Reinsurance

Article 3 describes the Parties' affirmative commitments with respect to reinsurance.

Paragraph:

1. and 2. U.S. reinsurers will not be subject to collateral requirements, or any requirement of similar impact, when operating in the EU unless EU reinsurers are also subject to those requirements in the EU. This prohibition applies both to contractual arrangements and to regulatory credit to a ceding insurer for the purchased reinsurance.

3. U.S. reinsurers will not be subject to local presence requirements (i.e. the establishment of a subsidiary, holding company, or other legal entity) or any requirement of similar impact, when operating in the EU.

4(a) - (l). Relief from local presence and collateral obligations for an EU reinsurer in the United States is dependent upon the EU reinsurer meeting financial condition and market conduct standards. The details of these standards, which remove excessive regulation, track existing state-based law and regulation.

5. In addition to the information required by paragraphs 4(a) - (l), reinsurers may voluntarily provide information to regulatory authorities.

6. In the event that an EU reinsurer fails to meet the standards and requirements of paragraph 4, then U.S. insurance authorities may re-impose collateral requirements on that EU reinsurer.

7. Subject to applicable law, U.S. ceding insurers can negotiate any provision in any reinsurance agreement, including for collateral.

8. Existing U.S. reinsurance agreements are not affected by the Agreement, i.e. the Agreement does not have a retroactive effect. Consistent with basic contract law, reinsurance agreements cannot be unilaterally amended. An amendment to a reinsurance agreement can be limited to the targeted subject matter of the amendment without changing the remaining provisions of the agreement.

If, for example, a reinsurer changed its name, then the parties to that reinsurance agreement could agree to amend the existing reinsurance agreement with respect to the name change only, which would not alter the agreement's requirement for collateral.

These provisions are drawn from NAIC Model Regulation 786 (Credit for Reinsurance).

9. If the Agreement were terminated, then the United States and the

EU can again require the posting of collateral or the establishment of a local presence for a reinsurer domiciled in the other jurisdiction.

e. Article 4 — Group Supervision

This Article describes the mutual affirmation of group supervision practices of the United States and the EU, and describes group supervision practices to be adopted by both the United States and the EU upon the date of provisional application, (i.e. date of signature, as provided in Article 10, Para. 2(a)).

Article 4 applies only to those U.S. insurers operating in both the United States and the EU.

Article 4 acknowledges that the United States and the EU have different approaches and systems with respect to insurance group supervision, and provides clarity regarding the interaction of those approaches and systems going forward.

Paragraph:

(a) Recognizing the value of supervisory colleges, the Agreement clarifies that only U.S. insurance supervisors will supervise U.S. insurers at the worldwide group level. In other words, EU supervisors can apply EU law and regulation to U.S. insurers only for operations and activities that occur in or originate from the EU. This limitation applies to all aspects of group supervision, including solvency and capital, governance, and reporting.

In other words, U.S. insurers are supervised at the worldwide group level as determined by U.S. state insurance regulators.

(b) Subject to Article 3, U.S. insurers and reinsurers operating in the EU are subject to EU law and regulation only for purposes of operations and activities occurring in or originating from the EU.

(c) U.S. insurers are required to prepare only a U.S. state-based Own Risk Solvency Assessment (ORSA) at the worldwide group level, not both a U.S. and an EU ORSA. The summary report of the U.S. ORSA can be shared with EU supervisors through the insurer's supervisory college. In other words, at the worldwide group level, U.S. insurers will complete an ORSA consistent with U.S. state regulatory practices.

(d) The required elements of the ORSA, as described in this paragraph, are drawn from the NAIC Risk Management and Own Risk and

Solvency Model Act (#505) and the NAIC ORSA Guidance Manual.

(e) If the ORSA of an EU insurer or reinsurers reveals a serious threat to U.S. policyholders, then the U.S. insurance regulator may consult with the insurer's lead EU supervisor and may impose preventive, corrective or responsive measures.

(f) U.S. insurers operating in the EU report at the worldwide group level only to the lead U.S. insurance supervisor unless the information to be reported reveals a direct threat to activities or operations occurring in or originating from the EU. In other words, at the worldwide group level, U.S. insurers report consistent with U.S. state regulatory practices.

(g) U.S. regulators retain the ability to ask for information about non-U.S. activities that may pose a serious threat to the ability of an EU insurer or reinsurer to pay its claims in the United States.

This language tracks the "windows" of the NAIC Model Holding Company Act (#440) provisions that allow state insurance regulators to "scrutinize group activity and assess its potential impact on the ability of the insurer to pay its claims."

(h) As with all of Article 4, the group capital calculation applies only to U.S. insurers that operate in the EU. U.S. insurers and reinsurers operating in the EU are relieved of the EU's Solvency II group capital requirement upon the date of provisional application, i.e. the date of signature (Article 10, Para. 2(b)).

U.S. state insurance regulators who, in reply to international developments, have been developing a group capital calculation since 2014, have five years from the date of signature (Article 10, Para. 2(a) and 2(e)) to develop the group capital calculation for the subset of U.S. insurers operating in the EU. For that five (+) year period, and upon completion, U.S. insurers operating in the EU are not thereafter subject to reporting or maintaining the Solvency II worldwide group capital requirement. The language is not prescriptive in terms of the mechanics or specifics of the group capital calculation, but defers to the ongoing work of U.S. state insurance regulators.

The language regarding "authority to impose preventive, corrective, or otherwise responsive measures on the basis of the assessment, including requiring, where appropriate, capital measures" is intentionally broad. This language accommodates both the U.S. state regulatory approach (i.e. at

the entity level) and the EU Solvency II approach (i.e. at the holding company level).

(i) If the EU exercises enhanced group supervision over a U.S. insurer for purposes of financial stability, then the United States can terminate the Agreement.

f. Articles 5 and 6 — Exchange of Information and Annex

These Articles encourage continued and enhanced exchange of confidential information across borders and encourage U.S. and EU supervisors to utilize the template attached as an Annex to the Agreement.

g. Article 7 — Joint Committee

Article 7 provides for the establishment of a Joint Committee to address questions of the Agreement's interpretation and implementation.

h. Article 8 — Entry into force

The Agreement enters into force seven days after the Parties exchange written notice that internal approval processes have been completed. However, timing for the effective date of the Agreement provisions is specified in Article 10.

i. Article 9 — Implementation of the Agreement

Article 9 describes that the EU and the United States shall take all measures to implement and provisionally apply the Agreement.

j. Article 10 — Application of the Agreement

The Agreement is entirely cross-conditional. Neither the EU nor the United States receive the benefits of the Agreement without providing the benefits of the Agreement. For example, if, five years from the date of signature, the EU were to reject the U.S. state regulatory approach to worldwide group capital for U.S. insurers operating in the EU, then the EU would relinquish the benefits of the Agreement for EU consumers and industry.

1. The Agreement applies to U.S. insurers operating in the EU on the date of entry into force, or the date of signature, whichever is later.

2. (a) U.S. insurers and reinsurers operating in the EU are relieved of Solvency II worldwide group requirements upon signature of theAgreement (i.e. the date of provisional application).

(b) Provided that the U.S. state insurance regulators comply with Articles 3 and 4, then the provisions and benefits of Article 3 and 4 will be received by U.S. consumers, insurers, and reinsurers.

(c) The exercise by the EU of enhanced supervision over a U.S. insurer or reinsurer for EU financial stability purposes (and vice versa) can be grounds for termination of the Agreement.

(d) U.S. state insurance regulators adopted the NAIC's reinsurance collateral reform as a national accreditation standard effective January 1, 2019 (i.e. every state would have a conforming law or regulation by that date). The Agreement provides the states with additional time, potentially into 2023, to adopt measures consistent with the Agreement.

(e) The EU will not impose a Solvency II worldwide group capital requirement on U.S. insurers and reinsurers operating in the EU for five years from the date of signature, and then only if the United States has not developed a group capital calculation as described in Article 4(h).

(f) If the EU does not meet the obligations of Article 3 with respect to the elimination of local presence requirements, then U.S. state insurance regulators may impose a worldwide group capital requirement or assessment on EU insurers and reinsurers. The inverse is also true.

(g) The EU will eliminate local presence laws within two years from the date of signature.

(h) U.S. reinsurers operating in the EU will not be subject to collateral requirements, or the equivalent, within five years from the date of signature.

(i) The Agreement provisions regarding the Joint Committee, Termination and Mandatory Consultation, and Amendment will be effective upon the date of signature.

n. Article 11 — Termination and Mandatory Consultation

Subject to the procedures established in the Agreement, the Agreement can be terminated at any time by either party.

o. Article 12 — Amendment

Article 12 sets forth the process for amending the Agreement.

Question Number Two

The Agreement opened the entire EU reinsurance market to U.S. reinsurers, spared U.S. industry operating in the EU potentially billions of dollars in compliance costs, and embraced the U.S. state regulatory approach to insurance group supervision, thereby conferring on U.S. consumers and industry the wide range of legal benefits described in reply to Question Number One.

Stakeholders were consulted extensively before and throughout the negotiation of the Agreement. For purposes of the Agreement negotiations, Treasury and USTR created and successfully utilized an unprecedented mechanism to include U.S. state insurance regulators the negotiation of an international agreement. For example, a total of ten regulators from nine states participated as members of the U.S. state insurance regulator task force that contributed significantly throughout negotiations of the Agreement, three of whom also served on FACI.

The Federal Advisory Committee on Insurance (FACI) was first created in 2011. FACI's existence and endeavors are guided by the Federal Advisory Committee Act (Pub.L. 92-463, 86 Stat. 77 (1972)). Given that Treasury and USTR engaged extensively with Congress, state regulators, and other stakeholders throughout the Agreement negotiations, and given that the Agreement provides material legal, financial and commercial benefit to U.S. consumers and industry, alteration of the FACI role would be both duplicative and unnecessary.

Question Number Seven

Congressional authority is not constrained by Title V of the Dodd-Frank Act. Further, the EU is a union of independent sovereign nations whereas every other counter-party would likely be a single nation. However, the Agreement involves prudential insurance and reinsurance measures, and is not a trade agreement. Without comment on matters of international trade, matters of prudential oversight such as those contained in the Agreement are qualitatively different. For example, Congress does not "expedite rejection" or approval of NAIC model laws and regulations.

As provided in Title V of the Dodd-Frank Act, frequent engagement with all four Congressional committees of jurisdiction was extremely meaningful and helpful throughout the negotiation of the Agreement.

Question Number Eight

Insurance markets are increasingly global, and multi-national U.S. insurers have tremendous opportunities for organic growth in the developing markets of Central and South America, Asia and Africa, and Eastern Europe. The Covered Agreement authority in Title V (the "FIO Act") of the Dodd-Frank Act may be necessary to address and resolve differences in the regulation of the business of insurance between the United States and other jurisdictions.

For example, when the FIO Act became law in 2010, few in the United States *or* the EU knew whether and, if so, when or in what form, the EU's Solvency II regime would be implemented. The Agreement illustrates that the Covered Agreement authority can resolve important issues of cross-border insurance regulation and, at the same time, provide potentially billions of dollars in value to the U.S. consumers and industry. Due to the variability of potential fact patterns in increasingly globalized insurance markets, the FIO's Covered Agreement authority has an appreciably growing value to American interests, and potential expansion of the authority may be necessary.

Question Number Nine

No. A Covered Agreement can be negotiated with one or more foreign jurisdictions.

The International Association of Insurance Supervisors (IAIS) is not a foreign jurisdiction but is a voluntary association of members formed under the laws of the Switzerland. In this sense, the IAIS is akin to the NAIC which, of course, is also a voluntary association of members formed under the laws of the United States but is not a "jurisdiction."

Further, as detailed in reply to Question Number One, the Agreement demonstrates that Covered Agreement will be used to preserve and enhance the U.S. system of insurance regulation.

Congressman Hultgren

A. Yes. Reinsurance agreements are subject to the principles of basic contract law. Amendments to contracts, regardless of the magnitude of the amendment, require an agreement of the parties to the contract. An amendment to a reinsurance agreement that could result in the reduction of collateral would require that both parties to that reinsurance agreement agree upon the amendment. Collateral could not be reduced if the ceding insurer did not also agree.

B. The Agreement does not have retroactive application. The hypothetical of a reinsurer's scheme of arrangement (a "Part VII transfer of business"), or the application of a jurisdiction's unique legal or regulatory system, depends upon numerous complex variables and cannot be answered in the abstract. However, Article 3 of the Agreement preserves the authority of a ceding insurer's U.S. state insurance regulator to re-impose collateral and other requirements on a reinsurer that fails to satisfy the Agreement's financial condition and market conduct standards. Further, a Part VII transfer would likely trigger the standard provisions of a reinsurance agreement that allow the ceding insurer to accelerate the posting of collateral