



U.S. and EU Sign Covered Agreement; Issue Clarifying Statements

On Friday, September 22, 2017 the United States and the European Union signed a bilateral agreement on certain prudential measures regarding insurance and reinsurance (the “Covered Agreement” or “Agreement”).¹ Execution had been pending since both parties announced their intention to sign on July 14, 2017. Negotiation of the Agreement had been finalized six months earlier, on January 13, 2017.

The Agreement addresses three areas of prudential insurance regulation important to internationally active insurers and reinsurers: (1) reinsurance; (2) group supervision; and (3) the exchange of information between insurance supervisors. Please see our February 3, 2017 article entitled [EU/U.S. Covered Agreement: What’s Next?](#) for further background regarding the terms and conditions of the U.S./EU Covered Agreement and the historical context of reinsurance, solvency, and collateral regulation under the laws of the EU member states and the U.S. states.

In addition to a joint statement issued by both parties upon execution of the Covered Agreement, the U.S. issued an individual statement (the “U.S. Signing Statement”), and the EU issued a “fact sheet” (the “EU Fact Sheet”).² Likely in response to calls for clarification or renegotiation by the National Association of Insurance Commissioners (“NAIC”) and certain other interested stakeholders, including a request for clarification by the U.S. House of Representatives Committee on Financial Services, the U.S. Signing Statement sets forth the U.S. interpretation of several key areas of uncertainty under the Agreement, including collateral elimination, group capital assessment requirements, the process for renegotiating or amending the Agreement, and involvement of state insurance regulators in the Joint Committee process.³ Notably, the EU Fact Sheet does not address a number of the issues clarified in the U.S. Signing Statement, and some practical consequences of the Covered Agreement remain uncertain.

Collateral Elimination for EU Reinsurers

The Agreement requires the United States to gradually reduce and eventually eliminate the collateral required to allow U.S. insurers to receive full credit for reinsurance cessions to EU-based reinsurers

¹ Bilateral Agreement between the United States of America and the European Union on Prudential Measures Regarding Insurance and Reinsurance.

² Executive Office of the President, Office of the United States Trade Representative, *Treasury, USTR Sign Covered Agreement on Prudential Insurance and Reinsurance Measures with the European Union*, September 2017, <https://ustr.gov/about-us/policy-offices/press-office/press-releases/2017/september/treasury-ustr-sign-covered> [hereinafter *U.S. Signing Statement*].

³ See Letter from Sean Duffy, Chairman, and Dennis Ross, Vice Chairman, of the Housing and Insurance Subcommittee of the United States House of Representatives Committee on Financial Services to Secretary Steven Mnuchin of the U.S. Department of the Treasury (24 Feb. 2017).

that meet certain financial strength and market conduct requirements. Noting that under U.S. states' current risk-based approach, credit for reinsurance laws reduce, but do not eliminate, collateral requirements for non-U.S. reinsurers, and that several of the conditions in the Agreement for an EU reinsurer to avoid collateral requirements differ materially from those under current state laws, the NAIC observed that U.S. states may need to take alternative measures to ensure that ceding insurers in the U.S. are protected from any risk posed by non-U.S. reinsurance counterparties.⁴ The U.S. Signing Statement confirms that the Agreement “does not prevent a state insurance regulator from imposing non-collateral requirements . . . as conditions for ceding companies to enter into reinsurance agreements with EU reinsurers or to allow credit for such reinsurance,” but only if such requirements “do not have substantially the same regulatory impact as collateral requirements” and only “if the state insurance regulator applies the same requirements in the case of reinsurance agreements with U.S. reinsurers domiciled in that state.” The EU Fact Sheet is silent in that regard.

Group Capital Calculation

The Covered Agreement provides that generally an insurance or reinsurance group will be subject to the worldwide prudential insurance group supervision of only the “Home supervisory authority,” the territory in which the worldwide parent of the group is headquartered or domiciled, relieving U.S. insurers and reinsurers from the group capital, solvency, reporting, and governance requirements of Solvency II. However, the freedom from the EU supervisory authority’s group capital requirements is conditioned upon the U.S. insurance or reinsurance group being subject to a “group capital assessment” by its domestic regulator. Under the Agreement, that group capital assessment must “include[] a worldwide group capital calculation capturing risk at the level of the entire group, including the worldwide parent undertaking of the insurance or reinsurance group, which may affect the insurance or reinsurance operations and activities occurring in the territory of the [non-domestic supervisor]” and the domestic 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[.]”⁵

According to the NAIC, this provision could be read to suggest that, contrary to the current U.S. regulatory scheme, “states should impose capital requirements, with specific corrective measures, at the group level of a U.S. insurer, rather than at the legal entity level.”⁶ Observing that its current work to develop a group capital calculation “does not include a requirement for additional capital at either the group or legal entity level,” the NAIC expressed concerns that its ongoing efforts to develop a group capital calculation would not satisfy the Agreement’s requirements as understood by the EU. Addressing this concern, the U.S. Signing Statement clarifies that the Agreement “does not require development of a group capital standard or group capital requirement in the United States,” and that the states’ current development, through the NAIC, of a “group capital calculation which is intended to serve as an analytical tool for evaluating a firm’s capital position at the group level” will satisfy the Agreement’s group capital assessment requirement, provided that the work is completed and

⁴ Letter from Ted Nickel, NAIC President and Wisconsin Commissioner of Insurance, Eric A. Cioppa, NAIC Vice President and Superintendent of Maine Bureau of Insurance, Michael F. Consedine, NAIC Chief Executive Officer, Julie Mix McPeak, NAIC President-Elect and Commissioner of the Tennessee Department of Commerce & Insurance, and David C. Mattax, NAIC Secretary-Treasurer and Commissioner of the Texas Department of Insurance to Secretary Steven Mnuchin of the U.S. Department of the Treasury (15 March 2017).

⁵ Bilateral Agreement, *supra* note 1, at 4(h).

⁶ NAIC letter, *supra* note 3.

implemented within the required five year window.⁷ The U.S. Signing Statement further notes that existing state law already provides for application of capital measures at the insurance entity level, and that nothing in the Agreement “requires states to impose such capital measures on the basis of a capital assessment.”⁸ The EU Fact Sheet does not address the group capital assessment requirement, however, and it is unclear whether the understanding of the U.S. of those requirements comports with that of the EU.

Prospect of Perpetual Renegotiation

Another concern of the NAIC was that the Joint Committee established by the Agreement will “invite perpetual renegotiation of the Agreement’s terms that could significantly impact the insurance sector.”⁹ The U.S. Signing Statement clarifies that the “Agreement can be amended only by agreement of the Parties, in writing, in accordance with Article 12” of the Agreement.¹⁰ However, this does not necessarily address differences in interpretation of the Agreement that may arise out of the Joint Committee.

State Regulators’ Involvement

The NAIC expressed concern regarding the uncertainty of the state insurance regulators’ involvement with respect to the Joint Committee established to oversee implementation of the Agreement. According to the U.S. Signing Statement, the U.S. is committed to “the direct involvement of state insurance regulators, including their staff, in the work of the Joint Committee,” and the Joint Committee should be “well-informed of the views and interests of state insurance regulators.”

Remaining Practical Uncertainties

Despite the clarification provided in the U.S. Signing Statement, uncertainties remain, including the extent to which U.S. state regulators will impose enhanced risk-based capital requirements, or take other alternative measures, to ensure that U.S. ceding insurers and their policyholders are protected from any risk posed by EU reinsurance counterparties. Some also have suggested that upon elimination of collateral requirements under state insurance laws, ceding insurers still may require collateral on a contractual basis, especially in a soft reinsurance market.

There is further uncertainty regarding the potential for future covered agreements with non-EU members, such as the UK following a withdrawal from the EU, and Bermuda. NAIC CEO Mike Consedine’s statement regarding signing of the Covered Agreement emphasizes that the NAIC is grateful for Treasury and USTR’s cooperation with respect to this covered agreement, but the NAIC “would caution against using this mechanism in the future.”¹¹

Signing of the Agreement is not expected to produce any immediate changes in state insurance regulation because the Agreement gives states five years to make any required amendments to their

⁷ U.S. Signing Statement, *supra* note 2, at 2.

⁸ *Id.*

⁹ NAIC letter, *supra* note 3.

¹⁰ U.S. Signing Statement, *supra* note 2, at 3.

¹¹ NAIC, *NAIC Responds to Covered Agreement*, http://www.naic.org/newsroom_statement_170922_responds_to_covered_agreement.htm.

laws before federal preemption may kick in. We will continue to monitor the implementation of the Covered Agreement in the U.S. and EU during this time.