TESTIMONY

OF

MICHAEL C. SAPNAR

PRESIDENT AND CHIEF EXECUTIVE OFFICER

TRANSATLANTIC REINSURANCE COMPANY

HEARING ON

EXAMINING THE U.S.-EU COVERED AGREEMENT

BEFORE

THE SENATE COMMITTEE ON BANKING, HOUSING AND URBAN AFFAIRS

MAY 2, 2017
My name is Michael C. Sapnar and I am President and CEO of Transatlantic Reinsurance Company (TRC) and the immediate past Chairman of the Reinsurance Association of America (RAA). I am testifying today on behalf of my company, the RAA\(^1\), the American Insurance Association\(^2\) (AIA), the American Council of Life Insurers\(^3\) (ACLI) and the Council of Agents and Brokers\(^4\) (CIAB). I am pleased to appear before you today to express our collective full support for the recently concluded Bilateral Agreement between the European Union and the United States of America on Prudential Measures Regarding Insurance and Reinsurance (the “Covered Agreement”). I commend Chairman Crapo and Ranking Member Brown for holding this important and timely hearing and welcome the opportunity to address the Banking Committee. I also want to thank the Treasury Department, the U.S. Trade Representative and the participating state regulators for their 13 months of hard work in bringing the Covered Agreement to fruition.

Transatlantic Reinsurance Company is a New York domiciled professional reinsurer. TRC is a wholly-owned subsidiary of Transatlantic Holdings, Inc., a Delaware corporation, which is a wholly-owned subsidiary of Alleghany Corporation (NYSE: Y), a Delaware corporation. TRC has

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\(^1\) The RAA is a national trade association representing property-casualty companies that specialize in assuming reinsurance in the U.S. In 2015, RAA’s underwriting members and affiliates had surplus of $194 billion and $125 billion in gross written premiums.

\(^2\) The AIA is the leading property-casualty insurance trade association representing approximately 300 insurers that write more than $125 billion in premiums each year. AIA member companies offer all types of property-casualty insurance, including personal and commercial auto insurance, commercial property and liability coverage, specialty, workers’ compensation, homeowners’ insurance, medical malpractice coverage, and product liability insurance.

\(^3\) The American Council of Life Insurers (ACLI) is a Washington, D.C.-based trade association with approximately 290 member companies operating in the United States and abroad. ACLI advocates in state, federal, and international forums for public policy that supports the industry marketplace and the 75 million American families that rely on life insurers’ products for financial and retirement security. ACLI members offer life insurance, annuities, retirement plans, long-term care and disability income insurance, and reinsurance, representing 94 percent of industry assets, 93 percent of life insurance premiums, and 97 percent of annuity considerations in the United States. Learn more at [www.acli.com](http://www.acli.com).

\(^4\) The Council of Insurance Agents and Brokers has 205 members selling 80 percent of domestic commercial property/casualty premiums.
over 600 employees worldwide, most of whom are in the United States. TRC is robustly regulated in the United States with New York as its domiciliary regulator and New Hampshire as its group supervisor. TRC is licensed or qualified in every state, the District of Columbia, Guam and Puerto Rico and operates globally through a network of 20 branches and offices and 5 subsidiaries.\(^5\) The worldwide branch structure is a more efficient use of capital because it consolidates assets into one entity to enhance TRC’s standing as a potential counterparty for reinsurance transactions.

**The Covered Agreement Solves Real Problems Today and Makes U.S. Companies More Competitive**

The Covered Agreement is a “win” for U.S. companies doing business in the European Union (EU) and for the U.S. system of insurance regulation. It is also consistent with the current Administration’s regulatory policy to "enable American companies to be competitive with foreign firms in domestic and foreign markets, advance American interests in international financial negotiations and meetings, [and] make regulation efficient, effective and appropriately tailored.”

The Covered Agreement resolves several important prudential issues that are adversely impacting U.S. companies doing business in both the United States and the EU. These issues have been discussed by the parties for years, and in some instances decades, without resolution. The Covered Agreement will provide the following immediate benefits to the U.S. (re)insurance sector:

1. U.S.-based reinsurers can resume doing business in markets where they were excluded because of the January 1, 2016 implementation of the EU’s Solvency II regime. This development enables U.S. companies to keep capital and jobs in the United States rather than being forced to create Solvency II compliant branches or subsidiaries throughout the

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\(^5\) The branches and/or offices are in: London, Paris, Munich, Zurich, Dubai, Buenos Aires, Panama City, Rio de Janeiro, Hong Kong, Shanghai, Singapore, Sydney, Tokyo, Chicago, Miami, Overland Park, San Francisco, Stamford, Bermuda and Toronto. There are also five subsidiaries: TransRe London Ltd. in the United Kingdom; Calpe Insurance Company Ltd. in Gibraltar; TransRe Zurich Ltd. in Switzerland; Fair American Insurance and Reinsurance Company in New York; and Fair American Select Insurance Company in Delaware.
EU to maintain existing business. The Agreement also ensures that qualifying U.S.-based reinsurers will not have to post collateral in the EU.

2. Global group supervision can only be conducted by the home country supervisor: U.S. insurers with EU operating companies will only be subject to worldwide prudential insurance group oversight by their lead U.S. state regulator and not “upstream” supervision by EU Member States. It is estimated that this limitation on the application of Solvency II will save U.S.-based property/casualty and life companies potentially billions of dollars in additional capital and compliance costs.

3. Official acceptance throughout the EU of the U.S. insurance supervisory framework which benefits all U.S.-based insurance groups and provides valuable support for the U.S. regulatory system that can be leveraged in current and future international negotiations and regulatory dialogues. For example, this is important precedent for the argument that the U.S. approach to group capital (including valuation) should be incorporated into the IAIS International Capital Standard as an acceptable approach.

Our strong support for the Covered Agreement is consistent with TRC’s equally strong support for the well-tested U.S. state-based insurance regulatory system. The Covered Agreement is a targeted federal tool that is intended to supplement the state-based regulatory system by dealing with important international regulatory issues that state regulation cannot constitutionally address. No regulatory authority is created at the federal level and any potential federal preemptive authority is narrowly targeted.

**Transatlantic’s EU Issues**

As a global reinsurer, TRC specializes in managing risks, most notably natural and man-made catastrophes, for others. The one risk that is difficult to manage, however, is regulatory
uncertainty. In our business, regulatory uncertainty leads to lost jobs, increased operating costs, lost growth opportunities and reluctance on the part of new and existing clients to choose us as a service provider.

For over seven years, TRC has encountered challenges arising from the implementation of Solvency II and the lack of fair treatment for U.S. companies operating in the EU. As early as 2008, TRC was tracking the EU’s development of Solvency II and the potential negative consequences for U.S. companies. In testimony to the House Financial Services Committee Subcommittee on Insurance, Housing, and Community Opportunity in 2012, I identified issues that TRC was then having because of the impending implementation of Solvency II. I also testified that, at the same time the NAIC was lowering barriers by revising its Model Credit for Reinsurance Law in 2011 to make it easier for non-U.S. reinsurers to conduct U.S. business, the EU was raising barriers and making it more difficult for U.S. companies to do business in the EU. During the NAIC’s deliberations, TRC repeatedly asked state regulators to seek and obtain reciprocity of market access (most particularly the EU) in return for the favorable changes for non-U.S. reinsurers. This did not occur. In 2012, TRC supported the U.S.-EU Insurance Dialogue involving regulators from both jurisdictions. While this process enhanced the mutual understanding of both regulatory regimes, it yielded no tangible results addressing U.S. companies’ issues. Instead, TRC’s issues in the EU continued, including:

1. TRC was confronted with having to choose between having its local U.K. branch regulated on a Solvency II basis up to the U.S. holding company or forming a Solvency II-compliant entity somewhere in the EU to limit the upstream application of Solvency II to the U.S. operations. In an effort to avoid the upstream regulation, TRC chose to turn the U.K. branch into a subsidiary which required TRC to tie up $500 million in capital in the U.K.
This corporate move continues to negatively impact our operating costs. Nonetheless, the U.K. has continued to require more and more from this U.K. subsidiary, including requiring: additional independent directors on the board of our wholly-owned subsidiary; additional local compliance and risk management personnel in addition to our large U.S. home office staff; implementation of a partial internal model to comply with Solvency II; restrictions on various highly graded investments held by the U.K. subsidiary; and the ring-fencing of $800 million in assets to cover the loss reserves accumulated by the branch over a 30-year period of assuming reinsurance without incident. These requirements have cost TRC millions of dollars annually without any additional benefit to our customers. In addition, a concern by clients over TRC segregating its capital to form the U.K. subsidiary (instead of having the security of the company’s entire U.S. capital base) has cost TRC business opportunities.

2. In 2014, Poland, citing Solvency II, excluded U.S. Reinsurers from the local market. Much discussion ensued with the Polish regulator regarding this restriction, however, the regulator ultimately deferred to EIOPA\(^6\) for clarification. TRC was able to construct a workaround. Without that workaround, however, TRC, like many other U.S. reinsurers, would have been excluded from the Polish market unless it opened a branch in Poland with its own capital and personnel.

3. In late 2015, the U.K., again citing Solvency II, insisted that all U.S. companies operating in the U.K. needed to be Solvency II compliant up to the ultimate controlling entity or seek

\(^6\) The European Insurance and Occupational Pensions Authority (EIOPA) is a European Union financial regulatory authority whose responsibilities include microprudential oversight of insurance at the EU level (as opposed to the Member State level). EIOPA is often compared to the NAIC but is different in that it has certain regulatory authorities.
a discretionary and revocable “other methods determination” waiver from complying with Solvency II. This was a result of the E.U.’s failure to formally recognize the effectiveness of the U.S. state-based regulatory system for companies that are members of U.S.-domiciled groups.\(^7\) Ultimately, TRC was forced to incur the expense and time to seek a waiver of the group Solvency II requirement under the “other methods determination,” which, while granted, will expire on December 2018 unless revoked earlier. If the Covered Agreement is not signed, TRC will have to seek another waiver request in 2018.

Finally, although not impacting TRC, in late 2015, the German regulator issued a notice stating that after January 1, 2016, U.S.-based reinsurers would no longer be able to operate in Germany on a cross-border basis and would be forced to set up a local branch. This decision was based upon the fact the U.S. has not been deemed “equivalent” under Solvency II. Because TRC has an existing regulated Munich branch, we were allowed to continue writing business. Other U.S. companies, however, lost critical business with little notice. Shortly thereafter, Austria adopted a similar interpretation of Solvency II. Later in 2016, Belgium did something similar, seriously disrupting the annual renewal process for U.S. reinsurers and causing TRC to lose a valuable account. There are at least nine other EU states with similar laws. This uncertainty has a chilling effect on U.S. reinsurers’ business and may dissuade current and new customers from doing business with us.

**Prompt Signature of the Agreement Is Critical for U.S. Companies**

The statutorily mandated 90-day Congressional layover period has expired and the Administration should promptly sign the Covered Agreement. A delay in signature could result in elimination of

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\(^7\)Interestingly, the E.U. deemed the U.S.-based regulatory system equivalent for U.S. subsidiaries of E.U.-domiciled groups so that those entities did not have to be Solvency II compliant. While U.S. groups were expected to fully comply with Solvency II because of their EU subsidiaries, U.S. subsidiaries of E.U. groups were exempt from complying with Solvency II.
the benefits U.S.-based companies would receive under the Agreement. As a matter of good faith, the EU is currently forbearing from enforcing its Solvency II rules and regulations on U.S.-based companies doing business in the EU in anticipation of the parties’ signature of the Covered Agreement. However, this forbearance is not unlimited. For example, the German regulator (BaFin) advised the U.S. by January 13, 2017, letter (attached), that it would suspend its local presence requirements for U.S. reinsurers while both sides proceeded to finalize the Covered Agreement. The letter states:

The ongoing future supervisory approach regarding U.S. domiciled reinsurers will heavily depend on the fact whether the EU-U.S. Agreement comes in fact finally into force. This means that BaFin’s current statements regarding the treatment of U.S.-domiciled reinsurers on the basis of the EU-U.S. Agreement will not be valid (also in a retroactively sense) anymore if BaFin receives serious statements of one of the final decision making bodies of both parties that the agreement will not come into force respectively the agreement will fail [sic].

The Covered Agreement’s provisions eliminating local presence requirements are the linchpin for U.S. reinsurers to be able to write EU business. If the Agreement is not signed, these U.S. companies will not be able to renew, much less write any new, business in the EU without first going through the regulatory processes necessary to create branches and/or subsidiaries in multiple EU Member States. This not only requires sufficient time but also the relocation of capital and personnel from the U.S. to the EU. Because the annual renewal process begins in early September for January 1 renewals, it is imperative that U.S. companies -- and the EU market -- have certainty regarding U.S. companies’ ability to write business in the EU before that time. If the Agreement is not signed soon, Germany (and the other nine countries that have similar laws) may suddenly decide to enforce their local presence requirements, possibly removing the option for TRC to establish the requisite local presence in time for the 2018 renewal season.
**Asserted Challenges to the Covered Agreement Should Not Delay Signature**

Several companies contend that before the Covered Agreement can be signed, there must be an “official” clarification of certain terms executed by both the U.S. and the EU. These assertions are not only incorrect, but ignore the procedure set forth in the Agreement to resolve such issues. First, merely asserting something is unclear does not make it so. In fact, the plain meaning of the Agreement’s text demonstrates otherwise. The Agreement’s language is further reinforced by the National Association of Insurance Commissioners (NAIC) Model Laws and Regulations on which portions of the Agreement were based, the U.S. Treasury Department’s January 18, 2017 Fact Sheet (attached), and the European Commission’s April 4, 2017 Explanatory Memorandum to the European Council (attached). Second, Section 7 of the Covered Agreement establishes a Joint Committee of representatives from the United States and the EU which shall provide “a forum for consultation and to exchange information on the administration of the Agreement and its proper implementation.” Any questions about implementation can and should be addressed in this forum after the Agreement is signed. We strongly support that State insurance regulators should be included in this forum. Finally, to the extent this proposed “simple solution” to clarify the Agreement is a call to renegotiate the Agreement, this should be rejected as it would erase the benefits to U.S. (re)insurers and return the U.S.-EU relationship to the pre-agreement status quo of regulatory uncertainty.

A. The two key substantive issues addressed by the Covered Agreement do not need clarification:

1. **Group Capital.** Several have asserted that the Covered Agreement mandates a group capital requirement in the U.S., and possibly one that resembles Europe’s Solvency II. The language does not support this interpretation. First, Article 4(h) of the Agreement
states that for a U.S. or European insurance group to enjoy the benefits of the Agreement, it needs to be subject to a group capital calculation by its home supervisor. This word choice is significant because it specifically contemplates the NAIC’s current initiative to develop a group capital assessment or calculation (not a standard or requirement as in the EU). Second, Article 4(h) does not (and legally could not) alter existing state sovereign authority. Third, nothing in Article 4 (or elsewhere in the Agreement) suggests that Solvency II’s group capital standards should be imported into the U.S. To the contrary, the Agreement’s Preamble reflects a mutual acceptance by the EU and the U.S. of, and respect for, each other’s governing insurance financial regulatory architecture.

2. Prospective Treatment of Reinsurance Collateral Relief. The Covered Agreement text also does not support the assertion that collateral posted pursuant to existing contracts will be automatically released once the Agreement is signed. Article 3 incorporates text from Section 8(A)(5) of the NAIC’s Model Credit for Reinsurance Regulation, which does not allow automatic retroactive changes to existing contractual obligations based upon statutory reductions in collateral requirements. The Covered Agreement and the NAIC Model require changes to existing contracts to reflect changing statutory collateral rules only if amendments to the contracts are material (and, of course, agreed to by both parties). The Fact Sheet underscores the U.S view: “It is understood that changes to regulatory requirements for posting collateral would not apply to amended agreements unless such amendment constitutes a material change to the underlying terms of the agreement.”
B. A few companies also have argued that the Covered Agreement should have achieved an official Solvency II “equivalence” determination for the United States. Although this designation would have bestowed benefits on U.S. companies, it would have placed unacceptable requirements on the U.S. regulatory system. Importantly, state regulators never sought or wanted this solution for a simple reason: Solvency II’s statutory equivalence process involves a prescriptive, unilateral evaluation by the EU of another jurisdiction’s regulatory regime to assess whether its rules and regulations are “equivalent” (i.e., very similar to) Solvency II. The state regulators understood this when, in July 2014, they advised the EU that the U.S. would not be pursuing “equivalence” because of the significant changes to the U.S. supervisory system such a path would require.8

The Covered Agreement reflects respect for the state regulators’ July 2014 decision as it achieved significant benefits for the U.S. without any requirements that the U.S. adopt any Solvency II requirements. The Preamble of the Covered Agreement makes it clear that the U.S. does not intend to adopt any Solvency II requirements and that the EU understands this: “Sharing the goal of protecting insurance and reinsurance policyholders and other consumers, while respecting each Party’s system for insurance reinsurance supervision and regulation.” Furthermore, the very structure of the Agreement reinforces this agreed parity between the two regulatory systems as the Parties’ obligations and benefits are mutual and cross-conditional throughout the Agreement: both sides must continue to perform their

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8 July 11, 2014 letter from NAIC to Jonathan Faull (European Commission) (“As you know, U.S. state insurance regulators are not pursuing an equivalence determination. While it is possible to compare our respective statutory authorities on paper, it would be challenging to conduct a comprehensive comparison of our two regulatory systems in practice until Solvency 2 is fully operational and the outcomes it produces based on actual experience are better understood.”) (attached).
obligations to receive the benefits; if one side does not perform, the other side is relieved of its obligations under the Agreement.

C. Although the process could be improved, the Covered Agreement was negotiated and concluded in accordance with existing law. Process concerns should be addressed but should not adversely impact the decision to sign this Covered Agreement. One process issue that should be addressed is formalizing the role of state insurance regulators, who are essential to the negotiation and implementation of a covered agreement. It is important to note, however, that state regulators did have a formal substantive role in this Covered Agreement process. Former FIO Director Michael McRaith recently testified at the House Financial Services Committee Housing & Insurance Subcommittee Hearing that state insurance regulators attended and participated, often in person, in every negotiation. He also testified that state regulators promptly received every EU document and that there were conference calls for FIO and USTR to receive their input before documents were sent to the EU. NAIC President Ted Nickel testified at the same House hearing that NAIC suggestions were incorporated into the drafts sent to the EU.

In conclusion, the Covered Agreement addresses bilateral insurance regulatory issues that were creating barriers for U.S. companies in the EU. Although there may be lessons learned about the process, the Agreement is a significant and timely "win" for the competitiveness of U.S.-based insurers and reinsurers, insurance consumers, and the U.S. insurance regulatory system. The Covered Agreement removes regulatory uncertainty for companies and establishes fair terms upon which companies operating in both the EU and the U.S. can do business in these jurisdictions. This was accomplished without importing Solvency II into the U.S., something which could not have been achieved with a Solvency II equivalence determination.
Attachments
Bundesanstalt für
Finanzdienstleistungsaufsicht

Michael T. McRath
Director, Federal Insurance Office
U.S. Department of the Treasury
1500 Pennsylvania Avenue, NW
WASHINGTON, D.C. 20220
VEREINIGTE STAATEN VON AMERIKA

13.01.2017
Reference: VA 45-I 2263-2016/0023 (Please quote in your reply)
2017/0083827

Dear Mr McRath,

I would like to express again BaFin's serious willingness to apply the rules regarding the suspension of local presence requirement for US-reinsurers in the EU according to the agreement as soon as possible.

However, BaFin is only in the position to agree on this suspension under the condition that the EU-U.S. agreement reaches a certain legally binding status. Based on our current assessment, one can assume that this binding status is reached with the formal exchange of letters signed by the chief negotiators of both parties with the EU-U.S. agreement between both parties. According to my information these signed letters had been exchanged at 12 January. We understand that both sides are now proceeding with their domestic procedures respecting the final text.

We would like to emphasize that after the exchange of the signed letters mentioned above, the ongoing future supervisory approach regarding US-domiciled reinsurers will heavily depend on the fact whether the EU-U.S. agreement comes in fact finally into force.

This means that BaFin's current statements regarding the treatment of US-domiciled reinsurers on the basis of the EU-U.S. agreement will not be valid (also in a retroactively sense) anymore if BaFin receives serious statements of one of the final decision making bodies of both parties that the agreement will not come into force respectively the agreement will fail.

Yours sincerely,

[Signature]
Washhausen-Richter
(Deputy Chief Executive Director)
The United States has negotiated a covered agreement with the European Union (EU), hereunder referred to as the Covered Agreement. The Covered Agreement affirms the U.S. system of insurance supervision, protects insurance consumers, and provides meaningful benefits for U.S. insurers and reinsurers.

Pursuant to 31 U.S.C. § 314, the Federal Insurance Office (FIO) Act of 2010 authorizes the Secretary of the Treasury (Treasury) and the United States Trade Representative (USTR) jointly to negotiate a covered agreement with one or more foreign governments, authorities, or regulatory entities. A covered agreement is a “written bilateral or multilateral agreement regarding prudential measures with respect to the business of insurance or reinsurance.”

On November 20, 2015, Treasury and USTR notified Congress that FIO and USTR would begin joint negotiations with the EU. These negotiations began in February 2016 and concluded in January 2017.

The Covered Agreement limits the worldwide application of EU prudential measures on U.S. insurers operating in the EU, including the elimination of worldwide group capital, governance, and reporting requirements. EU prudential supervision of U.S. insurers will be limited to these insurers’ EU operations and activities. Additionally, the Covered Agreement includes state-based reinsurance provisions that build on work largely underway at the state level and are expected to reduce reinsurance costs for primary insurers and improve the affordability and availability of insurance products to personal and commercial insurance consumers.

In the United States, state insurance regulators have general authority over the business of insurance (including reinsurance). The Covered Agreement outcomes affirm the integrated U.S. system of state and federal insurance regulation, including the role of state insurance regulators as the primary supervisors of the business of insurance.

The Covered Agreement addresses three areas of prudential insurance supervision: group supervision, reinsurance, and exchange of information between supervisory authorities. In general, the Covered Agreement terms apply on a mutual basis. The group supervision and reinsurance provisions are conditioned upon one another under the application provisions of the Covered Agreement. Key provisions are summarized below.

**Group Supervision**

Effective January 1, 2016, the EU began applying a new insurance regulatory framework, known as Solvency II, that exposed non-EU insurers to uncertain, differential and costly regulatory
treatment if the insurer’s country of domicile is not determined by the EU to have a supervisory system that is “equivalent” to the Solvency II supervisory system. Specifically, under Solvency II, EU supervisors have the ability to apply solvency and capital requirements to the worldwide operations of any U.S. insurer operating in the EU, in addition to worldwide reporting and governance requirements. The Covered Agreement precludes EU insurance supervisors from exercising such authorities over the worldwide operations of U.S. insurers. Without the limitations on such worldwide supervisory authority provided by the Covered Agreement, U.S.-based insurers and reinsurers with EU operations would be subject to regulatory burdens of Solvency II.

Group supervision features of the Covered Agreement include (see Article 4 of the Covered Agreement):

- The group supervision practices described in the Covered Agreement apply only to U.S. and EU insurance groups operating in both territories.
- U.S. insurance groups operating in the EU will be supervised at the worldwide group level only by the relevant U.S. insurance supervisors. EU insurers operating in the United States will be supervised at the worldwide group level only by the relevant EU insurance supervisors.
- U.S. insurance groups operating in the EU will not have to meet EU worldwide group capital, reporting, or governance requirements.
- With respect to risks from outside their territories that threaten operations and activities within their territories, supervisors in both the United States and the EU can request information from insurance groups from the other party, and take appropriate action within their territory to protect policyholders and financial stability.

Reinsurance

Subject to certain conditions, the Covered Agreement eliminates collateral and local presence requirements for U.S. reinsurers operating in the EU insurance market, and eliminates collateral and local presence requirements for EU reinsurers operating in the U.S. insurance market, as a condition for and in connection with regulatory credit for reinsurance.

With regard to collateral requirements, the Covered Agreement builds on the reinsurance collateral reform adopted unanimously by U.S. state regulators in 2011 and implemented in many U.S. states. The Covered Agreement establishes financial strength and market conduct conditions that EU and U.S. reinsurers must meet in order to receive the benefits of the Covered Agreement. These requirements provide a substantially equivalent level of protection for ceding insurers and consumers to that which is currently provided by U.S. state laws regarding credit for reinsurance. Among other conditions, the Covered Agreement provides that an EU-based reinsurer will be eligible for collateral elimination in the United States if that reinsurer meets robust capital and solvency standards, and maintains a record of prompt payments to ceding insurers.
While relief from reinsurance collateral requirements will reduce regulatory burdens for EU reinsurers operating in the United States, the Covered Agreement also relieves U.S. reinsurers from the obligation to establish a local presence—i.e., a branch or subsidiary—in the EU.

Collateral in place and collateral requirements for current reinsurance agreements will not be affected. Collateral requirements will be eliminated only with respect to losses incurred and reserves reported related to reinsurance agreements entered into, renewed, or amended after the date that a state law or regulation conforms to the Covered Agreement. It is understood that changes to regulatory requirements for posting collateral would not apply to amended agreements unless such amendment constitutes a material change to the underlying terms of the agreement. Nothing in the Covered Agreement prevents parties to a reinsurance agreement from negotiating for the inclusion of collateral, or for renegotiating current agreements, as a commercial matter.

Reinsurance features of the Covered Agreement include (see Article 3 of the Covered Agreement):

- The U.S. states have 60 months (5 years) to adopt reinsurance reforms removing collateral requirements for EU reinsurers that meet the prescribed consumer protection conditions. FIO will begin the process of making potential preemption determinations of state laws that are inconsistent with the Covered Agreement terms after 42 months.

- For a U.S. or EU reinsurer, conditions regarding financial strength, market conduct (e.g., whether the reinsurer pays claims promptly), and reporting requirements are the bases for relief from collateral and local presence requirements. Failure to meet these conditions and requirements can result in the reimposition of collateral or local presence requirements. Other conditions for reinsurers include consent to service of process and commitment to the payment of final, enforceable judgments.

- Within 24 months, EU Member States will revise existing laws so that U.S. reinsurers can operate in the EU without establishing a branch or a subsidiary. For those U.S. reinsurers that have not yet established a branch or subsidiary but have been operating in the EU, local presence requirements will not be imposed.

**Exchange of Information**

The Covered Agreement encourages, in a non-binding manner, insurance supervisors in the United States and the EU to share information. To support such information exchange, an annex to the Covered Agreement includes model provisions for a memorandum of understanding on information exchange that insurance supervisors are encouraged to adopt.

**Implementation and Application of the Covered Agreement**

The EU Member States will apply the group supervision practices described in the Covered Agreement following signature and the Parties’ internal processes required for “provisional
application” of the agreement before it enters into force. This is anticipated to take approximately 3 months.

The Covered Agreement includes provisions to ensure adherence to Covered Agreement terms and a mechanism for the United States and the EU to consult as needed. The Covered Agreement sets out, on a provision-by-provision basis, specific timelines for implementation of the Agreement and also establishes conditionality between provisions to avoid the possibility that one Party could provide benefits while the other fails to do so. For example, the United States would not be required to implement the reinsurance collateral elimination provisions of the Covered Agreement if the EU fails to comply with the terms of the Agreement on group supervision and local presence. Similarly, the EU could re-apply Solvency II group supervision requirements to U.S. insurers’ worldwide operations if the United States does not complete the necessary reinsurance reform within five years. These conditions are established with the aim of ensuring full and timely implementation on both sides.

After five years, when each side has successfully completed its reinsurance reforms and applied group supervision practices consistent with the Covered Agreement, it is expected the outcomes of the provisions will become the steady state between the United States and the EU.

Use of this Fact Sheet

This fact sheet is for informational use only, and is not a legal document. This fact sheet should be reviewed in conjunction with the Covered Agreement, which represents the final legal text negotiated between the Parties, and contains important legal conditions and other terms that are not summarized above.
Proposal for a

COUNCIL DECISION

on the signing, on behalf of the European Union, and provisional application of the Bilateral Agreement between the European Union and the United States of America on prudential measures regarding insurance and reinsurance
EXPLANATORY MEMORANDUM

1. CONTEXT OF THE PROPOSAL

• Reasons for and objectives of the proposal

This proposal derives from a Council decision of 21 April 2015\(^1\) pursuant to which the Commission was authorised to start negotiations with the United States of America (US) for the conclusion of an Agreement on insurance and reinsurance. Pursuant to this decision and the negotiating directives, the European Commission negotiated a Bilateral Agreement with the US on prudential measures regarding insurance and reinsurance in the course of 2016.

This Bilateral Agreement covers three areas, group supervision, reinsurance and exchange of information between supervisors:

- It sets out the conditions for group supervision in both Parties of their respective insurance and reinsurance groups. EU and US insurance and reinsurance groups active in both jurisdictions will not be subject to certain requirements with respect to group supervision for their worldwide activities, but supervisors retain the ability to request and obtain information about worldwide activities which could harm policyholders or financial stability.

- It lays down the prudential conditions to be applied for the removal of local presence and collateral requirements for reinsurers regulated and supervised in the other Party.

- It contains provisions and, in an annex, a model memorandum of understanding for the exchange of information between supervisory authorities in the EU and the US. Supervisory authorities will be encouraged to use these provisions to ensure a high standard of professional secrecy in any exchange of confidential information necessary for carrying out their general supervisory activities.

The Agreement thereby lays down an appropriate prudential framework to be applied to insurers and reinsurers from both Parties.

This proposal for a Council Decision constitutes the legal instrument for the signature and provisional application of this Bilateral Agreement.

• Consistency with existing policy provisions in the policy area

EU legislation in the area of insurance lays down a prudential framework for the protection of policyholders and for financial stability. This Agreement further contributes to ensuring a high level of policyholder protection in the EU, notably via increased cooperation and exchange of information between supervisors, whilst also ensuring that both Parties’ duly regulated and supervised insurance and reinsurance undertakings are not subject to undue burden.

\(^1\) Council Decision authorising the opening of negotiations on behalf of the European Union with the United States of America for the conclusion of an agreement on reinsurance, 31 March 2015, ST 7320 2015 INIT.
• Consistency with other Union policies
In line with the objectives of the Investment Plan for Europe and the Capital Markets Union, this Agreement will facilitate investment by reinsurers.

This Agreement is without prejudice to negotiations on a Transatlantic Trade Investment Partnership with the US.

2. LEGAL BASIS, SUBSIDIARITY AND PROPORTIONALITY
• Legal basis
The legal basis for the Union to act is Article 207 TFEU read in conjunction with Article 218(5) TFEU.

• Subsidiarity (for non-exclusive competence)
This initiative falls under the exclusive competence of the Union. The subsidiarity principle therefore does not apply.

• Proportionality
This EU action, laying down prudential rules for insurers and reinsurers, is in line with the principles of Directive 2009/138/EC of the European Parliament and of the Council (“Solvency II”) and does not go beyond what is necessary to achieve its aims.

3. STAKEHOLDER CONSULTATIONS
• Stakeholder consultations
The negotiations were conducted in consultation with Member States through the relevant Council special committee (the Council Working Party on Financial Services) and Member States were regularly informed about the progress of the negotiations. The European Parliament has also been informed about the progress of the negotiations.

Industry stakeholders on both sides have voiced their support for this Agreement and in particular with respect to the supervision of cross-border insurance and reinsurance groups and for the removal of reinsurance collateral requirements.

• Collection and use of expertise
Prior to the start of this negotiation, the EU and the US have been closely following developments in each other's jurisdictions, exchanging information on regulatory developments, and have identified specific aspects of each other's regulatory systems as potentially problematic for insurers or reinsurers operating in the other jurisdiction.

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2 EU reinsurers estimate that they have about $40 billion of collateral posted in the USA, which could be used more effectively in other investments. The opportunity cost is estimated at around $400 million per year.


4 The Council Special Committee was consulted on 14 March, 13 June, 29 June, 7 September, 30 September, 18 October, 9 November, 29 November, 9 December, 16 December and 19 December 2016 as well as on 10 January 2017.

5 The Chair and Members of the European Parliament's ECON Committee were debriefed in camera on 29 June, 11 October, 16 November and 30 November 2016.
This was in particular conducted through the EU-US Dialogue project, which brought together EU and US officials as well as EU and US supervisory authorities.

The European Insurance and Occupational Pensions Authority participated as an observer to these negotiations.

4. BUDGETARY IMPLICATIONS
No impact on the EU budget.

5. OTHER ELEMENTS

• Implementation plans and monitoring, evaluation and reporting arrangements

The Agreement provides for the set-up of a Joint Committee, which will provide a forum for the EU and the US to consult and to exchange information on the administration of the Agreement and its proper implementation.

Member States will also need to undertake the necessary actions to ensure implementation of this Agreement.

• Detailed explanation of the specific provisions of the proposal

Article 1 sets out the objectives of this prudential Agreement between the EU and the US, in the areas covered by the Agreement. Article 2 sets out the definitions that apply for this Agreement.

Articles 3 and 4 concern respectively reinsurance and group supervision. After full application of this Agreement, reinsurers of one Party operating in the other Party will not be subjected to any requirement to post collateral or to establish a branch or subsidiary, if they meet the prudential conditions laid down in the Agreement, and insurance groups of one Party operating in the other Party which meet the conditions will not be subjected to a requirement to carry out a group solvency calculation for their worldwide activities nor to other aspects of group supervision for their worldwide activities. Supervisors can exercise group supervision on groups established within the territory of their Party, and can require information to be provided about worldwide activities which risk seriously harming policyholders in their jurisdiction or threatening financial stability, or seriously harm the capacity to pay claims.

Articles 5 and 6, and the Annex, concern exchange of information between supervisors, with the commitment for both Parties to encourage supervisors to cooperate in exchanging information for purposes directly related to the fulfilment of their supervisory functions.

Furthermore, the Agreement provides for the setting up of a Joint Committee to discuss the application and implementation of the Agreement under Article 7, and Articles 11 and 12 provide that the Parties can amend or terminate the Agreement, provided the conditions and procedures set out in those Articles are fulfilled, including mandatory consultation for termination of the Agreement.

Articles 8, 9 and 10 set out when the Agreement will enter into force and become applicable, and they also provide for the provisional application of certain Articles of the Agreement.

The Agreement essentially provides for three modes of application between the Parties:
1. Full application of every Article of the Agreement, which starts on either the date 60 months following the date of signature of the Agreement, or the date of entry into force of the Agreement, whichever is later, and – for Articles 3, 4 and 9 – provided the conditions set forth in Article 10(2)(b) are fulfilled.

The Agreement remains in full application unless it is terminated in accordance with Article 11.

2. Where entry into force of the Agreement is prior to the date 60 months following signature of the Agreement, certain parts of the Agreement start to apply on earlier dates:

   Article 7 [Joint Committee], Article 11 [Termination and Mandatory Consultation] and Article 12 [Amendment], apply as from the date of entry into force of the Agreement. Article 4 is also to be applied from that date, in accordance with Article 10(2)(a) by the EU, and on a best efforts basis for the US side.

   Article 3(1) and (2) apply with respect to EU reinsurers in a U.S. State as from the date of either the adoption by the US State of a measure consistent with those provisions, or the date at which any pre-emption determination becomes applicable, pursuant to Article 10(2)(d).

   Finally, Article 3(3) shall be implemented and applicable in the EU as from 24 months after the date of signature, pursuant to Article 10(2)(g).

3. Prior to the entry into force of the Agreement, certain parts of the Agreement will also be provisionally applied. This provisional application concerns the following Articles:
   – Article 4, in accordance with Article 10(2)(a), and
   – Article 7.

   Provisional application starts on the seventh day of the month following the date on which the Parties have notified each other that their internal requirements and procedures necessary for provisional application have been completed. It lasts until the date of entry into force of the Agreement (or until one Party notifies the other Party of its intention not to complete its internal requirements for the entry into force of the Agreement).

Annex I of the Agreement contains detailed provisions for a Memorandum of Understanding for the exchange of information between supervisors, which the Parties shall encourage supervisors on both sides to follow pursuant to Article 6 of the Agreement.
Proposal for a

COUNCIL DECISION

on the signing, on behalf of the European Union, and provisional application of the Bilateral Agreement between the European Union and the United States of America on prudential measures regarding insurance and reinsurance

THE COUNCIL OF THE EUROPEAN UNION,

Having regard to the Treaty on the Functioning of the European Union, and in particular Article 207 read in conjunction with Article 218(5) thereof,

Having regard to the proposal from the European Commission,

Whereas:

(1) On 21 April 2015, the Council authorised the Commission to open negotiations with the United States of America for an Agreement on reinsurance. The negotiations were successfully concluded by an exchange of letters between the lead negotiators on 12 January 2017.

(2) The Agreement should be signed on behalf of the European Union, subject to its conclusion at a later date.

(3) In view of enabling the set-up of the Joint Committee under this Agreement, which will provide a forum for the EU and the United States of America to exchange information on the proper implementation of the Agreement and in order to allow for the implementation of harmonised practices by supervisory authorities in the EU as regards group supervision which are already possible under the current EU legal framework in this area, Articles 4 and 7 of the Agreement should be applied provisionally,

HAS ADOPTED THIS DECISION:

Article 1

The signing of the Bilateral Agreement between the European Union and the United States of America on prudential measures regarding insurance and reinsurance is hereby approved on behalf of the Union, subject to the conclusion of the said Agreement.

The text of the Agreement to be signed is attached to this Decision.

Council Decision authorising the opening of negotiations on behalf of the European Union with the United States of America for the conclusion of an agreement on reinsurance, 31 March 2015, ST 7320 2015 INIT.
Article 2
The Council Secretariat General shall establish the instrument of full powers to sign the Agreement, subject to its conclusion, for the person(s) indicated by the negotiator of the Agreement.

Article 3
Articles 4 and 7 of the Agreement shall be applied provisionally in accordance with Articles 9 and 10 of the Agreement.

Article 4
This Decision shall enter into force on the day of its adoption.
Done at Brussels,

For the Council
The President
July 11, 2014

Mr. Jonathan Faull
Director General, Internal Market and Services
European Commission
1049 Brussels
Belgium

Dear Mr. Faull:

Thank you for your letter of June 6th regarding your views on the “Way Forward Project” and for your assessment of the US regulatory system in the context of the Solvency 2 equivalence requirement.

We agree that the Project has been useful in terms of enhancing mutual understanding of the US and EU regulatory systems. As our collective jurisdictions represent nearly two-thirds of the global insurance market, shared confidence in our different regulatory approaches is important to reinforce the transatlantic insurance market and ensure effective cross border supervision of global firms.

As you know, U.S. state insurance regulators are not pursuing an equivalence determination. While it is possible to compare our respective statutory authorities on paper, it would be challenging to conduct a comprehensive comparison of our two regulatory systems in practice until Solvency 2 is fully operational and the outcomes it produces based on actual experience are better understood.

There are clear structural and legal differences between our two supervisory systems, but we continue to believe that the US regulatory system results in outcomes for insurers and policyholders that we hope Solvency 2 will achieve once it is fully implemented. This belief is based on real experience during periods of recession and great stress, hard and soft markets, low interest rates, and increasing frequency and severity of catastrophic events. Irrespective of those views, any inflexibility in the equivalence process that precludes the Commission from reaching a similar conclusion about the efficacy of our system is entirely self-imposed. Equivalence is a function of European law subject to the Commission’s interpretation, so in lieu of delineating changes to the US supervisory system that by all accounts is among the most effective in the world, the Commission should instead reevaluate whether the equivalence mandate deserves to be reconsidered given its potential negative impact on US and European firms and policyholders.

Sincerely,

Membership of the NAIC International Insurance Relations Leadership Group

Senator Ben Nelson
NAIC CEO

Adam Hamm, Chair
NAIC President
North Dakota Insurance Commissioner
Monica J. Lindeen, Vice Chair
NAIC President-Elect
Commissioner, Montana Securities and Insurance

Sharon P. Clark
NAIC Secretary-Treasurer
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Joseph G. Murphy
Commissioner, Massachusetts Division of Insurance

Bruce R. Ramge
Director, Nebraska Department of Insurance

Chester McPherson
Acting Commissioner
D.C. Department of Insurance, Securities and Banking

Benjamin M. Lawsky
Superintendent
New York State Department of Financial Services

Julie Mix McPeak
Commissioner
Tennessee Department of Commerce and Insurance

Michael F. Consedine
NAIC Vice President
Pennsylvania Insurance Department

Kevin M. McCarty
Commissioner, Office of Insurance Regulation

John M. Huff
Director, Missouri Department of Insurance

Gordon I. Ito
Hawaii Insurance Commissioner

Sandy Praeger
Kansas Insurance Commissioner

James J. Donelon
Louisiana Insurance Commissioner

Thomas B. Leonard
Connecticut Insurance Commissioner