What is a Covered Agreement?

The Federal Insurance Office (FIO) was created by the 2010 Dodd-Frank Wall Street Reform Act. The FIO’s authority includes: (1) the power to assist the Treasury Secretary in negotiating “covered agreements,” and (2) the power to determine whether State insurance measures are preempted by such covered agreements.

A “Covered Agreement” is a written bilateral or multilateral agreement regarding prudential measures with respect to the business of insurance or reinsurance that:

1. Is entered into between the United States and one or more foreign governments, authorities or regulatory entities; and
2. Relates to the recognition of prudential measures with respect to the business of insurance or reinsurance that achieves a level of protection for insurance or reinsurance consumers that is substantially equivalent to the level of protection achieved under State insurance or reinsurance regulation.

Why is a Covered Agreement Important?

- It is important that the U.S. and the European Union (EU) resolve how U.S. companies doing business in the EU will be treated after Solvency II go into effect on January 1, 2016.
- Solvency II has several unilateral processes for evaluating third country jurisdictions for equivalence. To the extent jurisdictions are deemed equivalent, companies from those jurisdictions would be treated as if they were an EU-based company.
- State regulators advised the EU several years ago that they would not participate in this unilateral process, but would pursue a mutual recognition process. The two jurisdictions began the EU-U.S. Dialogue Project in 2012 to better understand each other’s regulatory regime.
- Several other jurisdictions (Bermuda, Japan, Switzerland, Brazil, China, etc.) are pursuing equivalence and will receive a decision later in 2015.
- It is important for U.S. and EU companies with business in the U.S. to know that the U.S. issue will be resolved in a similar time frame.
- If this occurs:
  - EU companies can use U.S. RBC requirements in their capital calculations.
- U.S. (re)insurers will have the same market access as European (re)insurers and, we believe, soon Bermuda, Swiss, and Japanese (re)insurers creating more access to and reducing the price of (re)insurance in Europe
- U.S. (re)insurance will be treated in the same manner as European reinsurance for purposes of solvency calculations.
- U.S. (re)insurers will not be subject to additional requirements imposed by EU Member States that currently exist including collateral requirements (France), special reporting (The Netherlands), or requirement to form a local branch (Poland), or a local subsidiary (UK).

- If this does not occur:
  - U.S. (re)insurers will be subject to any requirements individual European Members States choose to impose. There are no European rules regarding cross border sales; these are left entirely to the Member States.
  - U.S. companies may be subject to subgroup supervision in the EU/forced to form subgroup holding companies. Solvency II laws would be applied to the subgroup, including governance, risk management and capital requirements.
  - U.S. (re)insurers may be required to commit capital to form a branch or subsidiary to do business in the EU. These entities will be subject to Solvency II requirements.
  - EU insurance companies may have to increase capital reserves to meet the difference between RBC and Solvency II putting them at a competitive disadvantage.
  - EU insurance companies (including affiliates of U.S. companies) may not be permitted to take full credit for reinsurance provided by a U.S. reinsurer for regulatory capital purposes under Solvency II, which puts U.S. reinsurers at a competitive disadvantage vis-à-vis EU and equivalent jurisdiction reinsurers.

**Process for a Covered Agreement:**

The process for negotiating a Covered Agreement in the U.S. includes:
- Joint authority by the Treasury Secretary and the United States Trade Representative (USTR) to negotiate and enter into Covered Agreements.
- Joint consultation with four Congressional Committees (House Financial Services, House Ways and Means, Senate Banking and Senate Finance) at three points:
  - Before initiating negotiations;
  - During negotiations; and
  - Before entering into the agreement.
- The final legal text must be submitted jointly to the four committees on a day when both Houses are in session. The agreement is in force 90 calendar days after that date.
- “Joint consultation” must include consultation with respect to:
- Nature of agreement;
- How, and to what, extent the agreement will achieve the applicable purposes, policies, priorities and objectives; and
- Implementation of the agreement, including the general effect of the agreement on existing State laws.

In Europe, the Commission has requested and received a mandate to negotiate a covered agreement with the U.S. The Commission has indicated that the covered agreement may be a step towards equivalence by addressing concerns such as professional secrecy laws, reinsurance and group supervision but will not replace the requirement for a delegated act regarding equivalence.

**Preemptive Authority of a Covered Agreement in the U.S.**

A state insurance measure shall be preempted by a Covered Agreement if, and only to the extent that, the FIO Director determines the measure:

1. Results in less favorable treatment of a non-U.S. insurer domiciled in a foreign jurisdiction that is subject to a Covered Agreement than to a U.S. insurer domiciled, licensed or otherwise admitted in that State; and

2. Is inconsistent with a Covered Agreement.

The savings provision provides that nothing shall preempt “(A) any State insurance measure that governs any insurers rates, premiums, underwriting or sales practices; (B) any State coverage requirements for insurance; (C) the application of the antitrust laws of any State to the business of insurance; or (D) any State insurance measure governing the capital or solvency of an insurer, except to the extent that such State insurance measure results in less favorable treatment of a non-United State insurer than a United States insurer;”

**Process for Preempting State Law in the U.S.**

FIO must provide notice to the relevant state regulator(s) and public notice before the preemption determination is made. The Director’s determination shall be limited to “the subject matter contained within the Covered Agreement involved and shall achieve a level of protection for insurance or reinsurance consumers that is substantially equivalent to the level of protection achieved under State insurance or reinsurance regulation.”

After the decision is made, the Director must notify the State(s) and the four Congressional Committees. After the notice period expires, and there has been a notice in the Federal Register regarding the effective date of the preemption, the preemption is in effect and no state may enforce a state insurance measure to the extent it has been preempted under this provision.