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

[U.S.–EU Covered Agreement]

FACT SHEET
January 18, 2017

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.

<u>Group Supervision</u>

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.

<u>Reinsurance</u>

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.

<u>Exchange of Information</u>

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.

<u>Implementation and Application of the Covered Agreement</u>

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.