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# States' Regulatory Role Preserved In US-EU Insurance Pact

By **Jeff Sistrunk**

Law360, Los Angeles (September 25, 2017, 9:32 PM EDT) -- A landmark bilateral deal designed to put U.S. and European Union insurers and reinsurers on equal footing will subject domestic firms to capital requirements set by state insurance regulators, easing those authorities' concerns that the pact would undermine their mandate by applying the EU's regulatory regime to U.S.-based carriers' worldwide operations.

The so-called covered agreement, which was **signed by the U.S. and EU** on Friday and will be fully implemented in five years, will lift a burden for U.S. insurers struggling with Solvency II, the EU’s formidable capital rulebook for the insurance industry. Under the pact, U.S. groups active in the bloc will not be subject to Solvency II requirements on a worldwide basis for their activities outside the EU.

Instead, the agreement says that a group capital standard being developed by the National Association of Insurance Commissioners — a standard-setting body made up of state insurance regulators — should satisfy the pact's requirements for oversight of U.S.-based companies with a presence in the EU.

The NAIC's response to the finalized covered agreement was largely positive, with the organization praising the efforts of the U.S. Treasury Department and the U.S. Trade Representative — which represented the country in its negotiations with the EU — to press for terms respecting the country's state-based system of insurance regulation.

"We've worked closely with Treasury and USTR on these clarifications and appreciate their affirmation of the primacy of state regulation," Ted Nickel, the NAIC's president and Wisconsin insurance commissioner, said in a statement.

Attorneys and insurance industry observers agreed that the covered agreement should help quell many of state regulators' fears about losing their regulatory power.

"One of the major concerns of U.S.-based insurance and reinsurance operations going into this process was the application of capital requirements on a worldwide basis and whether the NAIC's group capital assessment would be relevant," said Sidley Austin LLP partner Andrew R. Holland, who leads the firm's insurance regulatory practice. "The covered agreement's limiting of the application of Solvency II on a group basis is the big win for the U.S.-based insurers and reinsurers."

Indeed, the agreement's section addressing group capital and supervision requirements for U.S. and EU firms conducting transatlantic business, Article 4, goes a long way toward eliminating duplicative regulations, which were a concern for negotiators from both jurisdictions, observers say. By allowing firms to be subject to groupwide standards set by their home jurisdictions, Article 4 is encouraging EU regulators to trust their U.S. counterparts and vice versa, said Jeffrey Kingsley, a Goldberg Segalla LLP partner and chair of the firm's global insurance services practice group.

"I think there may be some gray areas in the interpretation and implementation of that section, but generally, it will benefit insurers and reinsurers in both jurisdictions by allowing them to avoid having to comply with onerous reporting guidelines and regulatory restrictions that could make it

prohibitively expensive for them to enter the foreign market," Kingsley said.

In another win for the domestic state-based insurance regulatory regime, Article 4 shields U.S.-based insurance groups from Solvency II's rigorous disclosure requirements for worldwide operations. Furthermore, U.S. insurance regulators are empowered to obtain information about the EU parent company of an insurer active in the U.S., "if necessary, to protect against serious harm to U.S. policyholders, or a serious threat to financial stability, or a serious impact on the ability of an insurer to pay its claims" in the country, according to a summary of the deal issued by Treasury and the USTR.

The summary indicated that the agencies "[do] not see a basis to expect that state regulators" will encounter conflicts with state law if they adhere to those provisions of Article 4.

"That gives insurance groups the assurance that they will only be subject to worldwide group supervision by the regulators in their home jurisdiction but also provides U.S. regulators with a level of confidence that they will have the ability to seek information from the EU-domiciled parent where they have concerns about a company's ability to pay claims or its financial stability," said Jim Wrynn, senior managing director of FTI Consulting Inc.'s global insurance services practice and a former New York insurance superintendent.

Given that the covered agreement won't take full effect for five years, though, it is unclear whether state regulators will hit roadblocks in their efforts to comply with the pact. Thomas Dawson, a partner at Drinker Biddle & Reath LLP and co-chair of the firm's insurance regulatory and transactional team, said it is possible that EU authorities take issue with the NAIC's group capital framework once it is finalized.

"It seems as though the industry and government entities feel pretty good about what this agreement looks like at the moment, but like everything else, it remains to be seen how U.S. insurers and reinsurers operating in the EU fare over the next couple years," Dawson said. "Will we see EU regulators in fact taking a hands-off approach to group capital? There may be some criticism as to what the NAIC does with respect to group capital; EU regulators may insist that their approach is better."

It will also take the states time to achieve compliance with the covered agreement's separate provision removing the traditional requirement that EU reinsurers post 100 percent collateral for their U.S. liabilities before their U.S. insurer clients can receive credit for taking out the reinsurance, which had long been a source of frustration among the bloc's firms.

During negotiations on the covered agreement, the NAIC had questioned the need for a deal on reinsurance collateral, given that a majority of states have adopted the organization's "credit for reinsurance" model law scaling back collateral requirements for foreign reinsurers under certain circumstances. The NAIC previously voted to name Bermuda, Germany, Switzerland, the United Kingdom, Japan, Ireland and France as approved "qualified jurisdictions" eligible for lower reinsurance collateral requirements under the model law, based on the strength of the regulatory oversight in those jurisdictions.

Holland said the covered agreement marks a "big philosophical change in the way exposures to foreign insurers and reinsurers" have been historically regulated in the U.S.

"In a way, by mandating collateral, U.S. regulators were more easily able to rely on foreign insurers' own regulators," Holland said. "Now, for reinsurers based in the EU, there will be no regulatory requirement to hold collateral. This is a different way of thinking about regulation: U.S. regulators must now to some degree perform their own evaluation of EU reinsurers."

According to observers, states that have already adopted the NAIC's credit for reinsurance model law should only have to make slight tweaks to comply with the covered agreement's guidance on reinsurance collateral while the others will have to start from scratch.

"I think state regulators will have to make some minor changes to be consistent with the covered agreement, but I think previously implemented credit for reinsurance measures will largely stand," Kingsley said.

While the NAIC expressed gratitude that Treasury and the USTR heeded many of state regulators' concerns over the pact with the EU, the organization's chief executive, Mike Consedine, issued a statement discouraging the federal agencies from pursuing additional covered agreements with other jurisdictions.

"We appreciate the Treasury and USTR working constructively with us to resolve our concerns with the covered agreement but would caution against using this mechanism in the future," Consedine said in the statement.

Industry observers will certainly be watching to see if Treasury and the USTR look to negotiate covered agreements with other jurisdictions that are hotbeds of insurance and reinsurance activity.

"This is just the EU," Holland said. "We also have Bermuda, and with Brexit, there are a lot of questions about how the U.K. will address insurance regulation. There is a potential for more covered agreements, so everyone will be watching."

--Editing by Christine Chun and Aaron Pelc.

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