The Cincinnati Insurance Company ▪ The Cincinnati Indemnity Company
The Cincinnati Casualty Company ▪ The Cincinnati Specialty Underwriters Insurance Company
The Cincinnati Life Insurance Company

February 6, 2018

Superintendent Maria T. Vullo, Chair
Reinsurance (E) Task Force
National Association of Insurance Commissioners
c/o Mr. Jake Stultz
Via e-mail jstultz@naic.org

Re: NAIC Notice of Public Hearing and Request for Comments to Address Covered Agreement

Dear Superintendent Vullo:

The Cincinnati Insurance Companies (CIC) appreciate the opportunity to participate in the upcoming public hearing on February 20, 2018 in New York to address implementation of the reinsurance collateral provisions of Article 3 of the Covered Agreement. We respectfully submit these comments in conjunction with oral comments to be presented at the public hearing.

General Comments. At the 7th EU-US Insurance Symposium held on Friday, January 26, 2018 at the U.S. Chamber of Commerce, we shared our deep concerns with the covered agreement, which we view as a unilateral nullification of the McCarran Ferguson Act by the Administration without any meaningful Congressional process.[1] We strenuously opposed the signing of the covered agreement by the United States, for various reasons set forth in these three documents attached to our written comments:

- Exhibit A – Views of The Cincinnati Insurance Companies On Covered Agreements
- Exhibit B – The Process for Negotiating and Implementing a Covered Agreement In The U.S. Needs a Legislative "Check & Balance" By Congress
- Exhibit C – Cincinnati Financial Has Grave Concerns With The Covered Agreement

In our opinion, the NAIC's "sliding scale" reinsurance collateral model law and regulation[2] was working fine and was fairly and effectively giving non-US reinsurers relief from collateral to those firms worthy of relief from collateral. Approved in 35 states and well on its way to adoption in all 50 states, sliding scale model was never given a chance.[3]

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[1] Unlike the EU – which has two formal approval mechanisms by the European Council and the European Parliament before ratification of a covered agreement can occur – no formal approval mechanism exists for the U.S. Congress. As we argued in Congress, the covered agreement looks like a trade agreement and smells like a trade agreement so it should be ratified by Congress like any other trade agreement.

[2] Credit for Reinsurance Model Law (#785) and the Credit for Reinsurance Model Regulation (#786).

[3] See Exhibit D, attached hereto, "Implementation of 2011 Revisions to Credit for Reinsurance Model Law #785 and Model Regulation #786" [status as of September 2, 2016].

Given our longstanding opposition to the covered agreement, we will be watching the implementation process very closely to make sure there are no attempts to include provisions in the revised U.S. reinsurance collateral laws that are not authorized in the covered agreement signed by the U.S.

It is this frame of mind that we offer comments on the specific matters the NAIC has sought stakeholder input in advance of the Public Hearing on February 20.

NAIC Request for Specific Comments. The NAIC has requested specific comments on the following approaches to reinsurance collateral reform:

NAIC Request #1. Amending the Credit for Reinsurance Model Law (#785) and the Credit for Reinsurance Model Regulation (#786) to eliminate reinsurance collateral requirements for EU-based reinsurers meeting the conditions of the Covered Agreement.

> CIC Views. We believe the most efficient way to implement the reinsurance collateral provisions of Article 3 of the Covered Agreement is by making amendments to the Credit for Reinsurance Model Law (#785) and the Credit for Reinsurance Model Regulation (#786). We will have additional comments on this issue when we present oral testimony at the public hearing on February 20 in New York.

NAIC Request #2. Extending similar treatment to reinsurers from other jurisdictions covered by potential future covered agreement(s) that might be negotiated pursuant to the Dodd-Frank Wall Street Reform and Consumer Protection Act.

> CIC Views. We are quite conflicted on this topic. Although we deplore covered agreements for the reasons expressed above and hope that the United States never negotiates another covered agreement, we recognize that other jurisdictions may seek collateral relief in the U.S. via a covered agreement. We also recognize the inequity of EU jurisdictions getting relief from collateral in the U.S. via the covered agreement while non-EU jurisdictions get no such relief. To address this inequity, we would suggest that the NAIC consider revisions to Credit for Reinsurance Model Law (#785) and the Credit for Reinsurance Model Regulation (#786) which grant collateral relief to non-EU jurisdictions to the same extent and on the same terms that it is being extended to EU jurisdictions per the covered agreement. This would avoid the need for future covered agreements on reinsurance collateral. We will have additional comments on this issue when we present oral testimony at the public hearing on February 20 in New York.

NAIC Request #3. Providing reinsurers domiciled in NAIC Qualified Jurisdictions with similar reinsurance collateral requirements.

> CIC Views. See our answer to NAIC Request #2. To the extent that the covered agreement creates inequities between EU jurisdictions and non-EU jurisdictions under the NAIC's Qualified Jurisdictions paradigm, the NAIC should consider how to best resolve these inequities. We will have additional comments on this issue when we present oral testimony at the public hearing on February 20 in New York.

NAIC Request #4. Considering changes to the criteria for evaluating whether a jurisdiction should be a Qualified Jurisdiction.

> CIC Views. See our answer to NAIC Request #2. To the extent that the covered agreement creates inequities between EU jurisdictions and non-EU jurisdictions in regard to the criteria for evaluating whether a jurisdiction should be a Qualified Jurisdiction under the NAIC's Qualified Jurisdictions paradigm, the NAIC should consider how it might make changes to the criteria to best resolve these inequities. We will have additional comments on this issue when we present oral testimony at the public hearing on February 20 in New York.

NAIC Request #5. Considering additional "guardrails" relative to U.S. ceding companies, such as changes to the risk-based capital (RBC) formula or new regulatory approaches to help address the increased financial solvency risks caused by the elimination of reinsurance collateral.

> CIC Views. As a major purchaser of reinsurance, we are generally opposed to such guardrails. If the NAIC had such concerns before the covered agreement was signed, why did the NAIC tacitly waive its opposition the covered agreement before it was signed? Instead of punishing U.S. cedants with a "covered agreement tax" the NAIC should work on making sure that the states are equipped to modify their financial surveillance paradigms to ensure that the elimination of collateral under the covered agreement does not cause increased financial solvency risks. Regarding the idea of making changes to the risk-based capital (RBC) formula to help address any increased financial solvency risks caused by the elimination of reinsurance collateral, the NAIC's recently revised Property and Casualty Risk-Based Capital (P&C RBC) framework adequately addresses credit risk associated with reinsurance amounts recoverable. We will have additional comments on this issue when we present oral testimony at the public hearing on February 20 in New York.

NAIC Request #6. Any other considerations to weigh as part of the states' implementation of the Covered Agreement.

> CIC Views. The covered agreement creates a "Joint Committee" to serve as a forum for consultation and to exchange information on the administration and proper implementation of the covered agreement. CIC believes that proper implementation of the covered agreement requires appropriate transparency and engagement with stakeholders, as well as advocacy for U.S. interests. Because U.S. state regulators will be largely responsible for implementing the covered agreement, it is imperative that state regulators and state legislators be named as members of the Joint Committee to ensure that discussions in the Joint Committee will be well-informed of the views and interests of state insurance regulators. We will have additional comments on this issue when we present oral testimony at the public hearing on February 20 in New York.

Conclusion. CIC appreciates the opportunity to offer comments on implementation of the covered agreement and look forward to continuing to voice our views and concerns as the NAIC process advances. Please do not hesitate to contact us with any questions or concerns.

Sincerely,

Scott A. Gilliam
Vice President & Government Relations Officer

EXHIBIT A

VIEWS OF THE CINCINNATI INSURANCE COMPANIES ON COVERED AGREEMENTS

Statement for the Record Prepared for the Senate Banking, Housing & Urban Affairs Committee
Hearing on "Examining The U.S.-EU Covered Agreements"

[May 2, 2017]

THE U.S. SHOULD RENEGOTIATE THE PENDING COVERED AGREEMENT. The pending covered agreement should be pulled back and renegotiated since the process under which it was negotiated failed on many levels and resulted in an agreement with many procedural and substantive flaws, the terms of which could greatly damage the primacy of our state insurance regulatory system.

LACK OF TRANSPARENCY IN THE PROCESS. There was no transparency in the negotiation process. During the negotiation process there were no meaningful stakeholder process or updates for the public on the substance of what was being negotiated, and the text of the agreement was hidden from the public until it was filed with Congress on January 13, 2017.

STATE REGULATORS BARRED FROM THE NEGOTIATING TABLE. The law governing the covered agreement negotiations prohibited any meaningful participation by state regulators. State regulators were allowed to attend the negotiating sessions but were not permitted to directly or actively negotiate and were forced to sign nondisclosure agreements preventing them from revealing what they heard in those sessions. Had state regulators had real negotiating power, the outcome of the negotiation would have almost certainly been different and the terms of the covered agreement better. Instead, state regulators were put in the terrible position of being forced to watch on the sidelines as the Administration and a foreign power reshaped the landscape of state insurance regulation on reissuance collateral and group capital requirements.

THERE WAS NO NEED TO ADDRESS REINSURANCE COLLATERAL IN THE COVERED AGREEMENT. Had state regulators been allowed a meaningful role in the negotiations of the covered agreement, they would have most certainly argued against including the "zero reinsurance collateral" preemption provision in the covered agreement since the U.S. already has a state-regulated system that allows EU reinsurers to post zero collateral in the U.S. if they achieve the "Secure—1" financial strength rating under the NAIC's "sliding scale" reinsurance collateral model law. The NAIC model is well on its way to being adopted in all 50 states; 35 states have already enacted the model law and the pace for adoption by the rest of the states will now quicken since the NAIC has made enactment of the model law an accreditation requirement.[1]

THE NAIC'S "SLIDING SCALE" COLLATERAL LAW IS BETTER FOR CONSUMERS. The NAIC's "sliding scale" reinsurance collateral law is better for consumers than the provision included in the covered agreement since the NAIC model provides six different financial strength rating categories for EU reinsurers; the reinsurance collateral provision in the covered agreement only utilizes one financial strength rating for EU reinsurers. Under the NAIC sliding scale, the better the financial strength rating of the EU reinsurer, the lower the collateral requirement:

Secure—1 (0% Collateral)	Secure—4 (50% Collateral)
Secure—2 (10% Collateral)	Secure—5 (75% Collateral)
Secure—3 (20% Collateral)	Vulnerable—6 (100% Collateral)

This provides a better mechanism for U.S. insurers to judge the solvency and claims paying ability of EU reinsurers before they decide whether to do business with them, which ultimately protects consumers and policyholders who want assurance that payment of their claims will not be impacted by EU reinsurers with weak

[1] To put the issues relating to reinsurance collateral in context, it should be noted that the states have long required EU reinsurers to post collateral for their U.S. obligations given differences in EU accounting systems, differences in the rigor of insurance regulation in the EU, and difficulty with enforcement of judgments by U.S. primary insurers against EU reinsurers in their home jurisdictions, all of which make it challenging for state regulators to rate the ability and/or willingness of EU reinsurers to pay their U.S. obligations.

financial strength ratings. The NAIC sliding scale model law also protects the U.S. guaranty fund system, which relies upon U.S. insurers to do business with reinsurers with strong financial strength ratings who will honor their U.S. obligations after a ceding company becomes insolvent.

PREEMPTIVE POWER IS UNNECESSARY TO ACHIEVE MUTUAL RECOGNITION. The covered agreement creates a process for state reinsurance collateral laws to be preempted if they are not revised to comply with the terms of the covered agreement. Allowing a covered agreement to preempt state laws puts the power of dictating U.S. regulatory policy in the hands of non-regulatory federal bodies and foreign governments. The U.S. should continue to pursue mutual recognition agreements with foreign bodies which recognize the robustness of our state regulatory system and put U.S. companies on a level playing field, but they should not overwrite state laws or otherwise sacrifice state insurance regulation to achieve those objectives. As such, covered agreements should have no preemptive power and should be limited to securing mutual recognition of the U.S. system under the EU's Solvency II regulatory regime.

OTHER SUBSTANTIVE FLAWS IN THE COVERED AGREEMENT. The covered agreement has three additional substantive flaws that might have been avoided if state regulators had a voice in the process and a seat at the negotiating table:

- The covered agreement fails to grant the U.S. regulatory system full equivalency under the EU's Solvency II regulatory regime. As a result, U.S. domiciled insurers will not be permitted to operate in the EU on the same regulatory terms as insurers domiciled in the EU.
- The covered agreement requires the states to enact a group capital requirement, contrary to the desires of the NAIC (the NAIC is in the process of developing a group capital calculation which they do not want to become to become a capital requirement).
- The covered agreement creates a "Joint Committee" with considerable authority to implement the covered agreement in the U.S., but its members will not include anyone representing state insurance regulatory authorities.

NO MEANINGFUL CHECK & BALANCE BY CONGRESS. The law which governs the covered agreement negotiation process is also flawed by the absence of any meaningful check and balance by Congress. Under the current process, the Administration can unilaterally preempt state insurance laws through a covered agreement. The only Congressional check on this power is a 90 day layover requirement (a covered agreement may not be implemented until 90 days after it is filed with Congress). In contrast, the EU requires two legislative approvals before implementation. Congress needs to have check and balance power over covered agreements which is as meaningful as the EU's check and balance power over them.

CONCLUSION: RENEGOTIATE THE FLAWED COVERED AGREEMENT. The current law under which covered agreements are negotiated needs to be reformed by Congress to address the deficiencies identified above. Once that occurs, the Administration should return to the negotiating table with state insurance regulators, and, with the benefit of an open and transparent process and meaningful checks and balances, seek a covered agreement which grants mutual recognition and Solvency II equivalence to U.S. insurers doing business in the EU.

For Further Information Please Contact:

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EXHIBIT B

THE PROCESS FOR NEGOTIATING AND IMPLEMENTING A COVERED AGREEMENT IN THE U.S. NEEDS A LEGISLATIVE "CHECK & BALANCE" BY CONGRESS

- **A covered agreement cannot be implemented in the EU without legislative ratification by the Council of the European Union and the European Parliament.**

- **The United States Congress should have the same "check & balance" authority over the Administration's autonomous negotiation of a covered agreement.**

The incongruity between the EU & U.S. Approval Processes. Under the Dodd-Frank Act, Congress is not required to ratify any covered agreement negotiated by the Administration (Treasury and USTR). In contrast, any covered agreement negotiated by the European Union must be approved through two legislative processes.[1] Doesn't it seem odd that the EU requires legislative approval of covered agreements but there is no legislative approval process for covered agreements in the U.S.?

Covered agreements should be ratified like any other trade agreement. Congress must ratify trade agreements negotiated by the Administration, like the Trans-Pacific Partnership Agreement currently under consideration by Congress. Likewise, shouldn't Congress be required to ratify covered agreements, which regulate various aspects of the insurance trade between nations?

Unchecked preemption of state insurance law. Under the covered agreement process authorized under Dodd-Frank, the Administration is given carte blanch authority to negotiate away state insurance laws and regulations. I find it very unsettling that the Administration can negotiate a covered agreement with terms that can preempt state insurance regulation without approval by Congress. Shouldn't there be a legislative check and balance on this unbridled power to eviscerate state insurance law? Shouldn't Congress have a voice in the Administration's use of covered agreements to engage in piecemeal repeal of the McCarran-Ferguson Act?

Lack of transparency. Thus far the EU and U.S. negotiators have not presented the public with any details on the substance of their negotiations. In fact, it appears that all parties to the negotiations have signed nondisclosure agreements. Doesn't this lack of transparency make it incumbent on Congress to debate the terms of a covered agreement and have a vote on whether to ratify a covered agreement before it becomes law in the United States?

Trojan horse for international insurance standards. Congress has spent a considerable amount of time this year on the need for greater transparency and congressional oversight of international insurance standards setting processes, which culminated in the full Committee's passage of H.R. 5143 (Chairman Luetkemeyer's bill). We are concerned that a covered agreement could include terms which import international insurance standards into the U.S. without any Congressional review, debate or approval. Doesn't this make it imperative for Congress to debate and ratify any covered agreement negotiated by the Administration?

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[1] First, the Council of the European Union, a body made up of representatives from each of the 28 EU member states, must approve the covered agreement by qualified majority voting. Second, the European Parliament, a legislative body composed of 751 members, with seats allocated on the basis of the population of each member state (much like our U.S. Congress), must ratify the covered agreement by a majority vote. The European Parliament may accept or reject the proposed text of the agreement but cannot amend it. If the European Parliament does not give its consent, the covered agreement cannot be adopted.

EXHIBIT C

CINCINNATI FINANCIAL HAS GRAVE CONCERNS WITH THE COVERED AGREEMENT

QUICK SUMMARY – A NEGOTIATED ATTACK ON STATE INSURANCE REGULATION

STATE INSURANCE REGULATION UNDER ATTACK. Our concerns with the covered agreement are grounded in our support of our time-tested state insurance regulatory system. The covered agreement is a negotiated attack on state regulation which imposes federally-negotiated regulatory standards on the states in regard to ***reinsurance collateral*** and ***group capital***.

THE NEGOTIATION WAS FLAWED. The regulators whose system is being involuntarily altered under the covered agreement had no meaningful voice or leverage during the negotiations. State regulators were allowed to attend the negotiating sessions but they were not entitled to negotiate. The state regulators were also required to sign nondisclosure agreements after every negotiation session. Had state regulators had a meaningful voice in the negotiation the outcome on ***reinsurance collatera***l and ***group capital*** would have been much different.

REGULATORY POKER GAME. Given the terms of the covered agreement, it appears that federal negotiators were willing to gamble away state insurance regulatory authority over ***reinsurance collateral*** and ***group capital*** in exchange for making it easier for certain U.S. firms to do business in the EU under relaxed Solvency II requirements. That's unconscionable. If U.S. firms want to play in the EU sandbox they should comply with Solvency II like several other U.S. firms doing business in the EU have already done.

AMBIGUITIES NECESSITATE A PAUSE FOR PUBLIC COMMENT. In an April 7, 2017 letter to the Treasury Secretary Mnuchin and the Acting U.S. Trade Representative, 24 members of Congress expressed their bipartisan concern with the numerous ambiguities in the covered agreement and asked that it not be signed until they can be clarified and resolved. Proponents say just sign the agreement and we'll figure out the ambiguities later. That is not an option. Instead, the Administration should notice a 90 day public comment period for interested parties to flush out the ambiguities and determine if they were actually intended by the negotiators.

FOREIGN GIVEAWAY. EU reinsurers are already bragging about the $40 billion in collateral relief they will obtain under the agreement. In exchange, the states get new regulatory edicts on reinsurance collateral and group capital that they had no ability to shape or protest. These are the same EU reinsurers who begged the NAIC to adopt a sliding scale reinsurance collateral law under which required collateral would range from zero to 100% based on solvency and claims paying ability. Now they get zero collateral without any metrics to test solvency or claims paying ability.

NO CHECK & BALANCE BY CONGRESS. Unlike the EU – which has two formal approval mechanisms by the European Council and the European Parliament before ratification can occur – no formal approval mechanism exists for the U.S. Congress. The covered agreement looks like a trade agreement and smells like a trade agreement so it should be ratified by Congress like any other trade agreement.

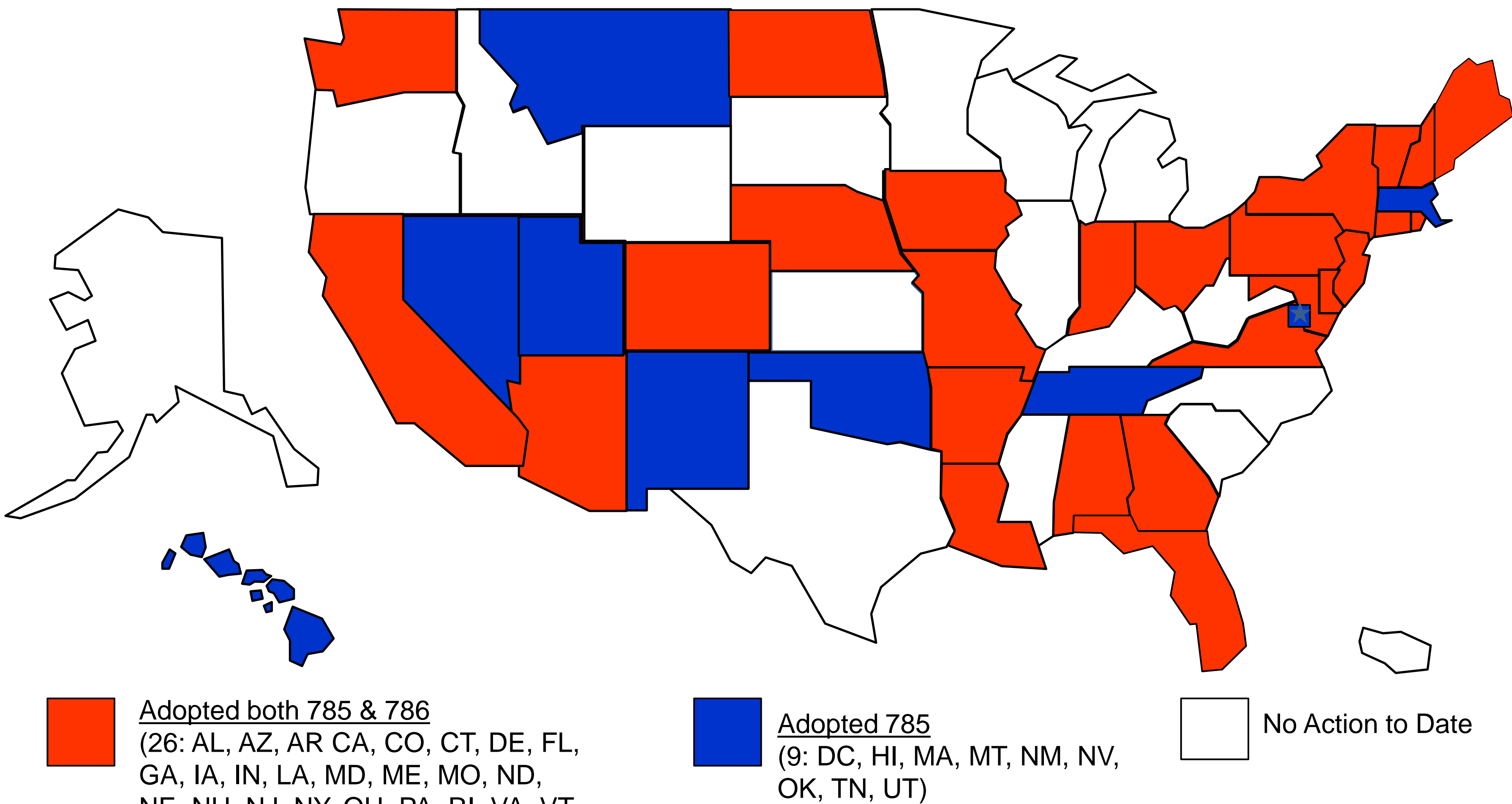
TROJAN HORSE. Our greatest fear, that covered agreements would become a Trojan horse for the importation of European bank-centric international standards on the U.S., has been realized. Under Art. 4 of the agreement the states have to adopt a European style group capital requirement. The Europeans are hoping the new Administration doesn't figure out the terrible consequences of the group capital requirement before it is signed.

RENEGOTIATE THE COVERED AGREEMENT. Clarifications and exchange of letters will not solve the dilemma posed by the ambiguities in the covered agreement. The negotiations must be reopened with state insurance regulators at the table and with real negotiating power and with federal negotiators who seek to preserve state regulation rather than destroy it.

May 2, 2017

EXHIBIT D

Implementation of 2011 Revisions to Credit for Reinsurance Models
Model Law #785
Model Regulation #786
[status as of September 2, 2016]



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Disclaimer: This map represents state action or pending state action regarding NAIC amendments to the model(s). This map does not reflect a determination as to whether the pending or enacted legislation contains all elements of NAIC amendments to the model(s) or whether a state meets any applicable accreditation standards.