Testimony of

Ted Nickel

Commissioner

Office of the Wisconsin Commissioner of Insurance

On Behalf of the National Association of Insurance Commissioners

Before the

Subcommittee on Housing and Insurance

Committee on Financial Services

United States House of Representatives

Regarding:

Assessing the U.S.-EU Covered Agreement

Thank you Chairman Duffy, Ranking Member Cleaver, and members of the subcommittee. My name is Ted Nickel. I serve as insurance commissioner for the state of Wisconsin and current president of the National Association of Insurance Commissioners (NAIC). I greatly appreciate your invitation to testify before you regarding the covered agreement between the European Union and the United States.

The NAIC is committed to working with Congress and the administration to address disparate regulatory treatment some EU jurisdictions are imposing on U.S. insurers doing business in the EU. While a covered agreement is one way to resolve these issues, we oppose this current covered agreement as drafted. We urge Congress and the administration, with direct involvement of states, to expeditiously reopen negotiations with the EU to reach an agreement which brings finality to these issues, and better protects U.S. policyholders, companies, and our state regulatory system.

In September, my colleague Tennessee Insurance Commissioner Julie Mix McPeak outlined for this subcommittee concerns state insurance regulators had with discriminatory actions EU member countries were taking against U.S. firms under the auspices of implementing the EU's new Solvency II regime, lack of necessity for a potentially preemptive covered agreement to resolve concerns relating to those actions, lack of transparency to Congress and stakeholders regarding the nature and progress of the covered agreement negotiations, and lack of meaningful inclusion of state insurance regulators in this process.[1] This agreement, as drafted, does little to resolve those concerns.

While state insurance regulators recognize the U.S. received some limited benefits, this agreement does not provide for full or permanent equivalence or recognition of our time-tested regulatory system, nor does it provide certainty for our U.S. insurance sector. Instead, in a single agreement with an outgoing administration, the EU achieved its primary objective of eliminating U.S. reinsurance collateral requirements designed to protect U.S. consumers. In return, U.S. companies and our regulatory system received only a form of "probation" – limited relief from prescriptive European regulation but under a continued threat where any relief could be revoked if we fail to meet Europe's ongoing expectations and standards. And the burden for this probation is placed almost entirely upon the states, and its underlying costs ultimately will be paid for by U.S. policyholders. My state insurance regulator colleagues and I seriously question whether this agreement meets statutory standards for a covered agreement set forth in the Dodd-Frank Act, which requires such agreement contain measures which are substantially equivalent to the level of protection achieved under state insurance or reinsurance regulation.[2] Indeed, substantive operative provisions of this agreement do not meaningfully address or even reference consumer protection.

Issues addressed by this covered agreement are entirely of the EU's own making (and could be unilaterally resolved by the EU changing <u>its</u> law on equivalence) but they are being solved

[1] United States. Cong. House. Financial Services Subcommittee on Housing and Insurance. *Hearing on the Impact of the U.S.-EU Dialogues on U.S. Insurance Markets*. September 28, 2016. 114th Cong. 2nd sess. Washington: GPO, 2016 (statement of Julie Mix McPeak, Commissioner, Tennessee Department of Commerce and Insurance)

[2] 31 U.S.C. § 313

entirely at the expense of U.S. industry, consumers and regulators. In spite of this imbalance, state regulators are nevertheless unanimously committed to resolving these issues, even if it means a revised federal agreement, so U.S. firms are not put at a competitive disadvantage when operating in the EU. However, as drafted, this covered agreement is not the answer and we urge the Trump administration to reopen negotiations with the EU to obtain a better deal for the United States. State regulators can support an agreement which achieves clear and permanent mutual recognition for our time-tested U.S. insurance regulatory system, includes meaningful state regulator input and transparency in its drafting and execution, and is unambiguous in its terms and finality. This covered agreement fails to meet any of those objectives, and we hope members of Congress will join us in calling for the expeditious reopening of negotiations.

<u>This Agreement Provides Limited Benefit to the U.S. Insurance Sector</u>

As you are aware, on November 20, 2015, the previous administration's Treasury Department and the Office United States Trade Representative (USTR) notified Congress they intended to initiate negotiations to enter into a covered agreement with the European Union.[3] They made it clear they would not enter into a covered agreement unless terms of the agreement were beneficial to the United States and state insurance regulators would have a meaningful role during the covered agreement process. In that notification, the Treasury Department and USTR set out the following negotiating objectives:

1) "treatment of the U.S. insurance regulatory system by the EU as 'equivalent'" under Solvency II "to allow for a level playing field for U.S insurers and reinsurers operating in the EU;"
2) "recognition" by the EU of the U.S. insurance regulatory system, including with respect to group supervision;
3) "Facilitat[ion of the] the exchange of confidential regulatory information between lead supervisors across national borders;"[4]
4) "nationally uniform treatment of EU-based reinsurers operating in the United States, including with respect to collateral requirements;" and
5) "permanent equivalent treatment of the solvency regime in the United States and applicable to insurance and reinsurance undertakings."

The previous administration failed to meet several of these objectives. While we recognize the agreement appears to provide some benefit to U.S. insurers operating in the EU by eliminating EU local presence requirements over time, this agreement does not require the EU to grant the U.S. permanent equivalence (or comparable treatment), and in fact, the word "equivalence" is nowhere to be found in the document. This means, even post covered agreement, insurers based in Bermuda or Switzerland, for example, (which have received equivalence) receive greater benefits from the EU than U.S. insurers. So even under this agreement, the United States, one of the most sophisticated and well-regulated insurance marketplaces on the globe, continues to be

[3] Wall, Anne. Harney, Michael. Letter to Congress Re: Initiation of Covered Agreement Negotiations, 20 Nov. 2015.
[4] The agreement encourages, but does not require, supervisory authorities to cooperate in exchanging information while respecting a high standard of confidentiality protection. It appears to do little of substance in relation to laws or procedures related to information exchange.

treated by Europe as a parolee. We remain under suspicion, we continue to be monitored, and whatever freedoms afforded by this agreement can be revoked.

Similarly, this agreement also fails to grant full "recognition" by the EU of the U.S. insurance regulatory system, including with respect to group supervision. While this agreement appears to prevent the EU from imposing its requirements on the "worldwide parent" located in the United States, it does not provide promised "recognition" or require the EU to recognize the U.S. as equivalent. Further, the language is ambiguous as to the obligations of the parties and the entities to which it applies (e.g., the insurance group, the insurance and non-insurance group, the legal entities, or a combination). Troubling, this agreement also places conditions on the ability of regulators to obtain information or take certain actions currently authorized under state laws. Indeed, there are potential conflicts between provisions and limitations in this agreement and existing state reporting processes as well as critical examination and hazardous financial condition authority.

In addition, many key terms describing the circumstances which would prompt action by regulators to comply with this agreement are undefined or ambiguous. For example, the agreement acknowledges a need for a group capital requirement or assessment, but it also requires "the authority to impose preventive, corrective, or otherwise responsive measures on the basis of the assessment, including requiring, where appropriate, capital measures."[5] The provision implies state insurance regulators are effectively required to develop and adopt a group capital requirement but also includes language suggesting the EU could apply its own group capital requirements and re-impose local presence requirements if states choose not to act. In other words, this agreement seems to compel states to subject a broad group of insurers to additional regulation with no guarantee the EU ultimately would not apply its own layer of requirements if it finds the additional U.S. approach to be unsatisfactory.

This agreement is littered with ambiguities such as these and they would have to be resolved by an undefined "Joint Committee" composed of representatives of the U.S. and EU. This agreement does not set forth how many representatives will compose the Joint Committee or indicate which persons or bodies will be represented. Importantly, there is no mention of a role for state insurance regulators, who are charged with implementing much of this agreement and whose laws and regulations may be directly impacted or preempted. We are already aware of agreement provisions the U.S. and EU negotiators interpret differently. If a meeting of the minds cannot be reached on these ambiguities, this agreement may be voided —under its terms, if any single provision of this agreement is violated, the other party is not obligated to follow other provisions of this agreement. This framework inevitably will lead to perpetual renegotiations through the Joint Committee and uncertainty for U.S. industry, policyholders, and regulators.

The one objective met was a key negotiating priority for the EU, elimination of reinsurance collateral requirements. In fairness, this covered agreement retains a few of the elements from the NAIC's Credit for Reinsurance model laws, including requirements with respect to enforcement of final U.S. judgments, service of process, financial reporting requirements, prompt payment of claims, and solvent schemes of arrangement. These requirements are also

[5] *Bilateral Agreement between the European Union and the United States of America on Prudential Measures Regarding Insurance and Reinsurance*, January 13, 2017, p. 12.

applicable to U.S. reinsurers doing business in the EU, and collateral may be imposed if these requirements are not met under a process established in this agreement. However, this agreement does not include any evaluation of reinsurer creditworthiness and despite the Treasury Department having verbally committed it would never accept an agreement which eliminates reinsurance collateral, it did exactly that.

Collateral is not just some illusory consumer protection. Reinsurance capital moves quickly worldwide in search of attractive returns. It is important; as we have seen when catastrophes strike, to have solid assurances that claims will be paid immediately. Existence of collateral provides strong incentives for reinsurers to perform on their obligations and regulatory requirements to protect all insurers, particularly smaller insurers who may not have the leverage to renegotiate and require it contractually from reinsurers with whom they do business. Even though the probability of failure may be low, particularly for large, financially sound, international reinsurers, the impact of failure could be catastrophic to U.S. ceding insurers and policyholders in the absence of collateral as a safety net. It is understandable some may argue financially strong reinsurers should not have to post collateral, but many non-U.S. reinsurers who failed (e.g., Gerling, Trenwick, Legion) were considered paragons of strength only a few years before their collapse.[6]

Though we believe it is necessary for counterparties to have "skin in the game" (a lesson the financial system was reminded of during the financial crisis with respect to other financial instruments), we have nevertheless attempted to be responsive to the European insurance industry and governments who have sought reduction of such requirements. We have worked tirelessly to reduce collateral requirements by amending NAIC's Credit for Reinsurance Model Act to allow for reduction in collateral based on the strength of the insurer and its regulatory regime. The amendments have already been adopted by 35 states representing approximately 69 percent of direct written premium and will become an accreditation requirement on January 1, 2019, leading to further adoption by states. In fact, based on these changes, the amount of collateral posted by EU reinsurers has dropped dramatically. In 2015, EU-based reinsurers posted only $31.4 billion or 15.4 percent of the almost $205 billion in collateral posted worldwide, but when you consider collateral represents significantly larger commitments to U.S. policyholders, retaining some collateral is a reasonable approach. While we are open to further discussions on collateral reduction and even changes to our present credit for reinsurance construct, wholesale elimination of this regulatory requirement to benefit foreign reinsurers should be weighed more thoughtfully against potential harm to U.S. companies and consumers. With absence of collateral, regulators will have to find other mechanisms with which to protect insurers and their policyholders from the risks posed by counterparties such as reinsurers possibly including new capital charges or restrictions imposed on ceding insurers. This covered agreement will essentially transfer credit risk of foreign reinsurers to their customers: U.S. insurance companies, and by extension, U.S. policyholders.

[6] *U.S. Reinsurance Collateral*, NAIC Reinsurance Task Force of the Financial Condition (E) Committee, March 5, 2006**,** p. 19.

The Process was Flawed

The poor results achieved during this negotiation are not surprising because the process was flawed from the outset. Following notification to Congress, the Treasury Department and USTR negotiated for over a year behind closed doors. Unlike a trade agreement, which is subject to established procedures for consultation and input from the states and a vote by the Congress, there was no formal consultation with a broader group of U.S. stakeholders including industry and consumer participants. State regulators were assured we would have direct and meaningful participation in this covered agreement process, but the small group of us included in the process were merely observers, only one allowed in the room at a time, subject to strict confidentiality with no ability to consult our staff and fellow regulators. This agreement was finalized in the waning days of the previous administration and announced on January 13, 2017—a week after the former Federal Insurance Office director had announced his resignation effective January 20th. The process was also skewed in favor of the EU from the beginning by the fact that it retained the ability to approve the agreement by the European Parliament and the European Council, whereas the U.S. retained virtually no congressional vetting authority prior to possible preemption of U.S. insurance regulations.

This was a flawed process which produced a flawed document. Instead of an agreement negotiated by subject matter experts from the U.S. accountable to the consumers and markets they represent, we have an agreement mostly negotiated by Treasury bureaucrats in the waning days of an outgoing administration. This agreement sets a precedent others around the world may try to imitate and, put in the simplest terms, forces U.S. acquiescence which weakens our standards in exchange for very little. Treasury and USTR stated they would not enter into a covered agreement unless the terms were beneficial to the U.S. They failed to meet that objective.

A Path Forward

Notwithstanding this specific agreement does not sufficiently benefit the U.S insurance sector, state insurance regulators remain committed to working with the administration, EU, Congress, and stakeholders to negotiate one which does. We would like the administration to expeditiously establish a negotiation process which is more transparent, allows for more robust congressional and stakeholder engagement, and provides actual meaningful and direct participation by insurance regulators including the ability for all impacted regulators to review terms as they develop. States are the primary regulators of the insurance sector and would have to implement provisions of any agreement. Our involvement and buy-in is essential to its success. In terms of specific substantive improvements, we would expect any agreement to provide for permanent mutual recognition, equivalence, or comparable treatment for U.S. firms operating in the EU, full recognition of the U.S regulatory system and its approaches to group supervision and capital, clarity in the agreement’s terms, and finality in its application. We recognize that the EU would have expectations regarding collateral and state insurance regulators would be open to making further changes to our credit for reinsurance laws to address those demands, but any approach we would seek would remain risk-based to ensure U.S. insurers and policyholders were adequately protected.

Conclusion

We are aware this agreement has its proponents, but we should not confuse any deal with a truly beneficial deal, and we perceive benefits of this agreement to be fleeting and illusory. Our request to renegotiate is not made lightly, or a case of making the perfect the enemy of the good. A renegotiation of this agreement using a better, more transparent process led by an administration which is not in its final days, with full participation of insurance regulators will lead to a better result for the United States. Working together with this current administration and Congress, we believe we can achieve the finality, certainty, and recognition lacking in this current agreement without sacrificing key consumer protections. Thank you for this opportunity to testify today and I would be pleased to take your questions.