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GOVERNMENT RELATIONS
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700 HALL OF STATES
444 NORTH CAPITOL STREET N.W.
WASHINGTON, D.C. 20001
202-471-3990
www.naic.org

NAIC
National Association of Insurance Commissioners
& The Center for Insurance Policy and Research

Covered Agreement on Reinsurance Consumer Protection Collateral

What is Reinsurance Consumer Protection Collateral?

- Historically, state insurance regulators have required foreign reinsurers to hold 100% collateral within the U.S. for the risks they assume from U.S. insurers. As reinsurers are ultimately providing insurance to other insurance companies that are directly protecting American policyholders, requiring consumer protection collateral in the U.S. is intended to ensure claims-paying capital is available and reachable by U.S. firms and regulators should it be needed, particularly in the wake of a natural disaster.

- Foreign reinsurers' regulators and politicians have objected to their companies having to post consumer protection collateral in the U.S. as such capital is unavailable for other purposes, including investment opportunities.

What are State regulators doing about Consumer Protection Collateral?

- Recognizing that the potential for variation across states makes planning for consumer protection collateral liability more uncertain and thus potentially more expensive, state regulators are working together through the NAIC to reduce consumer protection collateral requirements in a consistent manner commensurate with the financial strength of the reinsurer and our confidence in the regulatory regime that oversees it.

- Recently, the NAIC passed amendments to its "Credit for Reinsurance Models" that once implemented by a state, will allow certified reinsurers to post significantly less than 100% consumer protection collateral for U.S. claims.

- To date, 32 states have passed legislation to implement the revised NAIC Credit for Reinsurance Models, representing more than 66% of direct insurance premium written in the U.S. across all lines of business. An additional five states have indicated plans to take up the model law in the near future, which would raise the total market coverage to 93%.

- Individual reinsurers are certified based on criteria that include, but are not limited to, financial strength, timely claims, payment history, and the requirement that a reinsurer be domiciled and licensed in a "qualified jurisdiction."

- The NAIC has established a comprehensive process to evaluate jurisdictions' oversight of reinsurers to establish "qualified jurisdictions" for purposes of reduced consumer protection collateral. To date, Bermuda, France, Germany, Japan, Ireland, Switzerland, and the U.K. have been qualified. Discussions are underway with additional jurisdictions. The NAIC has also established a peer review system surrounding the certification of foreign reinsurers by states, which provides a foreign reinsurer an opportunity for a passport throughout the U.S. To date, more than 25 foreign reinsurers have been certified under this peer review system.

What is a Covered Agreement?

- The notion of a 'covered agreement' was included in the Dodd-Frank Act as unique stand-by authority for Treasury and the United States Trade Representative (USTR) to address, if necessary, those areas where U.S. state insurance laws or regulations treat non-U.S. insurers differently than U.S. insurers, such as reinsurance consumer protection collateral requirements.

- A covered agreement is a bilateral or multilateral agreement among the United States and foreign jurisdiction(s) regarding the recognition of regulatory measures with respect to the business of insurance or reinsurance.

- A regulatory measure subject to a covered agreement must achieve a level of protection for consumers that is "substantially equivalent" to the level of protection achieved under state law.

- A covered agreement can serve as a basis for preemption of state law under certain circumstances.

What steps must be followed to enter into a Covered Agreement?

- A covered agreement is negotiated jointly by the U.S. Treasury's Federal Insurance Office (FIO) and the USTR with foreign authorities.

- Before initiating negotiations, during the negotiations, and before entering into a covered agreement, the Treasury Secretary and USTR must jointly consult with the House Financial Services Committee, House Ways and Means Committee, Senate Banking Committee, and Senate Finance Committee. At a minimum, such consultation must cover: 1) the nature of the agreement, 2) how and to what extent such agreement will achieve the purposes of Title V of the Dodd-Frank Act, and 3) the implementation of the agreement and its effect on state laws.

- A covered agreement can only enter into force if the FIO and USTR follow the submission and layover provisions of Title V. These requirements include the FIO and USTR to jointly submit the agreement to the House Financial Services, House Ways and Means, Senate Banking, and Senate Finance committees on a day the House and Senate are in session and wait for a period of 90 days to elapse.

How can a Covered Agreement preempt state law?

- A state insurance measure can only be preempted if the FIO Director determines that:

    1. The measure results in less favorable treatment of a non-U.S. insurer domiciled in a foreign jurisdiction that is subject to a covered agreement, than a U.S. insurer domiciled, licensed, or admitted to do business in that state.
    2. The measure is inconsistent with a covered agreement.

- The scope of the review for such determination is limited to:

    1. The subject matter contained within the covered agreement involved.
    2. Whether the subject matter of the agreement achieves a level of protection for insurance consumers that is substantially equivalent to the level of protection achieved under state law.

- Before a state law can be preempted, the FIO Director is required to:

    1. Notify and consult with the appropriate state regarding any potential preemption.
    2. Notify and consult with the USTR regarding any preemption.
    3. Publish in the federal register for public comment a notice of the potential preemption including a description of each state insurance measure at issue and any applicable covered agreement.

- Upon making a determination of a preemption, the FIO Director is required to:

    1. Notify the appropriate state of the determination,
    2. Establish a reasonable period of time for the preemption to become effective, and
    3. Notify the relevant Congressional committees of such preemption.

- Once the preemption has become effective, the FIO Director is required to:

    1. Publish another notice in the Federal Register.
    2. Notify the appropriate state.

- A state has a right to appeal this determination in court pursuant to the provisions of the Administrative Procedures Act and such appeal shall be considered under a *de novo* standard of review (i.e. without judicial deference to the FIO Director's determination).

- Not all insurance regulatory measures can be preempted. The following state laws and regulations cannot be preempted:

    1. Those governing rates, premiums, underwriting, or sales practices;
    2. State insurance coverage requirements;
    3. State antitrust laws relating to the business of insurance; and
    4. Those relating to capital and solvency except to the extent that such measure results in less favorable treatment for non-U.S. insurers than U.S. insurers.

How does the discussion of a Covered Agreement relate to the European Union's Solvency II regulatory framework and the "US/EU Dialogue"?

- The Solvency II Directive provides for the EU to make an equivalence determination for non-EU countries in the areas of group supervision, group solvency, and reinsurance. The Directive also requires that an appropriate confidentiality regime be in place. The EU plans to start implementing its new Solvency II regime in January 2016, although some aspects will be delayed and phased in over the next 16 years.

- Non-EU based companies from countries that have been deemed equivalent may be subject to less stringent regulatory standards to operate in the European Union than those jurisdictions that have not been deemed equivalent. Importantly, EU companies do significantly more business in the U.S. than U.S. companies do in the EU and many, if not all, EU subsidiaries of U.S. companies are already structured in a way to meet the new European requirements even in the absence of equivalence.

- While the U.S. and EU systems are different, they strive for similar outcomes of protecting policyholders and ensuring a competitive and fair marketplace for consumers. The ongoing US/EU Dialogue process has been instrumental in enhancing our mutual understanding of our respective regulatory systems including the areas of group supervision and reinsurance consumer protection collateral among other matters.

- While a Covered Agreement may be one mechanism for achieving recognition of the United States under Solvency II, it is clear that it can also be achieved through other mechanisms such as recognition of existing structures and processes.

- In fact, the European Commission issued a decision deeming the U.S. system of group solvency and confidentiality provisionally equivalent without the need for a covered agreement.

What is the NAIC's position regarding a Covered Agreement on Reinsurance Consumer Protection Collateral?

- The federal government has not demonstrated benefits to U.S. insurers or consumers that would warrant a covered agreement preempting state law. There are alternatives to such drastic action, including state action already underway. However, if Treasury and USTR move forward, state insurance regulators expect to be a direct part of the negotiations to ensure that mutual recognition is not paid for with unnecessary preemption of state law.

- To the extent Treasury and the USTR maintain that a covered agreement is in the best interests of the United States, we have a number of questions, including:

  1. What is the scope of the agreement? How narrow is it? Is it limited to reinsurance consumer protection collateral or does it extend to other topics?
  2. What is the cost-benefit for the United States? Requiring all states to eliminate consumer protection collateral requirements for foreign reinsurers would clearly help non-U.S. companies, but is there a corresponding benefit to U.S. policyholders and companies?
  3. How will the agreement be substantially equivalent to the protections afforded U.S. consumers under state insurance laws? Reinsurance consumer protection collateral protects insurance consumers by ensuring that reinsurers pay on their claims to ceding insurers, who in turn, rely on such coverage to pay consumer claims. Reducing consumer protection collateral beyond a prudent risk-based regulatory assessment, as the NAIC approach provides, may increase the likelihood that reinsurance claims may not be paid, in full or on time, thereby potentially increasing risks to U.S insurers and policyholders.

Ethan Sonnichsen, Managing Director, Government Relations esonnichsen@naic.org
Mark Sagat, Assistant Director, Financial Policy and Legislation msagat@naic.org
Eric Thompson, Manager, International Relations ethompson@naic.org
Heather Eilers-Bowser, Financial Policy and Legislative Counsel heilersbowser@naic.org