THE IMPACT OF THE U.S.-EU DIALOGUES ON U.S. INSURANCE MARKETS

HEARING

BEFORE THE

SUBCOMMITTEE ON
HOUSING AND INSURANCE

OF THE

COMMITTEE ON FINANCIAL SERVICES

U.S. HOUSE OF REPRESENTATIVES

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WEDNESDAY, SEPTEMBER 28, 2016

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ADDITIONAL MATERIAL SUBMITTED FOR THE RECORD

THE IMPACT OF THE U.S.-EU DIALOGUES ON U.S. INSURANCE MARKETS

Wednesday, September 28, 2016

U.S. HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON HOUSING
AND INSURANCE,
COMMITTEE ON FINANCIAL SERVICES,
Washington, D.C.

The subcommittee met, pursuant to notice, at 2 p.m., in room 2128, Rayburn House Office Building, Hon. Blaine Luetkemeyer [chairman of the subcommittee] presiding.

Members present: Representatives Luetkemeyer, Royce, Garrett, Pearce, Posey, Ross, Barr, Rothfus, Williams; Cleaver, Clay, Green, and Beatty.

Also present: Representative Heck.

Chairman LUETKEMEYER. The Subcommittee on Housing and Insurance will come to order. Without objection, the Chair is authorized to declare a recess of the subcommittee at any time, and unfortunately, today we probably will have to have a recess somewhere between probably 2:45 and 3 o'clock, as we do expect votes to take place.

I apologize to the witnesses today, but unfortunately that is the way things happen in an afternoon session. So, I appreciate you sticking around whenever that happens because—depending on how far we get here, but hopefully, we can get through a lot of questions and testimony as quickly as possible.

Today's hearing is entitled, "The Impact of the U.S.-EU Dialogues on U.S. Insurance Markets." Before we begin, I would like to thank the witnesses for appearing before the subcommittee today. We look forward to your testimony.

I now recognize myself for 5 minutes for an opening statement. This subcommittee has spent a great deal of time focused on international factors affecting our domestic insurance markets. Today, we continue our oversight of the evolving international regulatory environment and the direct impact on U.S. policyholders.

I would ask everyone to please take a look at the chart on the screens. It is all around you. This is a depiction of the meetings of the International Association of Insurance Supervisors (IAIS) happening in the current 5-month window. Eighty percent of these meetings take place behind closed doors without public or congressional access.

Today's hearing will serve as an opportunity to hear from Team U.S.A. as to what exactly is being discussed and to press for badly needed transparency.

As I have said before, I don't believe it is necessarily in our best interest nor do we want to bring these international processes to a grinding halt. However, we should never underestimate the importance of these conversations or the need for greater transparency into these proceedings.

That is why my colleagues and I authored H.R. 5143, the Transparent Insurance Standards Act. H.R. 5143 will codify a stronger role for State governments and the U.S. Congress to conduct oversight of these international conversations. It also provides our regulators with leverage when entering into discussions with our European counterparts.

Today, we also have Congress' first real opportunity to examine the covered agreement negotiations between the Treasury Department and the U.S. Trade Representative and the European Union.

While I believe that insurers are best regulated at the State level, a covered agreement with the European Union, when structured properly and with input from State insurance commissioners and stakeholders, presents a unique opportunity to level the playing field for U.S. insurers and reinsurers. That is particularly important given the actions we are beginning to see out of European regulatory bodies.

Look no further than Shelter Re, domiciled in my home State of Missouri. Shelter Re was recently sent a letter by BaFin, the German financial regulator, demanding the creation of a German branch in order to continue to operate in that country.

Without objection, that letter and supporting material will be entered into the record.

It is my understanding that other insurers have received similar letters and that other nations are set to follow Germany's lead. It is obvious we are beginning to see how Solvency II-governed Europe operates in a world without a covered agreement.

That being said, I do have serious concerns for the lack of transparency surrounding the covered agreement process. I fail to see why our negotiators feel the need to be so secretive about this process. And the Chair will note the unfilled spot at the witness table designated for the U.S. Trade Representative.

The United States and the European Union are the largest insurance markets in the world, and ensuring that our model for insurance regulation is adequately and appropriately respected in this deal is of the utmost importance. That covered agreement should be narrow, in accordance with the law, and be focused on achieving mutual recognition of each other's group supervisory regimes as well as each other's regulation of reinsurance. It should create an equal platform for reinsurance collateral and avoid any unnecessary Federal intrusion into group supervision.

I have said in each of these hearings that it is vital for the United States to participate in these discussions and to be in a position to lead, not be led. I believe it serves the Nation well when all parties—the States, the Executive Branch, Congress, and all stakeholders—work in concert to grant negotiators with the greatest possible leverage.

We need to work cooperatively to signal to the European Union, the IAIS, and the Financial Stability Board that we will only lend our name to standards and agreements that benefit the United

States consumers and allow us to maintain a robust insurance marketplace at home.

I thank our distinguished panel for being here today. I look forward to your testimony.

With that, the Chair now recognizes the ranking member of the subcommittee, the gentleman from Missouri, my good friend Mr. Cleaver, for 5 minutes for an opening statement.

Mr. CLEAVER. Chairman Luetkemeyer, thank you very much for this hearing, and I thank the members of the subcommittee.

And to the witnesses, thank you for joining us this afternoon.

This hearing provides us with an opportunity to hear an overview on the ongoing negotiations between the United States and the EU, specifically in regards to a covered agreement. As we all know, the Federal Insurance Office and the United States Trade Representative announced their intention to move forward with the negotiations in November of 2015.

This agreement, as defined by the Dodd-Frank Act, is a written bilateral or multilateral agreement regarding prudential matters with respect to the business of insurance or reinsurance or stop insurance. On January 1, 2016, the EU began to implement its insurance regulatory scheme commonly known as Solvency II.

I think, for me at least, it is important to hear from the witnesses today on the ongoing process regarding the negotiations to ensure that the unique U.S. insurance market continues to thrive, both nationally and on a global level. Additionally, given the importance of the insurance market to the U.S. economy, this hearing provides another opportunity to discuss the work being done by Team U.S.A. at the International Association of Insurance Supervisors.

Following the financial crash of 2008, the Federal Insurance Office (FIO) was created with the passage of Dodd-Frank. FIO has been tasked with coordinating Federal efforts and developing Federal policy on prudential aspects of international insurance matters, including representing the United States in the IAIS.

Though the U.S. insurance industry is, of course, primarily regulated by the States, I would like to take note of the importance of having a Federal Insurance Office to assess the financial stability of the system as a whole and to represent the United States, along with the Federal Reserve and the NAIC, in these international discussions. And I look forward to having this discussion. I think this could be quite educational. Thank you.

Chairman LUETKEMEYER. Very good.

Today, we welcome the testimony of Mr. Michael McRaith, Director of the Federal Insurance Office, U.S. Department of the Treasury; Mr. Thomas Sullivan, Associate Director, Board of Governors of the Federal Reserve System; and Ms. Julie Mix McPeak, Commissioner, Tennessee Department of Commerce and Insurance, who is testifying on behalf of the National Association of Insurance Commissioners.

And we also have an open seat there. The subcommittee extended an invitation to Ambassador Robert Holleyman, our Deputy United States Trade Representative, or a designee from USTR. I am disappointed to report that USTR chose not to provide a witness today for our hearing. I fully expect that they will comply with

this subcommittee's request to respond to all questions submitted for the record, and I am disappointed, especially when they are specifically required to participate in negotiating covered agreements, that they chose not to be here. That is not good.

I thank our three witnesses for each of you taking your time to testify before the committee today. Each of you will be recognized for 5 minutes to give an oral presentation of your testimony, and without objection, your written statements will be made a part of the record.

I think you probably have all been here before and know how to utilize the lighting system in front of you: green means go; yellow means you have a minute left; and red means I have the last word.

With that, Mr. McRaith, you are recognized for 5 minutes.

STATEMENT OF MICHAEL T. MCRAITH, DIRECTOR, FEDERAL INSURANCE OFFICE (FIO), U.S. DEPARTMENT OF THE TREASURY

Mr. MCRAITH. Chairman Luetkemeyer, Ranking Member Cleaver, and members of the subcommittee, thank you for inviting me to testify.

We will soon release FIO's 2016 annual report on the insurance industry, our fourth annual report, which will cite 2015 data showing that the $8.1 trillion U.S. insurance industry reported surplus levels of over $1 trillion. Nonhealth insurers collected more than $1.1 trillion in premiums or nearly 8.4 percent of U.S. GDP. The report will show the changing U.S. insurance market, the expanding global insurance market, and the supervisory standards that are evolving in order to reflect these changes.

For these reasons, among others, FIO has a statutory role to coordinate and develop Federal policy on prudential aspects of international insurance matters, including representing the United States at the International Association of Insurance Supervisors.

International insurance standards are not new. The IAIS was formed in 1994. State regulators were among the founding members. International standards are neither self-executing nor binding in the United States. In the United States., Federal and State authorities would test a standard and may then tailor and implement that standard through the U.S. system of oversight.

In our IAIS work, we collaborate extensively with the Federal Reserve and State insurance regulators, including Tom Sullivan and Julie McPeak. For the United States to assert international leadership, the U.S. participants must be coordinated, and that is exactly what happens today. Today, the Federal Reserve, all 56 NAIC members, NAIC staff, and the FIO represent the United States at the IAIS.

With the most diverse and competitive insurance market in the world, the United States is well-positioned to work with our global counterparts to build consensus. Simply put, IAIS standards must serve the interests of U.S. consumers and industry and our national economy, or those standards will neither receive our support nor be implemented in our country.

In 2015, to enhance stakeholder input, the IAIS eliminated the pay-for-play requirement which required observers to pay an annual fee. The IAIS held approximately 14 hours of public engage-

ment in 2014, a total that increased tenfold in 2015. U.S. stakeholders are also invited to meet at Treasury directly with the U.S. IAIS members. These sessions, which include our State and Federal Reserve colleagues, are one path for input from consumers and industry on key issues.

One key issue known as the insurance capital standard has been the subject of IAIS consultation papers, including one released in July. ICS progress continues incrementally.

Working jointly with the USTR, and receiving feedback from State regulators and industry stakeholders, we are negotiating a covered agreement with the EU. The EU is implementing its insurance regulatory reform known as Solvency II, which could have significant negative implications for U.S. insurers and reinsurers.

If successful, a covered agreement would help resolve longstanding prudential insurance disputes between the U.S. and the EU and further clarify that the U.S. system of insurance oversight protects consumers, supports financial stability, and promotes global engagement.

A covered agreement would preserve our national interests, protect our consumers, and promote a level playing field for U.S. insurers. We will continue to report to this committee and others about development in the negotiations.

Finally, the U.S. market and its oversight are unique. Through effective collaboration, U.S. authorities will continue to provide global leadership in support of a vibrant, well-regulated market that promotes competition and financial stability, and protects consumers. In all of our work, Treasury priorities will remain the best interest of U.S. consumers and industry, the U.S. economy, and jobs for the American people.

Chairman Luetkemeyer, Ranking Member Cleaver, and members of the subcommittee, I want to thank you for the courtesies that you have extended to me throughout this Congress. Our conversations have always been informative, appreciated, and helpful. Thank you for your attention. I look forward to your questions.

[The prepared statement of Director McRaith can be found on page 36 of the appendix.]

Chairman LUETKEMEYER. Thank you, Mr. McRaith.

And I want to assure you that the feeling is mutual. You have been very forthcoming in all of our discussions that we have had, and we appreciate your willingness to share your information.

Mr. Sullivan, you are recognized for 5 minutes. Welcome.

STATEMENT OF THOMAS SULLIVAN, ASSOCIATE DIRECTOR, BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

Mr. SULLIVAN. Thank you, Chairman Luetkemeyer, Ranking Member Cleaver, and members of the subcommittee. I appreciate the opportunity and your invitation to testify on behalf of the Federal Reserve. The Fed welcomes the opportunity to participate in today's hearing, and I am pleased to be joined by my colleague from the Federal Insurance Office, Director McRaith, and the representative of the NAIC, Commissioner McPeak.

While each of us have our own unique authority and mission, the Federal Reserve remains committed to working collaboratively on

a wide range of issues, including insurance prudential matters, both domestic and international.

Dodd-Frank gave the Fed regulatory responsibilities for two populations of insurance firms: those that own a federally-insured bank or thrift; and those designated as systemically important by the FSOC. The Federal Reserve's supervisory objectives for the insurance firms it supervises encompass protecting the firm's safety and soundness while promoting financial stability.

We continue to develop regulatory and supervisory measures appropriate for these insurance firms, and in addition, we collaborate with State insurance supervisors and respect the important work that they do. For instance, we continue to be cognizant of the State insurance supervisors, regulate the types of insurance products offered by insurance companies and the manner in which insurance is provided.

Because of the overall structure of insurance regulation as specified by Congress in the McCarran-Ferguson Act and elsewhere, the line here is rather bright. The Federal Reserve's approach to insurance supervision distinguishes between insurance companies that we oversee solely because they control and insure depository institution and those that have been designated as systemically important by the FSOC.

In our advanced notice of proposed rulemaking, the Board has conceptually set out two capital frameworks: one which may be appropriate for large, complex, systemically important firms; while the other may be appropriate for firms such as the current population of insurance, savings and loan holding companies. In addition, the Board has issued proposals on reporting requirements and enhanced prudential standards for the FSOC-designated insurance companies.

As we continue exploring regulatory frameworks that we have set out and the other areas of our supervision, we appreciate the comments we have received on these outstanding proposals and the constructive observations contained in those comments. We also continue to meet with industry and other parties. In the last year-and-a-half alone, we have held over 60 meetings with stakeholders. Among other things, this reaffirms our continued commitment to increasing transparency in our rulemaking development.

The Federal Reserve has acted and will continue to act in international insurance standards in an engaged partnership and a multiparty collaboration with our colleagues from the NAIC, State insurance commissioners, and the FIO.

Last year, the Board was invited to join the NAIC and the FIO and their work on the EU-U.S. dialogue project to engage in a healthy exchange among supervisors and to determine a way forward as to the supervision of insurers whose operations span across these jurisdictions.

Alongside this dialogue project has been the negotiation of the possible covered agreement under the leadership and authorities of the FIO and the USTR. We respect the work of the FIO and the USTR toward an agreement that would enhance regulatory certainty for U.S. insurers and reinsurers operating in the EU.

We appreciate our current ability to advocate for international standards that work for U.S. firms, U.S. insurance consumers, and

U.S. financial markets more broadly. These international standards include work at the IAIS. The Federal Reserve participates in the development of international supervisory standards and guidance to ensure that they are appropriate for the U.S. market.

Indeed, the Federal Reserve continues to participate actively in standards setting at the IAIS while in consultation and collaboration with the States, the NAIC, and the FIO to present a coordinated U.S. voice. And crucially, it is important to remain mindful of the fact that the IAIS standards and FSB determinations have no binding force in the United States, and they are not self-executing. We remain committed to a supervisory framework that best meets the needs of U.S. insurers as they compete internationally and is appropriate for U.S. insurance markets and consumers.

Mr. Chairman, Ranking Member Cleaver, and members of the subcommittee, I would be happy to take your questions. Thank you.

[The prepared statement of Associate Director Sullivan can be found on page 44 of the appendix.]

Chairman LUETKEMEYER. Thank you, Mr. Sullivan.

And Ms. McPeak, you are recognized for 5 minutes. Welcome.

STATEMENT OF JULIE MIX MCPEAK, COMMISSIONER, TENNESSEE DEPARTMENT OF COMMERCE AND INSURANCE, ON BEHALF OF THE NATIONAL ASSOCIATION OF INSURANCE COMMISSIONERS (NAIC)

Ms. MCPEAK. Thank you. Chairman Luetkemeyer, Ranking Member Cleaver, and members of the subcommittee, thank you for the invitation to testify on behalf of the National Association of Insurance Commissioners.

There are a number of international developments important to our sector, but I want to focus today on the impact of the EU's new Solvency II regime on U.S. insurers and U.S. regulation and the Federal Government's misguided approach to addressing that issue with the covered agreement.

EU law requires an assessment of whether another country's regulatory system is equivalent to elements of Solvency II and then penalizes that country's insurers with additional regulatory requirements when that country is not deemed equivalent by the EU. This has the effect of either imposing the EU approach on the rest of the world or placing companies from those jurisdictions at a competitive disadvantage to its own industry when operating within the EU.

The EU may argue that serving as judge and jury of other countries' regulatory systems is an important tool for ensuring emerging markets are safe for EU investment. But the United States is the largest market in the world and has proven to be as effective as the best aspirations of Solvency II. Keep in mind, Europe's new system won't be fully implemented for another decade, may yet be revised further, and has been deemed inappropriate for the U.S. insurance sector by State insurance regulators and the Federal Reserve.

We are already subject to assessment and scrutiny by Governor's offices, State legislatures, Congress, Government watchdogs, and international standard-setters. And our track record of ensuring a competitive and fair market for over 145 years speaks for itself.

But as the saying goes, the EU doesn't have to take our word for it. We have directly engaged our EU counterparts for years on regulatory issues and to coordinate the oversight of global market players.

As part of the U.S.-EU dialogue project with Treasury and the EU, we have explored both our regulatory regimes indepth and discovered that, despite our structural differences, we have much in common. On the heels of the project, the EU granted provisional equivalents to the United States group solvency regime, which largely benefited EU insurers, and acknowledged our system's substantial confidentiality protections—all without a covered agreement.

The one remaining area of concern for the EU is State reinsurance collateral requirements posted by EU reinsurers. In spite of serving as a layer of protection for U.S. policyholders, particularly in times of national disasters, and questions about the enforceability of judgments to ensure foreign reinsurers pay U.S. insurer claims, we have nevertheless responded to this concern and worked to carefully reduce those requirements. Thirty-five States have now adopted those changes, and they recently became an NAIC accreditation requirement, virtually assuring that all States will come on board.

Despite this progress and the obvious lack of any other legitimate concerns with our system, the EU and our Federal Government have entered into closed-door negotiations for a covered agreement to resolve a problem that largely no longer exists, potentially at the expense of State insurance consumer protections.

Setting aside for a moment whether or not the U.S. regulatory system is equivalent to Solvency II, the Treasury and the USTR have moved forward with a covered agreement without answering an important question: Does the benefit outweigh the cost? To our knowledge, neither the Treasury nor the USTR have gathered data to address this question.

Further, the process has been conducted largely in secret. State insurance directors have been repeatedly promised direct and meaningful participation in negotiations, but the small group of us included in the process are merely observers, subject to strict confidentiality with no ability to consult our fellow regulators. This must change, and we are aware of no rule or law that applies to the covered agreement process that would preclude broader transparency and accountability.

Additionally, we urge Treasury and the USTR to take preemption of State insurance consumer protections and any expansion of the Federal Government's role in insurance regulation off the table. State legislatures and Congress should decide the specifics of U.S. insurance regulatory power and who shall exercise it, not Federal bureaucrats and certainly not the EU.

In conclusion, after more than a decade of dialogue and information exchange, the EU has all of the information it needs to recognize the U.S. insurance regulatory system and avoid future regulatory retaliation. Instead of negotiating a potentially preemptive agreement behind closed doors to solve a problem of the EU's creation, we urge our Federal colleagues to push back on the EU and urge them to reconsider their laws before agreeing to preempt ours.

Thank you again for the opportunity to be here on behalf of the NAIC, and I look forward to your questions.

[The prepared statement of Commissioner McPeak can be found on page 28 of the appendix.]

Chairman LUETKEMEYER. Thank you for your testimony.

And, with that, I will recognize myself for 5 minutes for questions.

Mr. McRaith, I have a copy of a press release from the Treasury Department here. This is a joint statement between you and the EU with regards to—"Bilateral Agreement on Insurance and Reinsurance Measures" is the headline and it says that you are very close on some key issues. Can you give us an update on where you are with the negotiations on a covered agreement?

Mr. MCRAITH. As reflected in that public statement, Mr. Chairman, the recent discussions in Washington that occurred last week did provide for some progress, some increased opportunity to reach an agreement through negotiations. However, it is and it remains unclear whether we will be successful in those negotiations. We intend to pursue the covered agreement, but we do want to be clear it is uncertain the outcome at this time.

Chairman LUETKEMEYER. So what you're telling me is you have agreed on a couple of things, but you are a long way from agreement, and there is none imminent? Is that right, what I read from your statement?

Mr. MCRAITH. I think I would characterize it more as saying that we are improving and increasing our understanding of the respective arguments and the negotiating positions. I would not say that we reached agreement on key issues. We did increase understanding on the key issues, and I would say we closed the gap of misunderstanding.

Chairman LUETKEMEYER. Do you have a timeframe within which you believe this will be done?

Mr. MCRAITH. Our aspiration is to move forward as quickly as possible given the implications for companies, including like Shelter Re, the one that you mentioned in your opening statement.

Chairman LUETKEMEYER. Now, following up on that part of it, this would appear to me to be kind of a dangerous situation we are letting sort of hang out there. Is this being addressed? Are you working on this issue? Are you pushing back?

I know I have had a lot of folks in the industry come to me and say now, with this situation, we need to push even harder for the bill that I have offered to make sure it is in place to be able to give you the leverage, to give us the oversight that is needed to be able to push back against these folks. Because if my companies in my district are getting it, I am sure there are other companies around the country that are getting this as well. And I understand there are other countries in Europe that are starting to look at this as well.

Mr. MCRAITH. We are acutely concerned about the implications for U.S. industry and U.S. consumers. Putting aside the characterization of the EU approach that some might offer, it is fundamentally their determination and their decision. We disagree with it. We don't like it. It will never work in the United States. It will not apply to U.S. firms outside of the EU. But we need to reach an

agreement at the Federal level in order to ensure that becomes the reality.

Chairman LUETKEMEYER. Okay. Is this included in your covered agreement discussions?

Mr. MCRAITH. The potential—if we were to reach an agreement, it would resolve all of these issues for our—it could potentially resolve all of these issues for our industry. That is the objective of our negotiation.

Chairman LUETKEMEYER. Mr. Sullivan, do you concur with how Mr. McRaith has characterized the negotiations at this point?

Mr. SULLIVAN. We recognize the authorities of the FIO and the USTR. I wouldn't characterize the negotiations because I am not as close to them as he is.

Chairman LUETKEMEYER. Okay. Ms. McPeak, you heard me discuss the situation with Shelter Re here in my State and with Mr. McRaith. And you made a statement earlier that said that problems no longer exist. That would appear to be kind of a problem to me. Do you see a way that you can resolve that without a covered agreement or without negotiations? Or what is your opinion of that?

Ms. MCPEAK. Yes, sir. Thank you for the question, Mr. Chairman.

I said the problems no longer substantially exist because we are addressing the reinsurance collateral being required to be posted by EU insurers through our NAIC model and the adoption by the States. But we are not sitting idly by with the actions of BaFin. At the NAIC, we had a hearing at our recent quarterly meeting asking for feedback from insurers about integration and implementation issues from the implementation of Solvency II. The issues of BaFin came to our attention. We had already charged our (E) Committee to look at ways that we might need to ensure consumer protections in the instance that collateral might be affected.

But in the meantime, we are also looking at our qualified jurisdiction process, because one of the aspects that we consider in deciding whether a jurisdiction is qualified for reduced reinsurance collateral under the model is whether they grant reciprocity to our insurers. And so the actions by BaFin would seem to be in violation of that, and we are certainly considering them.

Chairman LUETKEMEYER. Thank you for your response.

And I just wanted to add, we do have up on the screen—and will continue to have it there for a while—the number of meetings over the next 5 months, 80 percent of which are not open and transparent. And I think this is a concern. I hope some of my colleagues follow up with some questions with regards to this, because I think we need to have as much openness and fresh air to this process to make sure everybody knows what is going on, to alleviate concerns and rumors and conjecture and those things. So I appreciate your answers to those questions as they come up.

With that, I yield to the ranking member, Mr. Cleaver, for 5 minutes.

Mr. CLEAVER. Mr. Chairman, before I ask any questions, let me associate myself with your earlier comments and perhaps go even further. Realizing the need for transparency, as you just mentioned, I am extremely disturbed by the fact that the USTR did not

come here today. And if I were a conspiracy theorist, I would say they are meeting with the Russians. But I am frustrated, because, as you mentioned, it just doesn't look good. It is not a good thing.

And at a minimum, I would have thought they would have contacted you or contacted me as ranking member, and they did not. They didn't contact the staff. I needed to say that so I could feel better. And I would just as soon have the chart taken down. They are not here, and they are not going to show up, so there is no point in having that up there.

Now, good afternoon. Thank you so much for being here. My questions are based on trying to get some real clear information on what is going on.

So, Mr. McRaith, if you can just kind of bring us up to date on the status of the negotiations. Where are we on this day?

Mr. MCRAITH. We have met with our European Union counterparts on four occasions, with a State regulator at the table for each one of those sessions. We recently concluded a negotiating session last week in Washington that lasted 2 days. Our hope is to reconvene with our European counterparts in the near future to try to make further progress.

Mr. CLEAVER. One of the concerns I have is Brexit. We have had over 40 years—I don't know how—40-something years old, 40 years of England doing business can the EU or doing business in the EU. And without, they probably have all kinds of trade agreements. What is that—and I know the exit is not going to take place in the next week, but how is that being factored in?

London is the economic capital of Europe. What is going on in relation to these negotiations?

Mr. MCRAITH. The European Union is represented for purposes of these discussions by the European Commission. That representative represents all of the 28 members of the European Union, which includes the United Kingdom. If the U.K. were to withdraw from the European Union at some point in the future, then we would have to address that possibility at that time.

At this time, right now, given a world of hypotheticals, it is not something that is a key component of our negotiations. We will deal with the EU, and resolve that issue. If there are issues down the road that require us to deal directly with the U.K., we would do that.

Mr. CLEAVER. Ms. McPeak, or any of you, maybe Mr. McRaith again, trade agreements are front and center in all of the discussions politically around here. What is the covered agreement? How does the covered agreement differ from other trade agreements?

Mr. MCRAITH. A covered agreement involves prudential measures. Prudential measures that apply to the insurance and reinsurance industry do not—and it does not involve trade-related or market access issues. In that sense, it is a fundamentally different agreement or the agreement itself is of a different nature.

Mr. CLEAVER. All right. I am very concerned about the time, and I heard the little buzzer. So I will yield back the balance of my time. I want to make sure Mrs. Beatty has a chance.

Chairman LUETKEMEYER. Okay. We will try and get one or two more in here yet, but votes have been called, and we are down to

12 minutes. So Mr. Ross from Florida is the first one up, and he is recognized for 5 minutes.

Mr. ROSS. Thank you, Mr. Chairman.

In looking at that chart there, Director McRaith, it shows all the meetings that have been held this year. Let me ask you this question: Are you put on notice of all the meetings with regard to the IAIS concerning the international standards? Are you given notice?

Mr. MCRAITH. That is right. Yes, IAIS members receive—are aware of or receive notice of all meetings.

Mr. ROSS. So would it be safe to say that, as referenced above, assuming those are all IAIS meetings with regard to international standards, you were at least given notice of those meetings?

Mr. MCRAITH. That is a fair statement, yes.

Mr. ROSS. Did you attend or have any representative attend?

Mr. MCRAITH. Not necessarily. Many meetings, yes, but because we coordinate with our U.S. colleagues, there are some issues that specifically are within the province, for example, of the State regulators; we don't get directly involved with the market conduct committee, for example.

Mr. ROSS. Okay. Ms. McPeak, how active—or let me ask you this: How has this been for the NAIC to have opportunity to be part of the negotiations?

Ms. MCPEAK. The covered agreement negotiations?

Mr. ROSS. Yes, ma'am.

Ms. MCPEAK. We have a very small team of regulators that are subject to very strict confidentiality provisions to participate. We are allowed to have one State regulator in the room during a negotiation, and the rest of us who have signed that confidentiality agreement, the other five of us are briefed afterwards.

Mr. ROSS. And so, with regard to those meetings that are shown there on the graphic, have you been put on notice of those meetings?

Ms. MCPEAK. We generally have notice of those meetings if they are IAIS-related, yes, sir.

Mr. ROSS. And do you usually have a representative there?

Ms. MCPEAK. We would either have a State insurance regulator representative or a staff member of the NAIC present at the majority of those meetings. I wouldn't say all of them because not all of the issues we are actively engaged on, and we participate by phone if possible.

Mr. ROSS. Okay. Now, you talked about something earlier, reciprocity versus uniformity, and I think that is something that is really important here, because we have a system in place since McCarran-Ferguson that allows us probably by far and undisputable, in my opinion, with the best regulatory scheme for insurance on behalf of consumers in the world, and that is our individual State-regulated schemes.

We protect consumers. We make sure capital requirements are met. Now, capital requirements are somewhat heterogeneous. In other words, risk is dependent upon the geographic region. Would we not have a little bit different problem? You can't make a homogeneous risk on an international standard. So my concern is, what if we had a covered agreement that allowed for reciprocity instead of uniformity? Is that possible?

Ms. MCPEAK. I would defer to Director McRaith about the possibility of reciprocity, but I would agree with you that it is a very challenging endeavor to create a system of an international capital standard that is homogeneous across the world, because our valuation systems differ, just as one example.

Mr. ROSS. What would you say, Director, to that? What are the chances of reciprocity? In other words—we have a system in place, which you know, as a former insurance commissioner, by far beats anything.

Mr. MCRAITH. Congressman, you and I have had many conversations on this subject over the years.

Mr. ROSS. Yes.

Mr. MCRAITH. To be clear, the objective of the covered agreement is exactly that. It is a recognition that the U.S. system is the U.S. system. To the extent it will change, it will be your decision. It will not be driven by any external force or idea at all.

Mr. ROSS. And I appreciate that, because I firmly believe that having to keep different standards by our domestic carriers to meet the qualifications of the IAIS as well—or Solvency II—as well as their State regulator, is only going to inure to the detriment of the consumer with higher policies.

Mr. Sullivan, you talked about, again, in your statement that this is nonbinding and that the international standards are nonbinding. Is it us that will make the decision whether it is going to be binding, or is it a regulatory agency, such as the FSB, that is going to make it binding?

Mr. SULLIVAN. It would absolutely be the authorities here in the United States, be it the States and the NAIC through the promulgation of a model law or something to enact something similar to a standard. Or at the Fed, we would have to do that through our formal rulemaking. But in either case, we, the regulators in the United States, make the decision around what we are going to adopt, and we would likely tailor it to some of the uniquenesses that you pointed out about the U.S. markets.

Mr. ROSS. And I appreciate that. So, essentially, you are saying that it would be the FSB that would have to approve the covered agreement in order to make it binding?

Mr. SULLIVAN. No. The FSB does not have a role in the covered agreement. I don't know if Director McRaith—

Mr. ROSS. I am trying to figure out, because you say in your testimony that it would be some regulatory rulemaking authority that would make it binding. And I am trying to figure out who that would be in the United States that would bind our State regulators to international standards.

Mr. SULLIVAN. For international standards, it would be, again, either the NAIC through the promulgation of a model law and then the States adopting it or for the institutions that the Fed supervises us going through the rulemaking process.

Mr. ROSS. Okay. Thank you. I see my time is up, and I yield back.

Chairman LUETKEMEYER. The votes have been called. I think we are looking at five votes, so we will probably be back here at, I would say, 3:15 to 3:30, somewhere in that vicinity. So I apologize

to the witnesses, but if you can stick around, we should return shortly.

And, with that, we will call a recess.

[recess]

Mr. LUETKEMEYER. The subcommittee will come to order. And I apologize, again, to the witnesses for the extended delay here. We were whipping votes on our side. So it takes a long time for us to discuss and figure out what we are going to do. And then at the end of the day, we change our minds anyway. You guys know how the process works.

Mrs. Beatty is actually next in line, and she will go next, but to expedite things and maximize everybody's time here, let's go to Mr. Rothfus for 5 minutes and recognize him and begin the questioning.

Mr. Rothfus?

Mr. ROTHFUS. Thank you, Mr. Chairman.

Ms. McPeak, I am concerned about the sequencing of the FSB and the FSOC decisions that we see coming. As you know, in some cases the Financial Stability Board has gotten ahead of our own domestic regulators. I view this as problematic both for regulatory accountability and quality, as well as our national sovereignty.

I spoke about this issue earlier today with Chair Yellen, and it has been a frequent topic of discussion in our committee.

Do you believe that the United States should decide its position on international insurance standards, such as capital standards, prior to agreeing to an international standard?

Ms. MCPEAK. Certainly, I think that the domestic international capital standard is our priority and where we should direct our attention. We do feel like participating in a discussion on the international standard, though, is important both to influence the discussion at the international level and to make sure that our domestic standard is something that comes to a similar outcome.

Mr. ROTHFUS. Has your organization been participating with the Financial Stability Board meetings on insurance standards or the designation of insurers as a globally systemically important insurer?

Ms. MCPEAK. We don't participate in the Financial Stability Board. We do have a seat at the FSOC, but it is a nonvoting position there.

Mr. ROTHFUS. Did you or anyone from your organization at any time agree to designate any U.S. insurer as a globally systemically important insurer as part of any FSB discussions at all? Nothing? You have had no conversations with them?

Ms. MCPEAK. No, sir, we are not entitled to participate in those discussions. We have been very vocal that we don't think that we have any insurers in the United States that are globally significant and that we would not designate those as the domestic regulators of those companies.

Mr. ROTHFUS. Thank you.

Mr. Sullivan, earlier today I expressed my concerns to Chair Yellen about the sequencing of designation decisions coming from the FSB and the FSOC. There is a February 2015 letter from the FSB Chairman, Mark Carney, that he wrote to FSB members, and he wanted the FSB members to agree to full, consistent, and

prompt implementation of agreed reforms. This would seem to indicate that some FSOC decisions might follow from FSB determinations and that they don't arise out of an independent process.

That seems to be the spirit in which things have moved. MetLife and Prudential were designated by FSB in 2013 as GSII and only received FSOC designations after that date.

When undertaking its domestic designation process, does FSOC consider the designation decisions made by foreign regulators such as the FSB?

Mr. SULLIVAN. I think your question was appropriately directed to Chair Yellen and/or the FSOC. I would point out, though, I believe that the domestic designations did precede the FSB designations. MetLife, of course, was a bank holding company, so it was not subject to designation as a SIFI until it dropped its bank holding status, and then it was brought into the FSOC process.

Mr. ROTHFUS. One concern that the committee has heard from a wide variety of stakeholders is the need for proper sequencing of the domestic and international capital standards. Where are we on the domestic capital standard rulemaking?

Mr. SULLIVAN. As you may be aware, the Board issued an advance notice of proposed rulemaking in which we laid out an architectural framework for two intended paths that the board may, operative word, choose to pursue.

The ANPR is a result of much stakeholder engagement. As I mentioned in my oral and written testimony, we have had over 60 meetings with stakeholders in the last year-and-a-half. But notwithstanding that, we felt the necessity to further consult with interested of stakeholders and those that ranged in the spectrum from industry representatives to the Academy of Actuaries, the rating agencies, and the like.

So I feel really good about the extent and the openness that we have demonstrated in arriving at an ANPR, but we are very early in the process.

Mr. ROTHFUS. Can you tell us why it is important that the Federal Reserve complete its domestic capital standard work before consenting to the adoption of an international capital standard?

Mr. SULLIVAN. In our ANPR, we noted that we did not believe that the international capital standard was mature and advanced enough for us to consider it as an alternative. We therefore are charting our own path and moving forward with our own proposals.

Mr. ROTHFUS. Thank you.

I yield back.

Mr. LUETKEMEYER. With that, we will go to—Mr. Heck is not a member of this subcommittee, but we welcome him here today. As a non-member of the committee, he is the last one to be able to ask question. So until we get all the members through asking questions, Mr. Heck, we will ask you to wait, but we will get to you at the very end here if you will stick around.

With that, we go to the gentleman from Texas, Mr. Williams. He is recognized for 5 minutes.

Mr. WILLIAMS. Thank you, Mr. Chairman.

Thank you all for your testimony today.

The United States has the largest pro-consumer and competitive insurance market in the world. For over 150 years, the U.S. State-

based insurance model has worked, and I believe Congress has stated that rather clearly over the years.

Now, while the United States has a proven system in place, moving toward an unknown, untested international standard, in my opinion, would be unwise.

So that being said, Mr. Sullivan, can you provide the subcommittee with some examples of overseas insurance regulatory initiatives that if adopted in the United States might result in decreased U.S. competitiveness abroad?

Mr. SULLIVAN. I don't have any examples that come to mind. I would just say that our work continues to make sure that any standards that we would consider here comport with being in the best interests of U.S. consumers and our U.S. insurance markets.

Mr. WILLIAMS. And make sure we are competitive. That is the main thing.

Mr. SULLIVAN. Indeed.

Mr. WILLIAMS. Commissioner McPeak, is it possible that those standards applied in Solvency II could impact or affect domestic-only insurance companies, and if so, what do you think would be the impact?

Ms. MCPEAK. I think United States insurers subject to Solvency II requirements would be extremely detrimental to the competitive nature of the market. There are completely different accounting and valuations standards used for Solvency II that would require our insurers to essentially maintain a second set of accounting books, because the system that we have had in place for 145 years and has worked very well is a completely different statutory accounting system, and we feel comfortable with that.

Mr. WILLIAMS. Now, what is the downside to applying the standards established in Solvency II to U.S. companies that conduct international business? I think you said a lot of that right there.

Ms. MCPEAK. That is exactly right. It is the cost of complying with a completely different accounting and valuation financial analysis system.

Mr. WILLIAMS. I am going to also say that there is a fear that without proper oversight of U.S. negotiators, the internal international regulatory standards could become the gold standard all over the world.

Again to you, Ms. McPeak, how might this application of a gold standard with lack of proper oversight affect U.S. insurers?

Ms. MCPEAK. Again, the actions of Team U.S.A. at the international level must always consider the implications on the United States market, particularly in terms of consumer protection and the cost to consumers to comply with those international standards.

And I think that all three of us here who have participated in those discussions at the IAIS always bring forth the question of whether or not the standard is implementable in the United States, and that means something that we would be willing to adopt as regulators of the industry.

And in a lot of cases, we try our best to affect those standards before they are passed. But we are very clear that not every idea or standard that comes out of the IAIS is something that is going to work in the United States market.

Mr. WILLIAMS. Thanks for being clear about that.

Next question: Could international standards eventually trickle down to the State level even if they don't initially adopt them?

Ms. MCPEAK. I would be surprised. It could happen. But, generally, because of the substantial involvement of the NAIC, State insurance regulators are generally like-minded about the international standards and whether or not they are appropriate for the marketplace. And it would be very difficult for a single State or a group of States to adopt those standards that would create a very different system than the rest of the national market.

Mr. WILLIAMS. What are some consequences for U.S. insurers and the U.S. regulatory structure should international negotiations prove disadvantageous to the current system?

Ms. MCPEAK. As many of us have said, none of these standards are self-executing. And so we just certainly wouldn't adopt those here in the United States either through Federal congressional action or action of our legislatures and our States or rulemaking from the regulators that are here today. If it is not something that would work for the United States, I don't see that it would be something that would be adopted here.

Mr. WILLIAMS. Thank you for having your eyes wide open and not necessarily—we just have to make sure that U.S. consumers and companies are driving it and not following it. We appreciate that.

Mr. Chairman, I yield back.

Mr. LUETKEMEYER. The gentleman yields back his time.

With that, we go to Mr. Barr from Kentucky. He is recognized for 5 minutes.

Mr. BARR. Thank you, Mr. Chairman.

Commissioner McPeak, it's great to see you again. I enjoyed working with you in your days in Frankfort as the executive director of the Kentucky office of insurance. Congratulations on your move to the State of Tennessee.

And as a Congressman who represents the University of Kentucky, we want you home. When you get a chance to finish up your career in Tennessee, we would love to have you back in the Commonwealth of Kentucky.

Let me ask you a few questions about the subject of today's hearing. Obviously, you have testified that many U.S.-domiciled insurance companies are concerned that measures that are being considered by the IAIS are really ill-suited for U.S. insurers, specifically draconian bank-style capital standards. And also I think you just testified with my colleague from Texas that the costly accounting standards would be problematic for American insurers.

Specifically, can you elaborate on how the cost of compliance, if we were to adopt these European standards, would impact the competitiveness of American insurers? And then, what impact would it have on American consumers of insurance products?

Ms. MCPEAK. Certainly. Thank you for the question and the invitation to come back to Kentucky. I look forward to doing that someday.

Some of the standards that have been discussed at the international level cause us great concern in terms of valuing our assets and liabilities differently than our companies currently do in the United States. There are certain provisions about equity and mar-

gin over equity that would be counted differently for United States insurers that would ultimately lead to a greater reserving in capital needs for the company, which then trickles down to the consumer in increased costs, because you would be requiring companies to hold additional levels of capital in various instances where United States regulators have said we are very comfortable with this statutory accounting system and the reserving system that is currently in place.

Mr. BARR. To follow up, obviously the NAIC participates in some way in IAIS meetings related to covered agreement negotiations. Question: Is the NAIC's participation meaningful in your estimation or is it deficient?

Ms. MCPEAK. The NAIC does participate in covered agreement negotiations. Those are led by Director McRaith. There is a small group of us, a group of six who are allowed to participate, but only one individual can physically be in the room at the time of the negotiations. And so there is an issue with discussion and transparency with our group of six and then with our fellow regulators, our additional group of 56 States that would like to know what is going on there.

Mr. BARR. Director McRaith, I did appreciate your testimony earlier that, of course, your objective at the FIO is to confirm that the U.S. insurance regulatory system serves the goals of insurance sector oversight.

And, Mr. Sullivan, the same with your testimony.

But I would ask Commissioner McPeak on behalf of the State departments of insurance whether or not you believe that to be the case, that we are, in fact, pursuing that objective in these international negotiations?

Ms. MCPEAK. I think the interest from the industry and the resolving of the uncertainty that Director McRaith talked about is the finding of equivalence from the European Union and the European Commission on the various elements of Solvency II.

I understand that is certainly the mission of the negotiations, and I do believe that is the direction that the negotiations are under. I would suggest, though, that there is nothing today that would prevent the European Union from finding the United States system equivalent. We have proven ourselves to be very efficient and effective over our history.

Mr. BARR. And to Mr. McRaith and Mr. Sullivan, what concerns me, and the reason why I cosponsored H.R. 5143 with Chairman Luetkemeyer is that, whereas in the USTR process the information on negotiations that are conducted in connection with international trade negotiations are a very transparent back-and-forth dialogue, what seems to be missing in the international negotiations over insurance standards is any significant public back-and-forth dialogue between FIO and stakeholders in the midst of those negotiations.

And given our interest, Congress' interest in this legislation that would hoist upon you all additional transparency members, is the USTR process one that could be replicated by both Treasury and the Federal Reserve when it comes to these international insurance standard negotiations?

Mr. MCRAITH. Let me talk specifically with respect to the covered agreement negotiations, Congressman.

Mr. BARR. Yes.

Mr. MCRAITH. Fortunately, the work we are doing builds on years of public engagement with industry and stakeholders. Commissioner McPeak's written testimony even describes that in great detail. All of that is public. There were reports that were published.

Through our negotiations, we have engaged with industry stakeholders, with consumer stakeholders, we shared documents that we draft, documents we receive with the State regulators. The State regulators gave us important technical feedback. For the first time, I believe, we actually have a State official in the delegation and at the table for an international negotiation.

So when we conclude, the text will be with you for 90 days before it becomes final. So you will see it. It will also be published in the Federal Register.

Mr. BARR. Thank you for your testimony.

I yield back.

Mr. LUETKEMEYER. The gentleman's time has expired.

The gentleman from California, Mr. Royce, is recognized for 5 minutes.

Mr. ROYCE. Thank you very much, Mr. Chairman.

And I agree with the chairman's previous statement of support for a narrow covered agreement to be concluded as quickly as possible, because I think it serves as the only realistic hope we have of ensuring U.S. companies that they can really compete on a level playing field.

But a year ago, I sent a letter to the Treasury and the USTR urging them to expeditiously negotiate a covered agreement. My concern, which I stated at the time, was that without action, U.S. companies with businesses in the EU would be put at a direct competitive disadvantage and that continued open access of U.S.-based reinsurers would not be assured and U.S. insurers would be exposed to the risk of additional regulatory actions by individual U.S. companies.

Now, one of the reasons we are here is because, sadly, the prognostications here have been proven correct. Sadly, to date, we have also seen actions taken by regulators in the U.K., the Netherlands, Austria, Germany, and Poland to place U.S. companies at a disadvantage. In the latter two countries, U.S. reinsurers are now prohibited from conducting cross-border operations without forming and capitalizing a branch or a subsidiary. We could have solved this.

And I would ask rhetorically when we might expect the 19 jurisdictions that have yet to adopt the NAIC's model reinsurance law to get on board, but I also suspect I know the answer to that, and it is going to be not soon enough, and that is the comeuppance here.

So Congress predicted this would be the case. I could go back to Kanjorski's original observations this was exactly why the concept of a covered agreement was pushed on a bipartisan basis by this committee. The author of that provision, Paul Kanjorski, said at the time—and this was back in 2009—"The FIO and the USTR would be given the authority to enter into a covered agreement to allow for the preemption of State laws to harmonize reinsurance standards across national borders."

So with all due respect to everybody here, notice was served 7 years ago about where we were headed if we didn't get this worked out.

So where does that leave us?

And, Director McRaith, I would like to pose the question to you, because you know better than most how we got here. You were before us as a commissioner during the discussions on Dodd-Frank, and now you are leading negotiations on the covered agreement. And I just ask, what do you think of the notion of a State-by-State solution on reinsurance collateral at this point?

Mr. MCRAITH. Congressman, you are absolutely right. We are at a moment in time when these concerns are not hypothetical. This is not some metaphysical dilemma that we can debate until the cows come home. The issue is real for our industry. It is real today. The covered agreement gives us an opportunity to bring closure to issues that have been debated and discussed for decades. It is not to the exclusion of the States. It supports the State system.

As you note—I was director of insurance in Illinois—I strongly believe in the State system and the work that my colleagues, former colleague Julie McPeak and her current colleagues, do to protect consumers every day. The two are not mutually exclusive. The covered agreement preserves our system of regulation and delivers real, meaningful results for our industry operating in the EU.

Mr. ROYCE. I appreciate your observations, and I certainly concur.

And, Mr. Chairman, I thank you very much for this hearing and the ability to get to the bottom of a problem that needs to be solved here. So thank you.

Mr. LUETKEMEYER. The gentleman yields back.

With that, we go to the gentleman from Washington. I welcome him to our subcommittee and recognize Mr. Heck for 5 minutes.

Mr. HECK. Thank you, Mr. Chairman. Just to clarify, I am a member of the full Financial Services Committee.

Mr. LUETKEMEYER. Right.

Mr. HECK. And I appreciate the opportunity to be here very, very much.

I would like to begin with a question that any of you can answer, in fact I would ask all of you to answer, and that is, are any of you seeking to either overturn or to diminish the policy laid out in the McCarran-Ferguson Act that the States will be the primary regulators of insurance companies? Is anybody seeking to do that, overturn or diminish it? A verbal answer for the record would be much appreciated.

Mr. SULLIVAN. No. In fact, my oral and written testimony reflects a preservation of and a recognition of McCarran.

Mr. MCRAITH. Congressman, our work globally with the States and with the Federal Reserve is intended to preserve and support and enhance the U.S. system of oversight, which is fundamentally reposed with the State regulators.

Mr. HECK. So you do not seek to overturn or diminish?

Mr. MCRAITH. Congressman, I have testified in front of this committee and our office has published reports supporting the work of the State regulators.

Mr. HECK. Is that, then, a yes, you do not seek to overturn or diminish?

Mr. MCRAITH. I'm sorry. I thought I was being unequivocal. I will be more unequivocal. We are absolutely not seeking to overturn or diminish the role of the States as provided in McCarran-Ferguson.

Mr. HECK. Thank you very much.

Ms. MCPEAK. And, I am sure not surprisingly, I am a strong proponent of McCarran-Ferguson and the State regulation.

Mr. HECK. I am shocked.

Ms. MCPEAK. I know.

Mr. HECK. There is gambling in this establishment.

Thank you.

So I want you all to know in that spirit that today I will be introducing an insurance bill, because I think there can be more than one good idea about how to uphold the objectives and principles that we seem to have agreed upon by consensus that will codify good practices in international insurance negotiations.

My bill is predicated on two principles, and the first is that when the United States discusses insurance in international forums, our representatives should include primary insurance regulators from the States. That is the first principle.

Do any of you disagree with that principle?

Mr. SULLIVAN. No, sir. I think that is a good principle.

Mr. MCRAITH. We greatly appreciate our current collaboration with the States, including Commissioner McPeak, who is the vice chairman of the Executive Committee at the IAIS.

Mr. HECK. We seem to be struggling with being truly unequivocal today, Director McRaith. Does that mean that you—

Mr. MCRAITH. I am trying to give context for my remarks, which is we absolutely welcome and value our collaboration with the State regulators globally, including as it occurs today.

Mr. HECK. Commissioner McPeak, surprise us again.

Ms. MCPEAK. Yes, certainly, we would support such legislation.

Mr. HECK. And, Commissioner McPeak, how would you feel about a statutory mandate to include and/or consult insurance commissioners in international forums where insurance regulations is being discussed, a requirement that we do that as long as we all seem to agree upon it?

Ms. MCPEAK. We would certainly appreciate the structure not only for today, but in the future, as these international discussions will be continuing and the world of insurance is certainly much more being played out on the global front. And so having a statutory structure in place and a role for the State insurance commissioners is something that we would strongly support.

Mr. HECK. So the second principle that my bill that I will introduce later today—I don't know if I mentioned that I will be introducing legislation later today, but I will be—is that U.S. financial policy should be made in the United States.

Does anybody have any objections or disagreement with that principle?

Mr. SULLIVAN. I do not.

Mr. MCRAITH. No, sir.

Ms. MCPEAK. Absolutely not.

Mr. HECK. Commissioner McPeak, do you think that principle is being consistently, unwaveringly, and in good faith upheld at the present time and in the immediate past?

Ms. MCPEAK. I do in the sense that we are all currently working on an insurance capital standard for the United States that makes sense for us. State regulators are working on a part of that. Certainly, the Federal Reserve Board is working on their proposed rulemaking in that endeavor. But we are also engaged in discussions at the international level. I do feel like financial policy is being made in the United States for our United States market.

Mr. HECK. So given that answer, can I assume that, like my question regarding the other principle, you think that this one ought to be reflected in statutory language as well?

Ms. MCPEAK. I do think that would be extremely helpful to us as we are not only working on our own financial policies in the United States but also representing the United States internationally.

Mr. HECK. I thank you all very much. And I am only sorry, Commissioner McPeak, that you are not a Member of this institution so that you could cosponsor the legislation that—did I mention—I am introducing later today.

Thank you, Mr. Chairman, very much.

Mr. LUETKEMEYER. The gentleman's time has expired.

I have a couple of redirects for the panel.

With regard to the charts that we had on the board a while ago, there are 5 months' worth of meetings—there they are, they are back up—and 80 percent of those are meetings that are closed.

And I guess the first question is, Mr. McRaith and Mr. Sullivan, do you or your staff or some representative attend every single one of those meetings?

Mr. SULLIVAN. I will go first.

No, we do not. In fact, we, the Fed, have only recently become a member. I would say recently; we just celebrated our 2-year anniversary. As a member of the IAIS, we recently stood up my team inside of the Federal Reserve. So we are still kind of the new kids on the block. We have to pick and choose, quite honestly, what committees we do participate in, and those are the ones that have the most interest to us around financial stability and those sorts of committees—the insurance capital standard and the related subcommittees and working groups.

We can't be everywhere. For instance, as I mentioned in my testimony, we don't regulate insurance products or insurance markets the way the NAIC does. There are a number of those committees that work on those issues and there would be no need for us to have representation at those committee meetings.

Mr. LUETKEMEYER. Okay.

Mr. McRaith?

Mr. MCRAITH. I would echo that response. First of all, I can't read the screen.

Mr. LUETKEMEYER. I don't blame you. The one on the back is large.

Mr. MCRAITH. All right.

Mr. LUETKEMEYER. We have a really tight budget around here, so we only have one big screen. We have two small ones on the side, so—

Mr. MCRAITH. But generally speaking, our focus is on the areas of prudential oversight. Not all of the committee meetings that have occurred or will occur relate to prudential oversight. And we don't have unlimited resources. We have a small staff, a team who works very hard, and is very capable, but we don't attend every meeting and are not in every workstream.

Mr. LUETKEMEYER. Do you get summaries or feedback of some kind on those meetings so that you are aware of what was discussed in them? Because the point I made originally was that they are not open to the public. So, therefore, only, I assume, you or your representative would have access to those meetings. So, therefore, if you are not attending them, do you get information back on what was discussed so that in case something came up that you don't want to get blindsided by it? I would assume that you are getting some reports of some kind.

Mr. MCRAITH. Thankfully, for those committees in which we are not involved, we know the NAIC is involved, so we are comfortable that our interests as a country are being well-represented. But then also the IAIS has newsletters, Internet, website updates that are available to the public, to stakeholders at large, including the members. So we are able to stay abreast of developments.

Mr. LUETKEMEYER. Okay. So would you say, then, that by getting those updates, there is a transparent process for you, at least, that the public—I know Ms. McPeak has made the comment already about not being able to attend all of the meetings. Is there a way? I think industry would like to be able to see what is going on so they know.

I understand there has to be, to a certain degree, some ability to be able to work behind closed doors to be able to get certain things done, but I think the product of that discussion needs to be certainly available for people to see. And is that made public, then, so that the industry can see that on a regular basis so those 80 percent of those meetings people know what is going on?

Mr. MCRAITH. Mr. Chairman, from my perspective, there are two issues here. One is we absolutely do not want to publicly discuss what data or information that could be confidential or proprietary specific to an individual firm. I know you appreciate that as well.

Mr. LUETKEMEYER. I understand that there are proprietary concerns.

Mr. MCRAITH. But, secondly, in terms of development, before any standard or any development becomes something of formal policy or final in any sense, it is subject to extensive consultation in writing, in person, by telephone as well.

So, yes, there are meetings that occur without industry or stakeholders present, but then industry and stakeholders receive a lot of opportunity to contribute. In fact I mentioned, just in 2015, 140 hours or more devoted to engaging with stakeholders.

Mr. LUETKEMEYER. Ms. McPeak, would you like to comment?

Ms. MCPEAK. I would add to those comments to say that also on behalf of the NAIC, when issues are released for consultation to stakeholders, to the interested parties, we at the NAIC make that

a very public process so that we invite stakeholders to share comments with us in an open forum before we submit our own comments on behalf of State insurance regulators.

Now, the stakeholders can certainly submit their own comments on behalf of their own perspective, but we want to hear from them about the issues under consultation before we even submit our comments back as well.

Mr. LUETKEMEYER. Thank you.

One more quick comment here before we conclude. I don't think Mr. Cleaver has any redirects, but I have one more question with regards to the covered agreement situation.

If we get no covered agreement for an extended period of time, and we have somebody like Germany that is putting out demands that our companies who want to operate there put offices in there and their regulators are forcing our companies to do things, can this escalate at some point to retribution for them with their companies here if they are going to force our companies to do something over there? Is that a scenario that could happen? What is going to happen here if we don't do something with these covered agreements, I guess is the question, and could there be retaliation?

Ms. MCPEAK. I should probably respond to that, Mr. Chairman.

We are taking the actions by BaFin and other European Union countries very, very seriously, and the—

Mr. LUETKEMEYER. I would hope so. This is pretty significant. They are trying to make demands on our companies and dictate to them to change their business model.

Ms. MCPEAK. I could not agree more. And, again, I would reiterate my position that equivalence could be determined today. And instead, BaFin and other countries are taking different positions and requiring some additional corporate structures in order to participate in the markets in Germany.

So our review of the qualified jurisdiction status of Germany and other countries following the feedback that we received at our last quarterly meeting, one of the factors that we will be analyzing is whether the countries are providing reciprocal treatment to our insurers in their market.

If that is not the case, and that determination is still under review by our panel of State regulator experts that make that determination, if the country of Germany is no longer deemed to be a qualified jurisdiction for purposes of our model for reinsurance collateral reduction, the German reinsurers that want to participate in our United States market will lose the ability to have reduced collateral requirements and will be required to post additional collateral up to 100 percent of the reinsurance that they would write in the United States.

This is not insignificant, because our United States participation in Germany is about one-fourth of what the German interest is in our United States market in terms of reinsurance. So if we are unable to make a lot of headway with BaFin from regulator-to-regulator perspective, the German reinsurance market will certainly feel the effect of the United States' qualified jurisdiction decision.

Mr. LUETKEMEYER. Mr. McRaith?

Mr. MCRAITH. Mr. Chairman, I think the question emphasizes the point that we need to eliminate the world of hypotheticals,

eliminate the prospect of our companies incurring billions of dollars of additional charges, and we need to reach an agreement. And as I said earlier in reply to your earlier question, that is our objective, and we hope to report back to you in the near future.

Mr. LUETKEMEYER. I appreciate that comment, Mr. McRaith, but I think my point is that I want everybody to know that there are consequences that are out there if the individuals from IAIS and Germany and Great Britain, whomever is listening today, they know that there could be consequences for the lack of a covered agreement. There could be consequences for their actions. I think it is incumbent on this committee to make sure that statement is made and they know that our intentions are sincere and we will carry them out.

So with that, I want to thank the witnesses for your testimony today.

I know, Mr. McRaith and Mr. Sullivan, that you have been more than generous with your time with regards to my requests to update us on a regular basis. In the CHOICE Act, one of the things that is in there is to change things around to be able to come on a regular basis. Maybe we need to do that anyway just to get an update so we know where everybody is at, especially with the significance of this issue, to make sure that everybody knows what is going on to allay concerns, fears, gossip, what have you, and know what is going on.

So I certainly appreciate, again, all of you being here today and your willingness to cooperate with myself and my subcommittee and my staff to be able to get as much information as we can to stay on top of this.

The Chair notes that some Members may have additional questions for this panel, which they may wish to submit in writing. Without objection, the hearing record will remain open for 5 legislative days for Members to submit written questions to these witnesses and to place their responses in the record. Also, without objection, Members will have 5 legislative days to submit extraneous materials to the Chair for inclusion in the record.

And with that, this hearing is adjourned.

[Whereupon, at 4:17 p.m., the hearing was adjourned.]

A P P E N D I X

September 28, 2016

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Testimony of

Julie Mix McPeak

Commissioner

Tennessee Department of Commerce and 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:

The Impact of U.S.-EU Dialogues on U.S. Insurance Markets

Introductory Remarks

Chairman Luetkemeyer, Ranking Member Cleaver, and members of the Subcommittee, thank you for the invitation to testify today. My name is Julie Mix McPeak, and I am the Commissioner of the Tennessee Department of Commerce and Insurance, the Vice President of the National Association of Insurance Commissioners (NAIC), the Chair of the NAIC's International Relations Committee, and Vice-Chair of the International Association of Insurance Supervisors' (IAIS) Executive Committee. On behalf of my Department, my fellow state insurance regulators, and the NAIC, I appreciate the opportunity to testify today.

For 145 years, state insurance regulation has had a demonstrated track record of protecting U.S. policyholders, promoting financial stability in the insurance sector, and ensuring a competitive U.S. insurance marketplace. Whenever there have been issues of concern, we have addressed them. Whenever there have been periods of economic and financial distress, we have surmounted them. Today we can say the U.S. insurance sector is stronger than ever and our regulatory oversight is more effective than at any time in our history because state regulators never stop enhancing a system that works for the U.S. marketplace. Notwithstanding this track record and recent years of intense dialogue and substantive work, including collaboration in international supervisory colleges, the European Union (EU) has yet to fully recognize our system as equivalent under its new Solvency II insurance regime. In doing so, the EU appears to be seeking a competitive advantage for its domestic insurance industry at the expense of our own. Compounding the problem, rather than encouraging the EU to recognize our system on its merits, or encouraging the EU to overturn its discriminatory equivalence mandate, the Treasury and the Office of the United States Trade Representative (USTR) are now pursuing a formal Covered Agreement under the pretense that U.S. concessions are necessary to achieve EU recognition. Not only are we skeptical of the need for a Covered Agreement, we are also wary of its potential substance and strongly object to the lack of transparency in the process. We are simply not convinced that the perceived benefits of a potentially preemptive Covered Agreement to the U.S. insurance sector are worth the cost of U.S. insurance consumer protection.

Insurance Marketplace in the U.S. and EU

By way of background, the United States represents nearly 39% of all global insurance premium—more than $2 trillion. Taken individually, U.S. states make up 26 of the world's 50 largest insurance markets, including my home state of Tennessee. By comparison, the European Union represents 26% of global premium, approximately $1.36 trillion, and European countries, taken individually, make up 12 of the world's top 50 insurance markets. In 2015, EU-based reinsurers[1] wrote approximately $24.2 billion in reinsurance premium in the U.S., while U.S.-

[1] As Switzerland is not part of the EU, it is worth noting that Swiss-based reinsurers separately wrote approximately $12.6 billion in reinsurance premium in the U.S. in 2015.

based reinsurers wrote approximately $7.2 billion in the EU—a three-fold advantage. As you can see, the U.S. market is open and attractive to European insurers and reinsurers, so the EU has strong economic incentives to protect its companies' ability to do business in the United States while having other countries conform to their Solvency II system. These market conditions have weighed heavily on the EU's interest in promoting Solvency II as a worldwide standard, as well as promoting the perceived notion that a federal Covered Agreement is required in order to afford the U.S. equivalence under Solvency II's equivalence mandate. Our view is that a Covered Agreement is not necessary to resolve the uncertainty caused by EU's equivalence mandate, and international standards should be flexible and reflect consensus best practices, and not be a validation of one regional system in an attempt to impose that approach on the rest of the world.

Solvency II

A product more than ten years in the making, the EU began implementing its new Solvency II regime in January 2016. Certain key aspects, such as discount rates, will not be implemented for another 16 years and implementation thus far has been uneven across the EU despite claims that it is a uniform system. The European Union's Solvency II Directive provides for the European Commission to make "equivalence" determinations for third countries in the areas of group supervision, group solvency (i.e., group capital), and reinsurance. Each of these equivalence determinations also require that an appropriate confidentiality regime be in place. Non-EU-based companies from countries that have been deemed equivalent are subject to significantly less regulatory duplication to operate in the European Union than those jurisdictions that have not been deemed equivalent.

However, at this point, it is unclear the degree to which an equivalence determination would benefit the United States in economic terms. First, many European subsidiaries of U.S. companies are already structured in a way to meet the new Solvency II requirements in the absence of equivalence. Second, the United Kingdom, the 4th largest insurance market in the world, recently voted to exit the European Union and has announced an initiative to reexamine their insurance regulatory regime creating uncertainty as to the long-term application of Solvency II. Third, Europe has embarked on a mission to seek worldwide conformity with their system, which benefits their companies relative to companies in other countries. In fact, most of the countries that have received an equivalency determination have received it only on a temporary or provisional basis with significant conditions attached, designed to conform their regulatory systems to Europe's. Finally, while the Solvency II paradigm might be appropriate for the EU, state insurance regulators and, more recently, the Federal Reserve have determined that it is inappropriate for the U.S. market and unworkable for regulatory purposes. As Federal Reserve Board Governor Daniel Tarullo explained in May:

> "The valuation frameworks for insurance liabilities adopted in Solvency II differ starkly from U.S. GAAP and may introduce excessive volatility. [Solvency II] is also inconsistent with [the Federal Reserve's] strong preference for building a predominantly standardized risk-based capital rule that enables comparisons across firms without excessive reliance on internal models. Finally, it appears that Solvency II could be quite pro-cyclical."[2]

The case simply has not been made that the benefit to the U.S. insurance industry and consumers of conforming U.S. standards to more closely resemble European standards in order to achieve an EU Solvency II "equivalence" determination is worth the cost of preempting our U.S. regulatory regime, undermining U.S. consumer protections, and disrupting our own competitive and resilient marketplace.

U.S.-EU Dialogue

Nevertheless, for many years leading up to the launch of Solvency II earlier this year, state insurance regulators and European regulators have been meeting on a regular basis to facilitate mutual regulatory understanding and cooperation. We have long contended that although our regulatory system is structured differently than Europe's, it results in similar outcomes, and should not be a basis for imposing duplicative regulation on U.S. insurers operating abroad.

In 2012, the NAIC, Treasury's Federal Insurance Office (FIO), the European Commission, and European Insurance and Occupational Pensions Authority (EIOPA) convened a joint project (known as the U.S.-EU Insurance Project) to enhance the understanding of each other's approach to solvency oversight and to explore ways to increase transatlantic cooperation, with the implicit understanding that the project would lead to mutual recognition of our respective regulatory systems.

As part of this project, technical groups were formed to explore several core areas of insurance regulation including three areas subject to an equivalency determination and are now at issue in the Covered Agreement negotiations: 1) Confidentiality/Professional Secrecy, 2) Group Supervision, and 3) Reinsurance. With respect to confidentiality, the incorporation of freedom of information principles and public records access into our legal system, which we view as an appropriate transparency and accountability feature of our system, often has been characterized as a deficiency by EU counterparts. This view, however, has ignored the ability of state insurance regulators to collect and maintain certain confidential information that should be protected from disclosure and share that information with other regulatory and law enforcement bodies, including internationally, that can commit to keeping that information confidential. The

[2] Governor Daniel Tarullo, Board of Governors of the Federal Reserve System, "Insurance Companies and the Role of the Federal Reserve," May 20, 2016, National Association of Insurance Commissioners' International Forum, Washington, D.C., Keynote Address

technical committee charged with reviewing these issues concluded that while there may be differences in the form and application of professional secrecy and confidentiality laws in the U.S. and EU, the two systems are substantially similar in the subject matter addressed and the outcome to be achieved. We will always remain open to addressing any one-off issues that arise; however, in our experience, and as the technical committee found, both systems tend toward the same outcomes in terms of protecting confidential information and facilitating information exchange among regulatory bodies. Last year, the European Commission found that the U.S. system had substantial confidentiality protections in place as part of its provisional equivalence finding for the U.S. group solvency approach.

With respect to Group Supervision, despite significant educational efforts and the exchange of technical information on the part of the NAIC, it remains unclear what specific deficiencies the EU believes exist with our system of group supervision. The technical group received multiple detailed presentations from the NAIC regarding, among other things, U.S. insurance holding company laws and regulatory practices, how U.S.-led supervisory colleges are conducted, the U.S. Own Risk and Solvency Assessment (ORSA) requirements and use, corporate governance standards and disclosure, and group financial analysis. By all accounts, the NAIC believed Europe was generally satisfied with the state-based system regarding group supervision.

With respect to reinsurance regulation, while there is much we have in common, there are differences with respect to our approach to collateral requirements for foreign reinsurers operating in our respective jurisdictions. By way of background, collateral is used to ensure rapid payment by reinsurers to ceding insurers and ultimately to ensure policyholders' claims are paid. Under its Solvency II regime, Europe does not require collateral for reinsurance transactions between EU countries and with those countries that have received an equivalence determination. In the United States, historically, state insurance regulators had required that an unlicensed reinsurer, foreign or domestic, post collateral in a U.S. financial institution equal to 100% of the reinsurer's financial obligation as a means of ensuring payment of claims, and in the case of foreign reinsurers, rendering moot the potential challenge of enforcing judgments in a foreign court. In spite of some compelling arguments to maintain collateral, we recognized the concern of our European colleagues for a more level playing field and began the process of reducing collateral requirements. In 2011, the NAIC adopted revisions to our Credit for Reinsurance Model Law in November 2011, allowing reduction of the 100% collateral requirement for reinsurers in solid financial health (certified reinsurer) subject to a an effective regulatory regime (a qualified jurisdiction).[3] 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[4] throughout the U.S.

[3] Determinations are made by the NAIC Qualified Jurisdiction (E) Working Group. Jurisdictions are evaluated based both upon the authorities they have as well as their administrative practices.

[4] "Passporting" refers to the process under which a state has the discretion to defer to the certification of a reinsurer and the rating assigned to that certified reinsurer by another state.

As of today, 35 states and U.S. territories have adopted amendments to our credit for reinsurance laws that would implement this reduction. Those 35 jurisdictions represent more than 68% of direct insurance premium written in the U.S. across all lines of business. We are currently aware of nine additional jurisdictions that are actively considering the model or similar proposals, which would raise this market share to approximately 93%. This new approach on collateral will also become a NAIC accreditation requirement on January 1, 2019, which will help drive further state adoption and achieve a high degree of uniformity and consistency. As of September 1, 2016, the NAIC has approved seven jurisdictions as qualified jurisdictions, including the only four EU countries that applied, and 28 certified reinsurers, including seven European-based reinsurers that have been approved through the NAIC's process.[5] We believe this is an excellent example of states responding quickly to global market developments while preserving our focus on U.S. policyholder protection. To the extent the main political driver of a covered agreement is the reduction of collateral requirements across the country, we are confident we will achieve that result in relatively short order without the threat of federal preemption. We would urge our federal colleagues, and Congress, to bear in mind that the states are charged with the protection of U.S. policyholders, and thus it is both our responsibility and our obligation to determine the appropriate reinsurance collateral rules and levels to ensure insurance consumers are protected.

The U.S.-EU Dialogue project's factual report documented how the U.S. and EU have many more commonalities than differences including in the areas subject to a potential EU equivalence determination. As evidence of this, last year, the EU granted provisional equivalence to the United States regulatory system's group solvency regime and, as indicated earlier, acknowledged that the regulatory system had substantial confidentiality protections in place—without federal action or a covered agreement. However, while this allows European companies to continue operating in the U.S. without additional regulatory requirements, it did little for U.S. companies operating in Europe. Notwithstanding this recent decision and the substantive evidence produced through the Dialogue project, the EU still has not reached an equivalence determination on the United States in the areas of group supervision and reinsurance. This is not a surprise given the EU's incentives to create a more favorable competitive environment for its companies at the expense of other countries.

Covered Agreement

Yet, in lieu of pressing the European Commission to recognize our proven system and pushing back on disparate treatment of U.S. insurers and reinsurers, the Treasury and USTR instead have pursued a covered agreement presumably with hopes of resolving the equivalency question for

[5] As of January 1, 2015, Bermuda, France, Germany, Ireland, Japan, Switzerland, and the United Kingdom are qualified jurisdictions.

the United States.[6] This federal action could lead to unnecessary preemption of insurance consumer protections and otherwise undermine our regulatory system. In fact, FIO has suggested that it plans to use a Covered Agreement to insert itself in the process for qualifying jurisdictions for collateral reduction[7], a clear contravention of the Dodd-Frank Act, which specifically prohibits the office from exercising regulatory or supervisory authorities or using the covered agreement process to establish such authorities.[8] Any attempt to use a covered agreement to expand the federal government's involvement in insurance regulatory process is something the states strongly oppose, and we urge Congress to intervene should such a federal intrusion come to fruition.

Further, unlike a trade agreement, which is subject to established procedures for consultation and input, and which also requires a vote by the legislative branch, a covered agreement lacks these established processes and requires no further legislative action despite having the potential to preempt state laws and authorities—laws and authorities that have been carefully designed to supervise a multi-trillion dollar industry that touches virtually every American, and that have been repeatedly deferred to by Congress. Given these implications, a covered agreement should be subject to at least as much, if not more, transparency and input than bilateral or multilateral trade agreements. However, in the nine months since Treasury and USTR informed Congress of their intent to negotiate a covered agreement with the EU, the entirety of what is publicly known about the agenda, objectives, and specific impact on U.S. prudential regulation is encapsulated in that initial two page letter to Congress. Moreover, even though state insurance regulators had been repeatedly promised "direct and meaningful" participation in the negotiations, the small group of us included in the process are merely observers, subject to strict confidentiality with no ability to consult our fellow regulators, and the broader community of stakeholders has no insight whatsoever into the process. This must change, and we are aware of no federal rule or law that applies to the covered agreement process that would preclude this type of transparency and accountability. We urge Treasury and USTR to establish greater transparency and seek broader public feedback from state insurance regulators, state legislators, insurers, consumer representatives, and other stakeholders. Additionally, we urge Treasury and USTR to take preemption of state insurance consumer protections and any expansion of the federal government's role in insurance regulation off the table. State legislatures and Congress should decide the specifics of U.S. insurance regulatory power and who shall exercise it—not the EU and federal negotiators.

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[6] The authority to pursue a covered agreement was included in the Dodd-Frank Act as a unique stand-by authority to address, if necessary, those areas where U.S. laws might treat non-U.S. insurers differently than U.S. insurers, such as reinsurance collateral requirements. USTR and Treasury must consult with Congress and submit any proposed agreement to the House Ways and Means, House Financial Services, Senate Banking, and Senate Finance Committees for a 90 day review period before it can become effective.

[7] Treasury Department: Federal Insurance Office, "How to Modernize and Improve the System of Insurance Regulation in the United States," December 2013, Washington, D.C.

[8] 31 USC 313(k) ("Nothing in this section or section 314 shall be construed to establish or provide the Office or the Department of the Treasury with general supervisory or regulatory authority over the business of insurance.")

Recently, in what appears to be an attempt to gain leverage in the negotiations, certain EU member countries such as Germany and the U.K. have begun taking discriminatory actions against U.S. companies as they implement Solvency II. At our NAIC National Meeting last month, we provided a forum for stakeholders to report on their treatment in Europe so we could further evaluate the nature and extent of these new regulatory requirements being imposed on U.S. insurers. Though it is still not clear how material the impact is to the U.S. insurance sector, this is troubling and state insurance regulators are not sitting idly by. As part of the NAIC's qualified jurisdiction process an assessment is required as to the extent of reciprocal recognition afforded by the non-U.S. supervisory authority to reinsurers domiciled in the U.S. In this regard, we have initiated a review of Germany and the U.K.'s recent regulatory actions relative to U.S. insurers for further consideration of whether sufficient reciprocity still exists.

Conclusion

In conclusion, the U.S. insurance regulatory system is among the best in the world and the EU has the authority to recognize the remaining elements of the U.S. system as equivalent without further action by state or federal officials. After a decade of dialogue and information exchange, the EU has all the information it needs to reach this obvious conclusion and avoid future regulatory retaliation. Instead of negotiating a potentially preemptive agreement behind closed doors to solve a problem of the EU's creation, we again urge our federal colleagues to push back on the EU and urge them to reconsider their laws before agreeing to preempt ours.

Thank you again for the opportunity to be here on behalf of the NAIC, and I look forward to your questions.

EMBARGOED FOR DELIVERY

Michael McRaith, Director, Federal Insurance Office
U.S. Department of the Treasury
Hearing on the Impact of U.S. – EU Dialogues on U.S. Insurance Markets
House Committee on Financial Services, Subcommittee on Housing and Insurance
September 28, 2016

Chairman Luetkemeyer, Ranking Member Cleaver, Members of the Subcommittee, thank you for inviting me to testify today on the impact of U.S. – EU dialogues on insurance markets.

Today's hearing focuses on prudential aspects of international insurance matters, including the prospect of an agreement on such matters between the United States and the European Union. With respect to these topics, Congress granted the Federal Insurance Office (FIO) the following authority:

> to coordinate Federal efforts and develop Federal policy on prudential aspects of international insurance matters, including representing the United States, as appropriate, in the International Association of Insurance Supervisors (or a successor entity) and assisting the Secretary in negotiating covered agreements[.][1]

Whether in the context of domestic regulatory modernization or in the development of international insurance supervisory standards, any discussion of the U.S. insurance sector must begin with the recognition that the United States has the world's largest and most diverse and competitive insurance market. Thousands of insurers operate in the United States, ranging from small mutual companies that serve a few rural counties to massive global insurers engaged in a variety of financial services. While serving as the Illinois Director of Insurance, I learned firsthand about the importance of small and mid-size insurers to local and regional economies, as well as to insurance consumers and claimants. FIO strongly supports this marketplace diversity, and advocates not only for its preservation but also its enhancement.

This testimony describes the ways in which FIO's work serves our U.S. national interests and preserves both the diversity and competition within the U.S. insurance market and the unique U.S. insurance oversight system. In particular, this testimony discusses the ongoing negotiations of a covered agreement between the United States and the European Union and several other important international initiatives, including at the International Association of Insurance Supervisors (IAIS).

Covered Agreement

A covered agreement refers to a written bilateral or multilateral agreement regarding prudential measures, with respect to the business of insurance or reinsurance, which is entered into between the United States and one or more foreign governments, authorities, or regulatory entities.

As Members of this Committee know, we have been vigorously pursuing a covered agreement with the European Union since Treasury and the United States Trade Representative (USTR)

[1] 31 U.S.C. § 313(c)(1)(E).

announced our intention to do so last November.[2] Recent EU insurance regulatory reforms have increased the need for a covered agreement between the United States and the EU. After years of conceptual and technical development, the European Union began implementation of its Solvency II insurance regulatory regime on January 1, 2016. Under Solvency II, insurers and reinsurers may be subject to an alternative regulatory regime if an insurer or reinsurer's country of domicile has not been determined by the EU to be an equivalent jurisdiction under Solvency II.

Given the prominence of the United States as an insurance market, and given the longstanding nature and success of the U.S. insurance regulatory system, the United States will not submit to the EU's formal Solvency II equivalence process to assess and rule on the adequacy of the U.S. system. For example, 2015 year end data shows that the U.S. insurance market accounts for 26.88% of global insurance premiums, more than twice the amount of Japan, which ranks second (13.04%). While Solvency II has been praised within the EU, and reflects the substantial commitment and expertise of insurance leaders from throughout Europe, it is not a system that will be duplicated within the United States.

The U.S. insurance market – for which the states remain the primary regulators of the business of insurance – is the most diverse and competitive in the world, with thousands of insurers ranging in size, complexity, and global reach. With the complementary roles of the state regulators, the Board of Governors of the Federal Reserve System, and FIO, the United States has a system of insurance oversight that protects consumers, supports financial stability, and provides for global engagement.

In addition, the United States is the largest insurance market for many EU insurers and reinsurers. The EU is not as prominent a market for U.S. insurers and reinsurers as the United States is for EU industry. However, U.S. insurers and reinsurers generate billions of dollars in revenue from the EU market.

The EU's Solvency II regime allows for EU member states to supervise insurers and reinsurers that operate in the EU but are from non-equivalent countries, such as the United States, and may subject those insurers and reinsurers to additional capital, governance, and reporting requirements. In fact, several U.S.-based insurers and reinsurers have received written notice from EU supervisors of the potentially significant implications for those insurers and reinsurers arising from the implementation of Solvency II. In the covered agreement negotiations the United States seeks to level the playing field for U.S. insurers and reinsurers operating in the EU and to address critical prudential regulatory areas relating to group supervision and solvency, reinsurance supervision, including collateral, and the exchange of regulatory and supervisory information across borders.

If negotiations are successful, a U.S.-EU covered agreement would be a mechanism through which U.S.-based insurers and reinsurers receive an assurance of balanced regulatory treatment when operating in the EU market. In other words, if negotiations are successful, a covered agreement could help eliminate the uncertainty that shrouds participation of U.S. insurers and

[2] See Press Release, "Treasury, USTR Announce Intention to Negotiate Covered Agreement with the European Union" (November 20, 2015), available at https://www.treasury.gov/press-center/press-releases/Pages/jl0284.aspx.

reinsurers in the EU market, and may provide greater certainty on both sides of the Atlantic regarding interaction between the U.S. and EU regulatory approaches.

The U.S. system of insurance regulation is premised upon the role of the states – legislators, governors, and regulators. With respect to prudential oversight, state-based regulation has largely evolved with the recognition that the ability of an insurer to pay a claim is the bedrock on which the U.S. insurance market is based. To the extent that the U.S. system will change in substance or structure, any such change would be a determination for Congress or the states. Although Solvency II approaches some aspects of group supervision differently from the U.S. system, a covered agreement could affirm that U.S.-based insurers operating in the EU would not be subject to additional Solvency II requirements due to those differences.

A covered agreement could also address concerns regarding the treatment of EU reinsurers operating in the United States, particularly regarding collateral, a topic of great importance to the United States. By some estimates, U.S. ceding insurers purchase more than 90% of third party reinsurance from non-U.S. reinsurers, and the cost of that reinsurance affects the availability and affordability of insurance products for U.S. property owners, businesses, and consumers seeking retirement security, among other things.

A covered agreement could allow EU-based reinsurers to operate in the United States with less restrictive use of reinsurer capital while continuing to ensure consumer protection. In addition, the reinsurance industry operates most effectively and efficiently when able to spread capital – and risk – globally.

Further, a covered agreement could lead to more nationally consistent application of certain essential aspects of reinsurance collateral reform, which was unanimously approved by state insurance regulators in November 2011 in the form of an NAIC model law. These reforms have, to date, been implemented thoughtfully in many states, although not in all states and not in a consistent manner. In short, the United States could provide appropriate protections for U.S. consumers, and collateral relief to EU-based reinsurers, by agreeing to follow an approach substantially similar to one already approved by state insurance regulators.

As importantly, through a covered agreement the United States intends to ensure that U.S.-based reinsurers can continue existing business and seek to expand such meaningful business opportunities in the EU by ensuring a level playing field for U.S. reinsurers throughout the EU market.

Regulators and supervisors for multinational financial services firms must have the capacity to exchange sensitive regulated entity information across national borders on a confidential basis for regulatory and supervisory purposes. For this reason, another component of the covered agreement negotiations relates to the exchange of regulatory and supervisory information, and the maintenance of the confidentiality or professional secrecy of such information. In the covered agreement, the United States seeks to identify principles and procedures that could serve as guidance to facilitate information sharing between supervisors and regulators in both markets.

A covered agreement may enter into force with respect to the United States only upon expiration of a period of 90 calendar days after the Secretary of the Treasury and USTR jointly submit a copy of the final legal text of the agreement to the relevant committees of Congress, including

the House Financial Services Committee. We have and will continue to provide regular briefings for this and other Committees as we move forward.

State insurance regulators across the United States combine expertise and commitment that protects consumers. My personal experience as a state regulator, working with many great regulatory professionals from around the United States, further emphasized the importance of state regulator participation in the U.S. – EU covered agreement negotiations. To this end, Treasury and USTR have sought the views and expertise of state regulators and have made engagement and feedback with representatives of state regulators an integral part of the covered agreement process. On November 20, 2015, promptly after giving notice to and consulting with Congress regarding the joint intention of Treasury and USTR to negotiate a covered agreement, USTR and FIO met with state regulator leadership to discuss the process and the mechanism by which state regulator representatives would be included in a direct and meaningful manner.

In order to facilitate direct and meaningful feedback, as we develop U.S. positions in the context of the negotiations, we regularly engage and consult with a group of state insurance regulators. State regulator representatives review and provide feedback on U.S. documents before those documents are shared with our EU counterparts as well as providing additional feedback on the negotiations. Not surprisingly, the technical perspective offered by state regulators has been a strong component of the U.S. engagement.

In addition, both USTR and FIO have engaged with stakeholders throughout the negotiation process. In meetings with groups of company and trade association representatives, as well as with individual insurer consultations, stakeholders have provided invaluable insights into all three subject matter areas that are being addressed in the covered agreement negotiations.

Multilateral Standard-Setting at the International Association of Insurance Supervisors (IAIS)

In multilateral standard-setting work at the IAIS, FIO works closely with our colleagues at the Board of Governors of the Federal Reserve System (Federal Reserve), state insurance regulators, and staff of the National Association of Insurance Commissioners (NAIC). Notably, state insurance regulators participate in greater numbers at the IAIS than any other IAIS member, and each state insurance regulator has a vote in the IAIS plenary sessions.

IAIS – End of Pay-For-Play and the Advent of Increased Transparency

2015 brought structural reform to the IAIS that has eliminated the pay-for-play dynamic and significantly enhanced IAIS transparency. Before 2015, stakeholders paid an annual fee and, in exchange, received special access to IAIS materials and meetings. In 2015, the IAIS eliminated the annual fee, increased transparency through in-person stakeholder engagement, and enhanced engagement through the internet and by telephone. The success of this increased transparency is reflected in the exponential increase in direct, in-person stakeholder engagement, from approximately 12 hours in 2014 to over 140 hours in 2015.

In addition, the following examples illustrate the increased transparency at the IAIS:

- The IAIS website contains information available to the public, not just to stakeholders who pay the annual fee.

- Although for years the IAIS has used a public consultation process, since 2015 the IAIS has hosted explanatory meetings and telephone calls so that stakeholders can learn and ask questions about the substance and structure of the consultation document in advance of providing comments.
- After receiving comments on a consultation paper, since 2015 the IAIS has published the comments received, released a summary of comments, and offered a written reply to the comments.
- For the various work streams (e.g., capital, governance, and market conduct), stakeholder contact lists have been developed so that those stakeholders now provide preliminary input on a consultation paper prior to the paper's release for formal comment.
- IAIS now publishes a monthly newsletter to describe developments in the preceding month and events scheduled for the coming month.

While only a few IAIS work streams were directly open to stakeholders before 2015, the new governance and transparency practices provide a uniform approach to openness and stakeholder engagement for all IAIS activities.

U.S. stakeholders also have opportunities to meet and work with the U.S. participants. Working with state regulators and the Federal Reserve, FIO has coordinated opportunities for stakeholders (including industry and consumer advocates) to meet and present to all U.S. members of the IAIS at the same time, thereby enabling the U.S. members to receive the views of U.S. stakeholders in a U.S.-based forum. Each such meeting reflects a coordinated effort by the U.S. participants at the IAIS to benefit from U.S. stakeholder perspectives on the international standards under consideration.

IAIS – U.S. Participants Collaborate Extensively

The U.S.-based members of the IAIS include FIO, the Federal Reserve, the 56 state and territory insurance regulators who represent the individual sovereign jurisdictions within the United States, and NAIC staff. State regulators were among the founding members of the IAIS in 1994 and have been actively engaged ever since. Indeed, the state regulators and NAIC typically have more people participating and in attendance at an IAIS meeting than any other IAIS member. FIO became a full member of the IAIS in late 2012, and the Federal Reserve became a full member of the IAIS in late 2014.

In 2014, FIO coordinated the establishment of a steering committee comprised of the U.S. participants at the IAIS. The steering committee addresses pending and emerging international insurance matters and, while each member of the steering committee is independent of the others, including in their IAIS engagement, the steering committee works to promote shared understanding and open dialogue and alignment on relevant issues. Since being established, the steering committee has held regularly scheduled calls and in person meetings, with additional ad hoc calls or meetings occurring often.

In addition to the Steering Committee, FIO works and communicates daily with counterparts at numerous state insurance departments and the Federal Reserve. This collaboration occurs in relation to various IAIS working group meetings and in activities involving matters such as governance, risk management, capital standards, cybersecurity and financial crimes, and financial stability, among others. Collaboration occurs by telephone, through email, and full or

partial day in-person meetings. U.S. participants also meet and speak in person before and during IAIS meetings.

FIO's participation at the IAIS and in other international initiatives benefits U.S. insurance consumers and the U.S. insurance industry by promoting high quality and consistent prudential standards around the world, which helps maintain a level playing field and shield the United States from financial vulnerabilities that may affect other countries. Separately, and independently, the United States considers whether to adopt international standards and, if the decision is to adopt these standards, then implements them through federal or state regulatory authorities in a manner tailored to the U.S. market and regulatory structure.

Working together, FIO, the Federal Reserve, and state regulators inform the development of international standards so that the dual priorities of consumer protection and financial stability are reflected in IAIS standards that accommodate the U.S. approach.

IAIS – Insurance Capital Standard (ICS)

The IAIS continues development of the Insurance Capital Standard, or ICS, which, once developed and implemented, will allow for supervisors from around the world to understand and assess the group capital position of a large, multinational insurer. Many questions regarding the ICS remain open and under consideration, although the U.S. participants have worked in support of an approach that recognizes U.S. statutory accounting practices.[3]

Development of the ICS is incremental and will occur over a period of years. This will transpire only after extensive consultations with stakeholders and field testing. Field testing is the exercise through which volunteer insurers submit data to the IAIS in response to a standardized set of questions, thereby allowing for fact-based analyses of the issues under consideration. At present, 42 insurers from around the world are involved with field testing, nine of which are U.S.-based insurers.

The IAIS is also continuing development of the Common Framework for the Supervision of Internationally Active Insurance Groups (ComFrame).[4] This principles-based initiative will serve as a template for regulators to understand, evaluate, and oversee insurers that operate in multiple markets around the world. The IAIS is also reviewing certain insurance core principles (ICPs), or the standards that are developed through the IAIS, and that countries around the world, including the United States, will decide whether to adopt in a tailored manner.[5]

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[3] See IAIS, "Risk-based Global Insurance Capital Standard Version 1.0, Public Consultation Document" (July 19, 2016); IAIS "2016 Quantitative Field Testing package" (July 19, 2016), both available at http://www.iaisweb.org/page/supervisory-material/insurance-capital-standard//file/61565/2016-risk-based-global-insurance-capital-standard-ics-consultation-document.

[4] More information about ComFrame, including the most recent draft, is available at http://www.iaisweb.org/page/supervisory-material/common-framework#.

[5] See IAIS, "Insurance Core Principles" (November 2015), available at http://www.iaisweb.org/page/supervisory-material/insurance-core-principles#.

Recently, the IAIS has submitted to the Financial Stability Board a revised methodology for identifying global systemically important insurers (G-SIIs).[6] The revised methodology incorporated improvements that allow for a more comprehensive, factual analysis of insurers under consideration, although more work needs to be done to eliminate potential legacy deficiencies from the previous G-SII methodology. Again, working with our international colleagues, the U.S. participants at the IAIS have promoted an approach to global financial stability that supports the development of insurance markets, enhances competition, protects consumers, and serves the interests of financial stability.

Global and Regional Partnerships

EU – U.S. Insurance Project

Beyond covered agreement negotiations, collaboration between EU and U.S. insurance authorities is an essential component for protection of U.S. insurance consumers. The EU and the United States are both significant insurance markets. In terms of premium volume, despite the growing prominence of developing markets, the EU ranks first and the United States ranks second as consolidated markets. The EU and the United States are home to many of the world's most prominent global insurers – large multinational insurance groups are finding opportunities for important organic growth in new markets around the world. As markets and regulatory approaches have evolved, supervisors in both jurisdictions have undertaken significant modernization and reform efforts.

In light of these facts, FIO convened the insurance supervisory leadership of both jurisdictions at Treasury in January 2012. At this initial meeting, participants included FIO, state regulators, the European Commission, the European Insurance and Occupational Pension Authority, and the United Kingdom's Prudential Regulatory Authority. We call this the EU – U.S. Insurance Project. State insurance regulators, including Commissioners Voss, McCarty, Consedine, Lindeen and Huff, have made valuable contributions to the effort. In 2016, we have also welcomed the participation of the Federal Reserve.

Thanks to participants and supporting staff, the Project has been a demonstrably successful transatlantic collaboration. In September 2012, the Project released a report that identified similarities and differences between regulatory approaches in the EU and the United States and, in December 2012, the Project released an initial *Way Forward*,[7] which outlined common policy objectives and milestones through 2017. Following the EU's adoption of Solvency II in late 2013, and the December 2013 release of FIO's report entitled *How To Modernize And Improve The System Of Insurance Regulation In The United States*,[8] continued modernization by state

[6] See IAIS, "Global Systemically Important Insurers: Updated Assessment Methodology" (June 16, 2016), available at http://www.iaisweb.org/page/supervisory-material/financial-stability-and-macroprudential-policy-and-surveillance.

[7] See "EU-U.S. Dialogue Project: The Way Forward" (December 2012), available at https://www.treasury.gov/initiatives/fio/EU-US%20Insurance%20Project/Pages/default.aspx.

[8] See FIO, "How To Modernize And Improve The System Of Insurance Regulation In The United States" (December 2013), available at https://www.treasury.gov/initiatives/fio/reports-and-notices/Pages/default.aspx.

regulators, and developments at the IAIS, the Project released a revised *Way Forward* in August 2014 which updated the common objectives and milestones.[9]

The understanding developed through the Insurance Project provided the forum for authorities in the U.S. and EU to build technical awareness and provided a basis for resolution of certain long-standing issues through the covered agreement negotiations. The EU – U.S. Insurance Project continues to serve as an essential forum for sharing information and regulatory practices, especially in relation to regulatory modernization and implementation initiatives. With the advent of Solvency II and recent developments at the U.S. state and federal levels, consistent and substantive engagement between insurance authorities in the EU and the United States will remain an important area of focus. Indeed, after highly successful public events in each of the last four years – including more than 225 attendees at an NAIC meeting in December 2015 – the E.U.-U.S. Insurance Project will host another public meeting in October 2016 in Frankfurt, Germany. More than 200 attendees have already registered for this event.

Insurance Supervision in the Americas

FIO is privileged to work closely with counterparts from all regions of the world, and these relationships allow FIO, and the United States, to learn about the markets and regulatory practices in both developed and developing economies. On September 8 and 9, FIO hosted at Treasury the first ever "Insurance Supervision in the Americas" forum and invited leading insurance authorities from North, Central, and South America to attend. Attendees included lead supervisors for 16 countries, including the United States, which was represented by state regulators, the Federal Reserve, and FIO. Participants addressed topics including natural catastrophes, financial stability, and retirement security, and the discussions provided critical insights into the challenges for supervisors, consumers, and insurers throughout the Americas. The information FIO received from our North, Central, and South American colleagues helps us better understand and shape the direction of international developments, including standard-setting.

Conclusion

Through effective collaboration at home and abroad, U.S. insurance authorities – FIO, state regulators, and the Federal Reserve – continue to work collaboratively to promote a well-regulated insurance marketplace that protects consumer, promotes financial stability, and fosters competitive markets.

In all of our work, both internationally and domestically, Treasury priorities will always be the best interests of U.S. consumers, U.S. insurers, the U.S. economy, and jobs for the American people.

We welcome the chance to work with this Committee, and look forward to more discussions on these important topics.

Thank you for your attention. I look forward to your questions.

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[9] See "EU-U.S. Dialogue Project: The Way Forward – July 2014 Update" (July 2014), available at https://www.treasury.gov/initiatives/fio/EU-US%20Insurance%20Project/Pages/default.aspx.

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Statement by

Thomas Sullivan

Associate Director

Board of Governors of the Federal Reserve System

before the

Subcommittee on Housing and Insurance

of the

Committee on Financial Services

U.S. House of Representatives

Washington, D.C.

September 28, 2016

Introduction

Chairman Luetkemeyer, Vice Chairman Westmoreland, Ranking Member Cleaver, and other members of the subcommittee, thank you for inviting me to testify on behalf of the Federal Reserve.

The Federal Reserve welcomes the opportunity to participate in today's hearing, and I am pleased to be joined by my colleagues from the Federal Insurance Office (FIO) of the U.S. Treasury Department, the National Association of Insurance Commissioners (NAIC), and the United States Trade Representative (USTR). While we each have our own unique authority and mission, the Federal Reserve remains committed to working collaboratively on a wide range of issues, including insurance prudential matters both domestically and internationally. I will briefly address both of these areas: the Federal Reserve's work to develop domestic and international supervisory and regulatory standards that are appropriate for the U.S. insurance market and U.S. insurance consumers.

The Federal Reserve's Role in Supervising Insurance Institutions

Let me first touch on the statutory role of the Federal Reserve in supervising and regulating insurance firms. The Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act) gave the Federal Reserve regulatory responsibilities for insurance firms that own a federally insured bank or thrift and for insurance companies designated as systemically important by the Financial Stability Oversight Council (FSOC). These firms are highly diverse: they range in size from firms with total assets of approximately $3 billion to firms with total assets of over $700 billion. They engage in a wide variety of insurance and non-insurance activities. Some are fully domestic and others have material international operations. Some are organized as mutual companies, while others are owned by public shareholders. Some produce

only statutory accounting statements, while others also produce statements under U.S. Generally Accepted Accounting Principles.

The approach of the Federal Reserve in regulating insurance firms, complementary to and in coordination with the states, is derived from its overall statutory responsibilities for financial regulation as those have evolved over the years, most recently through the changes arising from the Dodd-Frank Act. First, as was the case before enactment of the Dodd-Frank Act, we are responsible for supervision of depository holding companies to ensure that they operate in a safe and sound manner and do not pose risks to their subsidiary depository institutions. This includes insurance companies that have subsidiary banks or thrifts. Second, the Dodd-Frank Act enhanced our statutory mandate for regulating and supervising holding companies with a view to the safety and soundness of the holding company and its functionally regulated subsidiaries. Third, the Dodd-Frank Act changed our statutory mandate to require that we consider the stability of the U.S. financial system in supervising large holding companies.

At the same time, the Dodd-Frank Act maintained the Federal Reserve Board's (Board) ability to tailor its supervision of firms based on the kind of financial intermediation in which they are engaged. For example, with respect to capital, the Board is now permitted to tailor its minimum capital requirements for firms that may also be regulated by state or foreign insurance regulators. In pursuing what might be termed its dual regulatory mandate of protecting the safety and soundness of depository institution holding companies and promoting U.S. financial stability, the Federal Reserve continues to develop regulatory and supervisory measures that are appropriate for its supervised insurance firms. In addition, we continue to be cognizant that states and state insurance supervisors regulate the types of insurance products offered by insurance companies that are part of holding companies we supervise and the manner in which

the insurance is provided. Because of the overall structure of insurance regulation as specified by Congress in the McCarran-Ferguson Act and elsewhere, the line here is rather bright.

The Federal Reserve's Regulatory Framework for Supervised Insurance Institutions

In this regard, the Federal Reserve's approach to insurance supervision distinguishes between insurance companies that we oversee solely because they control an insured depository institution and those that have been designated as systemically important by the FSOC. In its Advance Notice of Proposed Rulemaking (ANPR), the Board has set out two conceptual frameworks--one of which may be more appropriate for large, complex, systemically important institutions, while the other may be more appropriate for firms such as the current population of insurance savings and loan holding companies. We have used the flexibility given us by the December 2014 changes to the Collins Amendment to fashion an approach that reflects the ways in which insurance activities differ from those of banks and other forms of financial intermediaries. The bifurcated approach set out in the ANPR would efficiently advance the Board's differing supervisory objectives for the two populations of supervised insurance firms.

For the insurance companies that the FSOC has determined should be supervised by the Board, the ANPR sets out a capital framework termed the *consolidated approach*. The financial crisis demonstrated the need for stronger regulatory and supervisory assessments of the consolidated resiliency of large financial firms. Among other things, it revealed that too narrow a focus on the safety and soundness of individual legal entities in a corporate group could result in a failure to detect threats to the group and to financial stability that emerge from unregulated or less-regulated subsidiaries of the group. Hence the crisis reaffirmed the importance of consolidated supervision, encompassing the parent company and all its subsidiaries, which allows the Board to understand a supervised institution's activities, resources, and risks across

the entire enterprise. The ANPR's proposal of the consolidated approach reflects the importance of maintaining an enterprise-wide perspective and minimizing regulatory arbitrage at systemically important insurance companies. Because these firms are large, active domestically and internationally, internally and externally complex, and systemically important, the consolidated approach appears more suitable than the approach set out for the insurance savings and loan holding companies.

For the insurance savings and loan holding companies, the Board's ANPR sets out a capital framework termed the *building block approach*. The building block approach uses existing capital requirements for the various legal entities in an insurance group to construct an enterprise-wide capital requirement. The building block approach relies significantly on the state-based capital requirements for state-regulated insurance companies, in conjunction with the Board's existing bank capital requirements for other subsidiaries, to achieve an aggregated capital requirement for an insurance savings and loan holding company. Generally, the building block approach would aggregate capital resources and capital requirements across the firm's subsidiaries, with some adjustments, to calculate combined capital resources and requirements for the firm. For the insurance savings and loan holding companies, the building block approach would streamline implementation costs and other burdens while achieving the Board's supervisory objectives of ensuring the holding company's overall safety and soundness and protecting the subsidiary depository institution.

In addition to setting conceptual frameworks for capital standards, the Board has issued proposals on reporting requirements and enhanced prudential standards for the FSOC-designated systemically important insurance companies. The proposed reporting requirements differ substantially from reporting requirements for bank holding companies that are predominantly

engaged in banking and other non-insurance activities and are tailored to the assets, liabilities, and risks of insurance companies. They are designed, among other things, to keep the Board informed as to the financial condition and risk profile of these firms, including risks posed to the financial stability of the United States. The enhanced prudential standards would require firms to implement enterprise-wide risk management, establish a risk committee of the company's board of directors, and appoint both a chief risk officer and a chief actuary as well as meets institute liquidity risk-management requirements. The firm would also be required to have short- and long-term cash-flow projections, a contingency funding plan, liquidity risk limits, and monthly liquidity stress tests with a liquidity buffer covering net stressed cash flows over a 90-day period. We believe these proposed requirements are well-tailored to the business and risks of FSOC-designated insurance companies, and we look forward to reviewing the comments received.

The Importance of Stakeholder Engagement and Transparency

We have taken a good bit of time in arriving at some potential insurance regulatory capital frameworks precisely because we wanted to consider these issues thoroughly, and get them right. As we continue exploring the regulatory frameworks we have set out, and other areas of our supervision, we appreciate the comments we have received on the outstanding proposals, including 28 on the capital ANPR, 13 on the notice of proposed rulemaking on enhanced prudential standards for the systemically important insurance companies, and 4 on the proposed reporting requirements for these companies. Indeed, to allow interested parties additional time, we extended the comment period for our ANPR on domestic capital. We have found that the comments we have received offer many constructive observations. We also continue to meet with industry and other interested parties. In the last year and a half alone, we

have held over 60 meetings with stakeholders. Among other things, this reaffirms our commitment to increasing transparency in our insurance rulemaking development. We value the input of stakeholders and, together with the Board's supervisory objectives, it enhances the quality of our regulation.

Improving Regulatory and Supervisory Treatment for U.S. Insurers Operating in the European Union

The Federal Reserve has acted and will continue to act in international insurance standard setting in an engaged partnership with our colleagues from the NAIC, the state insurance commissioners, and the FIO. The Board is committed to continuing our multiparty collaboration with the state insurance regulators and the FIO on advocating standards internationally that are appropriate for the U.S. market. Last year, the Board was invited to join the NAIC and the FIO in their work on the EU-U.S. Dialogue Project to engage in healthy exchange among supervisors and determine the way forward as to supervision of insurers whose operations span across these jurisdictions. Alongside this dialogue project has been the negotiation of a possible covered agreement, under the leadership of the FIO and the USTR. We respect the work of the FIO and the USTR toward an agreement that would enhance regulatory certainty for U.S. insurers and reinsurers operating in the European Union.

The Federal Reserve's Participation in Developing Appropriate International Insurance Standards

As the consolidated supervisor of large, complex, and internationally active insurance firms, the Federal Reserve participates in the development of international supervisory standards and guidance to ensure that they best meet the needs of the U.S. insurance market. Our participation focuses on those aspects most relevant to the supervision of FSOC-designated

insurance firms. The Federal Reserve is participating alongside the FIO, the NAIC, and state insurance regulators in the development of a global group capital standard for internationally active insurance firms, in development of other policy measures for internationally active and systemically important insurers, and in research and analysis related to financial stability topics. We appreciate our current ability to advocate for international standards that work for U.S. insurance firms, U.S. insurance consumers, and the U.S. financial markets more broadly. Indeed, the Federal Reserve continues to participate actively in standard setting at the International Association of Insurance Supervisors (IAIS) in consultation and collaboration with state insurance regulators, the NAIC, and the FIO to present a coordinated U.S. voice in these processes.

In addition, since the financial crisis, U.S. authorities and foreign regulators have been working to identify financial institutions whose failure or distress may pose a threat to financial stability, including nonbank financial companies like insurance firms. The leaders of the Group of 20 nations, including the United States, charged the Financial Stability Board (FSB) with identifying firms whose distress would threaten the global economy. The FSB has coordinated its work in this area with global standard-setting bodies like the Basel Committee on Banking Supervision and the IAIS. The identification of a global systemically important insurer (G-SII) by the FSB and the IAIS requires a careful evaluation of the firm and its global systemic footprint in accordance with the methodology developed by the IAIS. The IAIS has developed its G-SII identification methodology through a public notice-and-comment process and updated its methodology for identifying G-SIIs this year.

Crucially, FSB designation of an entity as a G-SII does not result in the Federal Reserve becoming the entity's prudential regulator. Moreover, it is important to remain mindful of the

fact that IAIS standards and FSB determinations have no binding force in the United States unless the policies are adopted by a U.S. agency in compliance with applicable administrative rulemaking process. Neither the FSB, nor the IAIS, has the ability to implement requirements in any jurisdiction, and implementation in the United States would have to be consistent with U.S. law. Additionally, none of the global standards being developed by the IAIS are intended to replace the existing legal-entity requirements that are already in place for U.S. insurance firms. We remain committed to a supervisory framework that best meets the needs of U.S. insurers as they compete internationally and that is appropriate for the U.S. insurance market and consumers.

Mr. Chairman, members of the subcommittee, I thank you for inviting me here today. I look forward to an active dialogue on these issues with you all, and continued collaboration with this subcommittee.

ACLI
Financial Security...for Life.

Statement for the Record

Subcommittee on Housing & Insurance
House Committee on Financial Services
U.S. House of Representatives

Hearing titled "The Impact of US-EU Dialogues on U.S. Insurance Markets"

September 28, 2016

The American Council of Life Insurers (ACLI) is pleased to submit this statement for the hearing record expressing the views of the life insurance industry regarding the impact of U.S.-EU dialogue on U.S. insurance markets. A critical component of that dialogue, now underway, is the negotiation of a mutual recognition covered agreement. The ACLI supports the negotiation of a covered agreement with the European Union that strengthens U.S. competitiveness. Furthermore, the ACLI believes that state insurance regulators must be involved in the process and we have shared that view with the Federal Insurance Office (FIO), United States Trade Representative (USTR), and other stakeholders. As the primary financial regulators, state insurance regulators are essential to the negotiation and implementation of an effective covered agreement.

The American Council of Life Insurers (ACLI) is a Washington, D.C.-based trade association with approximately 280 member companies operating in the United States and abroad. ACLI advocates in state, federal, and international forums for public policy that supports the industry marketplace and the 75 million American families that rely on life insurers' products for financial and retirement security. ACLI members offer life insurance, annuities, retirement plans, long-term care and disability income insurance, and reinsurance, representing 95 percent of industry assets, 92 percent of life insurance premiums, and 97 percent of annuity considerations in the United States.

ACLI Supports the Negotiation of a Mutual Recognition Covered Agreement

In July of 2015, ACLI President & Chief Executive Officer, Governor Dirk Kempthorne, wrote to Secretary of the Treasury Jack Lew and United States Trade Representative Michael Froman, urging the start of negotiations on a mutual recognition covered agreement. That letter said: "Our Board has directed that ACLI advocate for negotiations with the European Commission on a covered agreement to begin soon. It has also directed that state insurance regulators must be involved in the process. We believe that involving state regulators is the most appropriate, useful, and effective approach. We are communicating this position to your Department, state insurance regulators, and to the United States Trade Representative." ACLI has consistently supported the negotiation of a covered agreement that would

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resolve differences between the two largest insurance and reinsurance markets in the world to ensure that U.S. insurers and reinsurers would not be subject to new regulatory burdens when operating in the EU. Last week, the ACLI joined Insurance Europe, the Reinsurance Association of America (RAA) and the American Insurance Association (AIA) in issuing a joint statement welcoming the resumption of negotiations between the U.S. and the EU. We reiterated our support for negotiation of a covered agreement and noted that a covered agreement has the potential for a win-win for consumers and competitive markets on both sides of the Atlantic. We continue to believe that the significant trade relationship in insurance and reinsurance between the U.S. and EU warrants continued dialogue and understanding between government agencies on both sides.

Mutual Recognition Covered Agreement Would Strengthen U.S. Competitiveness

In the absence of a mutual recognition covered agreement, U.S. insurers and reinsurers doing business in the EU are subject to considerable uncertainty and the prospect of adverse regulation. Since January 1, 2016, when the EU's Solvency II insurance regulatory framework became effective, any insurer in a country not recognized by the EU as equivalent could be subject to regulatory action in each EU member state in which they do business. In fact, EU member states have already contemplated new conditions and requirements on U.S. companies doing business in the EU, such as requiring the establishment of local operations. United States insurers and reinsurers doing business in the EU have received inquiries from regulators in multiple EU member states, including the United Kingdom and Germany, raising concerns that additional regulatory action may soon follow.

In this kind of unpredictable environment, U.S. businesses have little recourse against unexpected regulatory actions that are not based on market conditions. European competitors are not subject to the same uncertainty and can operate with greater confidence in their standing with local regulators. This unlevel playing field makes it more difficult for U.S. businesses to compete effectively. The longer that this regulatory uncertainty exists, the more likely it is that U.S. businesses may face unanticipated challenges across EU member states. We hope that negotiators will continue to meet, make progress, and work through remaining issues. We appreciate the commitment to these negotiations from the Federal Insurance Office and the United States Trade Representative, in consultation with state insurance regulators.

Covered Agreements Authority Establishes a Comprehensive Process for Consultation and Negotiation

It is important to note that the covered agreements authority establishes a comprehensive process for consultation and negotiation. The Dodd-Frank Act provides for joint Treasury and USTR authority, consistent consultation with Congress, and submission and layover of a final agreement to Congress. The comprehensive and inclusive process established in the law is designed to ensure that there is ample opportunity for input and oversight by Congress and other stakeholders. We would also urge U.S. negotiators to communicate with industry stakeholders throughout the process.

Conclusion

ACLI appreciates the committee's oversight of the covered agreements process and its impact on the

competitiveness of the U.S. insurance and reinsurance industry. ACLI supports the negotiation of a mutual recognition covered agreement, in consultation with state insurance regulators, and believes that a properly constructed agreement would benefit U.S. consumers and insurers. Thank you for convening this important hearing and for your consideration of the views of ACLI and its member companies.

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September 28, 2016

The Honorable Blaine Luetkemeyer, Chairman
Subcommittee on Housing and Insurance
House Financial Services Committee
U.S. House of Representatives
Washington, DC 20515

The Honorable Emmanuel Cleaver, Ranking Member
Subcommittee on Housing and Insurance
House Financial Services Committee
U.S. House of Representatives
Washington, DC 20515

VIA Electronic Mail

RE: Hearing entitled "The Impact of US-EU Dialogues on U.S. Insurance Markets"

Dear Chairman Luetkemeyer and Ranking Member Cleaver:

The American Insurance Association (AIA) writes to express our appreciation for holding the hearing entitled "The Impact of US-EU Dialogues on U.S. Insurance Markets." AIA represents approximately 325 major U.S. insurance companies that provide all lines of property-casualty insurance to U.S. consumers and businesses, and write more than $127 billion annually in premiums. It is crucial that Congress use its oversight capability to monitor on-going US-EU dialogues and maintain focus on competitiveness issues that impact U.S. insurers and reinsurers doing business in an international marketplace.

AIA has consistently advocated for a united U.S. voice on international insurance issues and supports Congressional oversight and increased transparency in both domestic and international standard-setting fora. It is our hope that the subcommittee will recognize that the ability of U.S. insurers to provide insurance risk in markets around the world, as well as the capital to do so, is increasingly affected by the international regulatory environment.

The reality is that the major barriers to U.S. insurers in the rest of the world are largely regulatory. Now that the Solvency II Directive in the EU is being implemented, it is clear that U.S. insurance groups with operations outside of the United States will face significant competitive challenges if issues surrounding mutual recognition are not addressed.

These barriers that U.S. insurance groups are facing in the EU are growing in number and severity, and are inconsistent with the international principles of fair treatment and open markets. Specifically, regulators in the U.K., Germany, Poland, Austria, Spain and the Netherlands have all taken steps that further disadvantage U.S. companies and, in some instances, inhibit access to their markets. Therefore, it is imperative that international negotiations continue on how best to address these issues. U.S. negotiators must be supported to ensure that regulatory changes in the EU do not result in conditions that disadvantage U.S. insurers and reinsurers.

Negotiations such as those for covered agreements are also important opportunities where the strengths of the U.S. state-based system and its interoperability with other systems can be affirmed. To that end, we are pleased that state commissioners were given a formal role in the covered agreement process to consult and support negotiators during and between negotiating rounds.

Achieving timely and meaningful prudential recognition, including a permanent solution to regulatory barriers, must be the goal of the covered agreement negotiations. Furthermore, while the parties negotiate the covered agreement, it is equally important that European regulators stop taking steps that discriminate against U.S. insurers conducting business within their borders. Though opponents of the covered agreement have stated that the covered agreement is unnecessary, no other viable, short-term, alternative plans have been proposed for addressing the discriminatory barriers that U.S. insurers are facing in Europe.

We believe that negotiations to address regulatory barriers in other markets are essential for the continued health and growth of U.S. insurers and reinsurers. So, we look forward to promoting an international insurance marketplace that supports the U.S. state-based system and allows U.S. insurers to compete on a level playing field outside the U.S.

Respectfully submitted,

Wes McClelland

Vice President, Federal Affairs
American Insurance Association

Summary of the Issue

Solvency II is an insurance legislative program aimed at unifying the EU market. Implementation of the program became effective on January 1, 2016. The program states the main directive is to introduce a new and unified EU regulatory regime into the insurance business. Lloyds of London states that the key objectives of the program are to improve consumer protection, modernized supervision, deepen EU market integration, and increase international competitiveness of EU insurers. However, the program limits business opportunities for insurance and reinsurance companies established outside of the EU.

BaFin, is the legislative authority in Germany that is enforcing guidelines with the Solvency II implementation. Its stringent commitment to the policy is seen in the threats that are made to non-compliant German insurance companies. As stated in the BaFin document, " Please note that the operation or commencement of reinsurance business without the authorization required pursuant to section 67 (1) sentence 1 of the VAG is considered a criminal offence punishable with imprisonment (section 331 (1) and (3) of the VAG), regardless of whether the lack of authorization is due to intent or negligence." See Exhibit A. Furthermore, the BaFin website (https://www.bafin.de/EN/Homepage/homepage_node.html) also encourages "whistleblowers". As of July 2, 2016, BaFin has established a contact point. This procedure allows persons with knowledge of a suspected breach or improper relationship to expose those in their organization without ramifications. See Exhibit B

BaFin is requiring outside insurance companies to "establish a German branch office if they wish to carry on primary insurance or reinsurance business in Germany." However, one exemption is allowed. "Section 67 (1) sentence 2 first half-sentence of the VAG provides an exemption for insurance undertakings that wish to carry on solely reinsurance business in Germany. According to this exemption, the requirement for authorization and the establishment of a branch office does not apply if primary insurers or reinsurers from third countries carry on solely reinsurance business in Germany through provision of cross-border services and if the European Commission has decided in accordance with Article 172(2) or (4) of Directive 2009/138/EC that the solvency regimes for reinsurance activities carried out by undertakings in the relevant country are equivalent to the regime described in that Directive." BaFin is challenging the 50 different state-based regulations and the varying requirements for each. In order to be allowed to conduct business within the insurance industry in the EU, the United States needs to be recognized as an "equivalent regime". Exhibit C

Timeline of Events

- On January 5, 2008, Shelter Reinsurance supplied a Department of Insurance Certificate to BaFin certifying that Shelter Re was an approved reinsurance company in the state of Missouri operating in good standing.

- On January 19, 2009 we received a letter from BaFin stating that the certificate had been received and upon review BaFin agreed to allow Shelter Re to conduct business in Germany from its registered office in the United States. The letter stated that the decision was subject to future EU assessment of the situation. Exhibit D

- On September 27, 2011 an additional letter and certificate was sent to obtain certification for Shelter Mutual to be approved as a mixed reinsurer in Germany in addition to Shelter Reinsurance. Exhibit E

- On November 21, 2011 Shelter Mutual received a letter from BaFin asking for additional information. This was passed onto Shelter attorney Jim Tuley. It is believed that the certification for Shelter Mutual was never completed due to the fact that Shelter Re would be the sole writer for German business. Exhibit F

- On June 13, 2016 we received a letter stating the German Insurance Supervision Act had taken effect on January 1, 2016 and the before mentioned confirmation was now considered void. Exhibit G

- On September 6, 2016 Joel Smith, Account Executive for Shelter Reinsurance, received an email from a German client, canceling a scheduled meeting at the Baden Baden Reinsurance Conference. The reason for the cancellation was referenced as the BaFin Solvency II policy. The email referenced a threat from BaFin which stated that anyone conducting reinsurance business with a non-admitted reinsurer may be fined and receive up to 5 years in prison. Exhibit H

- Greg Lockard, Director of Reinsurance, traveled to Monte Carlo on September 10, 2016 and was schedule to meet with European insurance companies. However, one meeting with a broker that produces German business for Shelter Re, was canceled the day before due to the current BaFin decision. Exhibit I

Shelter Reinsurance Limits and Premium from German Companies

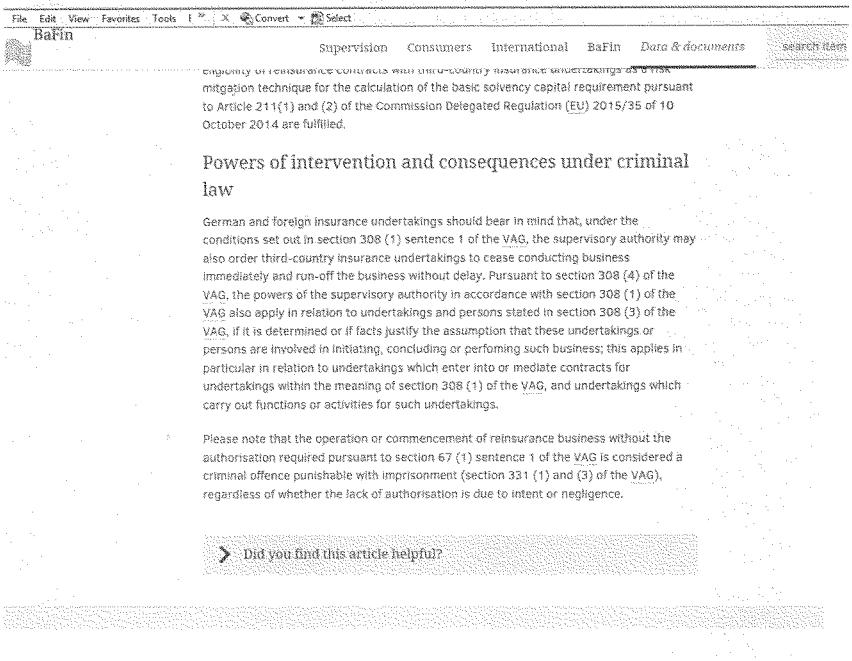
Shelter Reinsurance currently participates on eight different programs with five German companies. The premium earned from these five companies is $6,266,457. The breakdown of limit and premium are shown below. This loss in yearly premium will create a substantial hardship on Shelter Re and prohibit the company from pursuing any new business in the region.

Shelter Mutual Ceded Program

Shelter Mutual currently has 22 companies on their reinsurance panel. Of the 22 companies, three are German reinsurers. In 2016, Shelter Mutual paid $1,455,250 in premium to the three German companies shown below.

2016 Shelter Mutual Ceded Premium Paid to Germany						
Company	Layer 1	Layer 2	Layer 3	Layer 4	Layer 5	Total
Comp A	$ 48,000.00	$ 43,500.00	$ 47,500.00	$ 35,000.00	$ 67,500.00	$ 241,500.00
Comp B	$ -	$ 163,125.00	$ 178,125.00	$ 131,250.00	$ -	$ 472,500.00
Comp C	$ 180,000.00	$ 163,125.00	$ 142,500.00	$ 70,000.00	$ 185,625.00	$ 741,250.00
						$ 1,455,250.00

Exhibit A



File Edit View Favorites Tools | Convert Select

BaFin

Supervision Consumers International BaFin *Data & documents* search term

Eligibility of reinsurance contracts with third-country insurance undertakings as a risk mitigation technique for the calculation of the basic solvency capital requirement pursuant to Article 211(1) and (2) of the Commission Delegated Regulation (EU) 2015/35 of 10 October 2014 are fulfilled.

Powers of intervention and consequences under criminal law

German and foreign insurance undertakings should bear in mind that, under the conditions set out in section 308 (1) sentence 1 of the VAG, the supervisory authority may also order third-country insurance undertakings to cease conducting business immediately and run-off the business without delay. Pursuant to section 308 (4) of the VAG, the powers of the supervisory authority in accordance with section 308 (1) of the VAG also apply in relation to undertakings and persons stated in section 308 (3) of the VAG, if it is determined or if facts justify the assumption that these undertakings or persons are involved in initiating, concluding or performing such business; this applies in particular in relation to undertakings which enter into or mediate contracts for undertakings within the meaning of section 308 (1) of the VAG, and undertakings which carry out functions or activities for such undertakings.

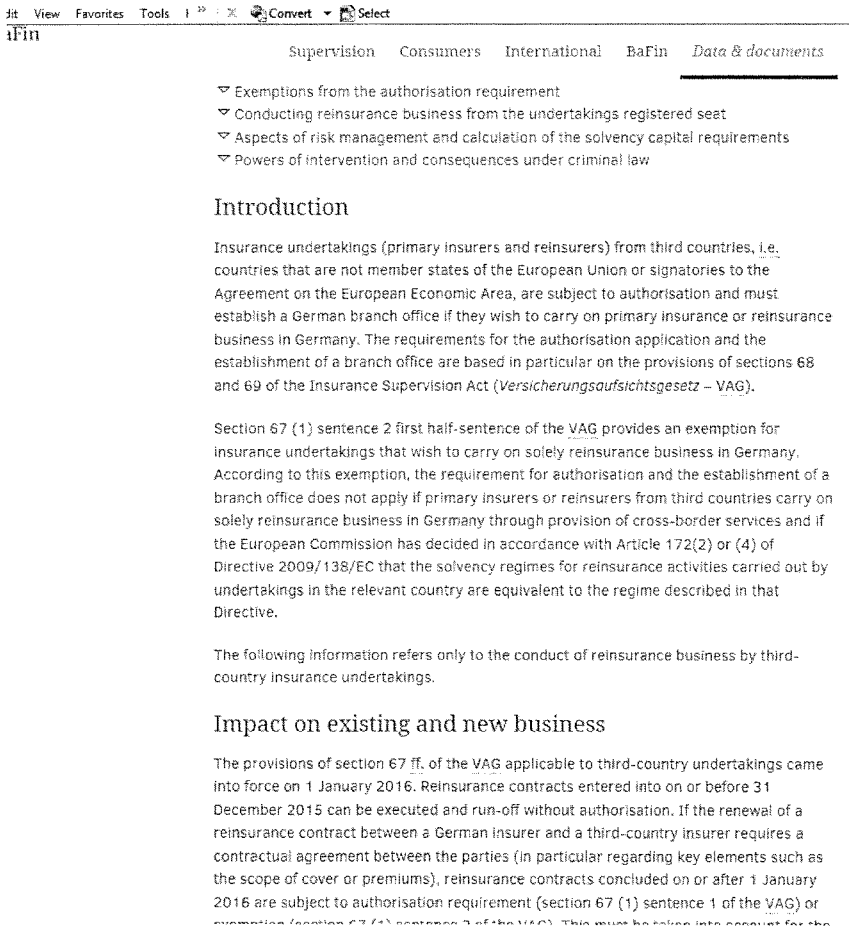
Please note that the operation or commencement of reinsurance business without the authorisation required pursuant to section 67 (1) sentence 1 of the VAG is considered a criminal offence punishable with imprisonment (section 331 (1) and (3) of the VAG), regardless of whether the lack of authorisation is due to intent or negligence.

Did you find this article helpful?

Exhibit B


Menu
Suche
BaFin
Federal Financial
Supervisory Authority
Whistleblower

Exhibit C



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BaFin

Supervision Consumers International BaFin *Data & documents*

- Exemptions from the authorisation requirement
- Conducting reinsurance business from the undertakings registered seat
- Aspects of risk management and calculation of the solvency capital requirements
- Powers of intervention and consequences under criminal law

Introduction

Insurance undertakings (primary insurers and reinsurers) from third countries, i.e. countries that are not member states of the European Union or signatories to the Agreement on the European Economic Area, are subject to authorisation and must establish a German branch office if they wish to carry on primary insurance or reinsurance business in Germany. The requirements for the authorisation application and the establishment of a branch office are based in particular on the provisions of sections 68 and 69 of the Insurance Supervision Act (*Versicherungsaufsichtsgesetz* – VAG).

Section 67 (1) sentence 2 first half-sentence of the VAG provides an exemption for insurance undertakings that wish to carry on solely reinsurance business in Germany. According to this exemption, the requirement for authorisation and the establishment of a branch office does not apply if primary insurers or reinsurers from third countries carry on solely reinsurance business in Germany through provision of cross-border services and if the European Commission has decided in accordance with Article 172(2) or (4) of Directive 2009/138/EC that the solvency regimes for reinsurance activities carried out by undertakings in the relevant country are equivalent to the regime described in that Directive.

The following information refers only to the conduct of reinsurance business by third-country insurance undertakings.

Impact on existing and new business

The provisions of section 67 ff. of the VAG applicable to third-country undertakings came into force on 1 January 2016. Reinsurance contracts entered into on or before 31 December 2015 can be executed and run-off without authorisation. If the renewal of a reinsurance contract between a German insurer and a third-country insurer requires a contractual agreement between the parties (in particular regarding key elements such as the scope of cover or premiums), reinsurance contracts concluded on or after 1 January 2016 are subject to authorisation requirement (section 67 (1) sentence 1 of the VAG) or

Exhibit D

Bundesanstalt für
Finanzdienstleistungsaufsicht

BaFin

BaFin | Postfach 12 53 | 53002 Bonn

Board of Directors
Shelter Reinsurance Company
1817 West Broadway
Columbia MISSOURI, USA, 65218
VEREINIGTE STAATEN VON AMERIKA

19.01.2009
Reference: VA 42-Sch-2008/0027 (Please quote in your reply)
Confirmation of approval for conducting reinsurance business on the freedom to provide services from Iowa according to section 121i subsection 1 sentence 3 of the German Insurance Supervision Act

Your letter January 5, 2008

Dear Sir or Madam,

Based on the certificate provided by the Department of Insurance, Financial Institutions and professional Registration of the State of Missouri and our assessment made in accordance with the requirements of section 121i (1) sentence 3 of the German Insurance Supervision Act (*Versicherungsaufsichtsgesetz* – VAG), the company

Shelter Reinsurance Company,
Columbia, Missouri, USA

is permitted to conduct reinsurance business in Germany from its registered office in all insurance classes under the freedom to provide services.

However, I would like to explicitly point out that the current administrative practice is subject to a future uniform European assessment of the equivalence of the supervisory system of the relevant home country and has no weight as a precedent with regard to future interpretations of section 121i (1) sentence 3 of the VAG. Moreover, I reserve the right to request updates of the certificate on a regular basis.

Furthermore, this approval should not be regarded as a precedent for the treatment of third-country reinsurers in other EU/EEC member states or for future equivalence assessments.

Finally, I would like to point out that the approval will be denied or revoked if satisfactory cooperation between BaFin and the relevant

Insurance and Pension Fund Supervision

Office address:
Bundesanstalt für
Finanzdienstleistungsaufsicht
Graurheindorfer Str. 108
53117 Bonn | Germany

Contact:
Arhold
Section VA 42
Fon +49 (0)2 28 41 08-3988
Fax +49 (0)2 28 41 08-1550
thorsten.arhold@bafin.de
www.bafin.de

Operator:
Fon +49 (0)2 28 41 08-0
Fax +49 (0)2 28 41 08-1550

Official residences:
53117 Bonn
Graurheindorfer Str. 108
Georg-von-Boeselager-Str. 25
Friedrich-Wöhler-Str. 2

60439 Frankfurt
Lurgiallee 12

Exhibit D Second Page

Bundesanstalt für
Finanzdienstleistungsaufsicht

BaFin

supervisory authority of the home country is no longer ensured or if your company starts conducting insurance business other than reinsurance business.

Yours faithfully,

Waclawik

Exhibit E

SHELTER INSURANCE COMPANIES

Teresa Heim
Assistant Reinsurance Specialist
573-214-6307
theim@shelterinsurance.com

September 27, 2011

BAFIN
MR. ARHOLD
BUNDESANSTALT FUR
FINANZDIENSTLEISTUNGSAUFSICHT
GRAURHEINDORFER STR. 108
53117 BONN
GERMANY

RE: BAFIN
Shelter Mutual Certificate

Dear Mr. Arhold:

Shelter Mutual Insurance Company would like to be approved as a mixed reinsurer in the country of Germany.

Enclosed you should find a certificate from the State of Missouri showing our professional registration. This certificate states that Shelter Mutual Insurance is an upstanding business in the United States. The State of Missouri has no objection to allowing Shelter Mutual to participate in reinsurance activity in Germany.

Please feel free to contact me if you need any other information in order to approve Shelter Mutual as a mixed reinsurer.

I look forward to receiving your approval soon.

Respectfully,

Teresa Heim

Exhibit E – Second Page

7

STATE OF MISSOURI

DEPARTMENT OF INSURANCE, FINANCIAL INSTITUTIONS AND PROFESSIONAL REGISTRATION

P.O. Box 690, Jefferson City, Mo. 65102-0690

This is to certify that

Shelter Mutual Insurance Company
1817 West Broadway
Columbia, MO 65218

Was organized in 1945 as an insurance company under the laws of the state of Missouri, has its principal place of business in the United States of America, and has been exclusively operating in the business of insurance, including reinsurance, since its organization. Pursuant to Missouri Revised Statutes section 379.010 et seq. the company is subject to supervision by the Missouri Department of Insurance, Financial Institutions and Professional Registration. Under the above-mentioned law and its charter the company is authorized to transact business by reinsuring risks from all insurance classes other than life insurance and annuities, in both the United States and abroad. To the best of my knowledge, within the past five years the company has not committed any violations of laws or rules of this state which would impair its authority to transact business and has not committed any violation which would give rise to criminal prosecution.

This department has no objection to the mentioned company operating its reinsurance activity also in Germany and meeting any obligations that may result from that activity in freely convertible currency.

Furthermore, this department has the willingness and is able to cooperate with the Federal Financial Supervisory Authority (BaFin – Bundesanstalt fur Finanzdienstleistungsaufsicht) in a satisfactory manner.

So signed and official seal affixed this 21st day of July, 2011 at my office in the City of Jefferson, State of Missouri, United States of America.

John M. Huff, Director

Exhibit F

Bundesanstalt für
Finanzdienstleistungsaufsicht

BaFin

BaFin | Postfach 12 53 | 53002 Bonn

To the Board of Management
Shelter Mutual Insurance Company
1817 West Broadway
Columbis MO 65218-0001
VEREINIGTE STAATEN VON AMERIKA

21.11.2011
GZ: VA 31-I 4401-US-2011/0001 (Bitte stets angeben)
2011/0650297
Betrieb des Rückversicherungsgeschäfts durch gemischte Erstversicherungsunternhmen mit Sitz in einem Drittstaat gem. § 105 Abs. 2 Satz 2 VAG
Hier: Shelter Mutual Insurance Company

Your letter dated 27. September 2011 - Teresa Heim

Dear Madame,
dear Sir,

thank you very much for your aforementioned letter and the enclosed certificate.

Pursuant to section 105 Subsection 2 sentence 2 of the VAG (*Versicherungsaufsichtsgesetz, Insurance Supervision Law*), insurance companies which are authorized to carry out direct insurance business as well as reinsurance business (*mixed insurance companies*) and are domiciled in a non-member state may, in principle, conduct reinsurance business in Germany via intermediaries.

This presupposes that the mixed insurance company

1. is authorised to carry on direct insurance business as well as reinsurance business in its home country,

2. has its registered office in that country,

3. is supervised in its home country in compliance with internationally accepted standards and that

4. there is satisfactory cooperation between the competent authority of the home country and the Federal Financial

Versicherungs- und Pensionsfondsaufsicht

Hausanschrift:
Bundesanstalt für
Finanzdienstleistungsaufsicht
Graurheindorfer Str. 108
53117 Bonn | Germany

Kontakt:
Herr Schöps
Referat VA 31
Fon +49 (0)2 28 41 08-7170
Fax +49 (0)2 28 41 08-7668
VA31@bafin.de
www.bafin.de

Zentrale:
Fon +49 (0)2 28 41 08-0
Fax +49 (0)2 28 41 08-1550

Dienstsitze:
53117 Bonn
Graurheindorfer Str. 108
Georg-von-Boeselager-Str. 25

53175 Bonn
Dreizehnmorgenweg 44-48

60439 Frankfurt
Lurgiallee 12
Marie-Curie-Str. 24-28

Exhibit F – Page 2

Bundesanstalt für
Finanzdienstleistungsaufsicht

BaFin

Supervisory Authority (Bundesanstalt für Finanzdienstleistungsaufsicht – BaFin).

As the issue "satisfactory cooperation" is concerned I would very much appreciate if the State of Missouri, Department of Insurance, Financial Institutions and Professional Registration could confirm the following in writing:

- The State of Missouri, Department of Insurance, Financial Institutions and Professional Registration will, upon written request, confirm or verify information relevant for supervisory purposes or obtain such information about the entity in question or its key functionaries,

- The State of Missouri, Department of Insurance, Financial Institutions and Professional Registration will, without having received a request, inform the BaFin without delay if it becomes aware of an incipient crisis relating to the entity in question,

- BaFin asserts to request confidential information only if it is relevant to lawful supervision or examination of a regulated entity or person, and shall use the confidential information received only for those purposes and any related criminal court proceedings. BaFin asserts to obtain prior written consent of the Authority before voluntarily passing on of any confidential information.

Yours sincerely,

Im Auftrag

Schöps

Exhibit G

Bundesanstalt für
Finanzdienstleistungsaufsicht

BaFin

BaFin | Postfach 12 53 | 53002 Bonn

Shelter Reinsurance Company
1817 West Broadway
65218 COLUMBIA, MISSOURI
VEREINIGTE STAATEN VON AMERIKA

13.06.2016
Reference: VA 45-I 2271-2016/0009 (Please quote in your reply)
2016/1045237
Conducting reinsurance business in Germany

My letter of 09 January 2009

Dear Sir or Madam,

in my letter dated 09 January I informed you that Shelter Reinsurance Company was permitted to conduct reinsurance business in Germany from its registered head office. This information was based on the legal basis in section 121i (1) sentence 3 of the German Insurance Supervision Act (Versicherungsaufsichtsgesetz – VAG) in the version which was valid until 31 December 2015.

In consequence of an amendment of the German Insurance Supervision Act with effect from 01 January 2016 the regulation regarding insurance and reinsurance undertakings which are domiciled in non-EU/EEA member states conducting reinsurance business in Germany by the provision of cross-border services changed from 01 January 2016.

Therefore, my aforementioned confirmation has expired and is not valid anymore.

According to section 67 (1) sentence 1 of the German Insurance Supervision Act in the version of the Act to modernise Financial Supervision of Insurance Undertakings of 1 April 2015 (hereinafter VAG 2016) insurance and reinsurance undertakings domiciled in non-EU/EEA member states will need a licence from BaFin to conduct insurance or reinsurance business in Germany. These undertakings have to establish a branch in Germany (see section 68 (1) sentence 1 VAG 2016). Insurance and reinsurance undertakings which exclusively conduct reinsurance business from their registered head offices will not need a licence, if the European Commission has decided on the basis of Art. 172 (2) or (4) of Directive 2009/138/EC of the European Parliament and of the European Council of 25 November 2009 on the taking-up and pursuit of the business of In-

Insurance and
Pension Funds Supervision

Office address:
Bundesanstalt für
Finanzdienstleistungsaufsicht
Graurheindorfer Str. 108
53117 Bonn | Germany

Contact:
Mr. Skrobis
Section VA 45
Fon +49 (0)2 28 41 08-2373
Fax +49 (0)2 28 41 08-1550
poststelle@bafin.de
www.bafin.de

Operator:
Fon +49 (0)2 28 41 08-0
Fax +49 (0)2 28 41 08-1550

Official residences:
53117 Bonn
Graurheindorfer Str. 108

53175 Bonn
Dreizehnmorgenweg 13-15
Dreizehnmorgenweg 44-48

60439 Frankfurt
Marie-Curie-Str. 24-28

Exhibit G – Page 2

Bundesanstalt für
Finanzdienstleistungsaufsicht

BaFin

surance and Reinsurance (Directive 2009/138/EC) that the solvency regime of the relevant third country that applies to reinsurance activities of undertakings with their head office in that third country is equivalent to the system laid down in Directive 2009/138/EC.

However, so far the European Commission has not decided on the solvency regime in Missouri resp. USA on the basis of Art. 172 (2) or (4) Directive 2009/138/EC. Thus, Shelter Reinsurance Company is not allowed to conduct reinsurance business in Germany from its head office in Missouri anymore. If Shelter Reinsurance Company intends to conduct reinsurance business by underwriting new reinsurance contracts, Shelter Reinsurance Company has to apply for a licence and to establish a branch in Germany. Only the administration of the existing portfolio in order to terminate the activities in Germany does not require a licence.

Please inform me whether Shelter Reinsurance Company conducts business in Germany and intends to continue its activities in Germany.

Please confirm receipt of and compliance with this letter in writing.

Yours faithfully,

Skrobis

Exhibit H

Fw: Meeting in Baden Baden - decision by German regulator BaFin iro non-admitted reinsurance
Greg Lockard to: Teresa Heim 09/21/2016 11:22 AM

Shelter Re
www.shelterre.com

Greg Lockard, CPCU, ChFC, ARe
Director of Reinsurance Operations
Shelter Reinsurance Company
Office: (573)214-4326
Cell: (573)489-1380
glockard@Shelterinsurance.com
www.ShelterRe.com

---- Forwarded by Greg Lockard/Reinsurance/Shelter on 09/21/2016 11:22 AM----

From: Joel A Smith/Reinsurance/Shelter
To: Greg Lockard/Reinsurance/Shelter@shelter insurance, Trina J Gooch/Reinsurance/Shelter@shelter insurance
Date: 09/06/2016 12:42 PM
Subject: Fwd: Meeting in Baden Baden - decision by German regulator BaFin iro non-admitted reinsurance

Joel Smith, CPCU, CLU, ChFC, ARe
Account Executive
Shelter Reinsurance Company
Phone: 1 (417)891-5824
Cell: 1(417)827-6509

Begin forwarded message:

From: [redacted]
Date: September 6, 2016 at 1:49:31 AM HST
To: JASmith@ShelterInsurance.com
Cc: [redacted]
Subject: Meeting in Baden Baden - decision by German regulator BaFin iro non-admitted reinsurance

Dear Joel,

I hope you are doing well.

Exhibit H – Page 2

We write to you in respect of a recent interpretative decision published by German regulator BaFin regarding admitted reinsurance offered by Non-EU or SII-equivalent-country reinsurers.

According to this decision and German regulatory law non-admitted reinsurance is no longer (w. e. f. 1/1/16) permitted. This means that US reinsurers need authorization by BaFin to conduct reinsurance, which inter alia includes a branch office within Germany. Conducting reinsurance with an non-admitted reinsurer does not only preclude the deduction of reinsurance for the purpose of the solvency capital calculation. Even more so the conducting of reinsurance is an offense which may be fined by up to 5 years of prison! Conducting does not only include the formation of a reinsurance contract but already any action with the purpose of forming a reinsurance contract - therefore even a meeting.

In view of this BaFin decision we would like to cancel our mutual meeting in Baden Baden and trust for your understanding.

Please find herewith a link to the English version of the BaFin decision.

https://www.bafin.de/SharedDocs/Veroeffentlichungen/EN/Auslegungsentscheidung/VA/ae_160901_rueckversicherung_drittstaaten_va_en.html?nn=7858880

We will closely follow the upcoming discussions and developments in this very new topic and keep you updated via [redacted] as regards the renewal process.

If you have any questions please do not hesitate to call.

Cheers

[redacted]

Fw: Monte Carlo Meeting with [redacted]
Greg Lockard to: Teresa Heim 09/21/2016 11:20 AM

Shelter Re
www.shelterre.com

Greg Lockard, CPCU, ChFC, ARe
Director of Reinsurance Operations
Shelter Reinsurance Company
Office: (573)214-4326
Cell: (573)489-1380
glockard@Shelterinsurance.com
www.ShelterRe.com

----- Forwarded by Greg Lockard/Reinsurance/Shelter on 09/21/2016 11:20 AM -----

From: [redacted]
To: Greg Lockard <GLockard@ShelterInsurance.com>
Cc: [redacted]
Date: 09/12/2016 05:02 AM
Subject: Monte Carlo Meeting with [redacted]

Dear Greg,

Unfortunately we have to inform you that [redacted] has to cancel your meeting tomorrow based on the current decision of the German BaFin (Bundesanstalt für Finanzdienstleistungsaufsicht) about the cooperation with reinsurance companies from third countries.

We trust on your understanding about this short-term information.

Best regards

[redacted]

For release on delivery
2:00p.m. EDT
September 28, 2016

Testimony of

Ambassador Robert Holleyman

Deputy United States Trade Representative

Office of the United States Trade Representative

Executive Office of the President

Before the

Subcommittee on Housing and Insurance

Committee on Financial Services

United States House of Representatives

Regarding:

The Impact of U.S. – EU Dialogues on U.S. Insurance Markets

Chairman Luetkemeyer, Ranking Member Cleaver, Members of the Subcommittee, the Office of the United States Trade Representative (USTR) regrets that we are unable to attend this hearing and respectfully submits the following written statement for the record.

U.S. financial services and insurance firms help Americans to secure and grow wealth, finance opportunities, and prepare for retirement. These firms provide services critical to every sector of the economy, including small- and medium-sized businesses. Financial services exports contribute a $68 billion surplus to the U.S. balance of payments, reflecting the competitiveness of the American financial and insurance industries.

Financial services, including insurance services, are an essential component to the transatlantic trade and investment relationship. Both the United States and the European Union (EU) have well developed and diverse insurance markets. U.S. insurance and reinsurance suppliers and workers have engaged with the EU market for many years and continue to find new market opportunities in the EU, while EU insurance and reinsurance companies fully participate in the U.S. market. In general, USTR negotiates trade commitments to ensure expanded and continued access to global markets.

The covered agreement with the European Union is a new type of agreement, for which we share statutory negotiating responsibility with the Department of the Treasury. A covered agreement is a specific type of agreement for the recognition of prudential measures relating to insurance or reinsurance. The Federal Insurance Office (FIO) Act of 2010 (Pub. L. 111–203, title V, § 502) defines a "covered agreement" as "a written bilateral or multilateral agreement regarding prudential measures with respect to the business of insurance or reinsurance that – (A) is entered into between the United States and one or more foreign governments, authorities, or regulatory entities; and (B) relates to the recognition of prudential measures with respect to the business of insurance or reinsurance that achieves a level of protection for insurance or reinsurance consumers that is substantially equivalent to the level of protection achieved under State insurance or reinsurance regulation."

The Department of Treasury and USTR are currently involved in negotiations with the EU for a covered agreement pursuant to the terms of the FIO Act and intend for this agreement with the European Union to help address challenges experienced by U.S. insurers and reinsurers resulting from implementation of Solvency II, the new insurance regulatory framework of the EU and to address concerns relating to treatment of EU reinsurers in the U.S. market. Our two agencies are vigorously pursuing these negotiations for a successful outcome.

The EU's Solvency II regime allows for EU Member States to supervise insurers and reinsurers that operate in the EU but are from "non-equivalent" countries, such as the United States. Member States may subject those insurers and reinsurers to additional capital, governance, and reporting requirements. Treasury and USTR have made plain to the EU our concerns about several U.S.-based insurers and reinsurers that have received written notice from EU supervisors of potential action that could harm the competitiveness of these companies in the EU market. In the covered agreement negotiations underway, the United States seeks to level the playing field for U.S. insurers and reinsurers engaged with the EU market. We seek to address critical

prudential regulatory areas relating to group supervision and solvency, reinsurance supervision, including collateral, and the exchange of regulatory and supervisory information across borders. In the United States, state insurance regulators are the main supervisors of the business of insurance and Treasury and USTR are engaged in the covered agreement negotiations within this existing regulatory framework.

In addition to resolving concerns with respect to Solvency II, and as Treasury and USTR outlined in our letter of November 20, 2015, to Chairman Hensarling and Ranking Member Waters upon launch of these negotiations last year, we are pursuing objectives with respect to certain aspects of reinsurance regulation and exchange of information among insurance supervisors. We have welcomed our discussions with the relevant committees of jurisdiction as we have engaged in this work.

Historically, in order for a U.S. insurance company purchasing reinsurance to obtain statutory credit for the liabilities assumed by the reinsurer, certain foreign reinsurance companies have been required to post collateral in order to engage in the U.S. market. The National Association of Insurance Commissioners adopted a revised Model Law in 2011 and since that time many states have revised collateral requirements based on that model. A covered agreement could address concerns regarding the treatment of EU reinsurers operating in the United States, particularly regarding collateral, using an approach substantially similar to one already approved by state insurance regulators.

The majority of non-affiliated reinsurance purchased by U.S. insurers is from non-U.S. domiciled reinsurance companies, with European Union reinsurance providers having significant U.S. market share. As we consider this issue for the covered agreement, Treasury and USTR will ensure that strong consumer protection continues and will seek to ensure the continued availability and affordability of insurance products for U.S. businesses and consumers.

Regulators and supervisors for multinational financial services firms must have the capacity to exchange sensitive regulated entity information across national borders on a confidential basis for regulatory and supervisory purposes. Treasury and USTR are therefore discussing with the EU principles and procedures that could serve as guidance to facilitate information sharing between supervisors and regulators in both markets.

As we move forward, we look forward to continued engagement with Congress, regulators and supervisors, and stakeholders. Treasury and USTR remain committed to working to conclude an agreement with the European Union that continues strong consumer protection and seeks to level the playing field for U.S. insurance and reinsurance suppliers.

STATEMENT OF PROPERTY CASUALTY INSURERS ASSOCIATION OF AMERICA

HEARING ON "THE IMPACT OF US-EU DIALOGUES ON US INSURANCE MARKETS"
HOUSE COMMITTEE ON FINANCIAL SERVICES
SUBCOMMITTEE ON HOUSING AND INSURANCE

SEPTEMBER 28, 2016

The Property Casualty Insurers Association of America (PCI) represents nearly 1000 insurers and reinsurers that write more than $200 billion annually in coverage throughout the U.S. and world. Reflecting the strength in diversity that is a hallmark of our sector in the U.S. and internationally, our members range from small one state writers to companies that operate in more than 100 countries.

Background

Congress in the Dodd-Frank Act affirmed the state-based regulation of insurance and the McCarran-Ferguson Act and the states' historic focus on consumer and policyholder protection. But there have been a number of emerging gray areas as the new regulatory roles have evolved where additional Congressional clarity could be very helpful. For example, Congress abolished the Office of Thrift Supervision and transferred its authorities over thrifts with insurance affiliates to the Federal Reserve Board. But the Federal Reserve has taken a dramatically different approach to its supervisory role than the OTS, including actively participating in the International Association of Insurance Supervisors (IAIS) together with the newly created Federal Insurance Office (FIO) and numerous state insurance regulators. The Dodd-Frank Act includes a brief reference to FIO's role at the IAIS, but provides no guidance as to how the Federal Reserve, FIO and states should work together, what their goals should be, or how they should defend the U.S. insurance regulatory system internationally.

The two supervisory perspectives of banking regulation and insurance regulation can be dramatically different, for example on issues such as capital leveraging and liquidity risk, or the more holistic issues of macro-economic stability versus policyholder protection. Congress recognized the need to address the regulatory divergence and provide more guidance with passage of the Insurance Capital Standards Clarification Act two years ago, clarifying that the Federal Reserve Board can apply insurance-based capital standards – rather than bank-centric rules – to the insurance activities of insurance holding companies it supervises. Legislation recently approved by the House Financial Services Committee, the Transparent Insurance Standards Act of 2016 (H.R. 5143), would similarly clarify the intent of Congress on international issues for U.S. federal negotiators to follow a more insurance-centric approach for insurance standards, including collaborating with the state insurance regulators and seeking mutual recognition of the U.S. insurance regulatory system internationally.

Our state and federal representatives negotiating international insurance standards do their best to represent their agencies and ultimately the United States, but they have very different perspectives, constituencies and priority objectives. For example, in 2008 the Department of the Treasury, in its Blueprint for a Modernized Financial Regulatory Structure, recommended an optional federal charter for insurance. The Federal Reserve is in the process of creating a consolidated supervisory system for entities within its jurisdiction, essentially creating a second layer of holding company oversight. The states have generally opposed federal regulation of insurance except in limited instances. And yet all

with their very different regulatory perspectives and goals are in some manner representing the United States at the IAIS in the development of global insurance standards that could have profound implications for the future of our regulatory system, but no benefit to consumers.

Congressional oversight has been very helpful to the evolving U.S. process, particularly in encouraging regulatory cooperation and transparency. By enacting legislation such as H.R. 5143 Congress can help ensure that our Team USA regulators have the *same* priorities and objectives and greater public transparency and Congressional clarity and oversight in carrying out their missions. This in turn will improve the likelihood of efficient and effective outcomes in international insurance regulatory deliberations that will serve consumers and maximize competition and innovation.

H.R. 5143 does not hinder our federal representatives in international discussions. Instead, it gives them greater power and leverage because our negotiating partners will understand that all key players in the U.S., state and federal, have the same position to support or oppose a proposition.

Specific Issues

The State-Based Insurance Regulatory System Has Been Successful Because It Is Consumer Focused.

For nearly 150 years, the states have regulated insurance and coordinated their activities through the National Association of Insurance Commissioners. Our state system of regulation has performed well in good times and bad, including during the financial crisis of 2008-2009.

Indeed, the overall performance of the state-based regulatory system compares favorably with that of any other financial services regulation. In terms of size, degree of consumer protection, financial strength and amount and diversity of competition, the U.S. state-based insurance regulatory system is unmatched by any other system. We are pleased therefore that H.R. 5143 begins its findings with a recitation of this fundamental reality.

This success is not just an accident or an historical anomaly. The U.S. insurance regulatory system has been so successful because it focuses on the end user—the consumer. So we strongly support H.R. 5143's emphasis on putting consumer protection first (as does our state-based regulatory system), and the bill's focus on assuring that state regulation is respected in all final outcomes of international regulatory discussions.

The U.S. Needs to Speak with One Voice in International Regulatory Discussions.

In recognition of the strong performance of state regulation, Dodd-Frank reiterated the primary role of the states in insurance regulation. However, it also created the FIO in the Treasury, which under Title V is to coordinate federal policy and represent the Secretary of the Treasury, as appropriate, at the International Association of Insurance Supervisors. The FIO Director has since assumed a leadership role at the IAIS, chairing one of its two most important committees. In addition, Dodd-Frank gave the Federal Reserve Board regulatory authority over insurers with thrifts and those designated as systemically important. Based on this regulatory authority, it, too, is an active member of the IAIS. Meanwhile, the NAIC and states also serve on IAIS committees, and the states have the largest amount of technical expertise in all areas and are legally responsible and accountable for the health and regulation of the insurance markets in their states.

Unfortunately, without more Congressional guidance on their objectives and priorities, our U.S. and state representatives can have conflicting perspectives and priorities. For example, state and two federal representatives all took different positions on whether to eliminate consumer group and stakeholder involvement in IAIS working groups. Both transparency and accountability have since suffered.

Accordingly, we support the Congressional clarity provided in H.R. 5143 to encourage greater collaboration and consensus among the regulators, requiring the regulators to work towards achieving consensus on policy positions in all international insurance regulatory discussions, backed up by reporting mandates. Congress often requires joint rulemakings or actions by agencies with overlapping jurisdiction. Federal agencies often fail to achieve such consensus within the statutorily required time, continue working on the issues in the meantime, and under Congressional pressure eventually get to the same page. While agreement among multiple agencies can be difficult, it is a critical effort to assure all representatives of the U.S. speak with one voice. It strengthens that voice and also increases the likelihood that any international standard will be effective and worthy of serious consideration. While there is no penalty in the bill that would limit the agencies' ability to work together, Congress can and should set the appropriate goals and required outcomes to ensure a cooperative approach.

Transparency and Accountability Are Often Lacking in International Regulatory Discussions.

As previously noted, the IAIS voted in 2014 to close its working group meetings, with a few rare exceptions, thereby reducing the ability of U.S. companies and consumers to participate meaningfully in the process. Every bit as important, the Financial Stability Board, which was given extremely broad powers by the G20 ministers to set the regulatory agenda for all financial services sectors including insurance, operates behind closed doors with an occasional invitation to selected companies. The Treasury, Fed and SEC are the sole representatives of the U.S. and the states are not present, even when insurance regulatory issues are considered.

Because transparency is a core value and is fundamental to our system, and because it produces the best overall outcomes, it is critically important that Congress act to reverse the trend toward closing doors and excluding interested parties. The NAIC holds open meetings and conference calls of the great majority of its working groups and offers a good model of openness that has contributed substantially to the success of our system.

H.R. 5143 will assure increased transparency by establishing greater transparency as a negotiating objective and providing specific procedures to assure transparency and accountability (for example public notice and comment periods in connection with the congressional layover provisions). The bill also requires special and periodic reports on transparency.

The other element of transparency that H.R. 5143 addresses is the current lack of information from federal agencies before, during, and after international insurance regulatory deliberations at the IAIS, FSB and elsewhere. Congress makes the laws and has a unique role in protecting state regulation and setting the boundaries and limits for federal involvement in insurance. Congress can and should fulfill its role consistent with the McCarran-Ferguson Act, in which Congress generally reserved insurance regulatory authority to the states. Under H.R. 5143, Congress will be kept regularly involved in international trade negotiations and the draft bill would appropriately require a measure of accountability to Congress for international standard setting negotiations as well.

The Urgent Need for Mutual Recognition with the EU

The European Union -- the second largest insurance market in the world -- is now beginning implementation of Solvency II, a new insurance regulatory approach for Europe. Solvency II is based in part on global banking standards that reflect Europe's more concentrated and interconnected market, its tradition of greater intervention into the private sector, and its desire for a more one-size-fits-all common market standard. Solvency II's approach and structure is fundamentally different from the time-tested state-based insurance regulatory system in the U.S. that is more focused on consumer protection and supported by extensive data reporting and guaranty funds in every state. Solvency II is more focused on protecting investors than consumers. It may be the right system for Europe, but it is not right for the U.S. For example, all of the Team USA representatives have suggested that portions of Solvency II, such as required market valuation of liabilities, would not be beneficial to U.S. consumers.

Unfortunately, Solvency II contains a requirement that companies from "third countries", including the U.S., be treated differently unless the third country is deemed to be equivalent, a highly prescriptive process. The U.S. understandably, and in consideration of the success of our different and time tested system, declined to engage in that process.

Just before Solvency II implementation, UK regulators demanded extensive data reporting from U.S. companies, reaching beyond Europe to the U.S. holding companies, thereby impliedly giving extraterritorial effect to Solvency II. Since then, German regulators have gone much farther—actually terminating the ability of U.S. companies to operate there in their current forms, even though they had been in the market and fully regulated for decades. This kind of unjustified punitive action is no longer just a threat—it is happening right now.

Ironically, the European Union found the U.S. sufficiently "equivalent" to prevent Solvency II from requiring more capital for its companies doing business in the U.S. However, they have so far refused an entirely consistent finding of equivalence that would equally benefit U.S. companies doing business in Europe.

We have been in nearly constant touch with our covered agreement negotiators at the Treasury and USTR and with the NAIC. Attached to this testimony is a copy of a letter PCI President and CEO David Sampson wrote to the key US negotiators. The letter sets forth PCI's views on the appropriate U.S. priorities for a covered agreement and, in particular, the need to ensure that any final deal includes mutual recognition. We also appreciate the many expressions of congressional concern and we urge Congress to continue to exercise oversight over the covered agreement process. We believe that all U.S. parties fully understand the gravity of the situation and are doing their best at the negotiating table. But, if we do not succeed diplomatically, we fear there will be louder and more persistent calls for retaliatory action.

The Need for Continued Vigilance and Engagement in all Areas of International Regulatory Discussions

There is no area of insurance regulation not being discussed in international forums—capital, governance, executive remuneration, market conduct, resolution, cyber security and the role of technology, among others. The U.S. regulatory system has addressed each of these areas—often with decades of successful results for consumer protection and for a competitive and financially strong

market. So the collective challenge for all of us—Team USA, the Congress and U.S. consumers and industry is to work together for outcomes that respect our system as fully compliant with Solvency II. This means working for outcomes in every area that are sufficiently high level and principles based that they allow proven effective systems, although different, to be fully recognized. Below we provide a few examples of potentially beneficial outcomes.

- Capital issues have tended to dominate international discussions. We think the proven effective jurisdictional systems should be the essential elements of any international system. Additional capital, if any, should only be required when well identified vulnerabilities and systemic risk is demonstrated.

- With regard to governance, the critical issue is to maintain a flexible and proportional approach that focuses on outcomes and essential functions, not a one-size-fits-all mandate that does not reflect jurisdictional law and/or very different corporate structures. So far, the work of the FSB, IAIS and OECD are consistent with these notions and we urge that all players continue in that vein.

- Executive compensation is receiving increasing attention. Our view is that compensation should be a market determination, subject, however, to over-all consistency with high level principles.

- International market conduct standards should be based on the reality that consumers benefit not just from regulatory restrictions but also from innovation and competition. Therefore, a careful balance should be struck and costs as well as benefits should be weighed.

- Resolution of distressed or insolvent insurers is now receiving significant regulatory focus. The U.S. has a proven effective system that should not be impinged upon. Specifically, the role of the courts in the U.S. system should be emulated elsewhere and different levels of intervention provided pursuant to duly enacted legislation.

- Cyber security of insurers is being comprehensively addressed in the U.S. at the federal and state level. We are still working on achieving the best balance of security, cost and cooperation. Accordingly, other than some high level papers, US negotiators should not agree to positions in international regulatory discussions before the U.S. completes its process.

- As with cyber security, U.S. regulators are deeply involved in considering the effects of technology on insurers and the consumers they serve. Again, we think this process should reach finality before international standard setters go beyond their current work on identifying the impacts and challenges technology presents.

Conclusion

Since the enactment of Dodd-Frank, the international insurance regulatory world has evolved in ways that may not reflect congressional intent to protect the strength and competitiveness of the U.S. insurance market and its consumer focused state-based regulatory system. We commend the Congress for its efforts to date and urge swift action on H.R. 5143, which will improve international insurance regulatory deliberations and outcomes and clearly and effectively promote U.S. markets, the interests of our consumers and our proven effective state-based insurance regulatory system.

Property Casualty Insurers
Association of America
Advocacy. Leadership. Results.

David A. Sampson
President and CEO

August 14, 2015

The Honorable Jacob J. Lew
Secretary of the Treasury
US Department of the Treasury
1500 Pennsylvania Av., NW
Washington, DC 20220

Mr. Michael Froman
US Trade Representative
Office of the US Trade Representative
600 17th Street N.W.
Washington, DC 20506

Mr. Ben Nelson
Chief Executive Officer
National Association of Insurance Commissioners
1100 Walnut Street, Suite 1500
Kansas City, MO 64106-2197

Dear Secretary Lew, Ambassador Froman and Senator Nelson:

The Property Casualty Insurers Association of America's (PCI) approximately one thousand member companies provide insurance and reinsurance throughout the US and the world. Our membership includes single state mutual insurers, regional powerhouses, and international diversified financial firms. PCI has members in every US state and every global region, including a majority of the top 50 performing insurers ranked by Ward's and half of the top 10 insurers ranked by JD Power for consumer satisfaction. PCI's mission is to promote and protect the viability of a competitive private insurance market to the benefit of consumers and insurers.

The US Treasury Department, the United States Trade Representative (USTR) and the state insurance regulators are approaching a critical juncture in determining how to assure mutual recognition of the US insurance regulatory system by major trading partners, especially the European Union (EU), and whether to address issues regarding the US collateral for reinsurance system (potentially using the covered agreement authority under Dodd-Frank). This letter provides perspectives on how best to proceed in resolving each of these matters of importance. PCI has a long history of support for state regulation of insurance, but we also recognize Treasury's statutory responsibilities under the Dodd-Frank Act. PCI will continue to work constructively with Treasury, USTR, and state insurance regulators on these important issues.

2

I. Mutual Recognition

Treasury, the USTR and the state regulators have worked diligently for many years to encourage a robust international insurance trade, including actively working to facilitate trading of risks between the two largest insurance markets – the European Union and the United States (who together oversee roughly 70% of the world's insurance market). The EU has recently adopted a new regulatory framework intended to modernize its insurance regulatory system, Solvency II, which generally provides that, in order for non-EU insurers to be treated in the same way as European insurers, their home regulatory system must be deemed "equivalent" to Solvency II. Specifically, the Solvency II Directive (Directive 2009/138/EC), targeted for implementation from January 1, 2016, requires foreign countries to *apply* for an "equivalence" determination to avoid discriminatory treatment. Equivalence determinations are based on a series of requirements that the foreign country must have equivalent rules in areas such as group capital requirements, group supervision and reinsurance. State and federal representatives have indicated that the US will not apply for an equivalence determination, raising questions about whether US (re)insurers with subsidiaries in Europe will receive discriminatory treatment, such as being subjected to additional layers of EU group supervision and capital requirements.

In 2012, Treasury, US state regulators, the European Commission and EU regulators began the US-EU Dialogue Project to improve mutual understanding of the region's different regulatory systems, processes and markets. The state regulators also made significant modifications in state insurance regulation, including adoption of NAIC models that are now being implemented in the states on Own Risk and Solvency Assessment, Enterprise Risk Management requirements, and expansion of the Model Holding Company Act.

Most relevant, in 2011 the NAIC also adopted changes to the Credit for Reinsurance Model Law and Regulation reducing (in some cases to zero) required reinsurance collateral for non-US reinsurers reinsuring risks in the US, provided they are domiciled in a "qualified jurisdiction" and their security level, as determined by several recognized rating agencies, meet certain levels. These developments should have helped achieve greater mutual recognition and appreciation for the US state-based regulatory system. This does not seem to be the case based on European statements to date, and Treasury's Federal Insurance Office (FIO) has indicated that it will be seeking EU assurances of fair treatment of US (re)insurers. However, with no specific equivalence application in process, time is quickly running out for a mutual recognition agreement or understanding before January 1, 2016 in order to avoid the uncertainty of discriminatory treatment and a potential trade war. In particular, significant pressure continues from parts of Europe for the US to completely eliminate reinsurance collateral requirements. Conversely, in some European countries, US reinsurers are no longer acceptable for credit for reinsurance purposes and in other countries, regulators are requiring US reinsurance companies to convert their branches to subsidiaries and ring-fence capital in excess of the amounts required in the US.

PCI strongly supports mutual recognition of robust regulatory regimes, including the US and EU, and has raised with the federal agencies, states, and members of Congress the importance of preventing EU discrimination against US (re)insurers. PCI has also encouraged US insurance stakeholders, to the extent that a covered agreement with the EU is negotiated, to insist that a full mutual recognition commitment be a fundamental part of any overall deal.

3

II. Covered Agreement – Reinsurance Collateral

Background

The Dodd-Frank Act authorizes the Treasury Secretary and the USTR to jointly negotiate and enter into covered agreements on behalf of the United States, after consultation with Congress on the nature of the agreement, how it would achieve statutory goals, and its implementation and general effect. Covered agreements are defined under the law as agreements between the US and foreign authorities regarding prudential measures with respect to the business of insurance or reinsurance that achieve a level of protection for insurance or reinsurance consumers that is substantially equivalent to the level of protection achieved under State insurance or reinsurance regulation. State insurance measures are only subject to preemption to the extent that FIO determines that the measure results in less favorable treatment of a non-US insurer that is subject to a covered agreement than a US insurer domiciled, licensed, or otherwise admitted in that State. The single issue that Congress discussed during the Dodd-Frank Act that fit this description is state requirements for reinsurance collateral.

While state insurance regulators do not have direct oversight over non-US reinsurers, the regulators set the qualifications for the reinsurance credit claimed by primary insurers who purchase reinsurance. Primary insurers do not receive solvency credit from state regulators for reinsurance unless a state regulator finds that the non-US reinsurer is financially sound and, where appropriate, there is reinsurance collateral in place. The Treasury Department adopts a similar approach in requiring that non-US reinsurers post collateral on risks ceded to them by Treasury-approved surety bond writers. Reinsurance collateral can add additional transactional costs and is not needed by all primary insurers. However, a majority of reinsurance is purchased from foreign reinsurers and some primary insurers are concerned about their ability to collect in the event of a dispute. Regulators want the ability to ensure that primary insurers have access to adequate collateral to compensate policyholders in large events that trigger reinsurance coverage.

In 2011, the NAIC passed changes to its Credit for Reinsurance Model Law and Regulation that create a sliding scale for reinsurance collateral requirements based on the reinsurer's financial strength, claims payment history, and licensure in a qualified jurisdiction. A number of European countries, Bermuda and Japan have been recognized by the NAIC as qualified jurisdictions and more than 30 foreign reinsurers have been certified, most benefitting from significantly reduced reinsurance collateral requirements for their primary insurance purchasers to receive full credit for reinsurance. A majority of states representing a majority of insurance premiums have implemented the new model law over the past couple of years. Most of the remaining states will likely have achieved that goal in the near future.

(Re)insurers have largely supported the NAIC model in the states and PCI has discouraged state deviations. The NAIC has also developed a process both for certifying reinsurers at the state level (the "passporting" process) and for designating "qualified jurisdictions," which are identified as having sufficiently robust regulatory standards for reinsurers. While they have not yet achieved complete national uniformity, the states have made rapid progress and are well on their way toward that goal. We also note that the NAIC is committed to reviewing, on a periodic basis, the collateral levels established in the current model law and regulation, creating the potential for further relaxation of collateral requirements in the future as circumstances may warrant.

4

Stakeholder concerns

There are three primary criticisms raised by the Federal Insurance Office (FIO) regarding the NAIC process: (1) qualifying determinations are not nationwide; (2) the federal government is better positioned to balance insurance determinations with broader US economic or regulatory policy; and (3) the NAIC model depends too heavily upon assessments of reinsurers' creditworthiness by credit rating agencies (CRAs). FIO has suggested that it is well-positioned to make determinations about qualifying foreign jurisdictions. It is further suggested that the states' lack of uniformity and focus on national interest leads to a conclusion that Treasury and USTR should pursue a covered agreement for reinsurance collateral requirements, based on the NAIC for Reinsurance Model Law and Regulation. State regulators have highlighted that the business of insurance is regulated by the states as Congress has confirmed multiple times with reference to the McCarran-Ferguson Act, partly in recognition of the local insurance risks and needs that vary across the country. State regulators have also observed that the NAIC process for determining reinsurance collateral requirements is rapidly moving towards national uniformity without a covered agreement and that shifting from the states to the Federal Insurance Office control of the balance between protecting insurance policyholders and other national interests is not an express statutory goal of the Dodd-Frank Act.

There was broader consensus during Congressional Dodd-Frank Act deliberations that federal government reliance on CRAs was suboptimal. However, replacing existing private sector analysis with new government evaluations has to be done carefully to avoid creating much more burdensome and expensive certification.

Supporters of state insurance regulation have also noted that there are alternatives to achieving uniformity without a fully preemptive covered agreement, such as setting a deadline for state uniformity (as done in NARAB legislation in the Gramm-Leach-Bliley Act) or having a covered agreement preempt only those states that have failed to uniformly implement the NAIC model. The threat of covered agreement negotiations has probably encouraged the state race towards a more uniform system of reduced collateral and a covered agreement could be structured to further expedite this process. However, if a covered agreement is subsequently adopted preempting state law there could be potential significant complications as state insurance departments still ultimately regulate primary insurers and determine their solvency standards. A covered agreement would not be striking down explicit state requirements for reinsurance collateral, but rather in essence demanding that the states recognize full credit for reinsurance for primary insurers despite contrary state laws -- creating practical implementation challenges and potential constitutional questions if not carefully constructed.

PCI has advocated in several instances for increased uniformity in credit for reinsurance provisions. PCI is open to multiple approaches towards the same outcome but we are concerned about the unintended consequences of federal standards layered on top of and potentially conflicting with state requirements. Preemption would create more uncertainty to the extent that a covered agreement compromise reduces reinsurance collateral as the Dodd-Frank Act requires, as a condition of preemption, that the agreement achieve a level of protection for insurance or reinsurance consumers that is substantially equivalent to the level of protection achieved under State insurance or reinsurance regulation.

5

Members of Congress are expressing increasing concern about international pressures being applied to state insurance regulation. The growing angst is evidenced in the number of bills being introduced or that have passed key Senate committees or in House appropriations reports that would clarify Congressional intent in opposition to international pressures for a harmful, global, one-size-fits-all regulatory approach. Congress clearly intended the covered agreement process to be an *option* to facilitate improved mutual recognition for reinsurance and to address foreign complaints about US discrimination in reinsurance collateral. However Congress also kept the provision intentionally very limited and not mandatory. Suggestions by some foreign parties that a covered agreement be used as a vehicle to address issues unrelated to reinsurance collateral requirements, such as trying to facilitate further federal intrusion into insurance group supervision, fall far outside the limited Congressional delegation and could generate significant Congressional and stakeholder opposition. The greater the departure from the NAIC credit for reinsurance models, and the more extraneous issues are included, the greater the danger of creating controversy and even opposition.

Transparency and Cooperation

Treasury and USTR could help pave the way for acceptance of any agreement negotiated by ensuring that the negotiations are conducted with full transparency. The Dodd-Frank Act requires consultation with Congress before covered agreement negotiations are initiated and again 90 days before the agreement may enter into force. Complaints have been escalating in Congress, with bipartisan and bicameral concern, against the worsening lack of transparency in international insurance negotiations. Similar bipartisan and bicameral calls have been made for federal and state agencies to work together with respect to insurance to coordinate US policy and negotiating strategy. Concerns about covered agreements reflect not only opposition by some to further preemption of state law (or layering of additional federal law), but also anxiety that the US negotiators will reduce consumer protections, tack on extraneous provisions, fail to demand real value for the US in return (such as mutual recognition), or fail to coordinate between the states and federal agencies a common approach so that any federal commitments can be incorporated into the state solvency process as seamlessly as possible.

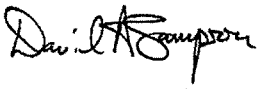
The USTR typically leads a very robust public and Congressional vetting process when negotiating trade agreements, which includes extensive opportunity for stakeholders to weigh in. When negotiating on issues affecting insurers, USTR has worked closely and productively with state insurance regulators. This was an important reason for the inclusion of the USTR in the covered agreement negotiating process. All covered agreement stakeholders would benefit from a similar transparent and inclusive consultation process throughout negotiations, including close and regular consultation with state insurance regulators and domestic (re)insurers. PCI appreciates the initial efforts by the USTR, FIO and the states to solicit and receive stakeholder input. PCI strongly believes that the best possible outcome can only be obtained if Treasury and USTR as well as state insurance regulators engage proactively with each other regarding any negotiation of a covered agreement. The more Congressional and other stakeholder consultation can be achieved with adequate transparency and cooperation, the greater the likelihood of mutual satisfaction with lessened political opposition.

III. Conclusion

PCI strongly supports efforts to achieve mutual recognition especially from the EU for US (re)insurers. PCI also appreciates the desire for increased uniformity and ongoing improvements in the regulation of reinsurance collateral. While PCI will not take a position in support or against a covered agreement until our members know specifically what it would include, we have and will continue to express our views on how best to achieve mutual recognition and how best to move forward to address remaining reinsurance collateral issues.

PCI hopes our comments will be received in the constructive spirit in which they are offered and we pledge to continue to work cooperatively with all stakeholders. If you have questions or need further information from PCI please contact me or Bob Woody at (202) 639-0496 or Robert.Woody@pciaa.net.

Sincerely,



David A. Sampson

Questions for Thomas Sullivan, Associate Director, Board of Governors of the Federal Reserve System from Chairman Luetkemeyer:

1. The pending notice of proposed rulemaking (NPR) on incentive-based compensation does not distinguish between insurance savings and loan holding companies (ISLHCs) and large banks. Given that the Board has acknowledged the important differences in the business models of these two types of institutions, will you commit to a horizontal review of ISLHCs before the rule is made final for these companies?

Consistent with the statutory requirements of section 956 of Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act), the Agencies[1] joint notice of proposed rule-making[2] covers all depository institution holding companies, including all savings and loan holding companies.[3] As described in the preamble, the proposed rule does not establish a rigid, one-size-fits-all approach. Rather, the Agencies have tailored the requirements of the proposed rule to the size and complexity of covered institutions. In addition, the proposed rule would allow firms to tailor the incentive-based compensation arrangements to the nature of a particular institution's business and risks, as long as those incentive-based compensation arrangements appropriately balance risk and reward. The Agencies have encouraged institutions to provide feedback on the potential impact of the proposed rule on covered institutions through the comment process.[4] The Agencies have included numerous questions, touching on all aspects of the rule. The comment process is intended to help us assess and address the impact of the rule on all types of covered institutions, including insurance savings and loan holding companies. At the request of certain insurance companies, we have met with those companies, and will include summaries of these meetings in the rulemaking record. Through these meetings, we will be able to obtain a deeper understanding of how their compensation practices work to inform the final rule. Similarly, the Agencies will consider your comments, and all other comments received, as a final rule is developed.

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[1] Office of the Comptroller of the Currency; Board of Governors of the Federal Reserve System; Federal Deposit Insurance Corporation; Federal Housing Finance Agency; National Credit Union Administration; and U.S. Securities and Exchange Commission.

[2] 81 FR 37670 (July 10, 2016).

[3] Section 956 of the Dodd-Frank Act defines "covered financial institution" to include any of the following types of institutions that have $1 billion or more in assets: (A) a depository institution or depository institution holding company, as such terms are defined in section 3 of the Federal Deposit Insurance Act ("FDIA") (12 U.S.C. 1813); (B) a broker-dealer registered under section 15 of the Securities Exchange Act of 1934 (15 U.S.C. 78o); (C) a credit union, as described in section 19(b)(1)(A)(iv) of the Federal Reserve Act; (D) an investment adviser, as such term is defined in section 202(a)(11) of the Investment Advisers Act of 1940 (15 U.S.C. 80b-2(a)(11)); (E) the Federal National Mortgage Association (Fannie Mae); (F) the Federal Home Loan Mortgage Corporation (Freddie Mac); and (G) any other financial institution that the appropriate federal regulators, jointly, by rule, determine should be treated as a covered financial institution for these purposes.

[4] As of the preparation of this response, the Agencies have already received multiple comments letters regarding the application of the proposal to insurance SLHCs and have met with insurance industry representatives.

Questions for The Honorable Thomas Sullivan, Associate Director, Board of Governors of the Federal Reserve System from Chairman Luetkemeyer:

2. The incentive-based compensation NPR would subject not only ISLHCs, but their insurance subsidiaries, to restrictions on incentive-based compensation. Given that (1) other financial regulators did not apply the rule's restrictions to functionally regulated subsidiaries, (2) ISLHCs' insurance subsidiaries are functionally regulated by the states, and (3), the statute does not require the rule to apply to insurance subsidiaries, will you exclude ISLHCs' insurance subsidiaries from the final rule?

Section 956 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act) requires the Agencies[1] to adopt rules regarding incentive based compensation that apply to depository institution holding companies, including all savings and loan holding companies.[2] Section 956 does not grant the Agencies explicit exemptive authority.

The Agencies continue to consider the comments received on the proposal. At the request of certain insurance companies, we have met with those companies, and will include summaries of these meetings in the rulemaking record. Through these meetings, we have been able to obtain a deeper understanding of how their compensation practices work to inform our work towards a final rule.

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[1] Office of the Comptroller of the Currency (OCC); Board of Governors of the Federal Reserve System (Board); Federal Deposit Insurance Corporation (FDIC); Federal Housing Finance Agency (FHFA); National Credit Union Administration (NCUA); and U.S. Securities and Exchange Commission (SEC).

[2] Section 956 of the Dodd-Frank Act defines "covered financial institution" to include any of the following types of institutions that have $1 billion or more in assets: (A) a depository institution or depository institution holding company, as such terms are defined in section 3 of the Federal Deposit Insurance Act ("FDIA") (12 U.S.C. 1813); (B) a broker-dealer registered under section 15 of the Securities Exchange Act of 1934 (15 U.S.C. 78o); (C) a credit union, as described in section 19(b)(1)(A)(iv) of the Federal Reserve Act; (D) an investment adviser, as such term is defined in section 202(a)(11) of the Investment Advisers Act of 1940 (15 U.S.C. 80b-2(a)(11)); (E) the Federal National Mortgage Association (Fannie Mae); (F) the Federal Home Loan Mortgage Corporation (Freddie Mac); and (G) any other financial institution that the appropriate federal regulators, jointly, by rule, determine should be treated as a covered financial institution for these purposes.

Questions for Thomas Sullivan, Associate Director, Board of Governors of the Federal Reserve System from Chairman Luetkemeyer:

3. In its ANPR on insurance capital standards published this summer, the Fed has worked to tailor capital standards to the insurance companies under its supervision. As you know, Congress supports that approach and enacted legislation to provide the Fed with that flexibility. However, the building blocks approach (BBA) in the ANPR is much more consistent with the state insurance risk-based capital system than the consolidated approach (CA). Would you consider keeping the BBA framework for all insurance companies under Fed supervision? What are the advantages of such an approach?

The Dodd-Frank Wall Street Reform and Consumer Protection Act was amended to allow the Federal Reserve Board (Board) to tailor its minimum capital requirements as they would apply to persons regulated by state or foreign insurance regulators. The Board has flexibility to develop risk-based capital requirements that are tailored to appropriately reflect the risks of supervised institutions significantly engaged in insurance activities. Moreover, our supervisory program, complementary to and in coordination with the states, continues to be tailored to consider the unique characteristics of insurance operations and rely on the work of the state regulator(s) to the greatest extent possible.

The Board's advance notice of proposed rulemaking (ANPR) requests input from the public on two possible options for capital standards for supervised insurers. The Board has not reached decisions on approaches to be used to build a capital standard for supervised insurers. As stated in the ANPR, the Board's initial analysis of the relative strengths and weaknesses of the consolidated approach indicates that this approach may be an appropriate regulatory capital framework for the systemically important insurance companies. As a consolidated capital framework, this approach would cover all material risks of the systemically important insurance companies, reduce the opportunity for regulatory arbitrage and risk of double-leverage, and more easily enable supervisory stress testing and other macroprudential measures for these companies. We remain mindful of the advantages of the building block approach, which we discuss in the ANPR, and appreciate advantages to applying this approach to all supervised firms significantly engaged in insurance activities. In light of the Board's supervisory objectives, the advantages of the consolidated approach for the systemically important insurance companies, which tend to be large, internally and externally complex institutions, are most salient. It would be premature for me to comment on this framework before staff has finished its research vetting potential options. As indicated by the questions included in the ANPR, the Board welcomes comment on the considerations that should guide the development of its insurance regulatory capital framework for the two populations of supervised institutions significantly engaged in insurance activities, as well as whether the consolidated approach is appropriate to apply to systemically important insurance companies and key challenges in this application.

Questions for Thomas Sullivan, Associate Director, Board of Governors of the Federal Reserve System from Representative Posey:

1. The mission of the state insurance regulators is to protect the interests of the policyholder and those who rely on the insurance coverage provided to the policyholder first and foremost. The regulators also support facilitating the financial stability and reliability of insurance institutions for an effective and efficient marketplace for insurance products. What is the mission of the Board of Governors Federal Reserve System (FRB) with respect to insurance and how does it differ from the state regulations? What is the FRB's mission with regard to international insurance regulation?

With the enactment of the Dodd-Frank Wall Street Reform and Consumer Protect Act (Dodd-Frank Act), the Federal Reserve Board (Board) was assigned responsibility as the consolidated supervisor of insurance holding companies that own thrifts (insurance depository institution holding companies), as well as insurance companies designated by the Financial Stability Oversight Council (FSOC) to be supervised by the Federal Reserve (systemically important insurance companies). The Federal Reserve's principal supervisory objectives for the insurance firms that it oversees include protecting the safety and soundness of the consolidated firms, as well as mitigating risks to U.S. financial stability. These objectives complement the primary mission of state legal entity insurance supervisors, which tends to focus on the protection of policyholders, adding the Federal Reserve's perspective that considers the risks across the entire firm. Moreover, the Federal Reserve's insurance prudential standards will not alter or replace the existing state-based framework, including capital requirements at the legal entity level, that are already in place. We continue to coordinate with state insurance regulators in the protection of policyholders and aim to avoid duplications of their supervision, leveraging the work of state insurance regulators where possible. The state insurance regulators' mission of protecting policyholders and the Federal Reserve's objectives of ensuring the safety and soundness of the consolidated firm and mitigating an FSOC-designated firm's risk to U.S. financial stability are not mutually exclusive propositions.

With regard to international insurance standard setting, some of the insurance holding companies subject to Federal Reserve supervision are internationally active firms that compete with other global insurers to provide insurance products to businesses and consumers around the world. Our supervisory activities for these firms include collaborating with our regulatory counterparts internationally. As part of this role, in late 2013, the Federal Reserve joined our state insurance supervisory colleagues from the National Association of Insurance Commissioners (NAIC) and the Federal Insurance Office (FIO) as members of the International Association of Insurance Supervisors (IAIS). Accordingly, the Federal Reserve has been and will continue to be engaged, in partnership with fellow U.S. members – the FIO, NAIC, and state insurance regulators – in the development of global standards for regulating and supervising internationally active insurers. These standards include, among others, capital, liquidity planning and management, effective resolution, and group supervision. As a general proposition, we believe in the utility of having effective global standards for regulation and supervision of internationally active financial firms. When implemented consistently across global jurisdictions, such standards help provide a level playing field for global financial institutions. Further, consistent global regulatory standards can help limit regulatory arbitrage and jurisdiction shopping and can promote financial stability.

It is important to note that the IAIS does not have the ability to impose requirements on any national jurisdiction, and implementation in the U.S. of any IAIS standard would have to be consistent with U.S. law and comply with U.S. administrative rulemaking process.

2. Does the FRB agree with the proportionality principle, namely that regulation should take into account a company's nature, scale and complexity? If so, please explain how the FRB will implement a proportional supervision approach to the insurance holding companies it supervises.

In its consolidated supervision of insurance firms, the Federal Reserve remains committed to tailoring its supervisory approach, including a domestic capital framework and other prudential standards, to the business of insurance, reflecting the different size, scale, complexity, and nature of the business models and systemic importance of the supervised institutions. In particular, among other requirements for consolidated supervision, section 171 of the Dodd-Frank Act requires the Board to develop minimum risk-based capital requirements for supervised insurance firms. The Board will take into account the greater flexibility provided by the Insurance Capital Standards Clarification Act of 2014. The Board currently supervises twelve insurance depository institution holding companies and two systemically important insurance companies. These firms are highly diverse: they range in size from firms with total assets of approximately $3 billion to firms with total assets of over $700 billion. They engage in a wide variety of insurance and non-insurance activities. Some are fully domestic and others have material international operations. Some are organized as mutual companies, while others are owned by public shareholders. Some produce only statutory accounting statements, while others also produce statements under U.S. Generally Accepted Accounting Principles. Indeed, the bifurcated approach set out in the Board's advance notice of proposed rulemaking (ANPR) on capital requirements for supervised institutions significantly engaged in insurance activities would efficiently advance the Board's differing supervisory objectives for the two populations of supervised insurance firms. The Board aims to develop regulatory capital frameworks for insurance depository institution holding companies and systemically important insurance companies that are consistent with the Board's supervisory objectives and appropriately tailored to the firms and the business of insurance. Moreover, our supervisory program, complementary to and in coordination with the states, continues to be tailored to consider the unique characteristics of the firms and their insurance operations.

3. What are the reasons the FRB has considered applying a more efficient and state-regulation-friendly building block approach to the insurers subject to the FRB's jurisdiction?

As explained in the Federal Reserve's ANPR, the Federal Reserve considered key strengths of the building block approach (BBA) including that: (i) it efficiently uses existing legal-entity-level regulatory capital frameworks; (ii) it is an approach that could be developed and implemented expeditiously; (iii) it would involve relatively low regulatory costs and burdens for the institutions; and (iv) it would produce regulatory capital requirements that are tailored to the risks of each distinct jurisdiction and line of business of the institution. The strengths of the BBA would appear to be maximized and its weakness minimized were the BBA to be applied to

insurance depository institution holding companies, which generally are less complex, less international, and not systemically important. In this context, incremental safety and soundness benefits would appear to be complemented by the lower compliance costs due to the smaller number of jurisdictions involved. In particular, the BBA is standardized, executable, applies U.S.-based accounting principles for U.S. legal entities, accounts for material insurance risks, strikes a balance between risk-sensitivity and simplicity, and is well-tailored to the business model and risks of insurance. However, the BBA may not capture the full set of risks that the systemically important insurance companies impose on the financial system without significant use of adjustments and scalars to the legal entity capital requirements,[1] thereby negating any potential burden reduction from the approach.

4. In the domestic and international systemic importance designation process will the FRB consider advocating an activity-based approach that weighs the comparative risk of insurance companies being considered for designation against banks and other financial firms to determine relative systemic importance, rather than only comparing insurance companies to other insurance companies?

Since the financial crisis, U.S. authorities and foreign regulators have been working to identify institutions whose failure or distress may pose a threat to financial stability, including nonbank financial companies like insurance firms. The leaders of the Group of 20 nations, including the United States, charged the Financial Stability Board (FSB) with identifying firms whose distress would threaten the global economy. The methodology by which the FSB identifies global systemically important insurers (G-SIIs) is developed by the IAIS and has been updated this year. The FSOC undertakes a process for designating nonbank firms as systemically important that assesses the potential harm that a firm's distress or failure could cause to the financial stability of the United States. In accordance with the Dodd-Frank Act, the FSOC's analysis is based on a broad range of quantitative and qualitative information available to the FSOC through existing public and regulatory sources and as submitted to the FSOC by the firms under consideration. The analysis is tailored, as appropriate, to address company-specific risk factors, including, but not limited to, the nature, scope, size, scale, concentration, interconnectedness, and mix of the activities of the firms. In this sense, the activities, risk profile, and systemic impact of each firm under consideration are integral to the FSOC's analysis, rather than a comparison of insurers against other insurers or banks, and designations reflect activities of the firm that could pose threats to U.S. financial stability. The IAIS' methodology for identifying G-SIIs also incorporates analysis of the firm's activities and increasingly reflects absolute reference values for indicators of systemic risk rather than relative comparisons of insurers against peer insurers. Additionally, as advocated by the Federal Reserve, the revised IAIS methodology requires a cross sectoral comparison of insurers against banks and other financial intermediaries in identifying systemically important insurers, together with an analysis of how the insurance industry's systemic risk changes over time. The Federal Reserve continues to advocate the broader use of absolute reference values and increased cross sectoral analysis in the IAIS' G-SII methodology.

[1] Under the BBA, existing legal entity level capital requirements may need to be "scaled" so that the various legal entity level capital requirements are brought to a comparable basis for aggregation.

5. Is the FRB considering expanding its source of strength doctrine to inappropriately apply it to insurers or requiring insurance legal/entity capital different from state regulatory requirements?

As stated in the Board's ANPR, to the greatest extent possible, the capital frameworks applicable to supervised institutions significantly engaged in insurance activities should take account of risks across the entire firm – in the holding company, in regulated subsidiaries, and in unregulated subsidiaries. The financial crisis demonstrated that risks of financial distress often spread across an organization from unregulated subsidiaries to regulated subsidiaries. In this regard, a consolidated capital requirement must take into account the risks within the consolidated organization, including insurance risks. The ANPR put forth frameworks that are intended to ensure that the institution has sufficient capital, commensurate with its overall institution-wide risk profile (i) to absorb losses and continue operations as a going concern, including through times of economic, financial, and insurance-related stress; (ii) to serve as a source of strength to any subsidiary depository institutions;[2] and (iii) to substantially mitigate any threats to U.S. financial stability that the institution might pose.

The Board appreciates the comments on the ANPR that it has received thus far. It would be premature for me to comment on the Board's consolidated insurance capital frameworks before staff has finished our research vetting potential options. The Board continues to focus on constructing, with engagement of stakeholders at various levels, a domestic regulatory capital framework for our supervised insurance firms that achieves the Board's regulatory objectives, is well tailored to the business of insurance, and relies on the work of the state supervisors as primary functional regulator(s) to the greatest extent possible.

6. What has the Fed done at the FSB to include U.S. state regulators and legislators as part of our delegation when insurance issues are being considered?

The Federal Reserve has acted on the international insurance stage in a continued, engaged partnership with our colleagues from the NAIC, the state commissioners, and the FIO. Our multiparty dialogue, while respectful of each of our individual authorities, strives to develop a central position on the most critical matters of global insurance regulatory policy. Several U.S. agencies participate in the work of the FSB and the IAIS, and provide input that considers implications for U.S. domiciled firms that we supervise. The FSB, in its identification of G-SIIs, relied on the methodology and analytical work conducted by the members of the IAIS. Numerous state insurance regulators, including those with significant insurance markets, the NAIC, the FIO, and the Federal Reserve were all active participants in this analysis and recommendation process. Moreover, the Federal Reserve, along with other members of the U.S. delegation at the NAIC and the FIO, actively engages U.S. interested parties on issues being considered by the IAIS.

7. Does the FRB support more transparency at the IAIS working group discussions of potential global insurance standards?

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[2] 12 U.S.C. § 1831o–1. *See also* 12 U.S.C. § 1844 and Section 706, Division O, of the Consolidated Appropriations Act, 2016, Public Law 114-113, 129 Stat. 2242 (2015).

The Federal Reserve supports transparency in the development of international insurance standards at the IAIS. With regard to the IAIS' G-SII methodology, for instance, on November 25, 2015, the IAIS issued a public consultation document on the methodology used to identify and analyze potential G-SIIs. The Federal Reserve participated in the review of comments received from stakeholders in the U.S. and around the world. The revised methodology was released as a public paper on June 16, 2016, and has been implemented. The revisions to the G-SII identification process increased the involvement of the insurance companies and their relevant supervisors in the process through its five phases: (1) the collection of data; (2) quality control on the data, initial scoring of the company, and grouping relative to a quantitative threshold for the score; (3) additional information collection and methodical assessment of companies that cross the quantitative threshold; (4) information exchange between the company, relevant authorities, and the IAIS; and (5) recommendation by the IAIS to the FSB, which then deliberates on a confidential basis to protect the confidentiality of company data. The updated assessment methodology contemplates transparency that was not part of the prior assessment methodology, including transparency with companies that are subject to phases 1 through 4 and other transparent engagement with companies subject to only phases 1 and 2, as well as certain public disclosure of aggregate and methodology information after the G-SII identification process is complete. Furthermore, the IAIS has committed to further developing public disclosure.

Moreover, we support the publication for public comment of consultation documents that present proposed approaches and frameworks for the supervision of internationally active insurance groups. We further support transparency and communication with stakeholders through participation in meetings with U.S. stakeholders either individually or jointly with the NAIC, state insurance commissioners, and the FIO.