**Testimony of**

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Chairman Duffy, Ranking Member Cleaver, Members of the Subcommittee, thank you for the opportunity to testify on behalf of the American Insurance Association (AIA) to provide our assessment of the Covered Agreement entered into by the United States (U.S.) and the European Union (EU).

Celebrating its 150th year in 2016, AIA is the leading U.S. property-casualty insurance trade organization, representing approximately 320 insurers that write more than $125 billion in U.S. property-casualty premiums each year. AIA member companies offer all types of property - casualty insurance, including personal and commercial auto insurance, commercial property and liability coverage, specialty, workers' compensation, homeowners' insurance, medical malpractice coverage, and product liability insurance. AIA's membership includes U.S. insurers that write insurance only within the U.S., U.S. insurers that write insurance inside and outside the U.S. (including in the EU), and the U.S. subsidiaries of multi-national insurers. This membership diversity gives AIA the ability to analyze issues from many perspectives and enables us to draw on the global experience and expertise of our companies with many forms of insurance regulation.

AIA believes that the new international agreement on insurance and reinsurance prudential measures is a win for industry and for the U.S. system of insurance regulation. It gives international recognition to the state-based insurance regulatory system and provides U.S. insurers and reinsurers the badly-needed certainty that they will no longer face discriminatory regulatory measures in the EU. Equally important, it sets a valuable precedent that will protect the state regulatory system from future attempts to import inconsistent or conflicting international regulatory standards.

The U.S. Treasury's Federal Insurance Office (FIO) and the U.S. Trade Representative (USTR) announced in November 2015 that they would enter into negotiations for a "Covered Agreement" on insurance prudential matters with the EU. On January 13, 2017, they revealed that those negotiations were complete, and submitted the Agreement to Congress. U.S. state insurance commissioners played a significant role advising the U.S. negotiators every step of the way, and through their efforts, the agreement affirms our state-based system of regulating insurance, incorporating key aspects of existing NAIC models and state provisions along the way.

The deal could not have come too soon. Since the EU's Solvency II Directive was activated on January 1, 2016, U.S. (re)insurance groups that do business in the EU have faced increasingly discriminatory regulations from EU Member State governments. Unnecessary regulatory divergence between the U.S. and EU quickly turned into market access barriers as U.S.-based reinsurers were told they could not offer reinsurance in the EU, and U.S. insurance groups were threatened with onerous, duplicative regulatory requirements arising from their operations in the EU.

By upholding the U.S. system of state-based insurance regulation, the Covered Agreement will re-establish a level playing field for U.S. insurers and reinsurers competing in the EU, requiring regulatory treatment of U.S. groups in the EU to be no less favorable than the treatment received by EU (re)insurers. Specifically, the Covered Agreement limits "global" group supervision to the home country supervisor, meaning U.S. insurers operating in the EU will be subject to applicable worldwide prudential insurance group oversight <u>only</u> by their home U.S. supervisor. In addition, it guarantees that EU regulators will no longer tell U.S. reinsurers that they have to establish a local presence in each EU country to do business there. In this way, the Agreement fosters a climate of reciprocal regulatory respect in the EU and the U.S., which will lead to a better operating environment in the world's two largest insurance markets.

The recognition afforded to the U.S. state-based system is also a victory for U.S. consumers and policyholders. Allowing market access to more companies under the Agreement's conditions – both in the U.S. and the EU – improves consumer choice and expands insurance and reinsurance availability. Equally important, our regulatory system is predicated on policyholder protection and, through the Covered Agreement, the EU is explicitly acknowledging the value of that approach for those insurance and reinsurance groups that call the U.S. home.

Additionally, the Covered Agreement is an alternative to submitting to the EU's "equivalence" process - a European legal process that provides benefits to insurance and reinsurance groups from countries that are willing to model their regulatory frameworks on the EU's Solvency II Directive. Rather than requiring significant changes to the U.S. state regulatory architecture, the Covered Agreement allows regulators on both sides to rely on the existing structure in each other's jurisdictions while at the same time providing the fair treatment guaranteed to "equivalent" jurisdictions.

It is important to note that it was the view of U.S. negotiators, including U.S. state insurance commissioners, not to enter into the EU's Solvency II "equivalency" process. On July 11, 2014, state insurance commissioners wrote to the European Commission confirming that the U.S. was not pursuing "equivalence," citing the significant changes to the U.S. supervisory system that such a path would entail and instead encouraging the Commission to reach an alternative "similar conclusion about the efficacy of our system."[1]

[1]Letter from NAIC International Relations Leadership Group to Jonathan Faull (Director General, European Commission) at p. 1 (July 11, 2014) ("As you know, U.S. state insurance regulators are not pursuing an equivalence determination. While it is possible to compare our respective statutory authorities on paper, it would be

Because of the Covered Agreement, the states preserve the current system without compliance with the burdensome Solvency II requirements for group global capital, reporting, and corporate governance. Indeed, in order to complete the "equivalence" process, U.S. supervisors would have had to develop a global group capital requirement that is similar in substance to the EU directive, rather than the group capital calculation initiative that is under development at the NAIC.

Moreover, many of the provisions in the group supervision and reinsurance sections are drawn directly from state law and state insurance commissioners' models promulgated by the NAIC, including (as noted) the current efforts of U.S. state insurance regulators in developing a group capital assessment and reducing statutory reinsurance collateral requirements. Importantly, per the scope of the Agreement, it also covers only those U.S. (re)insurance groups that have EU operations and, by extension, only those states that supervise those U.S. groups.

For "global" group capital in the U.S., the Agreement effectively accepts a group assessment or calculation as long as that assessment or calculation captures risk of the entire group (limited to insurance entities or those entities controlled by an insurance entity) and, consistent with current U.S. state law, the supervisor has the authority to take appropriate measures on the basis of the assessment. The Covered Agreement does not specify that the authority must extend to the entire group, however, and does not dictate what constitutes appropriate measures.

In fact, the NAIC is currently in the process of developing a group capital calculation, which it calls the "inventory method." The inventory method leverages the U.S. risk-based capital (RBC) approach to assess group capital through an aggregation of legal entity capital requirements. That method is envisioned as a tool that can be used by state regulators in the supervisory college context to better assess the capital adequacy of a U.S. group's global insurance operations, and meets the conditions outlined in the Covered Agreement.

The Covered Agreement also addresses the issue of reinsurance collateral. As stated in the Treasury Department's Fact Sheet, the Covered Agreement "eliminates collateral and local presence requirements for U.S. reinsurers operating in the EU insurance market, and eliminates collateral and local presence requirements for EU reinsurers operating in the U.S. insurance market, as a condition for and in connection with regulatory credit for reinsurance." As mentioned earlier, this provision guarantees that EU regulators will no longer tell U.S. reinsurers that they have to undergo the expense and duplication of opening local offices in each EU member state, in order to do business there.

Although the Agreement, consistent with existing language in Title V of Dodd-Frank, does allow for a very narrow preemption process to accommodate for non-discriminatory state reinsurance law practices, it is not clear that the preemption process will need to be used at all. The Covered Agreement recognizes and utilizes the work done by the NAIC during the development of its model on credit for reinsurance. Over the past several years, 35 states have already begun reducing the levels of statutory reinsurance collateral requirements through

challenging to conduct a comprehensive comparison of our two regulatory systems in practice until Solvency 2 is fully operational and the outcomes it produces based on actual experience are better understood.")

adoption of the NAIC's model law from 100 percent to between ten and twenty percent. Ultimately, each affected state will have 5 years to put in place those tools and provisions that effectuate the reinsurance and group supervision articles of the Agreement. If anything, those states have a head start because of the ongoing work on both issues fostered by the NAIC and individual state insurance commissioners. In addition, the NAIC has declared the credit for reinsurance model to be an accreditation standard on January 1, 2019, which will prompt the states to enact laws that will assure their accredited status well. It is our belief that without a provision to bring parity to the U.S. and EU (re)insurance markets, an agreement to recognize the U.S. state-based system for prudential regulation could not have been reached.

However, as mentioned, the Agreement retains many protections that allow for states and insurers to maintain healthy and well-functioning reinsurance markets in their respective jurisdictions. First and foremost, the Covered Agreement explicitly acknowledges that contracting parties will continue to be able to negotiate for appropriate levels of reinsurance collateral as part of those reinsurance contracts. The Agreement also confirms that the new collateral requirements are to be applied prospectively to new contracts, borrowing language that was part of a unanimously adopted NAIC credit for reinsurance model. Moreover, the benefits of the Agreement only apply to EU reinsurers meeting certain capital and surplus requirements and who have a history of prompt payment of reinsurance claims and comply with financial statement filing requirements – conditions that, again, produced state regulatory consensus in developing the NAIC credit for reinsurance model. As discouragement against bad actors, the states also maintain the ability to require prompt payment of reinsurance claims. And should an EU reinsurer resist a state's final judgment of payment, the state will be able to require 100 percent collateral for all of that reinsurer's liabilities in the state.

Having completed the first successful Covered Agreement negotiation, we now have the opportunity to reflect on both the product and the process. Given the fearful rhetoric that a Covered Agreement could become a back door to import broad swaths of European-style regulation, the Covered Agreement is ultimately proving to be a narrow, focused vehicle that compels the EU to recognize and respect the U.S. state-based system of insurance supervision. In fact, the Covered Agreement is proof that issues regarding prudential matters can be addressed while respecting local regulatory regimes. Importantly, the Covered Agreement advances the competitiveness of U.S. companies in the EU by providing a useful tool to resolve an international issue that was not originally foreseen when the Covered Agreement was conceived.

While improvements can be made to the negotiating process going forward, AIA hopes that this Agreement can continue to be evaluated on its merits. Process should always be scrutinized so that it works for all stakeholders in the future. For our part, AIA consistently advocated for a significant role for U.S. state regulators. And in a development that was unprecedented in U.S. Government international negotiations, our understanding is that a group of state insurance commissioners, chosen by their peers, was given an official consultative role in the process; were provided access to negotiating texts from the EU and the opportunity to comment on all such texts and U.S. proposals before they were presented to the EU negotiators; and were able to view all proposals from the EU.

However, anything that can be done to increase transparency and stakeholder involvement while maintaining the integrity of negotiations should be on the table. In fact, in an attempt to foster better communication, transparency, and uniformity, AIA has recently unveiled a proposal to formalize state insurance regulator involvement in future negotiations by creating a State Insurance Regulator Advisory Board that would coordinate with FIO. By facilitating an on-going, dedicated line of consultation between the states and FIO, state insurance regulators can better inform U.S. negotiators on critical insurance issues in advance of potential future international negotiations, as well as provide informed views for the development of other insurance-related policy matters at the federal level.

In response to the question of whether the Covered Agreement could create any unintended consequences for consumers, policyholders, or segments of the insurance industry, AIA does not believe that this is the case. To the extent that the Agreement follows (or, in some cases, builds upon) strong conditions in the NAIC model, the process of statutory collateral reduction has been anticipated and is underway already. Moreover, the increased levels of capital and the greater regulatory certainty of global reinsurance markets should create more competition among reinsurers and positive market effects, which could help offset any potential adverse effects for small insurers.

In the area of group supervision – and, more specifically, group capital – the Covered Agreement reinforces state regulation without importing inconsistent Solvency II measures and leverages ongoing initiatives launched by the NAIC. Equally important, the Agreement can be used as evidence that significant insurance markets can resolve international prudential issues without perpetuating unfair regulatory discrimination or forcing the adoption of rigid and unworkable standards. For example, in the debate surrounding the International Association of Insurance Supervisors' (IAIS) development of a global insurance group capital standard (ICS), AIA has repeatedly stated that the ICS should be constructed in a manner that respects local regulatory regimes, including the U.S. state-based RBC system. More than 2 years ago, we respectfully suggested that the IAIS allow flexibility to consider and incorporate an aggregation approach that is an early version of the inventory method being discussed by the NAIC and the building blocks approach proposed by the U.S. Federal Reserve Board. At the time, our suggestion was met with deafening silence, as the ICS process moved forward on a technical path. Perhaps the Covered Agreement will be a model for civil discussion on, and resolution of, this and other global supervisory initiatives.

In conclusion, the completion of the Covered Agreement is a success for U.S. insurers and the U.S. regulatory system. It is also a crucial step forward in addressing the modern issues that face global insurance markets. With support, its benefits for insurers and policyholders can continue to grow. Without support, those benefits will be threatened, and we will return to a climate of mutual distrust.