

Update on the Status of the Covered Agreement

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In the February issue of this publication we published an article on the Covered Agreement (“the Agreement”) negotiated and entered into by the Obama Administration with the European Union in January of this year.¹ The U.S. and E.U. announcements of the completion of the Agreement were made January 13, 2017, one week before the inauguration of President Trump.² The Subcommittee on Housing and Insurance of the House Financial Services Committee held a hearing on the Agreement on February 16, 2017, and the witnesses at that hearing expressed divergent views as to the appropriateness of the Agreement, with some urging the Trump Administration to attempt to re-negotiate the Agreement. However, based upon recent developments, the Trump Administration has decided to proceed and implement the Agreement. This article provides guidance with respect to the implementation of the Agreement.

I. The Approval and Effectiveness of the Agreement

There are several different dates set by the Agreement that are relevant to the implementation of the Agreement. First, the Agreement comes into force by its terms seven days after the date that the parties “exchange written notifications certifying that they have completed their respective internal requirements and procedures, or on such other date as the Parties may agree” (“the In Force Date”).³ Since there has not been any disclosure of an agreed-upon effectiveness date, the In Force Date will be the date that the Parties provide notification to each other of the completion of their internal approval procedures. Second, the Agreement “shall apply” on the later of the In Force Date or 60 months from the date of the Parties’ signature of the Agreement (“the Applicability Date”).⁴ Finally, there are some provisions which are to be “provisionally applied” by the Parties prior to the In Force Date or the Applicability Date,

¹ A version of this article may be found on our Reinsurance Focus blog at <http://reinsurancefocus.com/data/20/1/142/136/1957625/user/2137514/htdocs/blog/wp-content/uploads/2017/02/Special-Focus-Covered-Agreement-2.20.17.pdf>. The full text of the Covered Agreement, with the notification letters to Congressional committees, may be found at <https://www.treasury.gov/initiatives/fio/Documents/Final%20Covered%20Agreement%20Letters%20to%20Congress%20Full%20Text.pdf>.

² See <https://www.treasury.gov/press-center/press-releases/Pages/j10705.aspx> and <https://ustr.gov/about-us/policy-offices/press-office/press-releases/2017/january/joint-statement-us-eu-negotiations>.

³ Agreement, Article 8.

⁴ Agreement, Article 10, paragraph 1.

presumably immediately upon execution of the Agreement (“the Provisional Date”).⁵ As will be seen, there are a number of exceptions to the general proposition that the Agreement’s terms apply beginning on one of these three dates.

A. Approval by the U.S.

The “internal requirements and procedures” for the approval by the U. S. of a covered agreement are contained in the Dodd-Frank Act, which introduced the concept of covered agreements into the area of insurance and reinsurance,⁶ and establishes the process for the negotiation and approval of such agreements. Once negotiated and entered into by the Secretary of the Treasury and the United States Trade Representative, the full text of a covered agreement must be submitted to certain Congressional committees, and the agreement becomes effective after the expiration of 90 calendar days from the date of submission to the Congressional committees.⁷ A covered agreement is not a treaty and need not be submitted to Congress for its approval. The submission of the Agreement to the Congressional committees occurred January 13, 2017, and the 90 day period after such submission expired April 13, 2017.

After the House subcommittee hearing on the Agreement there was some doubt as to whether the new Administration would honor the Agreement or press for re-negotiation. However, after several months of silence as to the fate of the Agreement, the U.S. Department of the Treasury and the U.S. Trade Representative announced in July 14, 2017 press releases their intention to sign the Covered Agreement, without mention of any re-negotiation or changes to the Agreement.⁸ It appears that the “internal requirements or procedures” on the U.S. side set forth in the Dodd-Frank Act have been accomplished, and that the only remaining task is the actual execution of the Agreement as mentioned in the Agreement itself, which could occur very quickly.

B. Approval by the E.U.

The procedures for approval by the E.U. include approval by the E.U. Council and the European Parliament. The Agreement was approved for signature by the E.U. Council on May 29, 2017.⁹ In approving the Agreement for signature the Council adopted a decisional

⁵ See e.g., Agreement, Article 10, paragraph 2(a).

⁶ See 31 U.S.C. § 314.

⁷ See 31 U.S.C. § 313 and 314(c).

⁸ See <https://www.treasury.gov/press-center/press-releases/Pages/sm0124.aspx> and <https://ustr.gov/about-us/policy-offices/press-office/press-releases/2017/july/treasury-ustr-notice-intent-sign>.

⁹ See <http://www.consilium.europa.eu/en/press/press-releases/2017/05/29-compet-eu-us-insurance-agreement/> (the summary notification of the action of the Council).

document.¹⁰ The Council’s summary notification stated that the Agreement would be submitted to the European Parliament for approval.¹¹ It is not known how long the parliamentary approval process will take, although it may take quite a while, and the In Force Date cannot occur until that process is completed and the required written notifications are exchanged by the Parties. It has not been disclosed whether the E.U. will “sign” the Agreement prior to parliamentary approval. According to the Agreement, signature could trigger the Applicability Date even without the approval by the European Parliament.

II. The Process for the Implementation of the Agreement

The Agreement provides for the establishment of a Joint Committee, composed of representatives of the U.S. and the E.U., the purpose of which is to provide “a forum for consultation and to exchange information on the administration of the Agreement and its proper implementation.”¹²

The Agreement identifies six topics which the Joint Committee permissively “may address”:

1. matters related to the implementation of the Agreement;
2. the effectiveness of the Agreement, in the Parties’ jurisdictions, on insurance and reinsurance consumers, and the commercial operations of insurers and reinsurers;
3. any amendments to the Agreement proposed by either party;
4. any matter that requires mandatory consultation;
5. a notice of intent to terminate the Agreement; and
6. other matters as may be decided by the Parties.¹³

The Agreement identifies four instances which require mandatory consultation within the Joint Committee:

1. mutual agreement of the Parties, if either Party proposes consultation;

¹⁰ See <http://data.consilium.europa.eu/doc/document/ST-8055-2017-INIT/en/pdf> (the decision and action of the Council).

¹¹ See <http://www.consilium.europa.eu/en/press/press-releases/2017/05/29-compet-eu-us-insurance-agreement/>

¹² Agreement Article 7, paragraph 1.

¹³ Agreement Article 7, paragraph 3.

2. an initial consultation within 180 days after the date of entry into force or provisional application of the Agreement, whichever is earlier, and once per year thereafter, unless the Parties otherwise decide;
3. a written request for mandatory consultation is made by either Party; and
4. either Party provides written notice of intent to terminate the Agreement.

The Joint Committee is to be chaired on a rotating basis by each party, it may operate through working groups, and it may adopt its own rules of procedure.¹⁴

The U.S. notice of intention to sign the Agreement stated broadly that the Trump Administration “plans to issue a U.S. policy statement on implementation.”¹⁵ It is not known whether this policy statement will address substantive policy-type issues, more technical, non-substantive implementation issues, or whether the substance of this statement will be appropriate for discussion by the Joint Committee.

III. The Timing of the Implementation of the Agreement

The Agreement provides for staggered implementation, with some terms becoming provisionally applicable even prior to the In Force Date or the Applicability Date. Subject to some exceptions, the Agreement’s provisions become applicable on either the Provisional Date or the Applicability Date.¹⁶

A. Group Supervision Generally

The Agreement expresses some urgency with respect to the implementation of the group supervision provisions for insurance and reinsurance companies. The Agreement provides that the provisions of Article 4 – Group Supervision, shall be provisionally applicable on the Provisional Date, i.e., immediately until the In Force Date.¹⁷ Once the In Force Date is reached, from the seventh day of the next month forward the E.U. shall ensure that supervisory authorities and other competent authorities implement the group supervisory provisions while the U.S., likely due to the state-based regulatory structure for the supervision of insurance, shall exercise its best efforts in encouraging supervisory authorities and other competent parties to implement the group supervisory provisions.¹⁸

¹⁴ Agreement Article 7, paragraphs 4-6.

¹⁵ See <https://www.treasury.gov/press-center/press-releases/Pages/sm0124.aspx>.

¹⁶ Agreement Article 10, paragraph 1.

¹⁷ Agreement Article 10, paragraph 2(a).

¹⁸ Agreement Article 10, paragraph 2(a).

B. Reinsurance Collateral Generally

Until the In Force Date, the reinsurance collateral provisions of Article 3, paragraphs 1 and 2 of the Agreement shall apply to an E.U. reinsurer in a U.S. state on the earlier of: the adoption by that State of reinsurance collateral measures consistent with Article 3, paragraphs 1 and 2 of the Agreement; or the determination by the U.S. that such state's reinsurance collateral laws are preempted by the Agreement.¹⁹ Subject to certain group supervision and local presence provisions, the reinsurance collateral provisions shall be fully implemented by the Parties no later than 60 months (five years) from the date of signature of the Agreement.²⁰

Given the fact that the reinsurance collateral requirements in the U.S. are found in state laws, the implementation of the reinsurance collateral-related provisions of the Agreement in the U.S. will implicate the preemption determination provisions of the Dodd-Frank Act.²¹ These provisions provide the Director of the Federal Office of Insurance the authority to make determinations that state laws are preempted by a covered agreement under certain circumstances.²² Current state laws concerning reinsurance collateral, and the applicable Model Act and Model Regulations upon which many state laws are based, likely meet the standards for a preemption determination under section 313(f), and the states will need to amend those laws to avoid a preemption determination.²³ The Agreement requires that the U.S. "encourage each U.S. state to promptly adopt" revised credit for reinsurance measures that are consistent with the Agreement.²⁴ The U.S. is to begin evaluating potential preemption determinations no later than three and one-half years after the signature of the Agreement.²⁵

C. Reinsurance Collateral and Group Supervision

The applicability of some of the provisions of the Agreement are contingent upon the implementation of other provisions of the Agreement. For example, after the In Force Date:

¹⁹ Agreement Article 10, paragraph 2(d).

²⁰ Agreement Article 10, paragraph 2(h).

²¹ See 31 U.S.C. §§ 313 and 314.

²² See 31 U.S.C. § 313(f).

²³ Other provisions of state law may be implicated in this process. For example, section 6 of the Model Financial Guaranty Insurance Guidelines (Model 1626), titled Reinsurance, contains provisions relating to credit for reinsurance.

²⁴ Agreement Article 9, paragraph 3.

²⁵ Agreement Article 9, paragraph 4.

- the reinsurance collateral provisions of Article 3, paragraphs 1 and 2 of the Agreement are applicable only so long as the other Party enforces the local presence requirements of Article 3, paragraph 3 and the group supervision provisions of Article 4 of the Agreement;²⁶
- the group supervision provisions of Article 4 of the Agreement shall be applicable only if, and as long as, the other Party satisfies the obligations of the reinsurance collateral provisions of Article 3, paragraphs 1 and 2 of the Agreement;²⁷ and
- the local presence requirements of Article 3, paragraph 3 of the Agreement are applicable only if, and so long as, the supervisory authorities of the other Party exercise supervision as required by Article 4 and satisfy the reinsurance collateral provisions of Article 3, paragraphs 1 and 2 of the Agreement.²⁸

D. Group Capital and Assessment Requirements

With respect to group capital requirements, up until the In Force Date, the E.U. supervisory authorities may not impose a group capital requirement at the level of the worldwide parent undertaking of an insurance or reinsurance group, with regard to a U.S. insurance or reinsurance group with operations in the E.U.²⁹ However, a group capital or assessment requirement may be imposed by the E.U. during this period of time if the U.S. does not meet the local presence requirements of Article 3, paragraph (b) of the Agreement.³⁰

E. Local Presence Requirements

The local presence provisions of Article 3, paragraph 3 of the Agreement are applicable in the E.U. no later than 24 months from the date of signature of the Agreement, provided that the Agreement has been provisionally provided or has entered into force.³¹

F. Other Provisions

The provisions of the Agreement concerning the Joint Committee, termination, mandatory consultation and amendment shall be applicable from the earlier of the Provisional

²⁶ Agreement Article 10, paragraph 2(b)(i).

²⁷ Agreement Article 10, paragraph 2(b)(ii).

²⁸ Agreement Article 10, paragraph 2(b)(iii).

²⁹ Agreement Article 10, paragraph 2(e).

³⁰ Agreement Article 10, paragraph 2(f).

³¹ Agreement Article 10, paragraph 2(g).

Date or the In Force Date.³²

IV. Other Potential Market-Related Implications of the Covered Agreement

The Agreement may have implications in reinsurance markets other than the E.U. and the U.S. For example, it would be permissible for the States to continue to require collateral for reinsurance provided by reinsurers domiciled outside the E.U. To the extent that the reinsurance collateral provisions of the Agreement lowers the cost of the participation of E.U. domiciled reinsurers in the U.S. market, it may have the effect of placing non-E.U. domiciled reinsurers at a competitive disadvantage in the U.S. market with respect to E.U. domiciled reinsurers. With the exit of the U.K. from the E.U. the Agreement will not apply to U.K. domiciled reinsurers. It may be expected that to avoid placing the Lloyds market and London reinsurers at a competitive disadvantage in the U.S. market, the U.K. will seek to obtain a bilateral agreement with the U.S. incorporating the basic terms of this Agreement. Similarly, given the importance of Bermuda domiciled reinsurers in the U.S. catastrophe risk market, Bermuda may seek a similar agreement with the U.S.

Of course, if the U.S. states revise their credit for reinsurance requirements in a manner that applies consistently to all foreign reinsurers, and not just to E.U. domiciled reinsurers, the playing field will remain level in that respect no matter where a reinsurer is domiciled. This approach would avoid complication in the US. in the application of credit for reinsurance principles, and may be in the best interests of U.S. ceding insurers, as it would seem to encourage more competition between foreign reinsurers for U.S. risks.

CONCLUSION

Although the principles and basic requirements relating to the future regulation of some of the important aspects of the international business of insurance and reinsurance have now been agreed to by the U.S. and the E.U., the implementation of those provisions with respect to the U.S. and E.U. markets is just beginning, and is a process that will take years to accomplish, not months. Whether the States will create different requirements for different domiciles of reinsurers would seem to be problematic for many reasons, but would be possible. The saga of the controversies in these areas continues, albeit with a different story line going forward in some respects.

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This article reflects the views of the author, and does not constitute legal or other professional advice or service by Carlton Fields Jordan Burt, PA and/or any of its attorneys. This article appeared on the firm's reinsurance and arbitration blog, www.ReinsuranceFocus.com.

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³² Agreement Article 10, paragraph 2(i).