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Selected International Insurance Issues in the 115th Congress

Updated October 4, 2017

Congressional Research Service
https://crsreports.congress.gov
R44820

CRS REPORT
Prepared for Members and
Committees of Congress

Summary

The growth of the international insurance market and trade in insurance products and services has created opportunities and new policy issues for U.S. insurers, Congress, and the U.S. financial system. Insurance regulation is centered on the states, with the federal government having a limited role. While the risks of loss and the regulation may be local, the business of insurance, as with many financial services, has an increasingly substantial international component as companies and investors look to grow and diversify. International insurance trade is covered in the World Trade Organization (WTO) agreements and in a number of U.S. free trade agreements (FTAs).

The 2010 Dodd-Frank Wall Street Reform and Consumer Protection Act

The 2010 Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank; P.L. 111-203) enhanced the federal role in insurance markets through several provisions, including the Financial Stability Oversight Council's (FSOC's) ability to designate insurers as *systemically important financial institutions* (SIFIs); Federal Reserve oversight of SIFIs and insurers with depository affiliates; and the creation of a Federal Insurance Office (FIO) inside the Department of the Treasury. Alongside FIO, Dodd-Frank defined a new class of international insurance agreements called *covered agreements* for recognition of prudential measures which the FIO and the United States Trade Representative (USTR) may negotiate with foreign entities. Although not a regulator, FIO has the authority to monitor the insurance industry and limited power to preempt state laws in conjunction with covered agreements. Dodd-Frank requires congressional consultations and a 90-day layover period for covered agreements, but such agreements do not require congressional approval.

International Insurance Stakeholders and Concerns

The international response to the financial crisis included the creation of a Financial Stability Board (FSB), largely made up of various countries' financial regulators, and increasing the focus of the International Association of Insurance Supervisors (IAIS) on creating regulatory standards, especially relating to insurer capital levels. The Federal Reserve and the FIO have assumed roles in the IAIS, whereas previously the individual states and the U.S. National Association of Insurance Commissioners (NAIC) had been the only U.S. members. The Dodd-Frank Act also created the position of independent insurance expert as a member of FSOC, though the FSOC independent insurance expert has generally not participated in international bodies with a focus on systemic risk. Any agreements reached under the FSB or IAIS would have no legal impact in the United States until adopted in regulation by federal or state regulators or enacted into federal or state statute. Congress has little direct role in international regulatory cooperation agreements such as those reached at the FSB or IAIS.

The new federal involvement in insurance issues has created frictions both among the federal entities and between the states and the federal entities, and has been a subject of congressional hearings and proposed legislation. The first covered agreement, negotiated with the European Union (EU), was submitted to Congress on January 13, 2017. The agreement was largely rejected by the states and the NAIC, with the insurance industry split in its support, or lack thereof, for the agreement. The 90-day congressional layover period ended in April 2017, and the United States and the EU signed the agreement on September 22, 2017.

Issues for Congress

Congressional interest in international insurance issues includes (1) the recently negotiated covered agreement addressing the EU treatment of U.S. insurers and the U.S. state requirements

for reinsurance collateral; and (2) the potential impact of international organizations and standards on the United States. Although the U.S.-EU covered agreement and potential IAIS standards are formally separate, there is some overlap. For example, the EU plays a significant role in developing international standards and would have an interest in seeing its regulatory approaches incorporated in such standards as opposed to U.S. approaches.

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Introduction

U.S. insurers and Congress face new policy issues and questions related to the opportunities and risks presented by the growth in the international insurance market and trade in insurance products.

Insurance is often seen as a localized product and U.S. insurance regulation has addressed this through a state-centric regulatory system. The McCarran-Ferguson Act,[1] passed by Congress in 1945, gives primacy to the individual states, and every state has its own insurance regulator and state laws governing insurance. While the risks of loss and the regulation may be local, the business of insurance, as with many financial services, has an increasingly substantial international component as companies look to grow and diversify.

The international aspects of insurance have spurred the creation of a variety of entities and measures, both domestic and foreign, to facilitate the trade and regulation of insurance services. Financial services have been addressed in a number of U.S. trade agreements going back to the North American Free Trade Agreement (NAFTA) in 1994. The International Association of Insurance Supervisors (IAIS) was created more than 20 years ago, largely under the impetus of the U.S. National Association of Insurance Commissioners (NAIC), to promote cooperation and exchange of information among insurance supervisors, including development of regulatory standards. The 2008 financial crisis sparked further international developments, with heads of state of the G-20 nations creating the Financial Stability Board (FSB).

The postcrisis 2010 Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank)[2] altered the U.S. insurance regulatory system, particularly as it relates to international issues. With the states continuing as the primary insurance regulators, following Dodd-Frank, the Federal Reserve exercised holding company oversight over insurers who owned a bank subsidiary or who were designated for enhanced supervision (popularly known as *systemically important financial institutions* or SIFIs) by the new Financial Stability Oversight Council (FSOC), which includes a presidentially appointed, independent voting member with insurance expertise. The Federal Reserve, already a major actor in efforts at the FSB and the Basel Committee on Banking Supervision,[3] thus became a significant insurance supervisor and joined the IAIS shortly thereafter. Dodd-Frank also created a new Federal Insurance Office (FIO). The FIO is not a federal insurance regulator, but is tasked with representing the United States in international fora and, along with the United States Trade Representative (USTR), can negotiate international *covered agreements* relating to insurance prudential measures. The FIO also became a member of the IAIS and participated significantly in IAIS efforts to create insurance capital standards.[4]

The new federal involvement in insurance issues, both domestic and international, has created frictions both among the federal entities and between the states and the federal entities, and has been a subject of both congressional hearings and proposed legislation.

This report discusses trade in insurance services and summarizes the various international entities and agreements affecting the regulation of and trade in insurance. It then addresses particular

[1] Codified at 15 U.S.C. §1011 et seq.

[2] P.L. 111-203.

[3] The Basel Committee on Banking Supervision is a cooperative forum and standard-setting organization for banking regulators created in 1974.

[4] See CRS Report R44046, *Insurance Regulation: Background, Overview, and Legislation in the 114th Congress*, by Baird Webel for more information on the domestic insurance regulatory system in the United States.

issues and controversies in greater depth, including a focus on the U.S.-EU covered agreement, and concludes with a section on issues relating to international insurance standards.

International Insurance Trade

In 2015, U.S. services accounted for $751 billion of U.S. exports and $489 billion of U.S. imports, creating a surplus of $262 billion.[5] In financial services generally, the United States runs a substantial trade surplus, exporting $102 billion and importing $25 billion in 2015. Although the United States' exports of services such as brokerage, securities lending, and financial management exceed imports, the United States imported nearly $48 billion in insurance services and exported only $17 billion in 2015. This deficit has dropped from its peak in 2009, but U.S. insurance services trade has been consistently in deficit for many years (see **Figure 1**).

The plurality of U.S. insurance services exports are within the Western Hemisphere (44%), with Asia Pacific sales accounting for one-quarter and Europe for 28% of international insurance exports (see **Figure 2**).

U.S. Insurers Operate Internationally

A U.S. company, American International Group, Inc. (AIG) is a leading insurance and financial services organization. AIG insures commercial, institutional, and individual customers through extensive property-casualty and life insurance networks. In addition, AIG companies are engaged in providing life insurance and retirement services in the United States. Headquartered in New York, AIG operates in the Americas, Europe, Africa, the Middle East, and Asia Pacific.

U.S. holding company Allstate Corporation offers life insurance through Allstate Insurance, Allstate Life Insurance, and various other subsidiaries. The company writes a range of insurance policies, including automobile, home, life, and annuity insurance in the United States and Canada, and through joint ventures in Asia.[6]

Industry analysts note that while the current level of trade is relatively low for industry segments such as property, casualty, and direct insurance, it is rising as companies seek new markets for growth and risk diversification. For example, Liberty Mutual's international operations accounted for almost one-third of the firm's total revenue in 2016.[7] Similarly, the life insurance and annuities segment of the industry has relatively low levels of trade; with only 11.2% of industry operators foreign owned, this sector is growing due to technology advancements and merger and acquisition activity.[8]

[5] U.S. Bureau of Economic Analysis, Table 2.1. *U.S. Trade in Services, by Type of Service*, December 19, 2016.

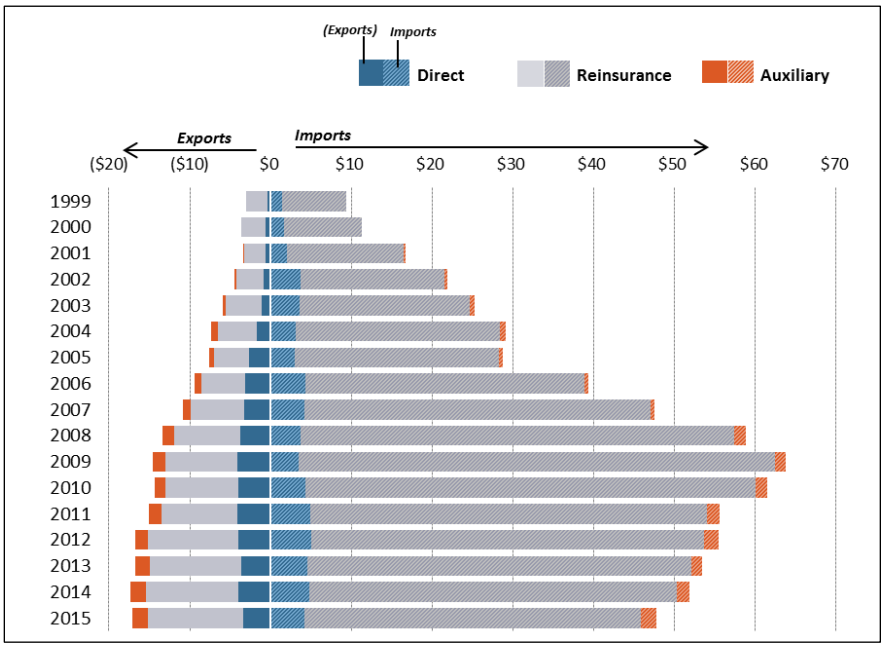
[6] MarketLine, *Insurance in the United States*, MarketLine Industry Profile, October 2012, pp. 18-29.

[7] Evan Hoffman, *IBISWorld Industry Report 52412: Property, Casualty and Direct Insurance in the US*, IBISWorld, December 2016, p. 26.

[8] Evan Hoffman, *IBISWorld Industry Report 52411a: Life Insurance & Annuities in the US*, IBISWorld, November 2016, p. 27.

Figure 1. U.S. Insurance Services Imports and Exports

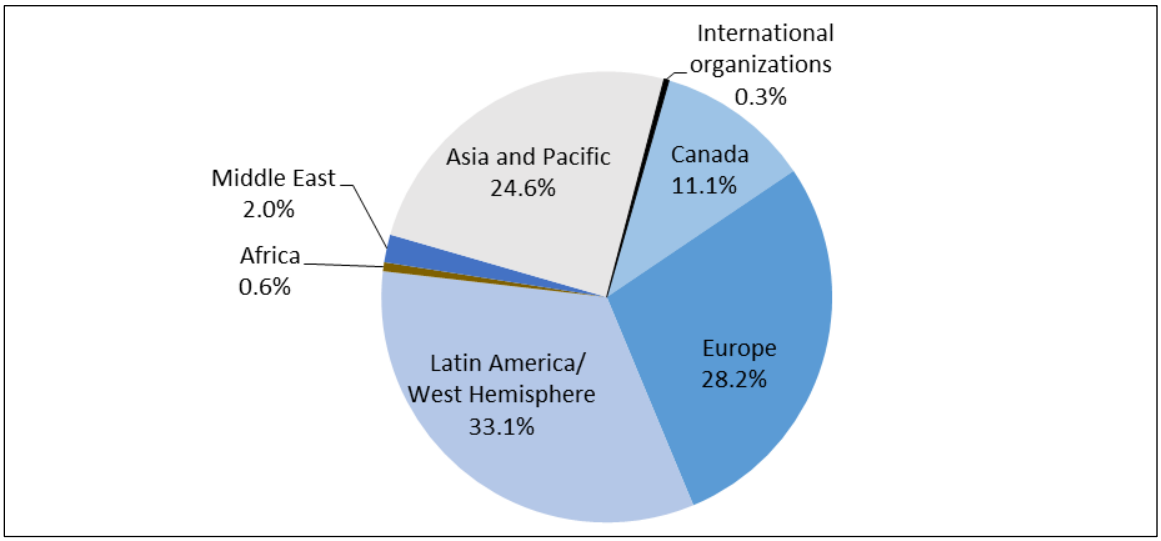
Billions of Dollars



Source: Bureau of Economic Analysis interactive data tool, December 19, 2016.

Notes: Direct insurance is sold by companies directly to customers. Reinsurance is insurance purchased by other insurers. Auxiliary services include actuarial services and insurance brokerage services.

Figure 2. U.S. Insurance Services Export Destination



Source: Bureau of Economic Analysis interactive data tool, December 19, 2016.

Insurance in U.S. Free Trade Agreements

Services, including financial and insurance services, are traded internationally in accordance with trade agreements negotiated by the USTR on behalf of the United States, similar to trade in goods. As a member of the World Trade Organization (WTO), the United States helped lead the conclusion of negotiations on the General Agreement on Trade in Services (GATS) in 1994, thus creating the first and only multilateral framework of principles and rules for government policies and regulations affecting trade in services among the 164 WTO countries.[9] The GATS provides the foundational floor on which rules in other agreements on services, including U.S. free trade agreements (FTAs), are based. Core GATS principles include most-favored nation (MFN), transparency, and national treatment.[10] As part of the GATS negotiations, WTO members also agreed to binding market access commitments on a positive list basis in which each member specified the sectors covered by its commitments. For insurance services, the United States submitted its schedule of market access and national treatment commitments, as well as exceptions, under GATS to allow foreign companies to compete in the United States in accordance with the U.S. state-based system.[11]

The GATS Financial Services Annex applies to "all insurance and insurance-related services, and all banking and other financial services (excluding insurance)." The Annex defines insurance services as follows:

> (i.) Direct insurance (including co-insurance):
>
> (A.) life
>
> (B.) non-life
>
> (ii.) Reinsurance and retrocession;
>
> (iii.) Insurance intermediation, such as brokerage and agency;
>
> (iv.) Services auxiliary to insurance, such as consultancy, actuarial, risk assessment and claim settlement services.[12]

The annex excludes "services supplied in the exercise of governmental authority," such as central banks, Social Security, or public pension plans.[13] In the U.S. Schedule of Specific Commitments, the United States lists market access and national treatment limitations that constrain foreign companies' access in line with state laws. These include clarifying which states have no

[9] For more information on the General Agreement on Trade in Services (GATS), see CRS Report R43291, *U.S. Trade in Services: Trends and Policy Issues*, by Rachel F. Fefer, and the World Trade Organization (WTO) website at https://www.wto.org/english/tratop_e/serv_e/gatsqa_e.htm.

[10] Most-favored nation (MFN) nondiscrimination commitments obligate parties to treat other parties' service suppliers equally; national treatment commitments obligate parties to treat other parties' service suppliers in the same way as domestic service suppliers; market access commitments obligate parties to allow other parties' services suppliers to enter their markets through various modes of supply.

[11] A full inventory of U.S. GATS commitments and exemptions is in the WTO-World Bank database at http://i-tip.wto.org/services/SearchResultGats.aspx or at https://www.wto.org/english/tratop_e/serv_e/serv_commitments_e.htm.

[12] WTO, GATS, *Annex on Financial Services*, "Definitions," 5(a), at https://www.wto.org/english/tratop_e/serv_e/10-anfin_e.htm.

[13] WTO, GATS, *Annex on Financial Services*, "Scope and Definition," at https://www.wto.org/english/tratop_e/serv_e/10-anfin_e.htm.

mechanism for licensing initial entry of non-U.S. insurance companies except under certain circumstances and which states require U.S. citizenship for boards of directors.[14]

Furthermore, the GATS and U.S. FTAs explicitly protect prudential financial regulation. The prudential exception within the GATS allows members to take "measures for prudential reasons, including for the protection of investors, depositors, policy holders or persons to whom a fiduciary duty is owed by a financial service supplier, or to ensure the integrity and stability of the financial system," even if those measures do not comply with the agreement.[15]

Most U.S. FTAs contain a chapter on financial services that builds on the commitments under GATS ("WTO-plus"). Like GATS, these chapters exclude government-provided public services. In addition to market access, national treatment, and MFN obligations, FTAs include WTO-plus obligations, such as increased transparency by providing interested persons from one party the opportunity to comment on proposed regulations of another party; allowing foreign providers to supply new financial services if domestic companies are permitted to do so; and providing access to public payment and clearing systems. Each FTA chapter defines the specific financial and insurance services covered and incorporates relevant provisions in other FTA chapters, such as Investment and Cross-Border Services.

Insurance in the Trans-Pacific Partnership

The financial services chapter in the Trans-Pacific Partnership (TPP) reflected the growing trade in insurance. As the most recent free trade agreement that the United States negotiated, TPP is as an example of the most extensive and enforceable "WTO-plus" commitments. For example, TPP included specific provisions to address competition with government entities that sell insurance, such as Japan Post, and provide a level playing field for market access (TPP Chapter 11, Annex 11-B, Section C). To this end, the United States also signed a side letter with Japan to address competition with Japan Post under TPP.

On January 23, 2017, President Trump directed the USTR to withdraw the United States as a signatory to the Trans-Pacific Partnership agreement; the acting USTR gave notification to that effect on January 30.[16]

Covered Agreements

In comparison to trade agreements, a covered agreement is a relatively new form of an international agreement, established along with the FIO in Title V of the Dodd-Frank Act. The statute defines a covered agreement as a type of international insurance or reinsurance agreement for recognition of prudential measures that the FIO and the USTR negotiate on a bilateral or multilateral basis.[17] FIO has no regulatory authority over the insurance industry, which is generally regulated by the individual states. This is a significant contrast to, for example, federal financial regulators, such as the Federal Reserve or the Securities and Exchange Commission (SEC), that might enter into international regulatory agreements at the Basel Committee on Banking Supervision or the International Organization of Securities Commissions, respectively.

[14] WTO, GATS, *United States Schedule of Specific Commitments Supplement 1*, GATS/SC/90/Suppl. 1, July 28, 1995, at https://docs.wto.org/dol2fe/Pages/FE_Search/ExportFile.aspx?id=20307&filename=Q/SCHD/GATS-SC/SC90S1.pdf.

[15] WTO, GATS, *Annex on Financial Services*, "Domestic Regulation," 2(a).

[16] For more information on the Trans-Pacific Partnership (TPP), please see CRS In Focus IF10000, *TPP: Overview and Current Status*, by Brock R. Williams and Ian F. Fergusson; and CRS In Focus IF10456, *TPP: U.S.-Japan Issues*, by Brock R. Williams et al.

[17] Codified at 31 U.S.C. §313(r)(2).

After such agreements are reached, the Federal Reserve or SEC would generally then implement the agreements under its regulatory authority using the federal rulemaking process.[18]

Although the FIO lacks regulatory authority, some state laws may be preempted if FIO determines that a state measure (1) is inconsistent with a covered agreement and (2) results in less favorable treatment for foreign insurers. The statute limits the preemption with a provision that

> (j) Savings Provisions.—Nothing in this section shall—
>
> (1) preempt—
>
> (A) any State insurance measure that governs any insurer's rates, premiums, underwriting, or sales practices;
>
> (B) any State coverage requirements for insurance;
>
> (C) the application of the antitrust laws of any State to the business of insurance; or
>
> (D) any State insurance measure governing the capital or solvency of an insurer, except to the extent that such State insurance measure results in less favorable treatment of a non-United State insurer than a United States insurer; [19]

Further strictures are placed on the determination, including notice to the states involved and to congressional committees; public notice and comment in the *Federal Register*; and the specific application of the Administrative Procedure Act, including *de novo* determination by courts in a judicial review.[20] Although there is no legal precedent interpreting the covered agreement statute, it appears that these provisions would narrow the breadth of any covered agreement, particularly compared to other international agreements reached by federal financial regulators.[21] International agreements have been undertaken without direct congressional direction under agencies' existing regulatory authorities. These authorities are then implemented through the regulatory rulemaking process, which may, in some cases, preempt state laws and regulations. Although the FIO and the USTR must consult with Congress on covered agreement negotiations, the statute does not require specific authorization or approval from Congress for a covered agreement. It does, however, require a 90-day layover period.

[18] For information, see CRS In Focus IF10129, *Introduction to Financial Services: International Supervision*, by Martin A. Weiss.

[19] Codified at 31 U.S.C. §313(j).

[20] See 31 U.S.C. §§313(f)-(g) and Freeman v. DirecTV, Inc., 457 F.3d 1001, 1004 (9th Cir. 2006) (explaining that *de novo* requires the court to "review the matter anew, the same as if it had not been heard before, and as if no decision previously had been rendered").

[21] For information on, for example, the Basel III international banking agreement, see CRS Report R44573, *Overview of the Prudential Regulatory Framework for U.S. Banks: Basel III and the Dodd-Frank Act*, by Darryl E. Getter.

Covered Agreements and Trade Agreements: Key Differences

Although the goals of a covered agreement and aspects of trade agreements may be similar—market access and regulatory compatibility—the role of Congress is different in each instance. Congress has direct constitutional authority over foreign commerce, while Congress has given itself a consultative role in insurance negotiations through the Dodd-Frank Act.

Key Differences Between Trade and Covered Agreements

- Legislative authority
- Negotiating agencies
- Role of states in negotiations
- Role of Congress
- Impact on state regulations
- Enforcement

The U.S. Constitution assigns express authority over foreign trade to Congress. Article I, Section 8, of the Constitution gives Congress the power to "regulate commerce with foreign nations" and to "lay and collect taxes, duties, imposts, and excises." U.S. trade agreements such as the North American Free Trade Agreement (NAFTA), WTO agreements, and bilateral FTAs have been approved by majority vote of each house rather than by two-thirds vote of the Senate—that is, they have been treated as congressional-executive agreements rather than as treaties.[22] This practice contrasts with the covered agreements, defined by Dodd-Frank (see above), which require congressional notification and a 90-day layover. The layover time could give Congress time to act on the agreement if Congress chooses, but congressional action is not required for a covered agreement to take effect. In further contrast, as mentioned previously, international agreements entered into by federal financial regulators, such as the Basel Capital accords in banking, have no specific congressional notification requirements, but must be implemented through the rulemaking process.

Trade Promotion Authority

U.S. bilateral, regional, and free trade agreements are conducted under the auspices of Trade Promotion Authority (TPA).[23] TPA is the time-limited authority that Congress uses to set trade negotiating objectives, to establish notification and consultation requirements, and to have implementing bills for certain reciprocal trade agreements considered under expedited procedures, provided certain statutory requirements are met.

As noted above, the Dodd-Frank Act requires that the FIO or the Treasury Secretary and the USTR notify and consult with Congress before and during negotiations on a covered agreement. In addition, it requires the submission of the agreement and a layover period of 90 days, but does not require congressional approval.

By contrast, legislation implementing FTAs must be approved by Congress. Under TPA, the President must fulfill notification requirements in order to begin negotiations and mandates to consult with Congress during negotiations. Once the negotiations are concluded, the President must notify Congress 90 days prior to signing the agreement. After the agreement is signed, there are additional reporting requirements to disclose texts, regulatory plans, and release the U.S. International Trade Commission's economic assessment of the agreement. The introduction of implementing legislation sets off a 90-legislative-day maximum period of time for congressional

[22] For more information on trade agreements and treaties, see CRS Report 97-896, *Why Certain Trade Agreements Are Approved as Congressional-Executive Agreements Rather Than Treaties*, by Jane M. Smith, Daniel T. Shedd, and Brandon J. Murrill.

[23] For more information on TPA, see CRS Report R43491, *Trade Promotion Authority (TPA): Frequently Asked Questions*, by Ian F. Fergusson and Richard S. Beth.

consideration, and the legislation is accompanied by additional reports. If these notification and consultation procedures are not met to the satisfaction of Congress, procedures are available to remove expedited treatment from the implementing legislation.

State Role

As discussed above, the FIO and the USTR jointly negotiate covered agreements, with the states having a consultative role set in the statute. In international trade agreements the USTR is the lead U.S. negotiator, with representatives from executive branch agencies participating to provide expertise. States are not formally consulted as part of trade negotiations and do not have a formal role in the executive branch interagency process or the USTR advisory committee system, established by Congress in 1974. USTR's Office of Intergovernmental Affairs and Public Engagement (IAPE) provides outreach to official state points of contact, governors, legislatures, and associations on all trade issues of interest to states.[24]

The USTR cannot make commitments on behalf of U.S. states in trade negotiations. This can be a source of frustration for negotiating partners who seek market openings at the state level. As part of trade negotiations, USTR may try to persuade individual states to make regulatory changes, but USTR is limited to what state regulators voluntarily consent to do. In general, state laws and state insurance regulations are explicitly exempted from trade negotiations. For example, in the proposed Trans-Pacific Partnership (TPP) agreement,[25] the United States listed measures for which TPP obligations would not apply, including "All existing non-conforming measures of all states of the United States, the District of Columbia, and Puerto Rico."[26] For government procurement obligations, the United States only includes central government and quasigovernmental entities in TPP. In contrast, as explained above, in the context of a covered agreement, FIO and USTR may make limited commitments that result in preempting some state laws and regulations.

Enforcing Trade Agreements and Covered Agreements

International trade agreements are binding agreements. If a party to a trade agreement believes that another party has adopted a law, regulation, or practice that violates the commitments under the trade agreement, the accusatory party may initiate dispute settlement proceedings under the agreement's dispute settlement provisions. Each party to a trade agreement has an obligation to comply with dispute resolution rulings or potentially face withdrawal of certain benefits under the agreement. Dodd-Frank does not specify how disagreements might be resolved in covered agreements, thus each covered agreement would need to clarify the dispute resolution process.

Regulatory Cooperation

As discussed, U.S. FTAs include market access commitments and rules and disciplines governing financial services measures, such as nondiscrimination and transparency obligations. Although FTAs customarily establish a *Financial Services Committee* comprised of each party's regulators

[24] For more information, see United States Trade Representative, *Advisory Committees*, at https://ustr.gov/about-us/advisory-committees.

[25] On January 30, 2017, the United States gave notice to the other TPP signatories that it does not intend to ratify the agreement, effectively ending the U.S. ratification process and TPP's potential entry into force, unless the Trump Administration changes its position.

[26] New Zealand Foreign Affairs and Trade, *Proposed Trans-Pacific Partnership: Annex I Schedule of the United States*, p. 16, at https://www.mfat.govt.nz/assets/_securedfiles/Trans-Pacific-Partnership/Annexes/Annex-I.-United-States.pdf.

to oversee implementation of the agreement and provide a forum for communication, U.S. FTAs to date exclude regulatory cooperation commitments for the financial services sector.

In U.S.-EU negotiations for the Transatlantic Trade and Investment Partnership (T-TIP) under the Obama Administration, the EU sought to include regulatory cooperation issues in the agreement that could have included some of the same matters as the recent U.S.-EU covered agreement (see below). Some Members of Congress supported this position, whereas U.S. regulators opposed the inclusion. The United States and EU did agree to establish the Joint U.S.-EU Financial Regulatory Forum; T-TIP negotiations are on pause until the Trump Administration decides how to proceed.

U.S.-EU Covered Agreement

On September 22, 2017, the United States and European Union signed the first bilateral insurance covered agreement.[27] The covered agreement had been submitted to the House Committees on Financial Services and Ways and Means and the Senate Committees on Banking, Housing, and Urban Affairs and Finance on January 13, 2017. A 90-day layover period is mandated in statute to allow Congress to review the agreement. The House Financial Services Committee Subcommittee on Housing and Insurance and the Senate Committee on Banking, Housing, and Urban Affairs each held a hearing on the agreement,[28] but no legislative action affecting the agreement has occurred.

In November 2015, the Obama Administration notified Congress regarding plans to begin negotiations with the EU on a covered agreement. Expressed goals for the negotiations included (1) achieving recognition of the U.S. regulatory system by the EU, particularly through an "equivalency" determination by the EU, that would allow U.S. insurers and reinsurers to operate throughout the EU without increased regulatory burdens, and (2) obtaining uniform treatment of EU-based reinsurers operating in the United States, particularly with respect to collateral requirements. The issue of equivalency for U.S. regulation is a relatively new one, as Solvency II has only come into effect at the beginning of 2016 (see "The European Union, Solvency II, and Equivalency" below), whereas the question of reinsurance collateral has been a concern of the EU for many years (see "Reinsurance Collateral" below). The covered agreement negotiations also sought to facilitate the exchange of confidential information among supervisors across borders.

According to the USTR and Treasury, the new bilateral agreement

- allows U.S. and EU insurers to rely on their home country regulators for worldwide prudential insurance group supervision when operating in either market;
- eliminates collateral and local presence requirements for reinsurers meeting certain solvency and market conduct conditions; and
- encourages information sharing between insurance supervisors.

[27] U.S. Trade Representative, "Treasury, USTR Sign Covered Agreement on Prudential Insurance and Reinsurance Measures with the European Union," https://ustr.gov/about-us/policy-offices/press-office/press-releases/2017/september/treasury-ustr-sign-covered.

[28] U.S. Congress, House Committee on Financial Services, Subcommittee on Housing and Insurance, *Assessing the U.S.-EU Covered Agreement*, 115th Cong., 1st sess., February 16, 2017, at http://financialservices.house.gov/calendar/eventsingle.aspx?EventID=401498 and U.S. Congress, Senate Committee on Banking, Housing, and Urban Affairs, *Examining the U.S.-EU Covered Agreements*, 115th Cong., 1st sess., May 2, 2017, at https://www.banking.senate.gov/public/index.cfm/2017/5/examining-the-u-s-eu-covered-agreements.

The proposal sets time lines for each side to make the necessary changes and allows either side to not apply the agreement if the other side falls short on full implementation. Unlike the goals expressed to Congress when negotiations began, the agreement does not explicitly call for equivalency recognition of the U.S. insurance regulatory system by the EU. However, the agreement's provisions on group supervision would seem to meet the same goal of reducing the regulatory burden on U.S. insurers operating inside the EU. The proposal goes beyond a previous state-level proposal on reinsurance collateral requirements put forth by the NAIC and adopted by many states, and allows for the possibility of federal preemption if states are not in compliance.

Several U.S. industry groups welcomed the agreement, including the American Insurance Association (AIA), the Reinsurance Association of America, and the American Council of Life Insurers (ACLI). The AIA's senior vice president and general counsel noted that, "when negotiations began, U.S. insurance and reinsurance groups were facing growing obstacles to their ability to do business in Europe, but this agreement removes those barriers–affirming not only each other's regulatory systems, but also their commitments to non-discriminatory treatment and open, reciprocal, competitive insurance markets."[29]

State regulators and state lawmakers, respectively represented by the NAIC and National Council of Insurance Legislators (NCOIL), expressed concern with the agreement due to the limited state involvement in the negotiation process and the potential federal preemption of state laws and regulations. NCOIL expressed disappointment of the final signing, stating "this agreement is an intrusion by both the federal government and international regulatory authorities into the U.S. state based regulation of insurance regulation."[30] Some insurers also question the utility of the agreement, with the president of the National Association of Mutual Insurers (NAMIC) seeing ambiguity that "will result in confusion and potentially endless negotiations with Europe on insurance regulation."[31] As mentioned, the agreement includes a review after an initial implementation period, at which time either the United States or EU may pull out of the agreement.

Reinsurance Collateral

The covered agreement aims to address EU concerns regarding U.S. state regulatory requirements that reinsurance issued by non-U.S. or *alien*[32] reinsurers must be backed by collateral deposited in the United States. In the past, this requirement was generally for a 100% collateral deposit. Non-U.S. reinsurers long resisted this requirement, pointing out, among other arguments, that U.S. reinsurers do not have any collateral requirements in many foreign countries and that the current regulations do not recognize when an alien reinsurer cedes some of the risk back to a U.S. reinsurer. Formerly, the NAIC and the individual states declined to reduce collateral requirements, citing fears of unpaid claims from non-U.S. reinsurers and an inability to collect judgments in courts overseas. This stance, however, has changed in recent years.

[29] American Insurance Association, "AIA Statement on the Impending Covered Agreement Signing," news release, September 22, 2017, at http://www.aiadc.org/media-center/all-news-releases/2017/september/covered-agreement-news-release.

[30] National Council of Insurance Legislators, "NCOIL Expresses Disappointment in Covered Agreement Signature," press release, September 23, 2017, at http://ncoil.org/wp-content/uploads/2017/09/covered-agreeemnt-signature-9.22.17.pdf.

[31] National Association of Mutual Insurance Companies, "NAMIC Responds to Covered Agreement Announcement," press release, January 13, 2017, at http://www.namic.org/newsreleases/170113nr06.asp.

[32] In the United States, the term *foreign* insurer generally denotes an insurer that is chartered in a different state; those insurers from a different country have been called *alien* insurers.

In 2010, an NAIC Task Force approved recommendations to reduce required collateral based on the financial strength of the reinsurer involved and recognition of the insurer's domiciliary regulator as a qualified jurisdiction. The NAIC, in November 2011, adopted this proposal as a model law and accompanying model regulation.[33] To take effect, however, these changes must be made to state law and regulation by the individual state legislatures and insurance regulators. The reinsurance models are part of the NAIC accreditation standards, and all states are expected to adopt them by 2019.

According to the NAIC, as of February 2017, 35 states have adopted the model law, representing approximately 69% of total premiums.[34] To date, more than 30 reinsurers have been approved by the states as certified reinsurers for reduction in collateral requirements. To receive the reduced collateral requirements, the reinsurer's home jurisdiction must also be reviewed and listed on the NAIC List of Qualified Jurisdictions. As of January 2017, seven jurisdictions have been approved.[35]

The state actions addressing reinsurance collateral requirements, however, have not fully met concerns of foreign insurers regarding the issue. Non-U.S. reinsurers reportedly would like a single standard across the United States that would eliminate, not just reduce, collateral requirements.[36] This desire was a significant part of the EU's expressed motivation to enter into covered agreement negotiations. A Council of the EU representative indicated that "an agreement with the U.S. will greatly facilitate trade in reinsurance and related activities" and would "enable us, for instance, to recognize each other's prudential rules and help supervisors exchange information."[37]

The European Union, Solvency II, and Equivalency

The covered agreement also aims to assist U.S. insurers concerned with potential regulatory burdens in relation to new EU market requirements that went into effect in 2016. The European Union's Solvency II is part of a project aimed at transforming the EU into a single market for financial services, including insurance. In some ways, Solvency II is purely an internal EU project designed to more closely harmonize laws among the EU countries. However, as part of the Solvency II project, new *equivalency* determinations of foreign jurisdictions are to be made by the EU.[38] An equivalency determination would allow insurers from a foreign jurisdiction to operate throughout the EU as do EU insurers. If the U.S. system of state-centered supervision of

[33] National Association of Insurance Commissioners (NAIC), *Credit for Reinsurance Model Law* (#785) and NAIC, *Credit for Reinsurance Model Regulation* (#786).

[34] Figures from the subcommittee hearing testimony of Ted Nickel, President of the NAIC at https://financialservices.house.gov/uploadedfiles/hhrg-115-ba04-wstate-tnickel-20170216.pdf; see also NAIC website, *Reinsurance*, updated April 7, 2016, at http://www.naic.org/cipr_topics/topic_reinsurance.htm.

[35] The seven jurisdictions are: Bermuda – Bermuda Monetary Authority (BMA); France – Autorité de Contrôle Prudentiel et de Résolution (ACPR); Germany – Federal Financial Supervisory Authority (BaFin); Ireland – Central Bank of Ireland; Japan – Financial Services Agency (FSA); Switzerland – Financial Market Supervisory Authority (FINMA); and United Kingdom – Prudential Regulation Authority of the Bank of England (PRA), see NAIC, *List of Qualified Jurisdictions*, January 1, 2017, at http://www.naic.org/documents/committees_e_reinsurance_qualified_jurisdictions_list.pdf.

[36] See, for example, Huw Jones, "EU Mounts Fresh Bid to End U.S. Reinsurance Collateral Rule," *Reuters*, April, 21, 2015, available at http://www.reuters.com/article/2015/04/21/eu-usa-insurance-idUSL5N0XI44T20150421.

[37] Council of the European Union, "EU-US agreement on reinsurance: Council agrees to negotiations," press release, April 21, 2015, at http://www.consilium.europa.eu/en/press/press-releases/2015/04/21-eu-us-agreement-reinsurance.

[38] For an explanation of the criteria see European Insurance and Occupational Pensions Authority (EIOPA) website, *Equivalence*, at https://eiopa.europa.eu/external-relations/equivalence.

insurers is not judged to be "equivalent" to the EU insurance supervision, U.S. insurers may face more difficulty in operating in EU markets. Past suggestions have been made that an EU regulatory change might serve as "a useful tool in international trade negotiations as it could help improve access for European reinsurers to foreign markets," such as the United States.[39] A June 6, 2014, letter from the European Commission to FIO and the NAIC drew an explicit connection between an equivalency designation applying to the United States and the U.S. removal of reinsurance capital requirements that the states place on non-U.S. reinsurers.[40]

Solvency II came into effect in the EU at the beginning of 2016. The EU has granted provisional equivalence to the United States along with five other countries and full equivalence to two countries. The grant of provisional U.S. equivalence, however, applies only to capital requirements of EU insurers with U.S. operations,[41] and U.S. insurers have reported experiencing difficulties with their operation in EU countries.[42]

International Insurance Entities

Outside of international trade negotiations and agreements, two separate but interrelated entities have the most significant impact on international insurance issues in the United States: the Financial Stability Board and the International Association of Insurance Supervisors.

The Financial Stability Board[43]

The FSB was established in April 2009 by G-20 nations to help strengthen the global financial system following the 2008 financial crisis. The FSB's functions include assessing vulnerabilities to the global financial system; coordinating with financial authorities of member nations; and recommending measures to protect and strengthen the global financial system. The FSB's members comprise financial regulatory agencies of G-20 nations. U.S. FSB members are the Department of the Treasury, the Federal Reserve Board, and the Securities and Exchange Commission; no insurance-focused representative from the United States is included. The FSB's recommendations and decisions are not legally binding on any of its member nations. Rather, the FSB "operates by moral suasion and peer pressure, in order to set internationally agreed policies and minimum standards that its members commit to implementing at national level."[44]

[39] European Commission, "Commission Proposes a Directive to Create a Real EU-Wide Market for Reinsurance," *Internal Market: Financial Services: Insurance: Press Release,* April 21, 2004, at http://europa.eu/rapid/pressReleasesAction.do?reference=IP/04/513&format=PDF&aged=1&language=EN&uiLanguage=en.

[40] Letter from Jonathan Faull, director general, Internal Market and Services, European Commission, to Michael McRaith, director, FIO, and Benjamin Nelson, chief executive officer, NAIC, June 6, 2014.

[41] See European Commission, *Equivalence Decisions*, at http://ec.europa.eu/finance/insurance/solvency/international/index_en.htm.

[42] See, for example, Elizabeth Festa, "Insurers, Reinsurers Voice Strong Concern Over Growing Costs, Burdens of Solvency II," *SNL Financial*, August 29, 2016 and "U.S. Insurance Industry Hits Barriers In EU Under New Solvency Directive," *Inside U.S. Trade*, June 17, 2016, at http://insidetrade.com/daily-news/us-insurance-industry-hits-barriers-eu-under-new-solvency-directive.

[43] The description of the Financial Stability Board (FSB) adapted from CRS Insight IN10388, *Designation of Global 'Too Big To Fail' Firms*, by Rena S. Miller and James K. Jackson.

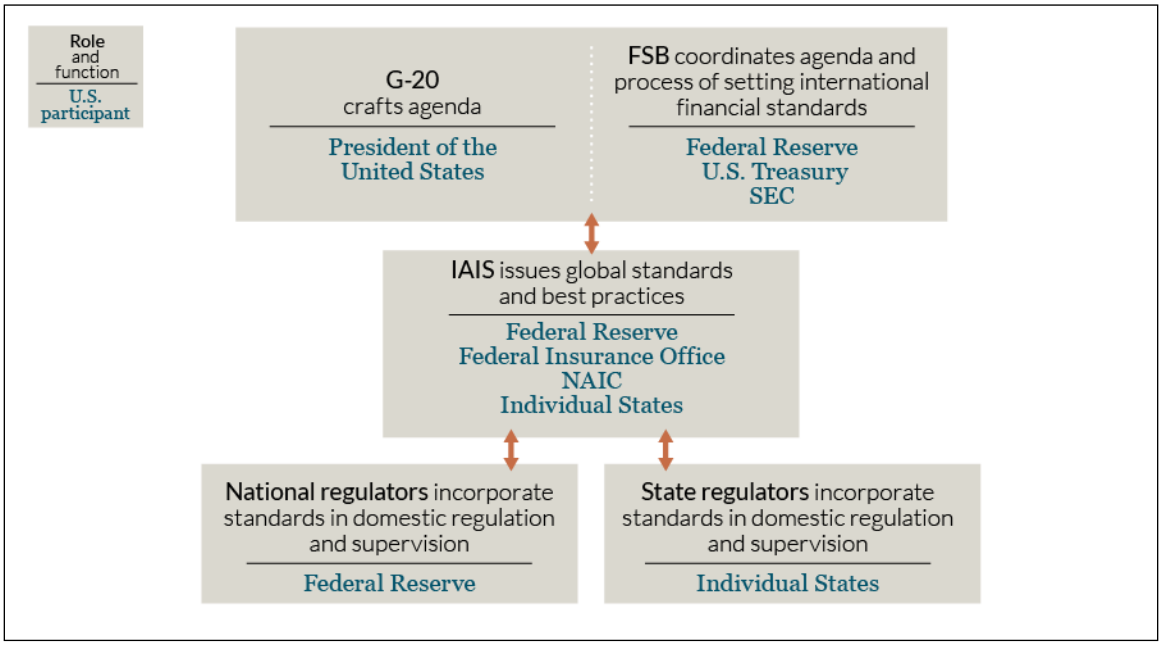
[44] FSB, *About the FSB*, at http://www.financialstabilityboard.org/about/.

The International Association of Insurance Supervisors

The IAIS, created in 1994, is the international standard-setting body, establishing a variety of guidance documents and conducting educational efforts for the insurance sector. Its mission is "to promote effective and globally consistent supervision of the insurance industry."[45] The IAIS is primarily made up of insurance regulators worldwide with most jurisdictions having membership. U.S. members include all the individual states, the NAIC, the Federal Reserve, and the U.S. Department of the Treasury's Federal Insurance Office. FIO and the Federal Reserve became IAIS members only after the passage of the Dodd-Frank Act. These U.S. members have held various committee positions, past and present. The FIO director has served as chair of the IAIS Financial Stability and Technical Committee, which plays a central role in drafting IAIS-proposed standards. The NAIC coordinates individual state participation in IAIS committees and working groups. According to the NAIC, three NAIC members serve on the IAIS Executive Committee, including one as vice chair, and three serve on the Financial Stability and Technical Committee, plus an NAIC representative serves as vice chair. State regulators and NAIC representatives also serve on many other IAIS working parties. The NAIC's 56 members have 15 votes in the IAIS general meetings, with the NAIC designating which of its members may exercise their votes.[46]

Figure 3 provides a graphical representation of the relationships between international entities and their U.S. members.

Figure 3. International Financial Architecture for Insurance



Source: Congressional Research Service.

Note: For a general overview of the international financial architecture, please see CRS In Focus IF10129, *Introduction to Financial Services: International Supervision*, by Martin A. Weiss.

[45] The International Association of Insurance Supervisors (IAIS) website at http://www.iaisweb.org/About-the-IAIS-28.

[46] The 56 NAIC members include all 50 states plus U.S. territories and the District of Columbia. The 15 votes and NAIC's role are codified in the IAIS bylaws, Article 6(4)(b), available at http://iaisweb.org/index.cfm?event=openFile&nodeId=34510.

International Insurance Standards and Designations

As part of its monitoring of global financial stability, the FSB designates a number of financial institutions as globally systemically important. An FSB designation is meant to indicate that the failure of an individual institution could have a negative impact on the global financial system. Initially, the designation focused on global systemically important banks (G-SIBs), but it also encompasses global systemically important insurers, and nonbank noninsurer global systemically important financial institutions (NBNI G-SIFIs), such as large asset managers, broker-dealers, and hedge funds. Designated institutions are expected to meet higher qualitative and quantitative regulatory and capital standards to help ensure their stability during a crisis.

The FSB has designated nine G-SIIs, including three U.S. insurers among them (AIG, MetLife, and Prudential Financial).[47] The FSB has also requested that the IAIS develop capital standards and other regulatory measures to apply to G-SIIs as well as Internationally Active Insurance Groups (IAIGs), insurers which fall short of the G-SII designation.[48]

The IAIS is developing a general Common Framework for the Supervision of Internationally Active Insurance Groups (ComFrame),[49] as well as specific capital standards to apply to G-SIIs and additional standards intended for other IAIGs as requested by the FSB. The IAIS announced the plan for capital standards in 2013 and is currently assessing the second round of consultations with completion expected mid-2017.[50]

International standards were a primary focus of H.R. 5143 in the 114th Congress,[51] which passed the House on December 7, 2016, on a vote of 239-170. Similar legislation has yet to be introduced in the 115th Congress.

Implementation of International Standards

In general, actions undertaken by international bodies, such as the FSB's designations of G-SIIs or adoption of capital standards by the IAIS, have no immediate effect on the regulatory system within the United States. To be implemented, such standards must be adopted by regulators in the United States or enacted into law if regulators do not already have sufficient legal authority to adopt the standards. In many cases, it is expected that members of such international bodies will adopt the agreed-to standards. For example, the Basel Committee on Bank Supervision (BCBS) charter includes among the members' responsibilities that they commit to "implement and apply BCBS standards in their domestic jurisdictions within the pre-defined timeframe established by the Committee."[52] In some situations, the translation from international standard to national implementation may be relatively straightforward because the agencies agreeing to the

[47] FSB, *2015 Update Of List of Global Systemically Important Insurers*, November 3, 2015, at http://www.fsb.org/wp-content/uploads/FSB-communication-G-SIIs-Final-version.pdf.

[48] FSB, *Global systemically important insurers (G-SIIs) and the policy measures that will apply to them*, July 18, 2013, at http://www.financialstabilityboard.org/publications/r_130718.pdf.

[49] For more information see, IAIS, *Frequently Asked Questions for The IAIS Common Framework for the Supervision of Internationally Active Insurance Groups (ComFrame)*, July 29, 2016, at https://www.iaisweb.org/page/supervisory-material/insurance-capital-standard/file/61723/ics-frequently-asked-questions-updated-29-july-2016.

[50] IAIS, *Risk-based Global Insurance Capital Standard Version 1.0 Public Consultation Document*, July 19, 2016, at http://www.iaisweb.org/page/supervisory-material/insurance-capital-standard/file/61565/2016-risk-based-global-insurance-capital-standard-ics-consultation-document.

[51] See CRS Insight IN10617, *International Insurance Issues and H.R. 5143*, by Baird Webel.

[52] Basel Committee on Banking Supervision, *Charter*, January 2013, p. 2, at http://www.bis.org/bcbs/charter.pdf.

international standards are the same agencies that have the authority to implement the standards at home.[53]

The mix of federal and state authorities over insurance in the United States, however, has the potential to complicate the adoption of international standards, such as the IAIS's capital standards that are under development. In the case of insurance, the U.S. representation at the IAIS includes (1) the NAIC, which collectively represents the U.S. state regulators, but has no regulatory authority of its own; (2) the 56 different states and territories, which collectively regulate the entire U.S. insurance market, but individually oversee only individual states and territories; (3) the Federal Reserve, which has holding company oversight only over systemically significant insurers and insurers with depository subsidiaries; and (4) the FIO, which has authority to monitor and report but no specific regulatory authority. Thus, it is quite possible for a situation to develop where some part of the U.S. representation at the IAIS may agree to particular policies or standards without agreement by the entity having authority to actually implement the policies or standards that are being agreed to.

Moral Suasion and Market Pressures

Although international standards may not be self-executing, nations may still face pressures to implement these standards. For example, the International Monetary Fund performs a Financial Sector Assessment Program (FSAP) of many countries every five years. In the latest FSAPs from 2010 and 2015, the judgments and recommendations offered regarding the U.S. insurance regulatory system compared U.S. laws and regulations to core principles adopted by the IAIS. Although U.S. regulators generally accept the IAIS core principles, the FSAP does note that state regulators specifically reject some aspects stemming from the core principles and the states "do not believe that each of the proposed regulatory reforms recommended in the Report is warranted, or would necessarily result in more effective supervision."[54]

Pressure may also derive from internationally active market participants, including both domestic and foreign firms. Companies operating in different jurisdictions incur costs adapting to different regulatory environments. To minimize these costs, companies may pressure jurisdictions to adopt similar rules. Even if one country's rules might be more favorable to the company seen in the abstract, it may still be more efficient for a company if all the countries adopt slightly less favorable, but substantially similar, rules. Thus, for example, a U.S. company operating in multiple countries might favor adoption of U.S. regulations similar to international standards to simplify business operations, even if it finds the U.S. regulations generally preferable.

Specific Policy Concerns with International Standards

Those concerned about potential international insurance standards often raise the possibility that these standards may be "bank-like" and thus inappropriate for application to insurers.[55] A primary

[53] This is the case, for example, in banking in which the Fed, Federal Deposit Insurance Corporation, and Office of Comptroller of the Currency are all members of the Basel Committee on Banking Supervision and in systemic issues in which the Federal Reserve is a member of the FSB.

[54] International Monetary Fund, *United States Financial Sector Assessment Program*, IMF Country Report No. 15/9, p. 37, at https://www.imf.org/external/pubs/ft/scr/2015/cr1590.pdf.

[55] See, for example, Testimony of Kurt Bock, Senate Committee on Banking, Housing, and Urban Affairs, Subcommittee on Securities, Insurance and Investment, Hearing on "Examining Insurance Capital Rules and FSOC Designation, " April 30, 2015, p. 5, at http://www.banking.senate.gov/public/_cache/files/8bff5d07-1a8d-436d-a289-aef15c41308d/23C6AE00CC53D93492511CC744028B5E.bocktestimony43015sii.pdf.

concern in this regard is the treatment of financial groups. In banking regulation, a group holding company is expected, if not legally required, to provide financial assistance to subsidiaries if necessary. In addition, safety and soundness regulations may be applied at a group-wide level. A somewhat similar focus on the group-wide level is also found in the EU's Solvency II and in possible future IAIS standards. Within U.S. insurance regulation, however, state regulators in the United States historically have focused on the individual legal entities and ensuring that the specific subsidiaries have sufficient capital to fulfill the promises inherent in the contracts made with policyholders.[56] Since the financial crisis, the U.S. regulators have increased oversight at the overall group level, but the possible movement of capital between subsidiaries remains an issue. The NAIC has indicated specifically that "It is critical that the free flow of capital (i.e., assets) across a group should not jeopardize the financial strength of any insurer in the group."[57] A group-wide approach that allows capital movement among subsidiaries could potentially improve financial stability as a whole if it prevents a large financial firm from becoming insolvent in the short run. It also could provide protection for individual policyholders if it results in additional resources being made available to pay immediate claims. The concern raised, however, is that this could also put other future policy claims at risk if there ends up being insufficient capital to pay these policyholders in the long run.

Congressional Outlook

With expected continued growth in the international insurance market as well as differences in regulatory approaches, the frictions between U.S. and foreign regulators as well as between state and federal regulators seem likely to continue. Congress may choose to address these issues in multiple ways including, for example,

- amending Dodd-Frank and the statutory role of FIO and the USTR in international insurance negotiations;
- legislating a role for states in U.S. representation to international insurance regulatory entities;
- endorsing international insurance standards and legislating their adoption by states; or
- endorsing the U.S.-EU covered agreement or seeking further clarifications or amendments to it.

Author Information

Baird Webel
Specialist in Financial Economics

Rachel F. Fefer
Analyst in International Trade and Finance

[56] One discussion of this argument can be found in Robert Litan, "Source of Weakness Worrisome Trends in Solvency Regulation of Insurance Groups in a Post-Crisis World," *Economic Studies at Brookings*, August 2014, at https://www.brookings.edu/wp-content/uploads/2016/06/trends_insurance_group_solvency_regulation_litan.pdf.

[57] NAIC, *U.S. State Insurance Regulators' Views: International Capital Proposals*, December 2013, p. 2, at http://www.naic.org/documents/committees_g_capital_position_statements.pdf.

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