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AN ALERT FROM THE BDO INSURANCE INDUSTRY PRACTICE

BDO KNOWS: INSURANCE

U.S. AND EU SIGNAL INTENT TO SIGN BILATERAL AGREEMENT AFFECTING THE INSURANCE INDUSTRY

By Imran Makda, James Evans and Phillip Hyatt

In July 2017, the United States (U.S.) Treasury Department and the Office of the U.S. Trade Representative signaled intent to sign the U.S. and EU Covered Agreement (Agreement), which outlines bilateral cooperation between the U.S. and European Union (EU) regarding insurance and reinsurance.

While the Agreement is a step towards equalization of insurance regulation between EU and the U.S., there will be significant hurdles along the way. How the framework is implemented across the individual states in the U.S., and United Kingdom in light of Brexit will begin to define the true implications to the reinsurance industry.

The Agreement has a mix of supporters and skeptics within the insurance industry. For instance, supporters indicate that it could reduce the possibility of EU Solvency II requirements becoming a barrier to insurance trade and investment. On the other hand, groups that have voiced concerns pose that “[the] proposed solution [is] an invented problem…” and warn that the Agreement could become a “backdoor to force foreign regulation on U.S. companies.” However, the U.S. Treasury Department said the Agreement is key to ensuring U.S. companies—within both foreign and domestic markets—become more competitive with effective and efficient regulation.

The goal of the Agreement is in alignment with the focus of the insurance regulatory environment: To protect policyholders and consumers, as well as jurisdictional regulation, while minimizing certain requirement burdens for U.S and EU insurance and reinsurance companies.

ABOUT BDO'S INSURANCE PRACTICE

BDO’s Insurance practice understands the complexities of the industry and the implications for your business. Whether you're looking to tap our extensive SEC experience in order to enter the public market, discuss the latest insurance accounting and reporting requirements from the NAIC, or comply with state regulatory agencies, BDO’s Insurance practice provides proactive guidance to our clients. We know that no two insurers are alike, and we tailor our services accordingly. We’re proud of our industry focus and experience, and our commitment to delivering the right team with relevant industry experience, both as we begin our relationship and for the long term.

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The proposed framework consists of the following key parts:

1. Group supervision
2. Exchange of information between supervisory authorities
3. Reinsurance

Group supervision – The EU Solvency II framework that went into effect January 1, 2016 may expose non-EU insurance companies to more strict or uncertain solvency and capital requirements if it is deemed that the domiciled head office or parent supervisory system is not equivalent to Solvency II. The Agreement would limit the EU supervisory system from exercising these capital requirements on the worldwide operations of U.S insurance companies. However, if the supervisory regulators of a host country determine that policyholders are at risk based on an array of factors—including financial instability of the insurer—then the host supervisory authority may impose preventive, corrective or other responsive measures. Prior to imposing these measures, both host and home supervisory authorities should consult each other.

The benefit of the group supervision would be in allowing supervision of U.S. and EU insurance companies at the worldwide group level by their respective supervisory system, and therefore, not subjecting these multinational companies to potential duplication or a more stringent capital structure. To note, the group supervision benefit would only apply to insurance companies that operate in both the U.S. and EU jurisdictions.

Exchange of information – The Agreement framework urges information-sharing between local and foreign supervisory jurisdictions. The intent is for such exchanges to occur in a non-binding manner, though a memorandum demonstrating understanding regarding the information exchange is encouraged. This has already started to occur, as exhibited by the presence of U.S and European regulators at Supervisory College meetings for large multi-nationals, as well as ongoing collaboration between National Association of Insurance Commissioners and International Association of Insurance Supervisors.

Reinsurance – The Agreement would eliminate the collateral and local presence mandate for U.S. insurers operating in the EU insurance market and likewise for EU insurers operating in the U.S. market. Insurers would, however, have to meet certain financial strength and market conduct conditions to be eligible for these exemptions. These requirements would be similar to current financial strength indicators that enable insurance companies in the U.S. to take credit for reinsurance.

Further, to qualify for these exemptions, the assuming reinsurers must have and maintain on an ongoing basis:

(i) at least 226 million Euro (where the ceding insurer has its head office in the EU) or 250 million U.S. dollars (where the ceding insurer is domiciled in the United States) of own funds or capital and surplus, calculated according to the methodology of its home jurisdiction;
   a. if the assuming reinsurer is an association including incorporated and individual unincorporated underwriters: (A) minimum capital and surplus equivalents (net of liabilities) or own funds, calculated according to the methodology applicable in its home jurisdiction, of at least 226 million Euro (where the ceding insurer has its head office in the EU) or 250 million U.S. dollars (where the ceding insurer is domiciled in the United States); and (B) a central fund containing a balance of at least 226 million Euro (where the ceding insurer has its head office in the EU) or 250 million U.S. dollars (where the ceding insurer is domiciled in the United States);

(ii) a Solvency Capital Ratio (SCR) of 100 percent under Solvency II or a Risk Based Capital (RBC) of 300 percent Authorized Control Level, as applicable in the territory in which the assuming reinsurer has its head office or is domiciled
   a. if the assuming reinsurer is an association including incorporated and individual unincorporated underwriters, a SCR of 100 percent under Solvency II or an RBC of 300 percent Authorized Control Level, as applicable in the territory in which the assuming reinsurer has its head office or is domiciled.

In addition, the assuming reinsurers would agree to provide prompt written notice to the supervisory authority in the territory of the ceding entity if the assuming company falls below these capital requirements, or if regulatory action was taken for serious noncompliance.

BDO'S TAKE

It will be years before individual states work their way through this outlined framework, and we expect them to receive significant guidance from the NAIC prior to their effort. We will not begin to see the implications of this covered agreement until 2018, when state legislators take up their efforts. Will additional agreements with other significant insurance regulatory authorities (UK, Bermuda, Switzerland, etc.) be necessary, or will states move toward legislation that minimizes the role of federal authorities? This story is just beginning.


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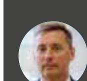
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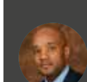
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