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ARTICLE

Equivalence and Insurance

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Abstract
The concept of equivalence is present in various forms in the Solvency II framework, the EU prudential regulatory framework for insurance and reinsurance. While equivalence in Solvency II does not grant, or should not be equated to, market access for market participants that make use of the equivalence instruments within Solvency II, equivalence plays an important role in insurance, in particular in the solvency capital calculation at group level, in group supervision and for the recognition of reinsurance under Solvency II. The conclusion can be drawn that equivalence is an essential building block of the current framework. The application of equivalence in the framework and in practice is discussed in this contribution, and while the application might be complex, it is indispensable. At the same time, other mechanisms, either within the Solvency II framework or more broadly at international level, influence the current state and might affect the evolution of equivalence going forward. While, inherently, there is a political component to equivalence as well, the instruments remain firmly based in (detailed) Solvency II rules and are applied accordingly in practice.

Keywords Equivalence · Solvency II · Third country · Group supervision · Reinsurance · Covered Agreement · Solvency capital requirement · International Capital Standards · IAIS

All (equivalent) jurisdictions are equal, but some are more equal or equivalent than others….

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1 Introduction

When discussing equivalence in EU financial services regulation generally, the first thing that might come to mind, certainly for financial services providers from outside the European internal market, is the use of equivalence as a means for non-European financial services providers to gain (direct) market access to the European internal market. While equivalence may certainly play a role in gaining market access, this has not been an objective of the European Commission for the application of equivalence decisions. According to a 2017 European Commission Staff Document, equivalence decisions:

> support the fulfilment of the following general objectives:
>
> - they balance the needs of financial stability and investor protection in the EU on the one hand with the benefits of maintaining an open and globally integrated EU financial markets on the other;
> - they are pivotal to promoting regulatory convergence around international standards and they are a major trigger for establishing or upgrading supervisory co-operation with the relevant third-country partners.
>
> Equivalence is not a vehicle for liberalising international trade in financial services, but a key instrument to effectively manage cross-border activity of market players in a sound and secure prudential environment with third-country jurisdictions that adhere to, implement and enforce rigorously the same high standards of prudential rules as the EU.[1]

This demonstrates that, according to the European Commission, in summary, an equivalence determination primarily serves prudential purposes. While benefitting primarily EU financial market participants, advantages may also be obtained by non-EU financial markets and market participants.

According to the European Commission Staff Document referenced above:

> An equivalence determination should achieve some or all of the following:
>
> - reduce or even eliminate overlaps in compliance for the EU entities concerned and in the supervisory work of EU competent authorities,
> - allow the application of a less burdensome prudential regime in relation to EU financial institutions' exposures to an equivalent third country than would otherwise be the case for exposures to non-equivalent third countries,
> - provide EU firms and investors with a wider range of services, instruments and investment choices originating from third countries that can satisfy regulatory requirements in the EU.[2]

[1] European Commission (2017).

[2] Ibid., p 5.

Notably, in a more recent publication from the European Commission, the emphasis on prudential considerations is still present, but less pronounced. As Busch points out in his contribution to this edition of this journal, equivalence is seen by the European Commission primarily as a risk management exercise, in which the risks (costs) of granting third-country entities access to the EU financial markets are weighed against the benefits of granting such access, all from the perspective of the EU.[3]

According to the European Commission in its 2019 Communication, the EU equivalence policy serves three objectives:

- it reconciles the need for financial stability and investor protection in the EU, on the one hand, with the benefits of maintaining an open and globally integrated EU financial market on the other;
- it is pivotal in promoting regulatory convergence around international standards;
- it is a major trigger for establishing or upgrading supervisory cooperation with the relevant third-country partners.

This general policy perspective also needs to meet the interests of the market participants who naturally focus on more immediate advantages of equivalence decisions, i.e. allowing authorities in the EU to rely on supervised entities' compliance with equivalent rules in a third country, such as:

- reducing (or even eliminating) overlaps in compliance requirements for both EU and third-country market players;
- making certain services, products and activities of third-country companies acceptable for regulatory purposes in the EU and thus facilitating their availability on the EU market;
- in some instances, enabling a coherent prudential regime to apply to EU banks and other financial institutions operating outside the EU, thus lowering the cost of EU firms' investments/exposures in third countries by facilitating capital management in particular.

2 Equivalence and Solvency II

Turning to the insurance context, the question can be raised how this generic European equivalence context has been applied in the Solvency II framework. As is explained in this contribution, Solvency II equivalence primarily has a prudential context, facilitating the operation of European insurance groups from a capital perspective, as well as supporting access to the European internal market of groups based in specific non-EU jurisdictions through the recognition of third-country group supervision. Lastly, equivalence is used in Solvency II to support the inherently international nature of reinsurance, allowing EU insurers to rely on

3 European Commission (2019).

third-country reinsurance contracts as risk-mitigating techniques in their solvency calculations.

Insurance groups often operate in multiple jurisdictions and are generally subject to prudential regulation at individual licensed insurance or reinsurance entity level, as well as, under the EU Solvency II framework, to supplementary supervision at group level. Questions with respect to the application of regulatory requirements arise when such groups have a presence (such as through subsidiaries or with their parent company) outside the EU internal market, or when they offer products to insurance or reinsurance entities within the EU internal market. As such, Solvency II equivalence may be relevant to them and to the EU insurance or reinsurance entities they do business with. Therefore, even if insurance companies operate strictly within one jurisdiction within the European Union, they might be confronted with questions regarding Solvency II equivalence, due to the reinsurance arrangements they have entered into with non-European reinsurance entities that may or may not be located in Solvency II equivalent jurisdictions.

The concept of equivalence in EU insurance and reinsurance regulation has been introduced to address a number of specific issues, related to the Solvency II prudential regulatory framework that entered into force as per 1 January 2019. In line with the overall objectives of the international strategy of the European Commission, and the objectives of equivalence decisions, both described above, equivalence in the Solvency II framework clearly has a prudential background.

From the outset, equivalence decisions have proven to be an indispensable part of the Solvency II framework, and the equivalence tools are actually being applied in practice, which is not always the case in other parts of the EU financial regulatory framework. As such, the Solvency II equivalence framework is relevant in practice, relatively advanced and still evolving. This will be discussed in more detail in this contribution. In addition, a number of developments are being discussed that are not directly related to equivalence, but are still closely related.

To be specific, the Solvency II framework provides for three specific equivalence arrangements, two of which (equivalence in the context of reinsurance and equivalence for the group solvency calculation) can take shape in three different forms (full, temporary and provisional equivalence) and the third one (equivalence for group supervision) in two different forms (full and temporary equivalence).

Equivalence for third-country reinsurance	Article 172 Solvency II Directive	Full equivalence
		Temporary equivalence
		Provisional equivalence
Equivalence for the Solvency II group solvency calculation	Article 227 Solvency II Directive	Full equivalence
		Temporary equivalence
Equivalence for group supervision	Article 260 Solvency II Directive	Full equivalence
		Temporary equivalence
		Provisional equivalence

The difference between temporary and provisional equivalence may need some additional explanation. *Temporary* equivalence is relatively self-explanatory. Equivalence was granted for a limited period of time (which ended in accordance with the relevant Solvency II provisions on 31 December 2020) and could subsequently be extended only for a year, primarily to conduct a (full) equivalence assessment. *Provisional* equivalence is akin to temporary equivalence but provides more flexibility when it is applied. It offers a solution for third countries that are in the process of modernising their risk-based solvency regimes or have a well-functioning solvency regime that is unlikely to be updated soon.[4] The advantage of provisional equivalence is that it can be extended for subsequent periods of ten years, following the expiration of the initial equivalence decision.

Two of the issues addressed through equivalence relate to the application of Solvency II group supervision. The first application of equivalence addresses the treatment of a third-country insurance or reinsurance subsidiary in the group solvency calculation. This relates to the recognition of solo prudential requirements in the Solvency II group solvency calculation. The second issue addresses the recognition of third-country group supervision by EEA insurance supervisors. The third issue with respect to equivalence relates to the recognition of reinsurance contracts as a risk-mitigating technique for the capital calculation of EU insurers and reinsurers in case such reinsurance contracts have been entered into by EEA insurance or reinsurance companies with non-EEA reinsurance companies.

As mentioned, Solvency II equivalence can be provided in three different forms: full equivalence, temporary equivalence and provisional equivalence. For completeness' sake, it should also be mentioned that, while equivalence is usually granted by the European Commission, alternatively, it can also be granted by national competent authorities in the EU in the absence of an equivalence decision by the European Commission, except in relation to reinsurance.[5]

So far, all equivalence decisions have been taken in the context of the entry into force of the Solvency II framework as per 1 January 2016. No additional new assessments have been undertaken since[6] and with the exception of the temporary equivalence decision for the Japanese regulatory framework in relation to reinsurance,[7] all equivalence decisions have remained in place.

Equivalence in the Solvency II context is not being used to grant non-EEA insurers or reinsurers direct access to the internal market. Equivalence does contribute to market access of third-country groups to the internal market and, reversely, aims

[4] See Van Hulle (2019), p 618, who refers to provisional equivalence as a 'magic solution' coming out of the negotiations for the Omnibus II Directive. Furthermore, in this context he refers appropriately to the French expression '*il n'y a que le provisoire que dure*' (only provisional things last forever).

[5] Art. 227(4) Solvency II Directive, Art. 260(2) Solvency II Directive.

[6] Regular assessments of the equivalence decisions currently in force do take place, see, e.g., EIOPA (2023a), p 20.

[7] Commission Delegated Decision (EU) 2016/310 of 26 November 2015 on the equivalence of the solvency regime for insurance and reinsurance undertakings in force in Japan to the regime laid down in Directive 2009/138/EC of the European Parliament and of the Council, OJ EU 4 March 2016, L 58/55: EIOPA (2020). The provisional equivalence decision, granted for 10 years in 2016, relating to the inclusion of participations in Japanese insurance and reinsurance undertakings remains in place.

to facilitate the market position of European groups operating in third countries, by avoiding the need to hold capital at group level in accordance with European standards, while third-country competitors operating in these countries will not be similarly obliged to do so.

While equivalence is not used in Solvency II to grant direct market access to third-country insurance or reinsurance undertakings, reinsurance equivalence in Solvency II does have a close connection with market access. It should ensure that third-country reinsurance companies can provide meaningful reinsurance coverage to EEA insurance and reinsurance companies, that is, reinsurance coverage that will result in the desired risk-mitigating effect for these EEA insurance entities.[8] Furthermore, it should be noted that market access to the internal market for reinsurance (third-country (re)insurance companies providing reinsurance coverage in EU member states) has certain specific features whereby it distinguishes itself from direct insurance, in particular due to the global nature of the business and its business-to-business character. Equivalence for reinsurance is further discussed in Sect. 5.

3 Equivalence – Group Supervision

3.1 General Observations

In addition to the prudential supervision at solo level of EEA licensed insurance and reinsurance undertakings, groups that include EEA insurance or reinsurance subsidiaries are subject to Solvency II group supervision. This includes groups with a third-country parent company or third-country parent companies. The fact that parent companies are located in a third country does not exclude them from Solvency II group supervision. If such parent undertakings are located in a non-equivalent third country, Solvency II group supervision requirements will still apply at the level of the group.[9]

Solvency II group supervision requirements do not apply if the parent undertaking is situated in a third country with equivalent group supervision. In that case, EU member states shall rely on the equivalent group supervision, exercised by the third-country supervisory authorities.[10] In addition, the third-country group should be exempted from group supervision at the ultimate parent company level in the European Union on a case-by-case basis, where this would result in more efficient supervision of the group and would not impair the supervisory activities of the

[8] Art. 172(3) Solvency II Directive.

[9] Art. 213(1)c Solvency II Directive provides that EU member states should provide for supervision, in accordance with Title III Solvency II Directive, at the level of the group, which applies to insurance or reinsurance undertakings, the parent undertaking of which is an insurance holding company or a mixed financial holding company which has its head office in a third country or a third-country insurance or reinsurance undertaking, in accordance with Arts. 260 to 263 Solvency II Directive. Art. 262(1)a Solvency II Directive provides that Arts. 218 to 235 and 244 to 258 Solvency II Directive apply, *mutatis mutandis.*

[10] Art. 261(1) Solvency II Directive.

supervisory authorities concerned in respect of their individual responsibilities.[11] Thus far, the European Commission has made determinations on equivalence for group supervision only for a limited number of third countries.[12] While these EC decisions on full equivalence have been granted for an indefinite period of time, they can be revoked by the European Commission, should there be reasons to do so. It is worthwhile to note that EIOPA continues to monitor the application of full equivalence in these third countries by the relevant supervisory authorities. As discussed in its report on supervisory activities in 2022, EIOPA finalised an equivalence monitoring exercise in Bermuda, which aimed at assessing if the supervisory implementation of the equivalent regime ensured the same outcome from a policy holder protection perspective as the protection under Solvency II.[13] In follow-up discussions, the Bermudan authority presented its draft action plan to address the recommendations from EIOPA. In 2022, EIOPA started preparations for the upcoming second exercise in Switzerland, with some of the recommendations from the first exercise still being work in progress.[14] As an alternative to full equivalence, equivalence for group supervision could have been granted by the European Commission also on a temporary basis, if the third country regime would meet certain criteria, which importantly includes a commitment to adopt and apply a prudential regime that is capable of being assessed as fully equivalent by the end of a limited period of time.[15] This possibility was not used in practice,[16] and due to the expiration of this period in the Directive, it has since then become obsolete. Unlike other forms of equivalence in the Solvency II framework, provisional equivalence is not available for group supervision.[17]

An alternative approach to equivalence is provided in Article 262(1)b of the Solvency II Directive, which provides that one of the methods set out in paragraph 2 of Article 262 can be applied instead of the approach set out in Article 262(1). This

[11] EIOPA (2015a), Guideline 5. The Guidelines provide the criteria that should be considered to reach the conclusion that more efficient group supervision is achieved.

[12] Bermuda: Commission Delegated Decision (EU) 2016/309 of 26 November 2015 on the equivalence of the supervisory regime for insurance and reinsurance undertakings in force in Bermuda to the regime laid down in Directive 2009/138/EC of the European Parliament and of the Council and amending Commission Delegated Decision (EU) 2015/2290, OJ EU 4 March 2016, L 58/50; and Switzerland: Commission Delegated Decision (EU) 2015/1602 of 5 June 2015 on the equivalence of the solvency and prudential regime for insurance and reinsurance undertakings in force in Switzerland based on Arts. 172(2), 227(4) and 260(3) of Directive 2009/138/EC of the European Parliament and of the Council, OJ EU 24 September 2015, L 248/95.

[13] Such an assessment is related to Art. 260(3), second paragraph Solvency II Directive, on the basis of which the equivalence assessment for group supervision should be regularly reviewed to take into account any changes to the Solvency II group regime, changes to the third-country regulatory group regime and any other change that may affect the decision on equivalence.

[14] EIOPA (2023a), p 20.

[15] This period ended, including the possibility of extension, on 31 December 2020 (Art. 260(6) Solvency II Directive).

[16] This might be explained by the fact that it bears quite some risks for groups to have an organisational structure that relies, for group supervision, on a future and uncertain positive equivalence decision.

[17] Unlike temporary equivalence, provisional equivalence can formally be extended for an indefinite period of time, while temporary equivalence could only be extended once, until ultimately 31 December 2020.

means that supervisory authorities should be allowed to apply ‘other methods which ensure appropriate supervision of the insurance and reinsurance undertakings in a group’. These methods should be agreed by the group supervisor, after consulting the other supervisory authorities involved. Clearly, the reference to ‘other methods’ is rather vague.[18] Paragraph 2 does specify that such other methods may include the requirement to establish an insurance holding company or a mixed financial holding company in the European Union and apply Title III to the insurance and reinsurance undertakings in the group headed by that insurance holding company or mixed financial holding company. Furthermore, the methods chosen shall allow the objectives of group supervision, as defined in Title III, to be achieved and shall be notified to the other supervisory authorities and to the European Commission.[19]

3.2 US-EU Insurance Dialogue and the US-EU Covered Agreement

A particular case in which the European Commission has not made an equivalence determination for group supervision but in which no Solvency II group supervision at the ultimate parent undertaking in the third country is required to take place relates to the United States. Since 2012, the United States and the European Union have been engaged in recurring meetings on prudential measures, relating to insurance and reinsurance. The EU-US Insurance Project started in 2012, when the National Association of Insurance Commissioners, the Federal Insurance Office, the European Commission and EIOPA agreed to participate in a dialogue project with the objective of enhancing mutual understanding and cooperation between the EU and US for the benefit of insurance consumers, business opportunity and effective supervision. In addition to topics such as reinsurance, group supervision, and group capital calculations, other topics of common interest are being discussed as well. Currently, the dialogue project includes a Climate Risk Financial Oversight Workstream, a Climate Risk and Resilience Workstream and an Innovation and Technology Workstream.

An important milestone of the US-EU Insurance Dialogue has been the Bilateral Agreement between the European Union and the United States on prudential measures regarding insurers and reinsurers of September 2017, effective as of 17 November 2017 (the so-called ‘Covered Agreement’[20]). This agreement does not cover

[18] European Commission (2021), para. 87 seeks to provide further detail on the possible ‘other methods’. The amendments to the Solvency II Directive are, as the completion of this contribution, not yet final.

[19] Art. 262(2), third paragraph Solvency II Directive.

[20] ‘Covered Agreement’ is a term used in the Dodd-Frank Act. According to the Office of the United States Trade Representative, ‘a “covered agreement” is an international agreement that relates to the recognition of prudential measures with respect to the business of insurance or reinsurance that achieves a level of protection for insurance or reinsurance consumers that is substantially equivalent to the level of protection achieved under state insurance or reinsurance regulation. Title V of the Dodd-Frank Act authorises the Office of the United States Trade Representative (USTR) and the Secretary of the Treasury to jointly negotiate a covered agreement on behalf of the United States with one or more foreign governments, authorities, or regulatory entities’: https://www.ustr.gov (accessed 15 November 2023). On the

Solvency II equivalence for the United States,[21] but still addresses three important topics related to equivalence, namely reinsurance, group supervision and exchange of information.[22] Focusing on group supervision, the Covered Agreement provides a basis for US insurers to operate in the European Union without the parent undertaking in the United States becoming subject to Solvency II group supervision, despite the absence of an equivalence determination by the European Commission.[23] However, Solvency II group supervision could still be required at the level of the ultimate parent undertaking in the European Economic Area. This last point can be seen as the application of 'other methods', as described in the preceding sub-section.Interestingly, the Covered Agreement does not seem to formally require that group supervision is actually exercised by the home state.[24] In this context, it is useful to refer to the developments at international level in the context of the IAIS (International Association of Insurance Supervisors) International Capital Standards and the position of the United States in this project, which is discussed in more detail in Sect. 6.

3.3 Group Supervision Equivalence Assessment

The assessment of and decision to grant equivalence for group supervision is undertaken by the European Commission, supported by EIOPA, which provides its advice in this respect to the European Commission. The assessment criteria are developed by the European Commission, which is mandated on the basis of the Solvency II Directive[25] to develop these criteria. An extensive list of criteria has in fact been

Footnote 20 (continued)

EU side, the Covered Agreement is negotiated by the Council on the basis of the procedure laid down in Art. 218 TFEU and authorised by Council Decisions (EU) 2017/1792, 10 Oktober 2017, OJ EU L 258/1 and (EU) 2018/539, OJ EU 6 April 2018, L 90/63.

[21] See Van Hulle (2019), p 617.

[22] See for the recurring meetings and discussions that take place between the contracting parties: https://finance.ec.europa.eu/eu-and-world/bilateral-relations/eu-us-dialogue-insurance_en (accessed 15 November 2023).

[23] It is interesting to note that, in the past, the International Working Committee on Financial Conglomerates and the Committee of European Banking Supervisors (CEBS) advised the European Commission, which subsequently endorsed this advice in the form of guidance on whether the supervisory arrangements of relevant US supervisors are likely to achieve the objectives of consolidated and supplementary supervision as set out in the Capital Requirements Directive (CRD) and the Financial Conglomerates Directive. The conclusion was, in respect of insurance, that a general statement of equivalence for the NAIC and the US insurance state supervisors could not be given. EEA supervisory authorities must therefore conduct all equivalence assessments on a state-by-state and firm-by-firm basis, CEBS and IWCFC (2008).

[24] Art. 4(a) Covered Agreement reads as follows: 'Without prejudice to subparagraphs (c) to (h) and participation in supervisory colleges, a Home Party insurance or reinsurance group is subject only to worldwide prudential insurance group supervision including worldwide group governance, solvency and capital, and reporting, *as applicable*, by its Home supervisory authorities, *and is not subject to group supervision at the level of the worldwide parent undertaking of the insurance or reinsurance group by any Host supervisory authority*' [emphasis added].

[25] Art. 260(2) Solvency II Directive.

developed by the European Commission,[26] which is taken into account by the European Commission and *de facto* by EIOPA in its assessment of the third-country regime, leading to an EIOPA advice to the European Commission on the equivalence of specific third countries. So far, full equivalence for group supervision has only been determined for two third countries, i.e., Bermuda and Switzerland.[27] The analysis of the group supervision frameworks in these two countries indicate that the EIOPA advice involves an in-depth assessment of the frameworks and is by no means a formality.[28]

3.4 Equivalence—Solvency II Group Solvency Calculation

3.4.1 General Observations

When a group, subject to Solvency II group supervision, holds a participation in a third-country insurance or reinsurance undertaking, the default method for the Solvency II group solvency calculation is that this participation is included in that calculation using Solvency II requirements. This means that, while the local third-country insurance or reinsurance entity applies local requirements to calculate its solvency requirements and for the coverage of those requirements by own funds, at group level this participation is included in the group solvency calculation in accordance with European Solvency II requirements. As a consequence, an insurance or reinsurance group, subject to group solvency requirements in accordance with Solvency II, with insurance or reinsurance participations in third countries, will have to hold capital at group level in relation to that participation equal to at least the difference between the Solvency II contribution of that subsidiary to the group solvency capital requirements and local capital requirements of that participation, despite the fact that the subsidiary may fully meet such local capital requirements and, as such, no capital shortfall exists locally, despite a theoretical shortfall of that participation in the group solvency calculation.

An alternative approach exists in the Solvency II framework in case the third-country regime has been declared equivalent according to Article 227 of the Solvency II Directive. If the third-country regime has been declared equivalent, local rules relating to the capital requirements and capital (eligible own funds) apply instead of Solvency II requirements for the inclusion of that participation in the group solvency calculation. Similarly to equivalence for group supervision, the European Commission will base its equivalence decision on an advice by EIOPA,

[26] Art. 380 Solvency III Delegated Regulation, which lists 23 criteria, intended to cover all relevant topics on group supervision to be assessed by EIOPA and the European Commission.

[27] Commission Delegated Decision (EU) 2015/1602 of 5 June 2015 on the equivalence of the solvency and prudential regime for insurance and reinsurance undertakings in force in Switzerland based on Articles 172(2), 227(4) and 260(3) of Directive 2009/138/EC of the European Parliament and of the Council, OJ EU 24 September 2015, L 248/95; Commission Delegated Decision (EU) 2016/309 of 26 November 2015 on the equivalence of the supervisory regime for insurance and reinsurance undertakings in force in Bermuda to the regime laid down in Directive 2009/138/EC of the European Parliament and of the Council and amending Commission Delegated Decision (EU) 2015/2290, OJ EU 4 March 2016, L 58/50.

[28] See EIOPA (2011); see also Van Hulle (2019), p 610.

which in its turn will base its advice on a thorough assessment of the local regime. The assessment criteria are specified in Article 379 of the Solvency II Delegated Regulation.[29] Similarly to the assessment of equivalence for group supervision, Article 379 contains a significant number of criteria and the assessment of equivalence is an elaborate process, which is initiated by a request for advice from the European Commission to EIOPA, which will conduct a thorough review of the third-country regime. Subsequently, EIOPA will publish its draft advice for public consultation before providing the final advice to the European Commission, which will then be able to take a delegated decision on equivalence, based on the advice by EIOPA, subject to scrutiny by the European Parliament and the Council. Equivalence decisions will be subject to regular review so as to take into account changes in the supervisory regime in the third country as well as in the Solvency II regime.[30]

3.5 Consequences of an Equivalence Decision for the Group Solvency Calculation

The application of an equivalence decision to insurance groups in practice merits some further discussion, as the participation in an insurance or reinsurance entity in an equivalent jurisdiction is not treated similarly in all respects as participations of a group in EU insurance or reinsurance entities.

In the first place, the equivalence decision is only relevant if the group solvency calculation is carried out in accordance with the so-called deduction and aggregation method (method 2), through which contributions to the group solvency calculation are aggregated rather than fully consolidated.[31] In fact, in most cases this will result in a combination of methods used in the group solvency calculation, rather than exclusively method 2.[32] The group supervisor decides on the application of this alternative method in consultation with the other supervisory authorities and with the parent company of the group, considering a number of elements, specified in Article 328 of the Solvency Delegated Regulation:

(a) whether the amount and quality of information available in relation to a related undertaking would not be sufficient for it to be subject to method 1;
(b) whether a related undertaking is not covered by a group internal model, in the cases where a group internal model, approved in accordance with Article 231 of Directive 2009/138/EC, is used for the calculation of the consolidated group Solvency Capital Requirement;

[29] In addition, EIOPA has developed guidelines for the assessment process by national competent authorities in circumstances where the European Commission has not taken a decision on the equivalence of a particular third country, which includes an annex with a questionnaire, Technical Annex, Part II, EIOPA (2015b).

[30] Art. 227 Solvency II Directive.

[31] In accordance with Art. 233 Solvency II Directive.

[32] See Art. 341 Solvency II Delegated Regulation, which makes explicit reference, in relation to the consolidated group solvency capital requirement, to a combination of methods.

(c) whether, for the purposes of paragraph (b), the risks that are not captured in the group internal model are immaterial in relation to the overall risk profile of the group;
(d) whether the use of method 1 in relation to a related undertaking or several related undertakings would be overly burdensome and the nature, scale and complexity of the risks of the group are such that the use of method 2 in relation to that related undertaking or those related undertakings does not materially affect the results of the group solvency calculation;
(e) whether intra-group transactions are not significant both in terms of volume and value of the transaction;
(f) where the group includes third country related insurance or reinsurance undertakings, whether delegated acts have been adopted pursuant to paragraphs 4 or 5 of Article 227 of Directive 2009/138/EC, determining that the solvency regimes of those third countries are equivalent or provisionally equivalent.

In this context, it is relevant to point out that, according to Recital 125 of the Solvency II Delegated Regulation, where a group includes related third-country insurance or reinsurance undertakings, and where the solvency regimes of those third countries have been determined as equivalent or provisionally equivalent, the group supervisor should give such a consideration priority when deciding on whether method 2 should be used exclusively or in combination with method 1.[33] Therefore, while the group supervisor still needs to take all elements into consideration, priority should be given to the fact that a positive equivalence decision has been taken.

If the group calculates its group solvency in accordance with the default method according to Solvency II (accounting-consolidation method), the contribution to the group solvency of that participation is calculated as if it were a participation in an EU insurance or reinsurance entity and as an integral part of the group, fully integrated in the consolidated accounts at group level.[34] A consequence of the equivalence decision is that the inclusion of that participation in accordance with local, equivalent, requirements can only take place if that participation is assumed to operate on a stand-alone basis in the group, applying the deduction and aggregation method in the group solvency calculation. Clearly this can lead to a loss of diversification effects at group level and as such, *ceteris paribus*, potentially to a less advantageous treatment of that participation in the group solvency calculation.

It should be noted as well that equivalence is only available in respect of the treatment of participations in third-country insurance and reinsurance undertakings. Other entities, which may ‘belong’ to the same third-country unit within the group and which will need to be taken into account in the Solvency II group calculation, need to be assessed separately, on an entity-by-entity basis.[35]

[33] See also EIOPA (2016), para. 5.

[34] Art. 230 Solvency II Directive.

[35] For instance, an investment firm or credit institution or intermediate holding company that might belong to the same organisational unit will not be covered by an equivalence decision under the Solvency II framework, but will need to be included in the group solvency calculation separately.

3.6 Opinion of the European Insurance and Occupational Pensions Authority on the Group Solvency Calculation in the Context of Equivalence

Furthermore, it should be stressed that ‘equivalence’ does not mean ‘equal’. This is reflected in the manner in which the contribution of the participation is included in the group solvency calculation. In September 2015, EIOPA published an opinion concerning the group solvency calculation that includes participations in third-country insurance or reinsurance undertakings in an equivalent jurisdiction, to which the deduction and aggregation method should be applied. The opinion addresses several issues, including the third-country capital requirement to be taken into account in the group solvency calculation and the assessment of the availability of eligible own funds at group level. In the first place, EIOPA considers that, where a third-country regime distinguishes between different levels of capital requirements, the highest local capital requirement should be selected as being the equivalent of the solvency capital requirement according to Solvency II. In the annex to the opinion, EIOPA specifies what this means for two specific jurisdictions, i.e., the United States and Brazil. In addition, on the basis of Article 222 of the Solvency II Directive, in connection with Article 330(1) of the Solvency II Delegated Regulation, an availability assessment of the eligible own funds of related undertakings should be carried out.

3.7 Opinion of EIOPA on the Application of a Combination of Methods to the Group Solvency Calculation

Shortly after the opinion discussed above, EIOPA published a second opinion, in which it focused in particular on the application of tier limits for the composition of eligible own funds at group level. Solvency II insurance groups have to hold eligible own funds at group level, in addition to the own funds they hold to back the solvency requirements at local level. The composition of these own funds should meet certain criteria, including with respect to tier limits. Solvency II eligible own funds are classified in three tiers, of which tier one eligible own funds form the highest quality capital (most subordinated) and tier 3 eligible own funds the lowest quality capital (least subordinated). Tier 2 and tier 3 capital can only form part of the eligible own funds up to a certain level, as it would otherwise not be considered to provide a sufficient level of security to serve as buffer capital. In many instances, insurance groups subject to Solvency II group supervision, rely on central funding for the capital needs within the group, typically through the parent company, which provides funding to parts of the group that are covered by method 1 and parts of the group that are covered by method 2. In accordance with Solvency II requirements, tier limits for method 1 are based on the consolidated group solvency capital requirement, while tier limits for the method 2 part of the group are based on the individual solvency capital requirements of the relevant entities. This could have unintended consequences, such as when the parent company providing the funding and issuing capital and debt is covered by method 1, in which case tier limits will only be calculated using the consolidated group solvency capital requirement. To avoid such unintended consequences, EIOPA recommends the following to supervisory authorities in these circumstances:

- To use a separate basis for calculation of the tier limits;
- That the amount of eligible subordinated debt at the level of the group should not exceed the one that would have been calculated if the group had applied exclusively method 1;
- If a prudential regime of an equivalent or provisionally equivalent third country does not categorise own funds into tiers or defines tiers which are significantly different from those established under Solvency II, then the own funds brought in by method 2 should be allocated to tiers according to the principles laid down in Solvency II for each individual third-country undertaking.

As becomes clear from this sub-section, while equivalence for the group solvency calculation has proven to be an indispensable part of the Solvency II framework, the application in practice is not without its challenges and practical complexities.

4 Equivalence – Reinsurance

More so than other types of insurance, reinsurance is an international activity, and an essential tool for insurers and reinsurers to mitigate and diversify risk. In addition, the reinsurance market is dominated by a few, very large reinsurance groups, which are not necessarily all based in the European Union.

Therefore, in order to ensure sufficient reinsurance capacity for European insurance and reinsurance companies, it is essential that insurance and reinsurance companies have access to the European internal market, including non-European companies. Equivalence plays an essential role in this respect. As indicated in Sect. 1, equivalence in relation to reinsurance undertakings in the Solvency II framework plays a different role in the Solvency II equivalence framework than the two other types of equivalence, in relation to the group solvency calculation and in relation to group supervision. If the solvency regime of a third country is deemed equivalent to the solvency regime in Solvency II, reinsurance contracts concluded by EU insurance or reinsurance undertakings with reinsurance undertakings in equivalent third countries shall be treated in the same manner as reinsurance contracts concluded with EU insurance or reinsurance undertakings subject to the Solvency II framework. However, this in itself does not imply direct market access of third-country reinsurance undertakings. In addition, Article 173 of the Solvency II Directive prohibits EU member states to impose collateral requirements within a member state in relation to reinsurance contracts entered into with reinsurance undertakings located in an equivalent jurisdiction. In addition to the recognition of reinsurance contracts in accordance with Article 172(2) of the Solvency II Directive, this provision eliminates a significant barrier for reinsurance undertakings to enter into reinsurance contracts with EU insurance and reinsurance undertakings. An important safeguard for EU reinsurance undertakings is that EU member states are not allowed to grant more favourable treatment to third-country reinsurance undertakings than to reinsurance undertakings located within the European Union, regardless of an equivalence decision.

In this context it is relevant to note that, recently, EIOPA published a consultation document on the supervision of reinsurance concluded with third-country insurance and reinsurance undertakings.[36] From this consultation document it becomes clear that EIOPA expects insurance undertakings to properly assess the reinsurance arrangement they intend to enter into from a number of perspectives,[37] which includes an assessment of the risks relating to the third-country environment, such as the legal environment.[38] This is irrespective of an equivalence assessment, although the assessment may be influenced by the equivalence determination. According to EIOPA, undertakings are, for instance, expected to identify the legal consequences arising in case of insolvency, winding-up procedures or recovery and resolution mechanisms, including the power of disavowal with, consequently, no enforceability of pledged collateral and no direct claim on the counterparty in the third country. Undertakings are also expected to identify how risks arising from such regimes may be mitigated and whether there are special areas to be considered in case of liquidation and bankruptcy of the third-country reinsurer. Furthermore, insurance undertakings are expected to consider the position of collateral, in particular possibilities to withdraw the collateral.[39] To a certain extent, the consultation paper does make a distinction between reinsurance contracts entered into with reinsurers in equivalent and non-equivalent jurisdictions, but equivalence does mean, according to the consultation paper, that an insurance undertaking does not have to take into consideration certain aspects of the third country's legal environment at all, such as third-country insolvency legislation.

Already under the EU Reinsurance Directive,[40] preceding the Solvency II Directive, the European Union was entitled to enter into negotiations with third countries regarding the means of exercising supervision over third-country reinsurance undertakings, conducting reinsurance business in the European Union and vice versa, regarding European reinsurance undertakings which conduct business in third countries. Such agreements seek to ensure in particular, under conditions of equivalence of prudential regulation, effective market access for reinsurance undertakings, for both EU reinsurance undertakings and third-country reinsurance undertakings, as well as mutual recognition of supervisory rules and practices. In addition, they should seek to ensure effective exchange of information.[41] The possibility for such

[36] EIOPA (2023b). The consultation period ends on 10 October 2023.

[37] According to the consultation document, insurance undertakings are expected to assess the business rationale and are encouraged to engage (proportionally) in an early supervisory dialogue if they intend to enter into reinsurance arrangements. Furthermore, EIOPA indicates that it has expectations with respect to the risk management and internal controls of the insurance undertaking and with respect to the content of the reinsurance contract.

[38] The consultation paper refers in particular to legal/compliance risk arising from the law for the third countries concerned, including, for example, risks resulting from international sanctions, as well as counterparty risk.

[39] EIOPA (2023b), paras. 3.7 and 3.8.

[40] Directive 2005/68/EC.

[41] Art. 173(3) Solvency II Directive.

agreements between the European Union exists, in addition to the arrangements in Solvency II relating to equivalence. So far, the Covered Agreement between the US and the EU, mentioned above, is the only agreement concluded on this basis.[42] The Covered Agreement should result in the abolition of local presence requirements (the incorporation of a branch) and collateral requirements on both sides within five years,[43] despite the absence of an equivalence decision by the European Commission.[44] According to EIOPA, the Covered Agreement has also certain consequences for the supervisory expectations, as expressed in the consultation paper discussed above.[45]

Furthermore, in this context, it should be noted that, absent an equivalence decision or an international agreement on the basis of Article 175 of the Solvency II Directive, EU member states may still establish additional requirements for non-EU reinsurance undertakings, such as the establishment of a branch. Also, reinsurance contracts entered into with such non-EU counterparties will be subject to higher capital charges than would apply to similar reinsurance contracts with counterparties located in equivalent jurisdictions.

5 Equivalence and Beyond

Although not strictly related to equivalence, the developments at international level are also worth mentioning in the context of equivalence. The International Association of Insurance Supervisors (IAIS) is currently developing an Insurance Capital Standard (ICS) as a consolidated group-wide capital standard for Internationally Active Insurance Groups (IAIGs). The ICS consists of three components: valuation, qualifying capital resources, and a standard method for the ICS capital requirement. The ICS will be the quantitative component of ComFrame, which is the Common Framework for the Supervision of Internationally Active Insurance Groups. ComFrame builds on the Insurance Core Principles (ICPs)[46] and establishes supervisory standards and guidance focusing on the effective group-wide supervision of IAIGs. ComFrame is a comprehensive and outcome-focused framework aimed at facilitating effective group-wide supervision of IAIGs by providing qualitative and (in a future phase) quantitative supervisory minimum requirements tailored to the international activity and size of IAIGs. The IAIS adopted ComFrame in November 2019, with implementation starting in 2020. The purpose of the ICS is to create a common language for supervisory discussions of group solvency to enhance global convergence among group capital standards. In 2019, a 5-year monitoring period

[42] As explained above, the Covered Agreement also covers a number of other topics, including in relation to group supervision.

[43] The Covered Agreement was concluded on 27 September 2017.

[44] On the basis of Art. 172 Solvency II Directive.

[45] In particular, reference is made to a provision in the US-EU Covered Agreement with respect to contractual consent by the assuming reinsurer to the jurisdiction of the ceding reinsurer, Art. 3.4 d Covered Agreement. See EIOPA (2023b), p 8, n. 15.

[46] Which are international supervisory standards developed by the IAIS for the insurance industry.

was agreed, prior to the implementation of the ICS. The 5-year monitoring period started as per the beginning of 2020. During this period, participating IAIGs will confidentially report ICS results that are being discussed in supervisory colleges. During the monitoring period, ICS results will not be used as a basis for triggering supervisory action. Following the end of this period, the ICS will be implemented as a group-wide prescribed capital requirement.[47] Interestingly, while not taking part in the ICS initiative, the United States is developing an aggregation method for a group capital calculation, which, if deemed compatible by the IAIS, will be considered an outcome-equivalent approach to the ICS as a prescribed capital requirement. These developments at international level can be seen as positive and as a building block for future equivalence assessment on the basis of Solvency II. At this stage it is clearly too early yet to draw conclusions on the potential success of the ICS and ComFrame.[48]

As mentioned in Sect. 2, all initial equivalence decisions are still in place, with the exception of the equivalence decision on temporary equivalence on reinsurance for Japan. It should be noted that this has been the only equivalence decision providing *temporary* equivalence, as opposed to provisional or full equivalence. Based on the Solvency II provisions, temporary equivalence could no longer be extended.[49] In a joint statement, EIOPA and the Japanese insurance supervisory authority (FSA) do stress that the expiration is due to:

> the different timelines for the termination of status of temporary equivalence under the Solvency II Directive and the future implementation of Japan's economic value-based solvency regime, respectively. It does not relate to an assessment of the quality of the supervision in Japan.
> Regulatory cooperation between the EU and Japan for the insurance sector remains strong, on the basis of the existing joint EU-Japan financial regulatory forum. To further enhance our relationship, the European Commission, EIOPA and the FSA will maintain close communication and discussions that include the enhancement of supervisory cooperation, with a view to ensuring the continuity of the quality of the supervision of cross-border groups by their respective authorities. Cooperation will also be strengthened through exchanges supporting the regulatory developments on both markets, which may potentially lead to a future assessment for full equivalence as established under Solvency II.[50]

As mentioned, the equivalence decision with respect to provisional equivalence does remain in place in respect of Japan as well.

[47] See https://www.iaisweb.org/ (accessed 15 November 2023).

[48] See, e.g., Van Hulle (2019), pp 643-644.

[49] With the exception of an extension of one year, on the basis of Art. 172(5), second paragraph Solvency II Directive, to carry out an assessment of equivalence. Apparently, no use has been made of this possibility in the Directive, which suggests that the future implementation of Japan's economic value-based solvency regime, as well as a subsequent equivalence assessment, will take more time.

[50] EIOPA (2020).

Meanwhile, the current decisions on equivalence, either full or provisional, remain in place and all subject to review. As a recent EIOPA supervisory report suggests, monitoring activities have been conducted or are being undertaken with respect to Bermuda and Switzerland, the two jurisdictions that have been granted full equivalence, and reference is made to action plans, suggesting that these monitoring activities amount to more than a formality.[51] Furthermore, it should be borne in mind that for those jurisdictions that are currently subject to a provisional equivalence decision, the expiration and/or renewal of the equivalence decisions (after an initial period of 10 years from the application of Solvency II) is approaching.

Clearly, in the context of equivalence, it is hard to ignore the United Kingdom. As a former EU member state of the European Union, the United Kingdom is most likely, of all third countries, the prudential regulatory regime for insurance and reinsurance that is the closest in content to Solvency II and, in that respect, would be an ideal candidate for equivalence under Solvency II. However, at the same time, the UK has indicated that it intends to diverge from Solvency II, adopting its own approach to insurance and reinsurance prudential regulation and complicating positive equivalence assessments from the EU side.[52] Meanwhile, the United Kingdom has deemed EU Solvency II requirements equivalent to the UK requirements, which should not be too surprising, given the fact that at the time of this UK equivalence decision, EU Solvency II and UK solvency requirements (including the assessment procedure for equivalence) were substantially equal.[53]

6 Conclusions

As has become clear from this contribution, the use of equivalence in the Solvency II framework has proven to be a valuable element in the overall Solvency II framework. The equivalence instruments in the Directive, addressing three distinct issues relating to the application of Solvency II, and in the three forms (full equivalence, temporary equivalence and provisional equivalence) that can be distinguished, have all been applied in practice and remain subject to ongoing monitoring by EIOPA. The instruments covered in the Solvency II Directive and complemented with detailed requirements in the Solvency II Delegated Regulation and EIOPA guidelines and opinions, together with elaborate assessments of third-country jurisdictions, contained in advice from EIOPA to the European Commission, constitute a

[51] EIOPA (2023a), p 20.

[52] The Financial Services and Markets Bill was introduced to Parliament on 20 July 2022. It creates new powers for the UK Treasury by regulations to make transitional amendments to, restate, or modify retained EU law relating to financial services and markets. These regulation-making powers are subject to Parliamentary approval. After the Bill gains Royal Assent, it will allow the Government to commence revocation of existing Solvency II legislation. See further, e.g., https://www.gov.uk/government/publications/draft-insurance-and-reinsurance-undertakings-prudential-requirements-regulations (accessed 15 November 2023); https://www.gov.uk/government/consultations/solvency-ii-review-consultation (accessed 15 November 2023).

[53] See https://www.legislation.gov.uk/uksi/2019/541/pdfs/uksiod_20190541_en_016.pdf (accessed 15 November 2023.

solid legal framework and indicate that Solvency II equivalence, while undeniably having a political dimension as well, is solidly rooted in the legal framework of Solvency II. The application of equivalence does have consequences in practice that go beyond strictly using third-country regulatory requirements. Beyond Solvency II equivalence, other instruments are being applied in the context of EU insurance and reinsurance regulation as well, in particular to take into account the international, cross-border nature of the insurance and reinsurance industry. While equivalence does not provide direct market access, it can facilitate market access to some extent or reduce competitive disadvantages or hurdles, both on the side of EU market participants and on the side of market participants in equivalent jurisdictions. In addition, international developments, in particular at the level of the IAIS, could support the further evolution of equivalence or optimistically, may, with further international convergence of prudential standards, even make the equivalence framework obsolete, 1 day...

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