BANCO DE ESPAÑA

FINANCIAL CONGLOMERATES, A VANISHING PROBLEM?

José María Roldán

Director General of Banking Regulation, Bank of Spain

Member of Committee of European Supervisors, and

Member of the Basel Committee on Banking Supervision

HIGH LEVEL MEETING ON THE IMPLEMENTATION OF BASEL II IN ASIA AND OTHER REGIONAL SUPERVISORY AUTHORITIES

Hong Kong
11-12 December 2006

DEFINITION OF A FINANCIAL CONGLOMERATE (FC)

- **Activity**

  Banking + Securities + Insurance (JF Definition: any of two)

  Insurance + any of other (Banking/Securities) (EU)

  – Threshold

    If one activity is non-material, not a FC

WHAT IS SPECIAL ABOUT F.C.

1. **Products, firms → not tagged as sectoral**
   - Similar financial product can be packed as an insurance product, a banking product, a securities product
   - Same business financial activity can be undertaken by a bank, an investment bank or an insurance company

2. **Convergence in risk management practices**
   - Private sector → advances in risk aggregation
   - Public sector → consolidated supervision as the best practice

3. **But differences still exit**
   - Risk Management → actuaries in insurance
   - Regulation → capital adequacy, definition of capital

CHALLENGE: KEEP DIFFERENT WHAT NEEDS TO BE DIFFERENT, BUT AVOID REGULATORY ARBITRAGE OR IMPROPER RISK MANAGEMENT PRACTICES

WHAT HAVE WE DONE

i. **Global Level**
   - **JF → Risk Management Practices and Regulatory Capital – Cross-sectoral comparison**

     -Risk integration and aggregation; Op risk transfer across sectors, credit risk transfer,…

ii. **Regional Level**
   - **EU → F.C. Directive**
   - **USA Umbrella Supervision (Gramm-Leach-Bliley Act)**

CONTENT

A. **Avoid double gearing**

   - Same capital, covering different financial risk

B. **Coordinate supervisors**

C. **Have a global picture of FC ("Consolidated or group-wide")**

DOUBLE GEARING -EXAMPLE

i. Insurance company in country A with € 6,000 capital…
ii. …establishes a securities firm in country B with € 3,000 of capital
iii. Insurance supervisor in A, if only looks at the insurance company, might conclude that it has € 6,000 to cope with risks
iv. Securities supervisor in B, if only sees the securities house, might conclude that the firm has € 3,000 of available capital
v. The problem is that the consolidated company has € 6,000 of available capital to deal with risks of both, the insurance and the securities firms

vi. Therefore, there is a need for consolidated or group-wide supervision but taking into account that capital needs differ by sector (i.e. banks, insurers and securities)

WHAT NEEDS TO BE DONE

- Industry: best practices in risk management, extend them across jurisdictions, across groups, across sectors

- Regulators: promote sound regulatory convergence (avoid arbitrage)
  - Definition of capital
  - Risk Based Regulation: EU, from B II to Solvency II

THE PARADOX: CONGLOMERATES, A VANISHING PROBLEM?

- **FUNNY THING: NEGATIVE CONNOTATION OF THE WORD F.C.**
- **NOT ONLY THERE ARE FEWER F.C., BUT EVEN F.C. DO NOT WANT TO BE CALLED F.C. !!**
- **WHY? NOT CLEAR**
  - **BECAUSE OF REGULATION:**
    - ***IF ELIMINATION OF CAPITAL/REGULATORY ARBITRAGE: NO REGRET***
    - ***OTHER REASONS***
  - **SIMPLE: INDUSTRY TREND**

- IF F.C. NOT SO RELEVANT, SHOULD WE GIVE UP EFFORTS?
- ANSWER: **NO!**
- RATIONALE FOR REGULATION IS <u>THERE</u>

1. SAME FINANCIAL INSTRUMENTS DYNAMICS
   SAME RISK MANAGEMENT
   SAME REGULATION
   IRRESPECTIVE OF SECTORAL TAG

2. COORDINATION OF SUPERVISORS
   LOOK AT THE BROAD PICTURE: FC AS A WHOLE

3. AVOID DOUBLE GEARING

CONCLUSION

- RATIONALE FOR EFFORTS: RIGHT TRACK
- STEP BY STEP: REGULATORS/INDUSTRY
- NOT CONFUSE “INDUSTRY TRENDS” WITH A “SOUND REGULATORY FRAMEWORK”

THANK YOU FOR YOUR ATTENTION

BANCO DE ESPAÑA

150 AÑOS DE HISTORIA
1856-2006