

FINANCIAL CONGLOMERATES, A VANISHING PROBLEM?

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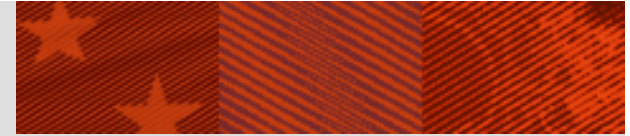
Member of the Basel Committee on Banking Supervision

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

Hong Kong

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DEFINITION OF A FINANCIAL CONGLOMERATE (FC)



- **Activity**

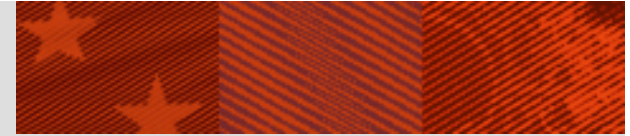
Banking + Securities + Insurance (JF Definition: any of two)

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 exist

- 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

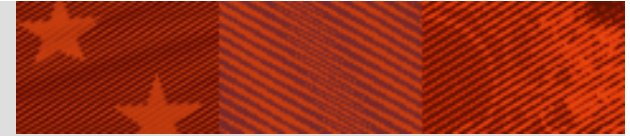


- **Industry: best practices in risk management, extend them across jurisdictions, across groups, across sectors**
- **Regulators: promote sound regulatory convergence (avoid arbitrage)**
 - **Definition of capital**
 - **Risk Based Regulation: EU, from B II to Solvency II**

THE PARADOX: CONGLOMERATES, A VANISHING PROBLEM?

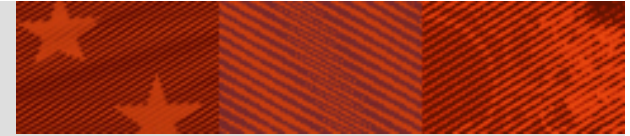


- **FUNNY THING: NEGATIVE CONNOTATION OF THE WORD F.C.**
- **NOT ONLY THERE ARE FEWER F.C., BUT EVEN F.C. DO NOT WANT TO BE CALLED F.C. !!**
- **WHY? NOT CLEAR**
 - **BECAUSE OF REGULATION:**
 - ***IF ELIMINATION OF CAPITAL/REGULATORY ARBITRAGE: NO REGRET***
 - ***OTHER REASONS***
 - **SIMPLE: INDUSTRY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



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