



Perspectives on:

# regulation in banking, investment management and insurance



**David Sayer**



**Dave Seymour**



**Frank Ellenbürger**



From left to right:  
David Sayer,  
Dave Seymour and  
Frank Ellenbürger.

Many authorities across the world are seeking to formulate new regulatory frameworks in the wake of the crash. But the final shape of any new system remains quite unclear; and it is unlikely to remain free of political distortion and interference. **David Sayer**, Global Sector Leader, Retail Banking, **Dave Seymour**, Global Sector Leader, Investment Management (IM) and **Frank Ellenbürger**, Global Sector Leader, Insurance, met recently to compare and contrast their different perspectives.

**David Sayer (Banking)** Looking at what's happening at the moment, it seems to me important that this crisis is seen to have been caused by the banks. So the diagnosis is focused on bank failures and the need to stop this happening again, often to the exclusion of other potential causes of the crisis including: trade surpluses, fiscal deficits, regulatory policies and so on.

**Dave Seymour (IM)** I agree. Just following up on the political dimension for a moment, there is a great deal of debate over the extent to which US executive and legislative policies during the mid 1990s, such as the modifications made to regulate and strengthen the Community Reinvestment Act anti-redlining procedures, as well as other legislative actions, may have impacted the crisis. Policy makers are now trying to fix it, but given the complexities, it is difficult to know what, or how much to regulate.

**Frank Ellenbürger (Insurance)** Of course by contrast with the huge stress and uncertainty in the economy caused by the banks, insurance and the insurance markets have continued to operate normally, without any major disruption. The same is true for reinsurance markets. The impact of the crisis on insurers has mainly been on the life side, with the value of investments tumbling. Those that have been most affected deviated from their core operations into financial products developed without understanding the risk that underpinned them. But the business model of insurers and the largely uncorrelated relationship between insurance risk and market risk have so far been stabilizing factors; hence insurance is much lower on the political and risk radar.

There is always a political dimension to financial markets. The world has discovered not only how dangerous financial markets can be, but how valuable functioning financial markets are to economies.

Dave Seymour



**Sayer** In the case of the banks, though, there is huge pressure now for taxpayers to provide guarantees and bailouts. These include liquidity support through guarantees and protection of savers and borrowers, asset purchases, forced recapitalization, bad bank schemes and so on. But the big questions that I think should still be answered are to do with how to reduce systemic risk in the banking system. This involves a range of issues: the nature of financial regulation; strengthening regulators; reducing the impact of failure of financial firms; protecting and supporting customers; improving competition.

**Seymour** And this raises the key issue of whether we can recreate a fiduciary society with a common framework and set of rules, or whether we are inevitably faced with a much more rigid, strict set of rules. Do we really need more regulation?

**Ellenbürger** Before any action is taken, it should be well thought through and balanced, taking into account the macro-economic considerations. Intervention should not create an uneven playing field between different sectors of the financial services industry. Although banking has been the crux of the crisis, a new framework or set of rules should look beyond this sector; introducing a 'one-size-fits-all' response will only lead to future complications. Each industry will require separate revisions.

**Sayer** In the banking sector, some trends are clear. The quantity of capital required will be high, and counter-cyclical requirements will be imposed to make banks hold more capital in the good times (unlike the Basel II framework, which is pro-cyclical). But it is yet unclear how this is going to work in practice, and in different economies. The other problem with imposing counter-cyclicity is that cyclicity will always be there. Someone has got to turn the lights out just as everyone else is enjoying the party. And that's really difficult. Looking back, it's hard to see how macro-prudential regulation would have been accepted in say 2005 or 1987 when the last booms were getting going.

**Ellenbürger** It will be interesting to see how the banks adapt to the anticipated counter-cyclical requirements requiring them to significantly shore-up their capital holding. Intrinsically insurers have always had to calculate their capital adequacy because of their exposures to risk when underwriting. But with the 2012 EU-wide implementation deadline of Solvency II, Europe's insurers will have to fundamentally review their capital requirements and risk management standards. Whether other key global insurance markets look to replicate this framework locally remains to be seen, and undoubtedly regulators will be heavily involved.

**Seymour** And that makes it even more difficult to see how greater regulation can effectively be extended to investment management. The G20 couldn't agree on regulating hedge funds. The European countries are pushing for regulation, while the US is looking for registration. The European Commission's draft directive on the issue is itself proving highly contentious among member states. Investment funds are products, not companies, and this makes providing safeguards for investors a different matter than in the banking sector. There is as yet no clear idea of how to tie investment funds into the systemic risk argument, especially in view of the easy flow of funds into and out of different economies and jurisdictions.



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Frank Ellenbürger

**Ellenbürger** Nevertheless, the systemic risks resulting from an overtly complicated banking system with an inadequately developed regulatory framework have been one of the causes of the current crisis, and these need to be addressed. The precondition for creating an anti-cyclical regulatory environment is to obtain transparency and a holistic view of the global financial system, without leaving large parts unregulated.

**Sayer** The debate over whether or not a global regulator is necessary, or possible, will inevitably go on. But however global the framework, it's a fact that global institutions come home to die. In the end, failing banks are the responsibility of their home regulators. In my view, the global role should be about ensuring consistency between national frameworks and limiting the scope for regulatory arbitrage. Regulation itself needs to remain local. In Europe, though, there is a particular problem caused by the single market. Since the single market requires free and open movement of capital, the case for a single European regulator may be stronger. It's not going to be politically easy to achieve, but the potential accession of Iceland to EU membership may be a trigger.

**Ellenbürger** International groups may benefit from diversification effects but also be exposed to accumulation or contagion risks. Those need to be mirrored by supervision on a cross-border basis.

**Seymour** Any regulatory reform must look to prevent the next crisis, not the last one.

**Sayer** It's also important that regulation avoids the moral hazard problem, and avoids giving investors and customers the impression that all risk has been removed from financial markets.

**Seymour** I guess one thing that we have certainly learned is that there is always a political dimension to financial markets. The world has discovered not only how dangerous financial markets can be, but how valuable functioning financial markets are to economies.

**Sayer** It's going to take time to work out solutions in the banking sector. What has happened by way of emergency action was what needed to happen, but the rest, a new approach to regulation, will take time. And that's a good thing. We need to take the time to get this right.



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David Sayer

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