

Convergence in Financial Services Markets

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Two kinds of convergence

Conglomeration

- Financial services firms in the same corporate group

Competitive convergence

- Banks, securities firms and insurers offering competing services

Conglomeration

U.S law—Gramm-Leach Bliley Act—
restricts conglomeration

--Banks can expand into insurance and
securities

--But Insurers and securities firms
reluctant to become subject to Fed

Conglomeration unlikely to occur

Competitive convergence

Each of the members of the financial services industry competes with the others

This, more than conglomeration, raises the question of future regulation

Regulatory arbitrage becomes possible

- Choosing the regulatory structure under which to offer a product

- Regulatory capture/regulatory competition

Convergence in other countries

Many developed and developing countries have recognized convergence and conformed their regulatory structures

--Australia, Canada, Columbia, Denmark, Japan, U.K., others

--Most did this because of conglomeration, not competitive convergence

Current pattern of US regulation

Banks are chartered and regulated at state and federal level

- Insured state banks regulated by FDIC

- National banks regulated by OCC

- Bank holding companies regulated by Fed

Insurers chartered and regulated only by states

Securities firms ordinary corporations regulated by SEC to protect customers, not companies

Treasury proposal

Three elements: short term, medium term and long term

Short term included an optional federal charter for insurers

Medium term included merging SEC and CFTC

Long term Included an “optimal structure”

Treasury's optimal structure

More than—and less—than a consolidated regulator for all financial services firms

- Business conduct regulator

- Prudential regulator

- Systemic risk prevention role for the Fed

By proposing to regulate all financial services firms according to “objectives” —not silos—
Treasury recognized implications of competitive convergence

Examples of competitive convergence

Banks vs securities firms (consumer services)

- Investment and savings products, as well as payment vehicles and credit cards
- Bank deposit accounts and CDs compete with mutual funds and short term notes
- Banks' private banking sections compete with securities firms' investment management

Examples of competitive convergence (cont.)

Banks vs securities firms (commercial side)

- Commercial paper and longer term debt securities sold by securities firms compete with short and longer term bank loans
- Securities firms now engage in bridge lending, competing with banks
- Securities firm privately place notes and bonds, competing with bank syndications
- Derivatives: interest rate and credit def swaps

Examples of competitive convergence (Cont.)

Banks vs Insurers

- BICs vs GICs (life companies)
- Bank deposits and CDs vs fixed annuities
- Surety bonds vs bank standby letters of credit
- Banks and insurance companies both active in credit default and interest rate swaps
- Bank CDS compete with bond insurance

Examples of competitive convergence (Cont.)

Securities firms vs Insurers

- Mutual funds competitive with universal life and variable annuities
- Life companies' investment advisory units compete with securities firms' roles
- Catastrophe bonds sold by securities firms compete with reinsurance
- Credit default swaps compete with surety bonds and bond insurance

Implications for regulatory structure

Competitive convergence more likely than any other issue to force regulatory restructuring

Congress resistant to change, but companies competing under different regulatory regimes makes no sense

Prospects: Jurisdictional fights, regulatory capture, inconsistent regulation

Implications for Insurance Regulation

No change of regulatory structure at the federal level will matter to insurance regulation unless an optional federal charter is first adopted

Prospects for serious consideration are reasonably good in next Congress

After that, competitive convergence will eventually force Congress to consider reform

Beginning with Treasury plan