Economic Capital and Regulation of Banks and Insurers

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Abstract: In many countries, insurers and banks are separately regulated. In some countries, banks and insurers are not allowed to be part of the same conglomerate and share capital. This raises questions about the efficient use of capital and return on equity to shareholders. In this empirical study, we view economic capital from a solvency perspective with the focus on downside risk. The key question addressed is "What efficiencies, if any, are gained by allowing banks and insurers of different types to merge and thus share capital." We examine to what degree bank and insurer performances have been correlated historically, especially in the downside tail. This case study is based on Canadian banks, life insurers and property-casualty insurers.