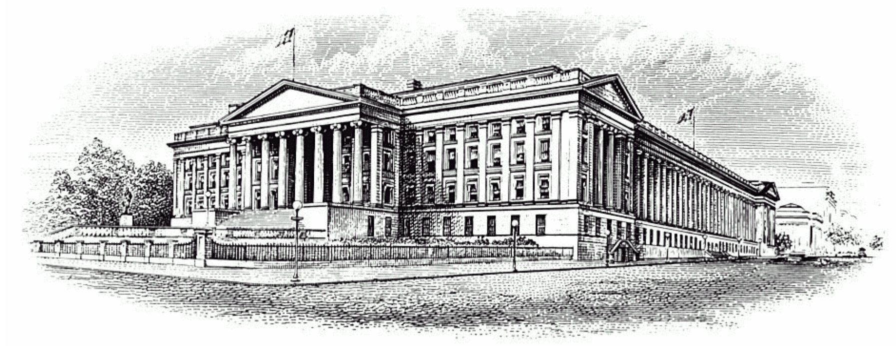

DEPARTMENT OF THE TREASURY
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Testimony of
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U.S. Department of the Treasury

Before the House Financial Services Committee

Introduction

Thank you, Mr. Chairman. It is a great pleasure to testify on the U.S.-EU Financial Market Dialogue. Indeed, the Treasury Department thanks the Committee for its continued attention to transatlantic financial market and regulatory relations and its support for the Dialogue. This backing has been integral to the progress made.

To be sure, there have been longstanding financial market discussions between the United States and Europe. But the US-EU Financial Market Dialogue, for all intents and purposes, began in March 2002. Since then, technical meetings of the Dialogue, which is led jointly by the Treasury Department and the European Commission Internal Market Directorate and includes the active participation of U.S. regulators, have taken place on more or less a quarterly basis. In addition, the Dialogue is supplemented by substantial interaction of senior policy officials.

Both the United States and the EU have increasingly viewed the Dialogue with satisfaction. At the last two US-EU Summits both sides provided favorable press statements about the Dialogue. For the upcoming Summit in Dublin, Ireland on June 27, we anticipate that Dialogue participants will provide a short joint report to Leaders. In my remarks, I will outline some key factors underpinning the Dialogue, recent achievements, and issues in which the Dialogue will likely play a role going forward.

The Dialogue's Objectives

The Dialogue from the start has been a two-way street reflecting mutual self-interest. A central aim of U.S. foreign economic policy is to promote a strong global economy. The United States is doing its part, but in Europe growth has lagged and needs to become more broad-based. Last September, G-7 Finance Ministers committed to an Agenda for Growth. This Agenda focuses on structural measures that countries can take to boost productivity and raise economic potential.

U.S. history shows that a strong, efficient capital market is a critical pillar for robust growth. Several studies have concluded that the creation of a truly liberal and integrated European capital market through Europe's Financial Services Action Program (FSAP) could raise EU growth by more than one percent per annum in a decade's time. Building on the successful introduction of the euro, progress on both the Agenda for Growth and the development of an integrated European financial market could be a lasting benefit not only for Europe, but also for the United States, emerging markets and developing countries throughout the world.

Our economies are part of a globalized economic and financial system. Hence, in observing the building of the European capital market, the United States has an interest in an FSAP that successfully anchors the European financial system in an integrated, state-of-the-art, open and soundly supervised global financial marketplace.

Also, U.S. financial institutions have long been global leaders and they are a vital part of the European financial landscape. We are clearly interested in seeing that our firms are able to compete globally on fair terms, which reward their competitiveness and demonstrated capacity to innovate. Indeed, we believe that US firms can help contribute to the European economy and financial system. For example, US firms have been leaders in the development of mutual fund products, which are critical for pension plans. Many analysts believe that greater use in Europe of such products under defined contribution plans is essential for addressing Europe's demographic challenges.

Just as the United States is interested in the evolution of the European capital market, so is Europe interested in the evolution of the US capital market. As the Chairman knows from the promulgation of the law informally bearing his name, US financial market legislation can have implications for market participants outside the United States. European firms are understandably interested in access to US capital markets.

Both parties to the Dialogue share an interest in promoting the common objective of strong capital markets that are soundly regulated. But in achieving these objectives, we both recognize that the United States and Europe have different financial, legal, historical and cultural traditions. Because of these differences, actions by one of us may have unintended spillover effects into the other's jurisdiction.

Before us are the paths of cooperation or confrontation. Together, we have decided that our challenge is to see through these different traditions, to work to achieve our common objectives in substance and to manage these spillovers. That is why the United States and Europe have a mutual self-interest in closely cooperating on financial markets through the Dialogue. That is why we meet often to promote understanding between us, to discuss emerging issues and the implications of these issues for each other, and to anticipate problems and work them out if possible. Managing the Dialogue successfully, we believe, will produce a win-win outcome for the US, Europe and the world.

The Agenda

The United States strongly supports the Financial Services Action Plan and we commend Europe for its ambitious goal of unifying its capital markets and for the progress made to date. At the present juncture, the European Parliament has approved all but three of the 42 FSAP measures, which are now in varying stages of implementation. Because thorny issues lay buried in the details of these measures, it was important for the U.S. to actively engage with the EU on their ramifications for U.S. interests.

It is perhaps axiomatic that financial markets will always be a step ahead of the regulators and that regulation should ensure soundness while not stifling dynamism. Thus, effective rule-making requires close cooperation with market participants. We have been particularly pleased by the more transparent processes in Europe for financial rule-making that have emerged over the last two years and the increased consultations with market participants, including US financial institutions operating in Europe. We are also pleased that Brussels and the European Parliament appreciate that working with market participants can improve European rule-making, create a greater consensus and buy-in for proposed regulations, and strengthen European financial markets.

Some of the key issues we have been discussing with Brussels are the following.

- <u>Financial Conglomerates Directive.</u> We have been discussing the Financial Conglomerates Directive for two years. It requires a foreign supervisory regime to be deemed “equivalent” by the EU for firms based in that country to operate within the single EU market without costly legal and financial changes that could prove harmful to the European market. Our supervisory regime is top flight and world class. But to help Europe reach a finding of equivalence, all U.S. regulators (FRB, SEC, OTS, NAIC) have cooperated closely with Brussels and with member state regulators in explaining their approaches to consolidated supervision. We are confident that this process, albeit slow, will be brought to a successful conclusion.

- <u>Prospectus and Transparency Directives.</u> These directives initially suggested that US firms listing new securities in Europe should prepare financial statements on the basis of International Accounting Standards by 2005, rather than US GAAP, or cease issuing in Europe. Further, the draft directives made no provision for grandfathering previously listed issues. We have discussed these matters with Brussels for the last year, and final texts provide for grandfathering of existing issues. Also, to enable continued new listings by US firms in Europe using financial statements prepared under US GAAP, criteria are being crafted to allow European countries to make an affirmative determination later this year that US GAAP is “equivalent” to IAS.

- <u>Investment Services Directive</u>. This directive sets conditions for European share trading and raised the question of whether firms needed to put all trades through stock exchanges or could match orders internally, which is a common market practice in the UK. In the end, Brussels softened features of the draft bill so as to permit internal order matching and price improvement for transactions greater than “retail” size.

- Takeover Directive. When drafted, this directive sought to build an integrated European market for M&A activity to help attract capital and rationalize inefficient firms. In the end, it allows member states to maintain national protections for some firms against takeovers. Brussels has assured the United States that any discrimination against third country firms would be inconsistent with Europe’s international obligations.

Thus far, Europe is making progress under the FSAP in building an integrated capital market. Compromises reflecting different European country practices are an inevitable part of the FSAP process. But Brussels, the Parliament and the member states are working to instill as liberal a vision as possible for the European capital market. While this vision may not be identical to the perspectives of the New York or London markets, its implementation is a work in progress, it represents an important step forward and the extension of this vision to the EU internal market will contribute to the growth of global capital markets.

For its part, the EU cares deeply about financial market developments in the United States. Though the start of the Dialogue predated corporate malfeasance disclosures with respect to Enron and WorldCom, rapid enactment of the Sarbanes-Oxley Act in mid-2002 gave Europe more reason to accelerate talks with us on corporate governance issues. As many of these issues are in the domain of my colleague from the Securities and Exchange Commission, I will not comment on them other than to note that both the letter and spirit of Sarbanes-Oxley were fully observed, and EU concerns were substantially accommodated.

In terms of the near-term agenda, both sides have also discussed a range of other issues, including the Basel II Accord, foreign trading screens and the Capital Equivalency Deposit Requirement (CED).

Looking Ahead

The quest to build a European capital market will not end with the 42 measures. Following the selection of a new Commission and European Parliament, the EU and the United States will need to tackle new challenges together in promoting a stronger and more vibrant transatlantic capital market.

Among these challenges are the promotion of convergent accounting standards on both sides of the Atlantic, improving corporate governance and strengthening investor protections and confidence, and reducing costs of investment in Europe by creating a European-wide system of clearance and settlements. The effort to promote convergent standards -- consistently applied, implemented and enforced -- is particularly critical. By effectively tackling these challenges, a truly vibrant and integrated transatlantic capital market may come into being.

Conclusion

In conclusion, Mr. Chairman, the Dialogue has been making good progress. But many challenges remain. Already, the Dialogue has increased the transparency of rule-making and imparted momentum to financial market reform in Europe. Furthermore, the Dialogue is rightly credited as having helped defuse transatlantic tensions in an important area vital to the functioning of the world economy. The goals of the Dialogue support the Agenda for Growth, which is a key theme for this year's G-7 process. Finally, there is the expectation on both sides of the Atlantic that if the US and EU can agree on financial regulatory standards, then others around the world will follow. As you can see, the potential benefits are enormous, and not just for the U.S. and EU. It is important that the Dialogue succeeds, and I believe it will.

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