

**TESTIMONY OF
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**THE US-EU ECONOMIC RELATIONSHIP:
WHAT COMES NEXT?**

**BEFORE THE
HOUSE FINANCIAL SERVICES COMMITTEE
SUBCOMMITTEE ON DOMESTIC AND INTERNATIONAL
MONETARY POLICY, TRADE AND TECHNOLOGY
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Madam Chair and members of the Subcommittee:

I am Marc E. Lackritz, president of the Securities Industry Association¹.

I appreciate the opportunity to testify today about the transatlantic financial services relationship and its signal importance for the economies of the United States and the member states of the European Union, and for financial services firms on both sides of the Atlantic. We appreciate your continued interest in the U.S.-EU Financial Markets Dialogue, and the European Union's Financial Services Action Plan (the "Action Plan" or the "FSAP").

¹ The Securities Industry Association brings together the shared interests of nearly 600 securities firms to accomplish common goals. SIA's primary mission is to build and maintain public trust and confidence in the securities markets. At its core: Commitment to Clarity, a commitment to openness and understanding as the guiding principles for all interactions between investors and the firms that serve them. SIA members (including investment banks, broker dealers, and mutual fund companies) are active in all U.S. and foreign markets and in all phases of corporate and public finance. According to the Bureau of Labor Statistics, the U.S. securities industry employs nearly 800,000 individuals, and its personnel manage the accounts of nearly 93 million investors directly and indirectly through corporate, thrift, and pension plans. In 2004, the industry generated an estimated \$227.5 billion in domestic revenue and \$305 billion in global revenues. (More information about SIA is available at: www.sia.com.)

These hearings take place at a time when the political news from Europe is dominated by the rejection by some of Europe's voters of an ambitious new EU charter.

But in the same four week period as France and the Netherlands had their "no" votes and the UK put off its referendum, several major cross-border or transatlantic mergers were announced: Unicredito Italiano – HVB; Banco Bilbao of Spain's €6.44 billion bid for Italy's Banca Nazionale del Lavoro; ABN Amro's launch of a €6.3 billion bid for Italy's Banca Antonveneta; and, just this week, BNP Paribas' agreement to buy Nebraska's Commercial Federal Corporation for \$1.36 billion. And, data available for the January-March 2005 period show that European investors traded nearly \$4.4 trillion in U.S. securities, and U.S. investors traded nearly \$1 trillion of European securities. As the numbers clearly demonstrate, while the political news has been mixed, European and transatlantic financial integration and consolidation proceeds unabated.

My testimony today will focus on the critical importance of continued U.S. – European financial engagement and, especially, the importance of continued involvement by the United States with Europe in the development of European – and increasingly transatlantic and indeed global – capital markets. In particular, I will make the following key points:

- Focus by the EU on harmonization and implementation is critical to the success of the FSAP;
- Progress in accounting convergence is a key building block of the development of the transatlantic capital market;
- Continuing robust SEC-CESR dialogue is essential for transatlantic capital markets convergence; and
- The reduction of global trade barriers in financial services should be a key area of U.S.-EU cooperation, and joint advocacy.

The Scope of U.S.-EU Capital Markets Relationship

The transatlantic relationship provides the global U.S. securities industry and its corporate, institutional and retail clients with tremendous opportunities. Indeed, SIA's largest members engaging in global business receive about 20 percent of their net revenues (excluding interest) from European markets. Their revenues from Europe are close to double what is earned from their Asian operations.

Our U.S. and European economies and capital markets are closely linked through trade and cross-border investment flows. The U.S. and EU together account for about 70 percent of global equity capitalization – about \$16 trillion in the U.S. and \$10 trillion in the EU. The two-way flow of trade, portfolio, and direct investment between our two regions exceeds \$1 trillion annually. Of the top 500 companies in the world, 358 are based in the transatlantic market, including 19 of the top 20. The recent historic enlargement of the EU by 10 new Member States has only magnified the region's importance to the United States – the EU now has 450 million potential investors and a GDP exceeding \$12 trillion. In comparison, the U.S. population totals 280 million, with a GDP almost reaching \$12.2 trillion.

The popular press may be filled with stories about the vast market potential of China and India, but the U.S.-EU capital markets remain the most deep, liquid, transparent, and sophisticated in the world. And while there will inevitably be disagreements in any close relationship, the political and economic ties between our two regions will only grow deeper and stronger over time.

It is for this reason that SIA has repeatedly urged the establishment of a U.S. Treasury Attaché in Brussels. Treasury's presence in Brussels would advance the important financial sector dialogue in which the U.S. and the EU are engaged. A Treasury Attaché in Brussels would facilitate greater dialogue with the Commission and other EU decision-makers as FSAP implementation proceeds, would facilitate coordination with the U.S. regulatory community as appropriate, and would make possible the close monitoring and study – in partnership with industry – of developments that have major – and increasing – significance to the U.S. markets and financial community. In addition, the

presence of a Treasury Attaché in Brussels would facilitate positive U.S.-EU cooperation on a pro-growth agenda, such as in connection with the Doha Development Round – which I will discuss in more detail later in my testimony. We respectfully urge support from the Subcommittee to place a Treasury Attaché in Brussels.

Focus On Implementation/Enforcement of FSAP

The legislative phase of the Financial Services Action Plan is now officially concluded. We congratulate the European Commission, the Commission staff, the European Parliament, the Council and CESR on completion of this ambitious and historic legislative agenda. But, the FSAP's legislative deadline was only a first step – FSAP measures must now be transposed, correctly and effectively, into national law and regulation, which is possibly an even more challenging task.

The European Commission's *Green Paper on Financial Services Policy (2005 – 2010)*² ("Green Paper") proposes that major goals for this period should be "the consolidation of existing legislation, with few new initiatives" and "ensuring the effective transposition of European rules into national regulation and more rigorous enforcement by supervisory authorities." We couldn't agree more. We believe the Commission should, for the time being, strongly resist proposing new financial services legislation.

We urge the European institutions to focus their energies instead on ensuring that the FSAP is implemented and enforced as intended, and that the national laws and regulations adopted to implement it will result in an integrated single capital market. As Treasury Secretary Snow recently stated, "Implementation will be key. If 25 different supervisors implement directives 25 different ways, the promise of a more integrated EU financial market will not be realized and it will be hard for the US and the EU to achieve convergence."³

² http://europa.eu.int/comm/internal_market/finances/docs/actionplan/index/green_en.pdf

³ U.S. Treasury Secretary John Snow at the Center for European Policy Studies Brussels, Belgium June 14, 2005, US-EU Cooperation for Growth, <http://www.treas.gov/press/releases/js2494.htm>

The Kok Report⁴ (released in November 2004) made clear its frustration with the lack of Member State commitment to implementing EU legislative measures, and noted that such behavior “must no longer be tolerated.” One of the report’s recommendations was to create an implementation scoreboard, ranking the 25 Member States on their progress toward implementation.⁵

We suggest that the Commission consider developing a dispute resolution mechanism that would allow implementation complaints to be brought to the Commission’s attention without fear of retribution at home country level. We would also recommend that the Commission create a position specifically dedicated to monitoring, and providing reports on areas of discrepancy in FSAP implementation and to collecting information on the efficacy of FSAP measures in practice.

For example, consider three critical measures with huge market implications: the Markets in Financial Instruments Directive, the Transparency Obligations Directive and IAS 39. Their proper implementation and enforcement and their application in practice will, in SIA’s view, be critical to FSAP success and to global financial markets integration more broadly. As the Green Paper states, “Improved economic performance and welfare creation will largely depend on the capability of European institutions, supervisory authorities and market participants to ensure that the existing rules are consistently applied and enforced...”⁶.

⁴ Facing the challenge: The Lisbon strategy for growth and employment, Report from the High Level Group, http://europa.eu.int/growthandjobs/pdf/kok_report_en.pdf

⁵ The Report made two key recommendations to faster transposition: 1) at the beginning of 2005, the Commission should produce a full list of internal market legislation still awaiting transposition in each of the 25 Member States, to be annexed to the Spring European Council conclusions. This list should be sorted by Member State, beginning with the worst offender; and 2) in the light of this scoreboard, the 2005 Spring European Council should set a final deadline by which transposition should be completed.

In addition, where measures at the Member State level are implemented incorrectly, the Commission should ensure the problems are promptly resolved. As a result, we strongly back the Green Paper’s commitment to “continuous ex-post evaluation whereby the Commission will monitor carefully the applications of...rules in practice – and their impact on the financial sector.”

⁶ Green Paper on Financial Services Policy (2005 - 2010), COM (2005) 177, p.8.

In addition, SIA is also monitoring closely the transposition of Basel II requirements into EU law. The Capital Requirements Directive will impose Basel requirements on all investment firms operating in Europe, including US firms. The SIA recently delivered a letter to financial regulators urging that they reconsider aspects of Basel II relating to trading book issues and to unsettled trades and indicating that significant revisions to the proposed capital requirements for both credit risk in the trading book and unsettled trades are warranted. SIA believes it is essential that the provisions in the CRD applicable to the trading book are set appropriately, so that regulatory capital is, in all cases, proportional to risk.

Noting that “A well-functioning risk capital market is a strategically important element of promoting new and innovative firms, entrepreneurship, raising productivity and the sustainable rate of economic growth in Europe,” the Commission indicates in the Green Paper that it will not “hesitate to propose to modify or even repeal measures that are not delivering the intended benefits.”

SIA is working, and stands ready to continue to work, with the European institutions and the Member States to make FSAP a success for Europe and for the global marketplace. Madam Chair, we very much welcome the engagement of the Subcommittee to ensure that implementation of FSAP results in an integrated EU capital market which will result in greater economic growth and job creation.

Accounting Convergence – The Roadmap

This past April, the U.S. and EU announced a new Roadmap describing “...the steps needed to eliminate the U.S. GAAP reconciliation requirement for foreign private issuers that use International Financial Reporting Standards...” as early as possible, between now and 2007.⁷

⁷ <http://www.sec.gov/news/press/2005-62.htm>

We commend the SEC for working with the European Commission to develop this “Roadmap” and hail it as an extremely positive step toward transatlantic financial markets convergence. We are pleased that the standard setters are in discussions with one another and that the process has become professionalized.

We hope that against the backdrop of the Roadmap outlining a process for convergence by 2007 it will be possible for the EU to make a full “equivalence” determination with respect to “US GAAP” for purposes of the Transparency and Prospectus Directives in very short order (and well before 2007). The Roadmap outlines a process of convergence, and it is critically important for market continuity that liquidity in the European markets not be needlessly curtailed, and that issuers not be needlessly penalized, while that process is under way.

We have reason for concern. On April 27th, the Committee of European Securities Regulators (“CESR”) published Draft Technical Advice for the European Commission on the extent to which Canadian, Japanese, and U.S. GAAP should be considered “equivalent” to International Financial Reporting Standards (“IFRS”). While the draft advice held that U.S. GAAP was generally equivalent to IFRS, it simultaneously published a list of additional ‘remedies’ that a U.S. issuer utilizing U.S. GAAP would have to make. The press release that accompanied publication of the draft advice described the remedies as relating to “significant differences in Accounting Standards,” that could be “handled through disclosure and not reconciliation.”⁸

While we understand that it was not the intention of CESR to require a full reconciliation between U.S. GAAP and IFRS, as a practical matter, given the number and extent of the proposed remedies, a U.S. firm would have no choice but to keep two sets of books to ensure that it has identified all possible significant discrepancies between the two sets of accounting standards. Apart from surely failing any reasonable cost-benefit test, such a result seems the very antithesis of accounting convergence. Indeed, we understand that a number of major accounting firms have already informed

⁸ *Press Release*, The Committee of European Securities Regulators, 27 April 2005; Ref. CESR/05-306.

clients that the level of review and attestation that would be required by auditors in such a scenario would be the equivalent of a full audit. Given the cost of such an undertaking, we expect that some U.S. companies would find it more cost-effective to de-list and thus deny themselves access to EU capital markets, rather than to comply with the proposed remedies.

Transatlantic Capital Market Convergence

The growing linkages between the U.S. and European markets create opportunities for regulations to spill over from one jurisdiction to another. We have already observed this phenomenon in the cases of the U.S. Sarbanes-Oxley Act and in the EU's Financial Conglomerates Directive...and I do not think we have seen the last of it. As a result, SIA has been among the strongest and most vocal supporters of the U.S.-EU Financial Markets Dialogue. I would like to take this opportunity to thank the Subcommittee for its continued support of the Dialogue, and also to commend the Treasury Department for its continued efforts with its EU counterparts to create an integrated, deep, transparent and liquid European capital market.

SIA has confidence that this pioneering effort – a regular, flexible dialogue at all levels among relevant U.S. and EU officials and regulators, with continuing input from the private sector – has the capacity to strengthen and possibly over time even transform the transatlantic economic relationship, while helping to overcome the inevitable disagreements that occur in a close relationship.

For that reason we applaud the new discussions between the U.S. SEC and CESR to open discussions with the goal of further regulatory convergence in the transatlantic capital markets.

The SEC-CESR dialogue is critically important. Our firms face regulatory frameworks in the U.S. and the EU that are largely geographically based and do not adequately reflect the global nature of financial services. Consequently, SIA urges regulators to view this Dialogue as more than just a way to solve problems once they

have arisen, but rather as a forum to engage in a broad, visionary, forward-looking agenda, in concert with industry.

Enhanced cooperation and understanding can be the basis to minimize regulatory differences and help make the transatlantic capital markets more efficient and accessible to investors and issuers. An uncoordinated approach leads to new regulatory hurdles and barriers that raise costs for all market participants. By contrast, an integrated, transatlantic capital market is clearly in the best interests of all participants – investors, issuers, and intermediaries – as well as the global economy.

We believe this so strongly that SIA is working with a number of trade associations on a project that will compare and contrast U.S. and EU rules in the equity and related derivatives markets, evaluate the substantive differences in such rules, and propose ways such differences might be accommodated, mitigated, or perhaps removed altogether. In effect, we will be putting forward the “business case” as to how identified regulatory inefficiencies, complexity, duplication, conflict or unnecessary cost could be addressed in order to establish a more coherent, effective and cost-efficient regulatory framework for that business. We hope that this project⁹ will serve as a first step in the regulatory convergence dialogue and, at the least, contribute to the already promising dialogue between U.S. and EU financial services officials and regulators.

⁹ The project has progressed to a point where a number of different topics for discussion have been isolated. These include:

- I) Formulate and agree a common set of client/customer/counterparty definitions for:
 - a) solicitation purposes; and
 - b) account documentation.

- II) Creating an agenda for public and private sector parties to work towards identifying areas of regulation in the context of equities and equity derivatives that would benefit from a more homogeneous approach to regulatory standards and requirements including, for example;
 - a) best execution standards;
 - b) treatment of client assets;
 - c) allocation procedures;
 - d) research distribution rules

We look forward to working with the SEC and CESR in a broad, forward-looking development agenda that will benefit our transatlantic and global clients.

U.S.-EU Partnership: Working Together to Reduce Barriers to Global Financial Markets

Finally, we urge U.S. and EU negotiators to provide joint leadership to achieve commercially meaningful WTO financial services commitments from developing countries. We hope the Subcommittee will provide leadership in ensuring that the Doha Round leads to commitments that reduce and eliminate the barriers that prevent our securities firms from even offering their products and services. Deeper and more liquid securities markets strengthen banks and other financial institutions by offering additional, liquid investment vehicles where capital can be productively employed. Moreover, it is increasingly recognized and established empirically that well-functioning capital markets increase overall economic growth, especially for developing countries.

The 1997 WTO financial services agreement was an important step forward in achieving trade liberalization and market access in financial services. Importantly, this agreement established a good foundation upon which WTO Members can pursue further liberalization to reduce and eliminate remaining barriers. We urge U.S. and EU negotiators to provide joint leadership to achieve commercially meaningful WTO financial services commitments from developing countries in the WTO Doha Round negotiations. The successful conclusion of the 1997 WTO Financial Services Agreement was in large part a result of the co-operative efforts of the U.S. and EU negotiators.

We recognize that the U.S. and EU, along with a number of other countries, recently submitted a “Communication” to the WTO, noting that “...further liberalization of financial services will help promote economic growth and improved standards of living for all WTO Members and are an essential element of the Doha Development round. We urge all WTO Members to provide meaningful financial services offers with a view to

achieving substantial liberalization in this key sector.”¹⁰ We would urge the U.S. and EU to show continued leadership on this critically important issue.

U.S. and EU negotiators should seek a forward-looking WTO agreement that commits countries to enhanced levels of regulatory transparency in addition to addressing specific trade barriers. Regulatory practice in the financial services industry has developed unevenly and often at odds with the market access and national treatment commitments of WTO members. We believe that regulatory transparency commitments have a unique power to break down barriers to global trade in financial services and urge negotiators to focus particular attention on them.

I would also like to take this opportunity to discuss the securities industry model schedule of market opening commitments. This schedule, initiated by internationally active securities companies from around the world working together through trade associations and industry groups in the U.S., Europe and Asia, provides a template to pursue new market-opening commitments in the current round of negotiations among member governments of the World Trade Organization. We seek to reduce trade barriers in the financial services sector by building on the financial services framework established by the General Agreement on Trade in Services.

To that end, we have developed a Model Schedule of GATS commitments to further open markets for trading, underwriting, asset management, and financial advisory services. This proposal is intended to supplement, and indeed complement, the work we are doing with you and other representatives of the U.S. government in many venues to achieve efficient international capital markets. Importantly, this schedule reflects the business models of our companies.

¹⁰ WTO Communication from Australia, Bahrain, Canada, The European Communities, Japan, Norway, Oman, Panama, Singapore, Switzerland, The Separate Customs Territory Of Taiwan, Penghu, Kinmen and Matsu, and the United States, S/FIN/W/43, June 8, 2005.

Despite progress made in financial markets liberalization over the past years, numerous barriers continue to restrict the ability of internationally active securities companies to deliver services in ways that maximize economic efficiency and enable the optimal delivery of services to clients, while contributing to stable growth. These barriers affect the supply of securities-related services delivered through a commercial presence and also on a cross-border basis. We seek to address these barriers through the Model Schedule¹¹, which embodies five core principles:

- *Commercial Presence* – securities companies should be permitted to establish or expand a commercial presence:
 - through the acquisition of an existing company or the establishment of a new company, and
 - in their choice of corporate form (e.g., wholly-owned subsidiary, branch, or joint venture with local partner);
- *Cross-Border* – securities companies should be permitted to provide services cross-border to sophisticated investors without the obligation to establish a local presence and without local authorization, which
 - reflects the practice of a number of key financial regulators, and
 - does not exempt securities companies from conduct-of-business rules, such as measures to protect against and punish fraud and market manipulation;
- *National Treatment* – foreign securities companies and their services, whether operating or being supplied through a commercial presence or cross-border, should be afforded national treatment;
- *Transparency* – financial regulations should be developed, adopted, and enforced in a transparent, non-discriminatory manner; and

¹¹ It is important to note that the draft Model Schedule contains provisions that are more liberal than current U.S. practice. We are currently engaged in discussion with the SEC on these key elements.

- *GATS Exceptions* – the Model Schedule is subject to existing regulatory safeguards, including the prudential carve-out and the exception for measures restricting payments and transfers.

Finally, we would like to see the U.S.-EU dialogue take on a greater sense of urgency. We believe that the U.S.-EU Summit – to be held June 20, in Washington, DC – is an ideal forum and time to call on both sides to view with more urgency steps toward regulatory convergence of the transatlantic capital markets. This is a unique opportunity to re-energize the alliance and point it toward tangible goals. It should not be missed.

We very much appreciate the Committee's serious interest in the deepening relationship between the U.S. capital markets and those of our largest trading partner – the European Union. We look forward to working with the U.S. and EU on a positive economic agenda for growth, including transatlantic regulatory convergence, and the reduction and elimination of barriers faced in third markets. SIA looks forward to working with your Subcommittee, the Congress, and the Administration as we work to help create the best possible foundation for the global capital markets, economic growth and new opportunities for us all.