THE EUROPEAN UNION'S FINANCIAL SERVICES ACTION PLAN AND ITS IMPLICATIONS FOR THE AMERICAN FINANCIAL SERVICES INDUSTRY

HEARING

BEFORE THE

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THE EUROPEAN UNION'S FINANCIAL SERVICES ACTION PLAN AND ITS IMPLICATIONS FOR THE AMERICAN FINANCIAL SERVICES INDUSTRY

Wednesday, May 22, 2002

U.S. HOUSE OF REPRESENTATIVES,
COMMITTEE ON FINANCIAL SERVICES,
Washington, D.C.

The committee met, pursuant to call, at 10:12 a.m., in Room 2128, Rayburn House Office Building, Hon. Michael Oxley [chairman of the committee] presiding.

Present: Representatives Roukema, Royce, Kelly, Gillmor, Weldon, Manzullo, Shays, Shadegg, Miller, Cantor, Hart, Capito, Tiberi, Lafalce, Waters, Mrs. Maloney of New York, Watt, Bentsen, Mr. Maloney of Connecticut, Sherman, Inslee, Mrs. Jones of Ohio, and Lucas.

Chairman OXLEY. The meeting will come to order. The Committee on Financial Services meets today to examine an issue that will have major implications for this committee and for America's financial services industry, the total overhaul of Europe's financial services sector.

Since 1999, the European Union has been working to implement an ambitious agenda known as the Financial Services Action Plan. Targeted for completion by the year 2005, this plan includes major changes for EU regulators, financial service providers and investors.

In late March of this year, I led a congressional delegation to Brussels, London and Berlin to meet with political and business leaders about developments in the European financial services sector. Ranking member LaFalce accompanied me on the trip, as did our colleague from North Carolina, Mel Watt. At each meeting we attended, the primary topic of discussion concerned major changes being undertaken as part of the Financial Services Action Plan.

While Europe's move toward integration has been widely praised in the U.S. for the measures it takes to streamline the European financial marketplace, some concerns still exist. These concerns include new rules for the supervision of financial conglomerates, international accounting standards and corporate prospectuses. Unfortunately, the plan includes the divisive issue of expensing for stock options. I simply don't understand why the EU would choose this forum, which after all is supposed to be dedicated to harmonizing accounting standards, to raise this contentious issue.

In addition, the action plan is at the heart of the EU's stated goal of making the European Union "the most dynamic and competitive knowledge-based economy in the world" by 2010. This committee must do everything possible to give American businesses the tools they need to compete in the global economy, and we must continue to anticipate challenges to American competitiveness.

The global economy will benefit greatly if our friends across the Atlantic are able to streamline their markets and regulatory authorities, but it must not come at the expense of transparency and free trade. The U.S. financial services industry is the most innovative, competitive and transparent in the world. Coupled with the fact that Europe is both our most active trading partner and our most powerful ally, we are well served by staying ahead of the curve with respect to the coming changes in Europe.

The Treasury Department, the SEC and Federal Reserve are closely following the changing financial services landscape in the EU. I would like to welcome representatives from each organization today, Governor Mark Olson, Assistant Secretary Randy Quarles and Ms. Annette Nazareth, who will be testifying about their impressions of the Financial Services Action Plan, and about their continuing dialogue with European counterparts.

I would also like to thank representatives from the private sector, and from academia, who will go into further detail on implementation of the plan, how it will effect U.S. interests.

Before the witnesses testify, I will now turn to the distinguished gentleman from New York, the ranking member of the committee, Mr. LaFalce, for any comments that he may have.

[The prepared statement of Hon. Michael G. Oxley can be found on page XX in the appendix.]

Mr. LAFALCE. And you have forgotten, your favorite traveling companion. Okay.

I really want to thank Chairman Oxley for holding this hearing on the European Union's Financial Services Action Plan. I think this hearing can serve a very important purpose by informing our members of the significant developments in the integration of the financial services sector taking place in the European Union. The EU's Financial Services Action Plan has the potential to transform the European market for financial services.

Integration of the EU financial services sector can have profound implications, not only for financial services firms but, more generally, for the strength and competitiveness of the EU's economy and businesses. I would like to emphasize, and I think our witnesses are going to agree, that an integrated market in Europe is ultimately of benefit to U.S. firms operating in the EU.

The efficiencies gained from a larger, integrated market will far outweigh the costs associated with the changeover. In fact, one estimate suggests that economic gains resulting from financial services integration could be an additional 43 billion euros, or about $40 billion for the EU economy annually. The United States, and the rest of the global economy, will benefit from the successful economic integration, and I hope we will do all in our power to support the Europeans in their endeavor.

And clearly the EU is up to the task of integrating complex regulatory schemes, not only in financial services, but across economic and social sectors. The introduction of the euro currency, first as an accounting entity, and now as circulating currency has gone remarkably well, and has silenced many critics of integration as a result.

It is important to keep the big picture in mind as we look at their plan. The members of the EU are in the midst of a grand political, social and economic experiment. It is not unlike the one our founding fathers embarked on 226 years ago. The introduction of the euro alone has been a significant step toward unifying their economies, just as the introduction of Federal Reserve notes did for our country early in the last century.

It may be inevitable that such a major revamping of the financial services regulatory structure in the EU will highlight differences in approach between our two regulatory systems. And we should be diligent in assuring that U.S. financial services providers operating in the EU are not disadvantaged by standards that may discriminate inappropriately against foreign financial service providers.

At the same time, we should be mindful that EU legislators must make the same judgments that Congress has had to make with respect to competition, fairness and consumer protection for our own financial services.

That is my prepared statement. Let me just take a few minutes now to make a couple of additional points.

First of all, we have a lot to learn from the EU. The adoption of the euro is tremendous, it is significant, it is profound. But when we negotiate trade agreements, we negotiate everything but something dealing with the currency of our respective countries.

And one of my chief concerns, when we negotiated the Canadian-American free trade agreement, was the relative value of our currencies. And when we negotiated it, was about 90 cents on the dollar, and today it is closer to 60 cents on the dollar. That is profound. You look at the trade balances, and they will parallel that change almost to the dotted i and crossed t. If you look at the impact, especially on border communities, it is profound, intuitively.

When I would go to a shopping market in Niagara Falls, New York, 25 percent of the people I greet couldn't vote for me, because they were Canadian. Today, they all could vote for me, but they just don't want to.

[Laughter.]

But there are no Canadians. I could met an awful lot of my constituents by going to Niagara Falls, Ontario. We have to take that into consideration.

I was the chief proponent of the Canadian-American, but I also have problems with the NAFTA, and my chief concern with the NAFTA, as chairman of the Small Business Committee, I had a hearing on the imminent devaluation of the Mexican peso. And within a short period of time, less than a year, I mean we had a precipitous devaluation, which was not uncommon with the Mexican peso, but it was profound. And it had an enormous, enormous impact on the standard of living on the people in those countries, et cetera. So my point is, we can't negotiate trade without considering currency and trying to bring them into stability.

Something else too. I will be finished in a second, Mike. There are so many things that if we want to engage an integrated global economy, we have to make sure that our standards are similar to theirs, you know, accounting and et cetera. But we can't try to get the Europeans to go for our standards if our standards are lower as political inconvenient. We should use the higher European standards as something to emulate and, when it is appropriate, vice-versa. And that is extremely important, and I thank the chair for his indulgence.

Chairman OXLEY The gentleman's time has expired. Any further opening statements the—

Mr. SHERMAN. Mr. Chairman—

Chairman OXLEY. The gentlemen from California, Mr. Sherman?

Mr. SHERMAN. Thank you, Mr. Chairman. I would like to use this opening statement to address what I think is the most important international financial issue facing this committee and perhaps this Congress, within the jurisdiction of this committee and the Assistant Secretary of the Treasury that comes before us.

This country's leadership is engaged in two parallel tracks. One is to tell the American people that we are in a war on terrorism, and that we are trying to protect their safety. The other is to go along and to get along with European financial bureaucrats at tea parties regardless of whether that poses a threat to American safety.

The State Department yesterday announced that Iran was the number one sponsor of state terrorism. The State Department was not fooled by the allegedly moderate, but powerless, front man who serves as president of Iran. The State Department understands that power in Iran is really held by unelected extremists. These unelected extremists have arranged their government to spend the minimum necessary on domestic expenditures which they need to do to hold onto power. Every additional dollar is then available for their nuclear weapons program and to sponsor terrorism.

Today, the World Bank is going to provide and is planning to provide hundreds of millions of dollars of the money needed for those domestic expenditures, freeing up an equal amount for Tehran's nuclear weapons development program, a program bent upon not only developing those weapons, but smuggling them into the United States. But the tea parties with European financial bureaucrats continue.

With the last administration, the World Bank decided to loan, I believe it was, $232 million. What did we do? We voted no, and when we got outvoted, we went to tea.

Okay, that was before September 11, and perhaps we didn't have to view the war on terrorism as being all that important.

Now, in a recent article by Dow Jones, it is revealed that the World Bank is planning to loan an additional $755 million. And unless Congress acts, we will do the same thing. We will vote no. We will vote no in a loud voice. We will get outvoted, because we cast only 16 percent of the votes. And as this article, which I would like to make part of the record of this hearing, reveals the European diplomats have already indicated that they are guaranteed to outvote us. And then we will go to tea with the European bureaucrats who understand that as long as Europe supports the government in Iran, that when that government develops nuclear weapons, they will be smuggled into American cities, not European cities.

Chairman OXLEY. The gentleman's time has expired.

[The following information was subsequently furnished by Hon. Brad Sherman for the hearing record.]

Mr. SHERMAN. I would just like to bring to the attention of the committee the intention to provide over $800 million to the World Bank at a time when the World Bank is planning to loan $755 million to the government of Iran.

I yield back.

Chairman OXLEY. The gentleman yields back.

Are there further opening statements? Noting none, then we return to our—I am sorry, Judge Jones?

Mrs. JONES OF OHIO. Thank you, Mr. Chairman.

I just want to welcome each of those witnesses to our hearing this morning, and particularly, Mr. Chairman, I would like to welcome Mr. Mark Olson, governor of the United States Federal Reserve Board.

On Friday of last week he was in my congressional district. The Federal Reserve sponsored a small business workshop for the small businesses in my congressional district. And this is a part of the hearing I want to thank him personally for coming and sponsoring that event on behalf of the small businesses in my congressional district.

And I look forward to the testimony of each and every one of the witnesses that is going to be testifying. And, of course, you can look forward to probing questions from each of my colleagues.

Thanks, Mr. Chairman.

The CHAIRMAN. Thank you.

We will begin with the hardworking Mr. Olson, particularly as this committee is concerned.

And we appreciate your being here with us, and you may begin.

STATEMENT OF HON. MARK OLSON, GOVERNOR, FEDERAL RESERVE BOARD

Mr. OLSON. Thank you, Mr. Chairman. I have a statement that I will submit for the record, but I would like to just pull a few comments from it for an opening statement.

First of all, it is appropriate to thank you for the hearing and for the timing of the hearing. You mentioned in your opening statements that we are looking at a 2005 deadline for implementation of the plan. And the question might arise is, is it too early to look at this issue?

But as we know, international negotiations are an iterative process, and so it is never too early for us to start taking a look. So the hearing is very timely.

The Federal Reserve supports the efforts of the European Union to try to achieve greater efficiency and transparency in its financial markets. And the Financial Services Action Plan is an important step in doing that. Encouraging international participation in these markets to promote an efficient and an innovative marketplace will benefit all of us.

Both you, Mr. Chairman, and Congressman LaFalce brought up the subject of assuring that U.S. financial institutions will have the opportunity to compete in a changing environment. We have noted that one of the important benchmarks that we have used to try to assure a level playing field is the concept of national treatment. National treatment became part of U.S. law in 1978, with the International Banking Act, and I think it is important to note that both the European Union and the U.S. have continued to follow that principle.

The results up to this point speak for themselves. From the European Union nations, there are currently 66 banks functioning in this country, with a total of $1.7 trillion in assets under management—banking and non-bank assets. So there is a very substantial participation of EU banks functioning in this country.

And at the same time, from the U.S. in the EU nations, there are 27 banks, with a total of $650 billion in total assets. So it is very clear that we have very good international cooperation with respect to international banking.

In achieving national treatment, there are a number of things that the Federal Reserve does and has done. As directed by the fiducial legislation, we assess the supervisory capability of the home country of the banks that do business in this country.

Importantly, we also have a very transparent rule-making process. When we propose rules that will affect foreign banks, the proposed rules are out for comment, we invite comment and often receive comment, both from the foreign banks and from foreign bank regulators, that help us assure that we are achieving national treatment.

We do provide flexibility in considering how the structural differences in jurisdiction can be accommodated, and there are a number of examples of where that has been done. Finally, in this country we have a wide variety of charters that would accommodate different levels of banking participation in this country by foreign banks.

There are three specific issues, with respect to the directives, that we would like to comment on.

The first is the financial conglomerate directive, which is aimed at the concern that the regulation or supervision focused on the individual entities may leave some gaps if not analyzed on a conglomerate, or consolidated, basis. We at the Fed are very comfortable that the consolidated supervision under our jurisdiction, with respect to bank holding companies and financial services companies, is fully consistent with that directive.

With respect to capital adequacy, we would like to point out, and I know that this committee is well aware, that the European Union's efforts with respect to capital adequacy are going at the same time that the Basel II negotiations are under way, and the timetables are relatively concurrent, so that we expect the differences or concerns with respects to differences in capital treatment will be addressed and recognized.

Finally, with respect to the international accounting standards, we would point out that while the financial reporting is under the jurisdiction of the SEC within the U.S., that there are significant efforts under way to assure, with the SEC's participation—the Fed is also involved—that we see a greater amount, and a continuing amount, of overlap in international standards and U.S. GAAP. And we will be participating in that process as we move forward.

Finally, Mr. Chairman, we would just point out that we at the Fed and the other regulators have excellent relationships with the European supervisors and other supervisors around the world. And I think it is that continuing ability to dialogue that has helped assure that there is consistency in the regulation.

And I would like to just end by saying that I very much enjoyed being with Congresswoman Jones on Friday, it was an excellent seminar. And I am happy to be here today.

[The prepared statement of Hon. Mark W. Olson can be found on page XX in the appendix.]

Chairman OXLEY. Thank you, Mr. Olson.

Mr. Quarles?

STATEMENT OF RANDY K.QUARLES, ASSISTANT SECRETARY FOR INTERNATIONAL AFFAIRS, U.S. TREASURY DEPARTMENT

Mr. QUARLES. Thank you, Mr. Chairman, Ranking Member LaFalce, and members of the committee. It is a pleasure to be here testifying today. I agree with Governor Olson that this is a very timely hearing.

I have prepared remarks for the record. I will not subject you to the tedium of reading them, but I just want to make a few comments.

The first is that the Financial Services Action Plan that Europe is in the process of implementing, in our view, offers a clear win-win of opportunity for both Europe and the United States, if it is well managed. The experience of the U.S. teaches us that efficient capital markets are among the most critical structural reforms for promoting robust growth. There are European estimates that suggest that financial market integration could boost European growth by at least half a percent annually, which is a significant addition.

It has been a strong theme of the Treasury and Secretary O'Neil that the U.S. cannot be the only engine of global growth, as we have witnessed in the last global slowdown. And a successful Financial Services Action Plan could help Europe become a welcome second engine of a growing global economy.

Another point I would make is that U.S. financial firms are among the most competitive and efficient globally. They are leading worldwide players. So U.S. firms can help Europe achieve its aspirations in the Financial Services Action Plan.

Clearly, for the reasons that you and others have outlined, the U.S. will need to continue monitoring the FSAP very closely, in light of a few principles, from our point of view.

The FSAP should be consistent with the reality of an open and global financial system; so it shouldn't tilt the playing field. It should reward the most efficient firms that are operating in the European market, regardless of the firms' country of origin.

And given that the financial services industry is usually a step ahead of its supervisors, the FSAP itself underscores the need for supervisors to consult closely with financial firms. So this process should take place in an open and transparent manner, the process of developing the regulations under the FSAP that will govern the operation of financial firms in Europe. And in our view, recently EU officials have undertaken some welcome steps to meet that challenge.

Next, in implementing the FSAP, the decisions that European policy makers will take will reflect the diverse interests and financial traditions of Europe, as well as the need to promote the safety and soundness of financial markets. But, in our view, the decision should be taken in a manner that rewards innovation and competitiveness, and recognizes the reality of how global firms operate.

These points relate to a number of specific FSAP directives that are on the table. First, U.S. investment banks often net out purchases and sales of securities. In other parts of the world, such transactions are put through exchanges. This issue is raised by an investment services directive. And in our view, this directive ought to be flexible enough to take account again of the reality of how firms operate, and that there are different ways to operate in a safe and sound manner.

Another: What is adequate capital for an investment bank will differ from what is adequate capital for a commercial bank, given the different nature of their businesses. This is an issue that arrives within the financial conglomerates directive, where one shouldn't attempt to shoehorn a capital regime designed for commercial banks under the operation of investment banks, simply because of the universal nature of European banks, because not all of our firms operate that way.

Next, firms may wish to list securities in a given country, even if their home base of operation is elsewhere. Authorities in the firm's home country, and they prefer that the listing take place there. That is an issue that will need to be addressed in the directive on prospectuses.

Now, inevitably, in all of these areas and more, there will be differences in the way U.S. and European authorities and financial institutions approach these issues of common interest.

So these issues need to be well managed. It wouldn't be appropriate, for example, for European officials to attempt to impose European regulatory standards on the rest of the world or to expect U.S. financial institutions to be identical in structure to European firms and to deny our institutions the benefits of the leading-edge technology.

Naturally, we would be concerned by any proposals that might discriminate against the European operations of U.S. financial institutions and suggest that U.S. supervision was not appropriate simply because it wasn't identical to Europe's way to doing business.

Rather, in our view, we need to put aside any formal differences, recognize that we share a common set of objectives, that the goal of increased European financial integration is beneficial to both Europe and the United States and to firms in both Europe and the United States, and to ensure that these objectives are being achieved in substance. It won't be easy, but we are working together to achieve that.

We are in close contact with our European counterparts. Last November, the senior EC official responsible at the day-to-day level for the FSAP visited Washington, met with John Taylor, the Undersecretary of the Treasury. In March, a team of Treasury, Federal Reserve and SEC officials visited Brussels. At the end of this month, the EC commissioner for the internal market, Frits

Bolkestein, will be visiting Washington. His chief lieutenants will then follow up in mid-June for further discussions.

So this is a process that we are very involved in and monitoring very closely and, in fact, are seeing progress in these discussions on a number of these issues of concern to us and to U.S. financial firms.

It is important to note that this isn't just a one-way dialogue. Just as the U.S. is greatly interested in how European financial markets are developing, European officials are interested in how U.S. financial markets develop. And recognizing this, the two-sided nature of this and the win-win nature of this, President Bush and President Prodi, at the May 2 summit in Washington, put this financial market dialogue at the top of the U.S.-EU positive economic agenda.

So let me just conclude by underscoring that the U.S. welcomed Europe's efforts to integrate its financial markets and that we at the Treasury, in conjunction with our colleagues at the SEC and the Fed, intend to remain closely engaged with Europe to help ensure that the FSAP contributes to a strong and more robust international financial system.

Thank you.

[The prepared statement of Randy K. Quarles can be found on page XX in the appendix.]

Chairman OXLEY. Thank you.

Ms. Nazareth?

STATEMENT OF ANNETTE NAZARETH, DIRECTOR, DIVISION OF MARKET REGULATION, U.S. SECURITIES AND EXCHANGE COMMISSION

Ms. NAZARETH. Chairman Oxley, Ranking Member LaFalce and members of the committee, thank you for the opportunity to testify before you today on behalf of the Securities and Exchange Commission on certain pending proposals of the European Commission. My testimony today will focus on the EC's proposal for a directive on consolidated supervision of financial conglomerates. I have also included in my written testimony a brief discussion on the adoption of international accounting standards, the proposed prospectus directive and the capital adequacy directive.

European capital markets have been undergoing a major transformation. One aspect of this transformation is the EC's commitment to integrate financial markets in the European Union.

The EC has stated that a single financial market will be a key factor in promoting the competitiveness of the European economy. An integrated market is being facilitated in part by the EC's development of the Financial Services Action Plan, which is a series of legislative proposals that would subject all financial services firms active in the EU to consistent standards of regulations.

One of the primary legislative proposals by the EC under the action plan is the proposal for a directive on the consolidated supervision of financial conglomerates. This proposal, which I will refer to as the proposed directive, would impose a series of quantitative and qualitative requirements at the holding company level of a financial conglomerate or a mixed financial holding company, which would be applied by an EU member state's home regulator, which will be designated as the coordinator.

If a financial conglomerate or a mixed financial holding company operating within the EU does not have its head office within the EU, the proposed directive provides for the verification by EU authorities that the firm is subject to supervision that is equivalent to the EC's proposed directive. If an equivalence determination is not made, then under the EC's proposal EU authorities could adopt other methods, such as imposing additional requirements on the firm to achieve the objectives of the proposed directive.

Several U.S. securities firms have communicated to the commission that they have serious concerns with the proposed directive. They fear that the EU authority that will make the equivalence determination will take the position that the commission's supervision of securities firms at the holding company level is not equivalent to the EC standards. They conclude that the proposed directive would not only increase their cost of doing business in Europe, but would also place them at a competitive disadvantage with European-based firms.

The commission shares many of the EC's concerns about how to contain and supervise risks posed by financial conglomerates and believes that our approach to the supervision of securities firms is as effective as that in the proposed directive.

The commission's mandate includes ensuring that our securities firms have the highest level of financial integrity and that they operate in a manner that promotes the protection of investors. Our regulatory regime has operated with remarkable success since the commission's financial responsibility regime was implemented in 1975. Very few large securities firms have failed, and in no instance has a failure had any significant impact on markets or required federal funding to liquidate a firm.

The commission's financial responsibility program is an important component of its supervision of securities firms. This program requires that broker-dealers maintain prescribed amounts of liquid net worth, safeguard customer funds and securities, keep and maintain accurate books and record and regularly file detailed financial information with the commission and with the self-regulatory organizations.

In addition to the regulation of securities firms, Congress, in 1990, amended the Securities Exchange Act to provide the commission with specific authority to obtain information regarding the financial activities of affiliates of securities firms.

Under these rules, often referred to as our risk assessment rules, securities firms that are part of a holding company structure are required to provide the commission with comprehensive financial and operational information on a periodic basis.

This information allows the commission staff to evaluate the material risks to securities firms posed by their affiliates. The information reported to the commission under the risk assessment rules is supplemented on a voluntary basis by risk information provided by the Derivatives Policy Group.

DPG members now file with the commission on a monthly basis certain internal financial and risk management reports at holding company level. These reports generally contain extensive information regarding the firm's financial condition and risk exposures, including granular detail with respect to their value at risk computations and credit risk exposures.

Finally, the commission may use its authority, granted under the Gramm-Leach-Bliley Act, to create a new type of voluntary holding company called a supervised investment bank holding company. Such a supervised investment bank holding company is generally defined as an entity that owns or controls one or more registered securities firms but is not affiliated with an insured bank, a savings association or a foreign bank. The staff plans to recommend that the commission implement this voluntary regime in the near future.

The commission believes that its regulation of U.S.-registered securities firms, and their affiliates, satisfy the proposed directives by providing equivalent group-wide supervision. Commission staff meet on a regular basis with foreign regulatory authorities to discuss regulatory issues and concern relating to global securities firms.

The commission's staff, as Randy Quarles mentioned, has had extensive discussions on these issues of equivalence with EC representatives and foreign regulators, and the commission is committed to continuing these discussions in order assist them in arriving at a favorable equivalency determination under the proposed directive.

Thank you for this opportunity to testify.

[The prepared statement of Annette Nazareth can be found on page XX in the appendix.]

Chairman OXLEY. Thank you, Ms. Nazareth.

And thank you all.

Let me begin by asking Mr. Olson about the issue that I had addressed in my opening remarks, and that is expensing stock options, a very non-controversial issue—we thought we would start you off with any easy one.

As you know, the International Accounting Standards Board, in conjunction with the action plan in Europe, is promoting the concept. What do you make of that? How does that jibe with how our system currently works? And ultimately, is there a competitive issue here lurking beneath an attempt to change the way that we look at how we expense these options?

Mr. OLSON. Mr. Chairman, our chairman has responded to questions regarding the accounting treatment for stock options. But that is not an issue that the full Fed board has taken a position on, in part because accounting issues come primarily under the jurisdiction of the SEC.

So whereas Chairman Greenspan is occasionally asked for his input on broader issues beyond the Fed, we have not taken a position on that issue. So I would defer on that one to the SEC.

The CHAIRMAN. Ms. Nazareth is avoiding my gaze, here.

[Laughter.]

Since you raise the issue, let me ask Ms. Nazareth for her viewpoint, and coming from the SEC.

Ms. NAZARETH. Well, I am not the commission's expert on the accounting issues. I think certainly the commission's position on all of these accounting issues is what we really should be working on is convergence of accounting standards, and it is unfortunate that, you know, one of the first issues that the IASB has chosen to consider is this very contentious issue, and in fact is taking a position that is contrary to what is currently the standard in the U.S.

So I think our goal, obviously—as with all of these issues, and certainly Ranking Member LaFalce said—you know, in all of these regimes we should be seeking whatever is the best approach and not taking the position that whatever is the most expedient, politically or otherwise. And this is obviously a very important but contentious issue, but I think it would be incumbent on all of the standard-setters to try to arrive at some common ground, in terms of how to report stock options.

The CHAIRMAN. Let me ask Mr. Quarles: The European Union, according to their statement, wants to become the most dynamic, competitive knowledge-based economy in the world in the next eight years. How realistic is that goal and does that present some competitive issues for our country?

Mr. QUARLES. Well, as for whether the goal is realistic or not, I think that we—obviously Europe is a very strong economy, and has the potential to be much stronger with appropriate structural reforms.

What I would stress, I guess, is that the United States doesn't really have anything to fear from competition. And, in fact, just as we believe that competition is good within our own economy, we are strengthened by having strong competitive economies abroad. Those are markets for our goods and services. And they keep us on our toes as well.

So I don't view that as a threat, so much as an opportunity for U.S. firms, and indeed a welcome goal of the Europeans, to seek to become the—and you have to discount the puffery in being the ″most dynamic economy″—but to increase the dynamism of their economy, and to increase the amount of innovation in their economy is, in fact, something that I think we should encourage, because, in fact, that will benefit U.S. firms that operate in Europe as much as it benefits European firms.

The CHAIRMAN. Thank you.

Ms. Nazareth, how does the SEC coordinate, if you do, with Treasury and the Fed in responding to the Financial Services Action Plan? Is there a working group, or do you all work separately?

Ms. NAZARETH. Well, I think it has been somewhat informal. But I think it has been very effective in the recent past. As Mr. Quarles said, a group representing both the SEC, Treasury and the Fed, you know, went to Europe and met with EC officials and with the regulators at the federal level, to discuss issues relating to the financial services directive and other elements of this. And I think it has been very, very productive. But I don't think there is necessarily a formal mechanism, but it has been very constructive informally.

The CHAIRMAN. Is USTR involved in this process as well?

Ms. NAZARETH. No.

The CHAIRMAN. No. I am out of time.

The gentleman from New York.

Mr. LAFALCE. I thank the chairman.

The chairman brought up the issue of the expensing of stock options. I have tried, I believe successfully, in my 28 years in Congress, never to take issue with FASB, believing that the intricacies of accounting are so complex and great that it is always best to defer to them, even when, for example, the chairman of the Federal Reserve Board might differ, as he did on occasion, or when the chairman of the SEC might differ, which he did on occasion; to just stay out of that.

And recently, I had dinner with Ed Jenkins, the Chairman of FASB. He will be leaving shortly, I think. And I asked him to give me a letter treating the history of FASB's recommendations, when they did recommend that stock options be expensed, and the opposition that they received from various individuals and groups. And he did send me a detailed letter explaining why he thought it was necessary then to expense them, and the difficulties he had in effectuating that. And I ask unanimous consent that Mr. Jenkins' letter be made a part of the record.

[The following information was subsequently furnished by Hon. John J. LaFalce for the hearing record.]

The CHAIRMAN. Without objection.

Mr. LAFALCE. Good. And we should have copies of that for anybody who might be interested shortly. I think it will make interesting reading.

One of the questions that I asked Mr. Jenkins was, Well, people are saying it is so difficult, evaluating stock options, extremely difficult. And he says, basically, nonsense. It is done all the time. It can be done. There is a specific methodology to do it.

I note that individuals such as Chairman Greenspan agree with him on that issue. Individuals such as Warren Buffett agree with him. We ought to get on with it. I think it is something the securities Industry Association should work with FASB on, in trying to come up with something. I think the capital markets would be much better. And now, if the European Union is taking that approach.

Is that correct, European agreement is going to be taking that approach calling for the expensing of options? Anybody want to comment?

Mr. OLSON. I am not sure if it is the European Union or if it is the International Accounting Standard Board.

Mr. LAFALCE. Oh, yes, the International Accounting Board. Have they adopted that, or are they in the process of adopting that?

Mr. OLSON. My understanding is that it is being debated now.

Mr. LAFALCE. Being debated? I think I got from Ms. Nazareth's testimony that she thinks it is likely to be adopted.

Is that correct, Ms. Nazareth?

Ms. NAZARETH. I don't think it is likely, but it is certainly being actively debated at this time.

Mr. LAFALCE. Well, I do think it is something that we should pursue. And I leave it up to you to pursue. I am not sure that the Congress is aggressively going to pursue that, but it ought to be pursued.

Now let's pursue another issue, though, too, and that is the issue of privacy. And I knew where the previous administration, Mr. Quarles, stood on the issue of privacy. Because I worked with them on the privacy bill. And we passed the best privacy bill that we could pass. But it was a good first step. It was not adequate. And therefore we specifically said the states could go further. Now, the industry at large would love to see federal pre-emption. And I am open to that, if we can take the additional steps necessary.

Working with the previous secretary of the Treasury, Mr. Summers, I introduced legislation, and he and Gene Sperling, et cetera, were at my side at a press conference, to take that next step. Now some are arguing to the European community, ″Well, you ought to hold us harmless. Whatever we have done so far should be adequate. I say, no, not at all; that was the first step.

What is the position of the Bush administration with respect to the adequacy of the privacy standards that were enacted as part of the Financial Services Modernization Act of 1999?

Mr. QUARLES. You are referring simply to the position on the privacy standards domestically, or in our—

Mr. LAFALCE. Domestically, yes, domestically.

Mr. QUARLES. —discussions with the EU?

Mr. LAFALCE. No, first domestically. Has the Bush administration taken a position?

Mr. QUARLES. I guess I should say that, without wanting to pass the buck to someone who is not here, the responsibility for that in the Treasury Department rests with the Assistant Secretary for Financial Institutions. And so I would be loathe to speak for her today.

Mr. LAFALCE. Well, I would think that in negotiating with Europe that it would be helpful to know what our position is domestically.

Mr. QUARLES. You are absolutely right.

And I am not aware that there has been any modification of the position on the adequacy of privacy standards.

Mr. LAFALCE. Modification? What do you mean modification? Modifications of a position suggest there is a position, that is one thing. Now, if you mean there is no position, that is something else.

Mr. QUARLES. I believe that the Treasury—we are at least engaging with the Europeans on the basis of ensuring that the Europeans view our standards as adequate.

Mr. LAFALCE. I was under the impression that Secretary O'Neill, at least personally, is a hawk on privacy, similar to Senator Shelby. And someone like Senator Shelby, who is the ranking Republican to be or the chairman to be, depending on the outcome of the elections, believes that the existing standards are grossly inadequate. And it is my understanding that Paul O'Neill personally shares his sentiments.

The CHAIRMAN. The gentleman's time has expired.

Mr. LAFALCE. Thank you.

[Laughter.]

The CHAIRMAN. It may be safe to say that the administration supports the Oxley language that was added to the Gramm-Leach-Bliley Act that became the final product. I would appreciate if you would check on that, but I suspect that is probably where the administration stands.

Mr. LAFALCE. Well, the Clinton administration supported it at that time. I thought it was the LaFalce language rather than the

Oxley language to tell you the truth, Mr. Chairman, because I was involved in the conference deliberations, you know, 100 percent.

Mr. QUARLES. If both of you claim that language, I am sure we must support it.

Mr. LAFALCE. Oh, you supported it, but we also thought it should go a lot further. Okay, thanks.

The CHAIRMAN. The gentleman's time has expired.

The chair would note that we have two votes on the floor. We have about eight minutes left. Does someone on this side of the aisle wish to say about three minutes of questions? What order did they come in?

Mr. Watt, I will recognize you for three minutes, if that is okay, then we will break for the vote.

Mr. WATT. That is fine, Mr. Chairman. I appreciate it.

I just wanted to, first of all, express my gratitude to you for the privilege of traveling to Europe on this most recent break that we had to discuss some of these issues. And I feel like I at least understand what the witnesses are saying, with that as a backdrop. And that was very helpful.

I did want to ask a question about this equivalence determination the conglomerates directive and play the devil's advocate a little bit.

From the European discussions that we had on this recent trip, it seemed to me that what they were advocating for was a single point of corporate accountability and a single point of regulatory or supervisory accountability, neither of which seems to be an outrageous position. So let me just, kind of, be the devil's advocate here.

It seems to me on the corporate accountability single point, we have found some lessons in the Enron situation that perhaps there needs to be a corporate accountability at the top. And we do have, kind of, a diffuse regulatory accountability between the Fed, the Treasury and the SEC, and it seemed to me that what they were saying was that there needs to be somebody where the buck stops on these issues. And that is particularly the case if you have an international European group that is wanting to deal with one point of contact or one final authority in the United States. It is even more imperative once you get outside of the United States to have, kind of, a single point of contact.

That didn't seem especially outrageous, and I would welcome your reaction to that. Maybe I am oversimplifying it, misstating it. What seems to be the negative side of what they seem to be saying on those two fronts?

I guess Ms. Nazareth seemed to address this more directly. It seemed to me that Mr. Olson and Mr. Quarles were talking more about the capital standards part of the conglomerate directorate.

But Ms. Nazareth, and if either of the others have comments on it, that would be helpful.

Ms. NAZARETH. We certainly don't take issue at all with the goals of what the Financial Services Action Plan is seeking to achieve, especially with respect to financial conglomerates. We share concerns over the ability to effectively monitor, you know, large complex institutions. We obviously are concerned about financial stability and the like.

I think, though, that there is a long history in this country of having, you know, more than one regulator for financial entities based on the businesses that they conduct. And there is a long and very proud history of coordination between the agencies. I think we need only look most recently to September 11 to see how successfully those financial regulators worked together in getting our markets, back up and running.

You know, there is often a sense when there is a change that is, sort of, an innovation in a new place that you get people who are very convinced of the rightness of their new approach. Certainly in Europe in some of the jurisdictions, you now have a single, one-stop shopping with respect to financial regulation: The regulation of the banks and the insurance companies and the securities firms lie in one entity.

Whether or not that model is superior to the more specialized, functional model that we have remains to be seen. It is a relatively new model in Europe. And, in fact, all of the countries within Europe don't have that model; it is just some.

Chairman OXLEY. The gentleman's time has expired.

I thank our panel. And we will dismiss this panel with our sincere thanks for your effort. And the committee stands in recess for 15 minutes.

[Recess.]

The CHAIRMAN. The committee will come to order.

We would like to call up the distinguished second panel. They are Professor Desmond Dinan, Jean Monnet Professor of Public Policy, George Mason University; Mr. Marc Lackritz, President of the Securities Industry Association; Ms. Karen Shaw Petrou, Managing Partner of Federal Financial Analytics Incorporated.

All of you, thank you for your participation. And, Professor, we will begin with you.

STATEMENTS OF PROFESSOR DESMOND DINAN, JEAN MONNET PROFESSOR OF PUBLIC POLICY, GEORGE MASON UNIVERSITY

Mr. DINAN. Thank you, Mr. Chairman, members of the committee. I am honored to be here this morning to testify on procedural, political and institutional aspects of the Financial Services Action Plan. Thanks for having invited me and thanks to the staff for having organized this event.

The commission adopted the Financial Services Action Plan in May 1999. It is, of course, part of the much larger goal of integrating the European Union economy, which is the main objective of the European Union. The committee's strategy was simple: to generate the political and institutional momentum with a package of approximately 40 measures and a deadline to achieve those by 2005.

You may remember, Mr. Chairman, the famous single market program of the late 1980s, early 1990s. That set out a number of measures, approximately 300, to achieve a single market and a deadline of 1992. The Financial Services Action Plan replicates the single market program in its approach, although it is much narrower in its focus.

The European Council, the Heads of State and Government endorsed the Financial Services Action Plan in June of 1999, which meant that they gave it added political momentum. And the incorporated the Financial Services Action Plan into the Lisbon strategy, which, as you mentioned this morning, Mr. Chairman, seeks for the European Union to become the most competitive and dynamic knowledge-based economy in the world by 2010.

Now I won't go into the legislative process in the European Union. You can find a description of that in my written testimony. Let me just say that it is extremely complicated and arcane. It takes me an entire semester to teach at the university. And I won't attempt to describe it to you in five minutes.

Let me just say that the European Union was concerned that the momentum behind the Financial Services Action Plan was waning and that some measures were not being enacted rapidly enough and that the quality of those measures was poor. And for that reason, the commission and some member states asked a committee of wise men, chaired by Alexandre Lamfalussy, a very eminent European banker, to produce a report on progress in implementing the financial services action plan.

The Lamfalussy report was critical of implementation on two grounds. Lamfalussy called, first of all, for a much greater consultation in the legislative process between the legislative actors, the commission, the European parliament, and the council, with industry, with interest groups and consumer groups.

And the Lamfalussy report also called for speedier enactment of legislation. Not just the primary legislation, that is, the directives which are necessary to provide general guidance and framework for implementation of the plan, but more importantly perhaps for the so-called secondary legislation; that is the legislation needed to provide the detailed implementation of the financial services measures.

The Lamfalussy proposal resulted in the establishment of two important committees with respect to the Financial Services Action Plan: the European Securities Committee, consisting of senior representatives of the commission of member states; and the European Securities Regulators committee, consisting of national regulators.

Will the plan be enacted? And will the plan be enacted on time? Well, there is a huge difference between rhetoric and reality in the European Union when it comes to any policy area. Even with the best will in the world, proposals are not always drafted on time, deadlines slip and inter-institutional strains emerge.

Already there was a huge institutional battle between the European parliament and the commission on procedural aspects of the Lamfalussy plan, which delayed adoption of the Lamfalussy plan by the European parliament for an entire year. The European parliament only adopted the plan in February of this year.

The main problem now, according to Lamfalussy, is lack of staff, a problem that I am sure is familiar to you here in Congress. In a recent article in the Financial Times, he expressed optimism generally about the procedures in place. But he said the main problem is a lack of qualified staff in the commission and in the relevant committee of the European parliament to get the work done.

Thank you.

[The prepared statement of Desmond Dinan can be found on page XX in the appendix.]

Mr. SHAYS. [Presiding.] Thank you.

Mr. Lackritz?

STATEMENT OF MARC LACKRITZ PRESIDENT, SECURITIES INDUSTRY ASSOCIATION

Mr. LACKRITZ. Thank you very much, Mr. Chairman, members of the committee. I appreciate the opportunity to testify today about the implementation of the EU's Financial Services Action Plan. And I thank you and commend you for your timely review.

As the professor said, the EU adopted this plan two and a half years ago. And I think it is increasingly important that the Congress, the administration and the U.S. financial services regulators become engaged participants in this critical European development.

The objective of the FSAP is to develop a single integrated EU capital market by 2005. Let me just say, we strongly support the implementation of this plan and would agree with the other witnesses that talked earlier this is actually a win-win for Europe. But more importantly, it is also a win for the United States.

U.S. securities firms have long participated in Europe's capital markets. We have participated directly in the gains that have been made. And we and our customers expect to be the primary beneficiaries of a more integrated, efficient EU capital market.

Our very largest members engaging in global business receive about 20 percent of their net revenues from Europe. And I might add that that is about two times more than the net revenues that we receive from Asia. And we employ about 35,000 Europeans in the business.

Let me review briefly some specific measures in this plan that are of potential concern to U.S. securities firms and our clients.

First, to get back to the issue that was raised by Treasury and also by the SEC in the earlier panel, the proposed financial conglomerates directive introduces group-wide supervision of financial conglomerates. We agree with the overall objective of promoting financial stability, but we have very strong reservations about some of the directive's provisions.

We are specifically troubled by the proposal's requirements that EU supervisors of regulated EU entity owned by a firm outside the EU must determine whether the group is subject to consolidated supervision that is equivalent to EU regulation. Rather than using the equivalence approach taken by the draft directive, we believe the concerns addressed by the proposal should be met through regular dialogue among global regulators.

U.S. and EU regulators have had an initial exchange of views on the supervisory issues raised by this directive, and we believe that continued dialogue will result in a more smooth transition to the new EU supervisory regime.

In addition, a new review of the investment services directive provides an historic opportunity for Europe's markets to create an environment for innovative, efficient, fair and internationally competitive markets, and we welcome this revision. The directive helps establish a passport which permits securities investment and trading services to be provided cross-border within the EU.

The latest round of consultations has focused on changing market structures, such as alternative trading systems, and specifically concentrates on issues of, first, trade transparency in market conditions where transactions occur other than on traditional exchanges, and, second, appropriate regulation for order flow that is internalized by investment firms.

We hope that the commission will produce a proposal for the new investment services directive that is targeted only at addressing existing gaps in an efficient single market and does not go out of its way to impose undue new regulatory burdens on Europe's capital markets and on participants like us.

Third, the EU prospectus directive is designed to address the currently uncoordinated regulatory framework for approval of prospectuses where securities are to be sold in more than one EU member state. The most significant outstanding issue with respect to the directive relates to whether or not an issuer is able to choose in which member state its prospectus documentation is reviewed and vetted.

Under the proposal, the current approach of requiring issuers to deal with only one member state where the securities are to be offered or traded would be replaced by an approach requiring the issuers always to deal with the member state in which they are organized, as well as where the securities would be offered. So they have a double-stop, basically, or redundant stops.

The European parliament has accepted the need to preserve choice, however the council continues to prefer home jurisdiction. We hope the commission's revision, which is expected this summer, will preserve the choice issue.

Fourth, the market abuse directive is intended to restate the current insider dealing directive and create a new offense of market manipulation.

Our concerns have focused on, first, the absence of an element of intent in the definition of the offenses, creating strict liability and raising the possibility of prohibition of current practices; second, proposed safe harbors which were not sufficiently extensive; third, failure to acknowledge that effective information barriers, such as we have in the United States, should constitute a defense to the principle of deemed knowledge; and fourth, the broad scope, which creates competing EU regulatory jurisdictions.

We are particularly concerned that the lack of an intent standard will reduce the flow of information to investors in the market. Significant, albeit insufficient, amendments were made in the European parliament and the council where broad agreement on the proposal has been reached.

Finally, though not part of the plan, the financial services industry has sought an adequacy determination from the EU so that flows of data between the U.S. and the EU are not subject to potential data stoppages. We commend you, Mr. Chairman, and your colleagues on the committee for sending a letter last year that supported a determination of adequacy for the U.S. financial services industry for purposes of the EU data protection directive.

We are also quite pleased that the Bush administration has begun a discussion with EU officials and will be seeking an adequacy determination in the course of that dialogue.

The U.S. privacy regime reflects a careful balancing of the needs and interests of consumers, financial institutions, government, and the specific economic and security interests of the United States. The export of European privacy standards to the threat of trans-atlantic data stoppages creates a very dangerous precedent and one that should be strongly resisted.

The U.S. securities industry plays an important role in EU capital markets and we are fully committed to the integration of the EU's capital markets. We look forward to working with the U.S. and the EU on a positive economic agenda to ensure that European capital market liberalization is achieved in a nondiscriminatory manner that is transparent, efficient and protects against risk.

Again, we very much appreciate the committee's serious interest in the deepening relationship between the U.S. capital markets and those of our closest trading partner, the European Union.

Thank you very much.

[The prepared statement of Mark E. Lackritz can be found on page XX in the appendix.]

Mr. SHAYS. Excuse me, is it Ms. Petrou?

Ms. PETROU. It is.

Mr. SHAYS. Thank you.

Ms. PETROU. I have been married seven years, but it is taking a while.

Mr. SHAYS. So let's figure out, that name Karen Shaw is?

Ms. PETROU. Earlier.

Mr. SHAYS. Okay. Very good. We will take it off.

Thank you. You have the floor.

Ms. PETROU. Thank you so much.

Mr. SHAYS. It is nice to have you here.

STATEMENT OF KAREN SHAW PETROU, MANAGING PARTNER, FEDERAL FINANCIAL ANALYTICS

Ms. PETROU. Thank you.

I am Karen Shaw Petrou, Managing Partner of Federal Financial Analytics. As a firm, we advise financial services firms, and indeed several governments, as to policy issues affecting the financial services industry. We do not represent any companies or clients before the United States Congress or the European Union.

I, too, would like very much to thank you and Ranking Member LaFalce for holding this hearing today. It is so unusual for the Congress to be looking in 2002 at an issue that may not really demonstrate its full competitive impact until 2010. The hearing is an important step not only in ensuring that U.S. policy interests are understood, but also helping the industry take this emerging Financial Services Action Plan seriously.

Companies tend to think quarter by quarter, and 2010 seems a long way out, but these issues are very significant, and preserving the fair competitive position of the United States in this critical industry sector is an important national priority.

The Financial Service Action Plan is a very important and quite worthwhile effort in the European Union to eliminate idiosyncratic and anachronistic rules that have impeded the ability of the financial services industry in the EU to serve consumers and corporations. Many of the reforms under review, particularly those in the pension area, for example, could result in significant improvements that benefit the EU and therefore also the United States.

However, I would like to summarize a number of issues that pose some significant competitive problems, and I believe these problems arise in part because our financial services industry is very significantly different than that of the EU.

My written testimony includes some statistics bearing this out, but I would like particularly to point to the fact that in the European Union banks are by far the dominant providers of financial intermediary services. In other words, they take money from savers and depositors and they turn it into the resources that support economic development. In the EU, in several countries, banks' assets are more than 3 times the national GDP.

In the United States, banking assets average about 70 percent of our GDP. We have a much more balanced structure between banks, securities firms, insurance companies and pension funds in our business of taking funds from all of us and turning them into the assets that promote all of our interest, and we have a very different regulatory structure as a result.

Attempting to force the European banking structure into an international financial regulatory one will create some significant problems for the United States. Chief among these, I believe, are pending in the capital rules and in the conglomerate regulation already discussed by several witnesses.

The capital rules are under development by the Basel Committee on Banking Supervision, and this is a panel on which U.S. regulators sit. But negotiations are proceeding in a way that could put the competitiveness and, indeed, the safety and soundness interests of the U.S. financial system at risk.

One key concern is a proposed new capital requirement on operational risk. This is the risk of systems failures or even man-made attacks, such as the one on September 11. The proposed operational risk-based capital framework in the EU will apply to banks and non-banks alike because the EU has the legal authority to do that. In the United States, it will apply only to banks, even though non-bank asset managers, and payment processors are very major participants. This could create some significant market distortions and even some safety and soundness issues, so I think this needs to be carefully considered.

Pending rules on asset securitization are also problematic. European banks are far less competitive in this emerging and important market where loans are turned into securities, thereby creating new funds for lenders to make more mortgages, more car loans and more funding available to borrowers across the United States.

Our technological innovation has spurred this market, and the European institutions have generally been slower to follow it. They are therefore proposing much higher capital charges on asset-backed securities than on the whole loans that comprise them, and this poses a significant competitive risk.

Mr. Lackritz and the first panel have discussed the conglomerate rule, so I won't go into that, except to echo the concern that this is a bank-like structure. Congress established the financial holding company structure in the Gramm-Leach-Bliley Act, and it was intended to form a framework in which banks, securities firms and insurance companies could combine in a single company.

Since Congress passed that law in 1999, only four non-banking companies have become financial holding companies, and the reason for that is the fact that the financial holding company structure superimposes bank capital rules and a bank regulatory framework on the securities and insurance industry in ways that are often inappropriate. Allowing the EU conglomerate regulation to reach across the Atlantic and do that raises some very significant issues and warrants careful attention.

Finally, I would like to mention the importance of how the United States is represented in these negotiations. Congress modernized its consideration of the financial services industry under your leadership, Mr. Chairman, by creating a Financial Services Committee in this Congress.

However, trade and financial services is still split among many different agencies in the United States government, and no one is really responsible for it. This makes it very hard for the industry to find a keen advocate with the necessary degree of technical knowledge in these highly specialized industries to present a unified position in these highly complex negotiations.

[The prepared statement of Karen Shaw Petrou can be found on page XX in the appendix.]

Mr. SHAYS. Ms. Petrou, let me interrupt you here. Thank you.

I just want to get a sense. We have one vote, that is the bottom line. I don't think we can go through all the questions.

Do you have questions, Mr. Shadegg, that you want to ask?

So I think what we will do is do you want to just go through yours? Are you going to come back?

Mr. LAFALCE. I think it is going to be difficult.

Mr. SHAYS. Okay, here is what I am going to do. I am going to stay while the ranking member can ask some questions, unless—excuse me, I was next in line. I will just go with the ranking member. You can ask your question, and then I will stay, and then we are going to have you come back.

So we are going to come back afterwards, if anybody wants to come back and ask a question.

Mr. LAFALCE. I thank the chair for his generosity. I will defer my questions. I can speak with the representatives personally over the phone. I thank the chair.

Mr. SHAYS. I am willing to wait.

Mr. LAFALCE. No, I want to let you go ahead.

Mr. SHAYS. Does someone want to ask a question now before we go and not come back?

Mrs. MALONEY OF NEW YORK. I will.

Mr. SHAYS. Okay, Ms. Maloney.

Mrs. MALONEY OF NEW YORK. I am very concerned about protecting American interests, American business, American financial institutions. And in your testimony, you have pointed out how our capital markets are so much larger than our European sisters' and brothers', and I would venture to say it is because they are well managed and that people trust them and they want to invest in them.

And I, for one, find it problematic that Europe is going to come over and preach to us on our accounting standards. We have had strong accounting standards, and the fact that there is one company that has been mismanaged does not speak to the overall strength of the American markets. And I really want to know what we are doing, steps we are taking, to make sure that in all these international agreements that our financial institutions and the businesses in America are not put at a disadvantage.

I found Ms. Petrou Shaw's testimony troubling when she spoke about the fact that in the so-called Basel accords the capital requirements will be putting our banks at a disadvantage, or our financial institutions at a disadvantage, their capital requirements are lower.

And then the comments of Mr. Lackritz, when you were mentioning how in the privacy situation the fact that our European sisters and brothers, with their standards, are creating "a dangerous precedent in data stoppages." So I am concerned that some of these international standards that they are putting out there may have the effect of putting our very strong, high-performing capital markets at a disadvantage.

And I guess this is a question I probably should be asking the Fed or the Comptroller, what steps are we taking in our overview to make sure that our businesses are not put at a disadvantage, and our financial institutions?

But Ms. Shaw, you mentioned several areas where these so-called accords would put us at a disadvantage.

Ms. PETROU. I think that is a concern. And part of it is the lack of unity in the United States' position with the EU where they have one negotiating team and we have many.

Mrs. MALONEY OF NEW YORK. But if their capital standards are lower than our capital standards, and we in this country want a higher capital standard, then our financial institutions are at a disadvantage.

Ms. PETROU. Yes, that is correct.

Mrs. MALONEY OF NEW YORK. So, I am concerned that as we move to globalization—we are at globalization. But quite frankly, I was stunned at the statement at how much larger our capital markets are than the entire European capital markets. We are, double the size, and I never realized that before.

So I would say they should be coming over here and learning a little bit from us, not coming over and trying to make us change all our standards to theirs.

Ms. PETROU. Yes.

Mr. LACKRITZ. Can I respond, Congresswoman?

Mrs. MALONEY OF NEW YORK. Sure.

Mr. LACKRITZ. First of all, I thank you very much for that kind of support. I think that is the kind of support that we would welcome in these negotiations.

I think that some of these directives—for example, like the financial conglomerates directive that I spoke of, and that the members of the earlier panel spoke of, and the privacy directive, and the directives that Ms. Petrou discussed, are good examples.

And I think what we need here is we don't need regulatory imperialism coming at us from Europe. What we need is a dialogue to ensure that we have a race to the top, to ensure that our firms are allowed to compete fairly, openly and on a nondiscriminatory basis. And that is what we are trying to do in course—and I think in these kinds of hearings, we are able to present the kind of information that hopefully you, as the oversight committee, and the administration will be able to take into the negotiations and strengthen our negotiating position with respect to the Europeans. Because I think you are absolutely right.

Mrs. MALONEY OF NEW YORK. Well, we have to run vote. But I would like to see what steps our government, or our not-for-profits, our institutions, are taking to make sure that our firms, our industries are not put at a competitive disadvantage. You know, they may present, you know, "Here is our standard." Then you find out that their standard basically creates a data stoppage for any processing in our country. Now, is that really a better standard, or is that an effort to give them a competitive advantage?

So I think that we have to really look at these things. You know, the new war is really an economic war in many ways.

Mr. SHAYS. Let me just let Mr. Dinan just make a response. Then I really want to close up.

Mr. DINAN. Well, my response would be that I appreciate your concerns, Congresswoman. I think they may be exaggerated, however, because Europeans are trying to learn from the United States. The whole point of the Financial Services Action Plan is to make the European Union more like the United States.

If you look at the strategic objective of the European Union, the European Union seeks to become, by 2010, the most competitive and dynamic knowledge-based economy in the world. In other words, with whom do they wish to compete? The United States. Whom do they wish to emulate? The United States. Europe is becoming more like the United States in economic terms.

As I said, I appreciate your concerns, and on specific issues they may be warranted. But overall, I think they are exaggerated.

Mrs. MALONEY OF NEW YORK. Well, again, I would request in writing from the panelists what steps are being taken that you know of, or what steps would you suggest that our negotiators look at to make sure we are not being put at a competitive disadvantage.

Mr. SHAYS. We need to vote here. I am sorry to have you come back, and I am sorry for the ins and outs and all the votes and all that. You all have been patient. You are aware of what goes on here. But we do have some questions we all want to ask you. So we are going to ask you. The first member who gets back, I am just going to empower them to start the meeting.

Recess until a member gets back. So it will be less than 10.

[Recess.]

Mr. SHAYS. The committee is called to order. Thank you for your patience and waiting.

Unfortunately, in this committee, I have to expose my ignorance. I haven't been a member very long. But out of my ignorance, I learn a lot.

And my simple mind tells me that the Europeans basically want to know what the United States does. As we the United States united our states, they are uniting their countries to have one basic system. And just as I wouldn't want them to tell us what to do, they probably don't want us to tell them what to do.

But, in fact, my first question is in this new environment of world competition, the fact is that—and I would ask each of you—in order for us to work together, we have to tell each other what we want and what we don't want. And I want to know if that is true. And then the next is, I want to know what leverage we have. And I want to know why they would care what we think. I realize we are an economic force but ultimately why won't they do whatever the heck they want to do?

Mr. SHAYS. Mr. Dinan, when you speak you have such an accent I kept thinking you were speaking for Europe, but—

[Laughter.]

--but in this concept if all three of you would share with me what you think.

Mr. DINAN. Well, if I could begin, you are right. And this was the gist of my remarks to Congresswoman Maloney, that the European Union to a great extent wants to replicate the United States, certainly economically. The European Union realizes that in this global economy and global environment, countries the size of the European countries even countries as large, by European standards, as Germany, the United Kingdom and France can't act alone. In order to be competitive, in order to be successful, they have to integrate. And the greatest model of economic integration and political integration is the United States.

And that is why they want to replicate the United States' tremendous economic achievement, especially recently in terms of increasing productivity and in terms of increasing jobs, because Europe is still plagued by relatively high unemployment and poor productivity.

But the European Union does not want to do this at any cost, because the European Union also wants to maintain what it sees as an extremely important aspect of European integration, that is solidarity and social cohesion. The European Union wants to maintain a relatively high social security safety net, much higher than in the United States, for instance.

So there are differences in the approaches and in the objectives.

The European Union, I think, wants to learn from the United States. And I presume the United States wants to learn from the European Union, because each has so much to offer the other.

And when we think of relations between the United States and the European Union, perhaps we think too much in traditional terms of intergovernmental relations. Because the relationship exists at all levels. There are networks, business networks, congressional networks, of course governmental networks, private sector networks, that are dense across the Atlantic and that are constantly exchanging information and exchanging knowledge.

Finally, why would the European Union not like to go it alone? Mr. Chairman, I am sure you are very familiar with the criticism which the European Union makes at the moment of the United States, which is that the United States is, in the view of the European Union, too unilateral.

Europeans don't like unilateralism. Europeans like multilateralism. They like institutions and organizations that are multilateral. They like to learn from each other.

The whole process of integration, the whole process of bringing 15 countries, soon to be 25 or 27—

Mr. SHAYS. Could I just interrupt you there?

Mr. DINAN. Yes.

Mr. SHAYS. The irony of that is I think of the European Union as one unit. So when they agree among themselves they think like they are multilateral, and I think they are unilateral in the sense that they then are this unilateral block that then wants to—so I mean, I guess I am just sharing a little bit of a bias. The French, they talk to the Germans and the Brits say they are multilateral. But if New York state talks to Connecticut and talks to California, that is not multilateral, obviously.

Mr. DINAN. Right.

Mr. SHAYS. So I am making the same comparison.

Could close up in a second and let Mr. Lackritz respond as well? Could you finish your point?

Mr. DINAN. Yes.

Mr. SHAYS. Do you want to make another point?

Mr. DINAN. No, I am going to leave it at that. Thank you very much.

Mr. SHAYS. I appreciate the answer. It is very helpful.

Mr. Lackritz?

Mr. LACKRITZ. Yes, thank you very much Mr. Chairman.

I think the question you raised is exactly the right question as we go into globalization discussions and negotiations. Because I think that we have to be very careful that there isn't a race to the bottom out of competitive concerns that weaken standards and lowers requirements. And at the same time, we have to take into account the political and cultural differences and the sensitivities of our trading partners and our potential partners around the globe.

So I think the question you raise is exactly right. I think I would differ a bit with the professor's point, in that I think the Europeans do want to learn from our experience and are trying to emulate the experience we have had over here. However, in a couple of specific areas, whether it is because of political differences or cultural differences, they really are trying to impose on their trading partners, meaning us, the standards that they have evolved for their own internal reasons or for their own internal political reasons. They are very different from the standards that we have here and culturally are very different too, whether it is from the standpoint of pension system or from the standpoint of privacy or from the standpoint of consolidated supervision.

In those circumstances, I think it is important for our negotiators to be strong on behalf of U.S. financial services providers and also talking to our partners about how it is a win-win situation. For them to cut off data, for example, as a result of pique at our privacy rules, really only hurts their own investors, their own companies and their own ability to attract capital since we have the largest pool of capital in the world.

So I think we have to try and do an effective job of helping people understand what is in their own best interest and at the same time in our best interest in creating win-win situations.

Mr. SHAYS. Just refresh me, one of you—and then Ms. Petrou we will go to you—what is the gross domestic product of that entire EU group versus the United States?

Mr. LACKRITZ. My recollection is their GDP is in the order of $330 billion. And our is not significantly a little bit higher.

Mr. SHAYS. You don't mean billion.

Mr. LACKRITZ. Trillion, excuse me, I am sorry.

Mr. SHAYS. You were giving me population, then, weren't you?

Mr. LACKRITZ. I confused the population. Excuse me.

Mr. SHAYS. Listen, I may be a new member to the committee, but I did see through that. You are just testing me.

Mr. LACKRITZ. No, the GDP for the United States is $10.5 trillion and for all the European countries it is a little bit less: $7 trillion plus.

Mr. SHAYS. Right. But a larger population.

Mr. LACKRITZ. Yes, a comparable population.

Mr. SHAYS. Ms. Petrou, did you want to jump in?

Ms. PETROU. No, but I think that, looking at the GDP numbers, which we tried to do as a way of just evaluating on a country-by-country or EU versus U.S. the different structure of the financial industries. The percentage that the banks control of assets in relation to European GDP, as I said, is much, much higher than the banks in the United States. And there are many fewer banks, very dominant providers of all financial services in the EU.

We have, for better or worse, a very different system. We have 50 states regulating insurance. We have 9,000 banks. We have 16,000 institutions that have access to the Federal Reserve payment system.

And the European Union, I think, views this as a very inefficient, troublesome system. And they are saying in some ways, "If you are coming to the EU, well, do business the way we understand it." But while we could improve certain aspects of our financial markets, as Mr. Lackritz was saying, to impose that across the Atlantic does raise concerns because fundamentally, our diverse, confusing, overlapping regulatory structure and chartering options have made the United States financial services industry the most competitive in the world.

Mr. SHAYS. Let me ask you, does it also make it harder—I am sorry, and then I will get to Ms. Hart or Mr. Shadegg, whichever wants to go next—does it make it harder for foreign competition to compete in the U.S. market? Is it one way we are almost able to protect industries and discourage competition?

Ms. PETROU. We have had a national treatment policy which, with occasional disputes, has been very effective.

For example, the European Union and the European countries have long permitted their banks to be in a wide range of businesses, including owning significant amounts of commercial shares that are impermissible in the United States. We have always said to the European financial companies, "Come to the U.S., you just have to do business in the U.S. our way, i.e., observe our limits within the banking industry."

Mr. SHAYS. Right. But I was asking something a little bit more than that. I was asking about the fact that many times U.S. businesses are having to adapt to state regulations, state rules, state process. Is that a further discouragement, or does that discourage foreign markets from entering? This doesn't need a long answer. If it doesn't, it doesn't. If it does, it does.

Ms. PETROU. I don't think it does any more than it discourages U.S. issues. The question is not one of national—in trade and financial services, it is a question of market efficiency.

Mr. SHAYS. Mr. Lackritz, did you want to respond?

Mr. LACKRITZ. Yes. I am not sure it has a deterrent effect on foreign investment in the United States. But we have a problem when we have 50 different state securities regulators, for example, going off in different directions.

Mr. SHAYS. I know it is difficult for the U.S. businesses to deal with. I would think it would just make it a little harder for foreign businesses to deal with.

Mr. LACKRITZ. It may. The data, as I recall, are that there are 67 European-centered banks that are doing business in the United States now. And there are 22 or 23 U.S. institutions doing business in Europe. So my sense is that that is probably not a big deterrent at this point.

Mr. SHAYS. Okay.

Mr. Shadegg, you were technically next in line, but you didn't get back first. So I have this problem of how to know to what to do. So I am going to give you 10 minutes.

Mr. SHADEGG. Ten minutes? I don't know if I will use 10 minutes, but let me begin; I have a variety of questions. I want to begin with the capital adequacy directive and its implications for the United States and for U.S.-based companies. And you say in your testimony that they propose to impose a new capital charge for operational risk. I am very concerned about the effect of all of this on the U.S. markets and U.S. jobs and on our competitiveness in the world.

But given the relative size of the two capital markets, I guess I am somewhat curious how they will impose this, the charge for operational risk, and how you see American companies, or U.S.-based companies responding to that.

Ms. PETROU. The current proposal in the Basel Committee offers three different options for how the operational risk-based capital charge would be imposed. And U.S. regulators have fought hard for one that relies on internal models of operational risk, where the EU is much more determined to impose what they call a basic indicator, which would mean that the operational risk-based capital charge would be a simple about 20 percent of gross income. And then through first the Basel Committee and then implemented through the EU capital adequacy directive, that would be the amount of capital the European banks and non-banks would have to hold against operational risk.

Mr. SHADEGG. That would, in fact, be damaging to U.S. interests, would it not? Or would it?

Ms. PETROU. It very well could be because in the EU market, we would be bearing that charge as well as a supervisory burden, and there are some significant market entry issues that are raised by that.

There are also profound issues in the United States where a U.S. bank in, say, the asset management business would have to hold a large amount of capital against operational risk, capital that would probably bear no real relation to the economic risk because it was set by the EU in this crude way. But all the non-bank competitors in the same line of business would be exempt from that capital charge.

Mr. SHADEGG. Are there things that the United States Congress should be looking at doing so that U.S. interests are not, in fact, hurt by such a charge?

Ms. PETROU. I think we are all hopeful that the Federal Reserve and the other U.S. regulators will work out this agreement so that the competitive and safety and soundness issues are addressed. But if this is not possible, then I would hope that Congress would look into it.

Mr. SHADEGG. Mr. Lackritz, to that point, you have been working with the interests in Europe on these issues. I guess my question of you is how receptive are they, and is this something that we in the Congress need to be somewhat concerned about, deeply concerned about? Where would you put it?

Mr. LACKRITZ. Well, first of all, I appreciate your question. And I think we would like you to be engaged and concerned, because this is a process that, sort of, ebbs and flows. And in some areas, we make progress and then in other areas we are less successful.

What we need, I think, and the administration has provided a good start on this, is a continuing dialogue with the EU regulatory officials and governmental officials, and ability to stress how our own laws are adequate or equivalent as the case may be. And so as a result, we appreciate both your engagement, oversight and support to encourage our negotiators to adopt these kinds of positions.

Mr. SHADEGG. Have the Europeans been receptive at this point, or are they resentful of America's structure?

Mr. LACKRITZ. I think the answer is yes.

Mr. SHADEGG. They have?

Mr. LACKRITZ. No, it is both. I mean they have been receptive and I think there is some resentment.

Mr. SHADEGG. Do you see a potential for an effect on jobs or on our competitiveness in the world market rising out of this?

Mr. LACKRITZ. I think there is an impact on jobs and financial services to the extent that we are restricted unnecessarily from competing in Europe. From the European standpoint, there is the impact of reduced economic growth because they are not going to be able to attract as much capital as they might want to attract.

As Ms. Petrou said, they are very bank-centric in Europe. They have been very bank-centric historically. Our capital markets and our diverse financial services industry is very, very different from that and has produced a very different pattern of economic growth and development.

And I think the professor's point that they are looking at us as a model for what they want to do means that they are trying to emulate some of the processes that we have done. But I think that we are in the process of, as we negotiate, trying to explain to them the benefits of openness, transparency, non-discrimination and those kinds of things.

Mr. SHADEGG. I don't want to go over my time, but maybe either you or the professor could answer this question. It seems to me that it is in our interest to negotiate in an open and forthright way between now and then. But it also seems to me that if they remain arbitrary, and if they impose requirements which do damage, there will be American companies, or American-based companies that will simply say, "We, in fact, will pull out. We will not meet your demands."

And it seems to me it is a little bit like the gamesmanship we sometimes play on the floor of put a rule out on the floor and you don't know if the rule is going to pass because you don't have 218 members that say ahead of time they are going to vote for it, but you, kind of, call their bluff. And at the end of the day they vote for it.

And it seems to me that if requirements are imposed upon us that are arbitrary or would be damaging, the real pain will be inflicted on the European economy, as you point out, by us pulling out.

Professor or either one of you, if you want to make a comment on that?

Mr. DINAN. If I could comment, first, Congressman, in my testimony I mention that there is a reform procedure called the Lamfalussy program.

Mr. SHADEGG. Yes.

Mr. DINAN. Mr. Lamfalussy is a very eminent European banker, a former head of the European Monetary institute, the precursor of the European Central Bank. And the commission and member states asked him to look at the Financial Services Action Plan. They felt that there were problems and Lamfalussy agreed that there were problems. There were procedural problems.

But a main problem that he identified, and therefore the main recommendation that he made, was that there be more consultation. And in that recommendation, which has since been implemented, he did not distinguish between people within the EU and outside the EU who could or should be involved in this consultation procedure.

And now there is much greater consultation in both primary legislation and also in secondary legislation. And I think and I presume U.S. interests are involved in that.

Obviously, the U.S. does not have a seat at the decision-making table. But the U.S. is a major player and U.S. interests are, I think, represented. And I know that the U.S. mission to the European Union is watching these issues very closely.

Mr. SHADEGG. Thank you all for your testimony.

I yield back the balance of my time.

Mr. SHAYS. I thank the gentleman.

Ms. Hart?

Ms. HART. Thank you, Mr. Chairman.

I only have one question that may actually have missed some of you and so if I repeat it, I apologize.

As this continues, I don't see any reason for us the United States to feel threatened in any way. And I know some of the earlier testimony suggested that this is a great opportunity, obviously, for American financial institutions. But is there something that Congress should be doing—this is really a question, I guess, for all three panelists—to help the U.S. institutions be more prepared to compete in this new market place?

Ms. PETROU. I think monitoring, as you have, the ongoing effort in the Congress to modernize and improve U.S. financial regulation and also to improve the structure of the industry to make us even more efficient and competitive. And to the degree the committee continues those initiatives, that will be the best way to promote U.S. interests in the EU.

Mr. LACKRITZ. The committee last year sent a letter, I believe it was to the Treasury secretary. It was signed by a number of members of the committee, urging the Treasury in its negotiations with the EU to push for an adequacy determination of our privacy laws. And it is that kind of support and cooperation, I think, between the branches of the government and policy and, sort of, unified support of the policy that is very, very helpful to our negotiators. And therefore, to our U.S. interests over there.

So in all these areas where there are problems that we see in this process, getting support from the committee to our negotiators, and therefore, showing the Europeans that we are very unified on this, is very helpful.

Mr. DINAN. I would say a hearing such as this is very encouraging. And I hope it will be reported in Brussels and in the relevant newsletters. And that will get the attention of the Europeans, the fact that the United States is aware of this issue.

I think the CODEL, which Congressman Oxley led, was very important. It is easy to bash CODELs, we know. I think that particular CODEL was so timely and so relevant. And similarly, the return visit of the officials of the commission. And the fact that there is an active negotiation and interchange taking place is very important.

Ms. HART. Thank you, Mr. Chairman.

Mr. SHAYS. Thank you very much.

Mr. Shadegg, do you have any other questions? I have a few more and then we will conclude.

Mr. Lackritz, you talked about why the private sector is concerned about some aspects of this plan. But I would like to know how U.S. firms will be placed at a disadvantage if all firms operating in the EU are subject to the same rules. What would be some of the disadvantages?

Mr. LACKRITZ. Well, the disadvantages that we referred to depends on the directive. If we take them directive by directive, for example, on the investment services directive where they are now in the process of reviewing that directive to determine how broad a passport to provide in providing investment services throughout the EU. They are beginning to look at how to control or regulate off-exchange transactions, what we would refer to in the United States as either internalization, alternative trading systems, electronic communications networks and the like.

We are very sophisticated, in terms of developing those kinds of facilities. There are currently 12 or 13 electronic communications networks, for example, operating in the United States. There is a regulation of the FCC providing for alternative trading systems.

To the extent that that directive veers off because of the interest of a European exchange, for example, to try and block competition from that European exchange, our firms who own these electronics communications networks would be severely disadvantaged.

Similarly, with respect to the data protection directive, that is not a question of playing by the same rules, that is a question of trying to play by—with respect to data transmissions, that is imposing a set of privacy regulations and legislation on the United States that is very different than what the Congress, in the Gramm-Leach-Bliley Act, decided to impose on the United States firms.

So we would again be disadvantaged. Our customers would be disadvantaged. And actually Europe would be disadvantaged because they would at least threaten to block data flows out of Europe to the United States. And that would end up hurting, I think, the Europeans far more than it would hurt us. But it would diminish our ability to compete.

So, I think in each of these areas there are specific examples of how we might be disadvantaged depending on the direction that the directive would take.

Mr. SHAYS. Okay. And then, actually, it just triggers this question, though. So is the onus on us to get them to try to work out an agreement, a compromise with us, or do we have to change what we do?

Mr. LACKRITZ. Because I think there is broad agreement that our financial services industry and our markets and our capital markets are really the best in the world right now, we would hope that they would be able to, as the professor said, try and emulate us and move a little bit more in the direction of the openness, transparency and non-discrimination that we have been advocating.

Mr. SHAYS. Just one last question to you: You had stated the SIA has worked closely with the European commission and the national regulators. And I am interested to know how receptive have the Europeans been to American advice and concerns?

Mr. LACKRITZ. I think in some areas they have been receptive and there has been great progress made. And in the other ones, I think that we have outlined here, there is still some work to do. So I think it is obviously a work in progress.

As I said, we are very supportive of their Financial Services Action Plan and we are very optimistic that the single integrated European capital market will be a win-win. It will be a win for Europe. It will be a win for the United States. But we will have a little work to do to get there.

Mr. SHAYS. Okay.

Ms. Petrou, according to your testimony the Financial Services Action Plan will generally make Europeans more efficient, in fact, far more efficient to use your word. Are there any elements of the action plan that the U.S. could use to make our system more efficient? It is, kind of, partly the question I asked Mr. Lackritz.

Ms. PETROU. I think there are areas where a federal standards—and I know this is a significant issue for this committee in terms of federal preemption and consumer standards like predatory lending and privacy. Many changes in terms of making the financial market in this country more uniform would undoubtedly improve efficiency.

But we have a national tradition of liking to preserve local jurisdictions, which is very different than the EU one. So I think we have a very different balance to maintain.

Mr. SHAYS. Okay. I have this general sense that the Europeans clearly allow—I mean a very real sense, the Europeans allow their banks to do so much that we don't allow here. But I am also getting the sense that there is greater regulation on the banks overseas. Is that true as well?

Ms. PETROU. That is true.

Mr. SHAYS. Okay.

Ms. PETROU. I am sorry, you said lighter regulation?

Mr. SHAYS. Greater.

Ms. PETROU. Oh, no, no. I am sorry, Mr. Chairman. It is generally lighter. It is quite different.

Because there are far fewer banks of size in each one of the European countries, there is a much more collegial system of bank regulation. For example, there is no examination. Supervisors generally do not go into the banks. Instead, the banking executives and their outside auditors are called in and then asked to describe their operations. It is a quite different system.

Mr. SHAYS. This is the question my staff wanted me to ask. And I am not quite sure I grasp it. I may ask them to jump in. But maybe you will grasp it and we can have the dialogue.

In your testimony you discuss the dominant role of the banks in the EU and the long tradition of bank regulation. That is the phrase that confuses from the question and says "Do you foresee the emphasize changing with the Financial Services Action Plan? Will this need to be changed in order for the EU to become more competitive?"

But based on your answer, there isn't a lot of regulation. So I am not sure there would have to be much change on their part. Is that the answer?

Ms. PETROU. I think the goal of the FSAP is to harmonize the different traditions of bank regulation within the EU, but not in any way to make it comparable to our system where we depend, as I mentioned, extensively on supervision as well as capital, and in addition, on a tremendous amount of disclosure.

Now there is an overall effort to harmonize bank regulation through the Basel Committee and the Joint Forum, which are groups of international regulators. But this is still proceeding in lots of fits and starts.

Mr. SHAYS. Could you turn to your statement on page four where you have the graph?

Ms. PETROU. Yes.

Mr. SHAYS. Could you turn to that and just walk me through it?

Ms. PETROU. I would, but I am mostly blind, Mr. Chairman.

Mr. SHAYS. Oh, I am sorry.

Ms. PETROU. So I will have to do it in my head because I can't see it.

Mr. SHAYS. Okay, I didn't know that. And your testimony is very well delivered and very thoughtful. So I wanted to take advantage of your extraordinary expertise.

You said, "As it is shown, relative difference in the role of banks can be seen by comparing bank held assets to a country's overall economy." And so you show insurance, you show pensions, you show investment funds and you show banks.

Ms. PETROU. Yes.

Mr. SHAYS. Is this within their own countries?

It is a comparison with the EU, and Japan and so on.

So what we had interpreted from that is they had more regulations rather than less. But is it possible that they have more regulations, but simply don't enforce them the same way?

Ms. PETROU. I think perhaps the testimony is not well phrased. They have had for many years in the EU what they call universal banking. And so the very few dominant financial institutions, going back several hundred years in some cases, were the institutions that became investment houses, and that also owned significant portions of the industrial base of those countries.

For example, Deustche Bank has had major industrial interests in German companies since the end of the Second World War.

Mr. SHAYS. You know, this isn't really regulation as much as the percent of the gross domestic product. And so it is really just saying banks both in the EU and in EU 15 and EU 11 are extraordinarily dominant in their economies compared to the U.S. and Japan. And so I understand the context of your question then.

Thank you. Sorry to show my ignorance on that.

Mr. Dinan, I would like to ask you three questions. You are clearly an expert on European government institutions. The committee would like to know, who has been the driving force behind the Financial Service Action Plan. And how successful do you think they will be in implementing this plan? So who has been the driving force in Europe?

Mr. DINAN. I think the driving force has come from within the EU institutions themselves and outside it. Within the EU institutions, the main driving force is the directorate general for the internal market in the commission. And the commissioner with responsibility for that is Frits Bolkestein, who is a senior Dutch politician and an economic liberal. So he is ideologically very much in favor of market liberalization and is pushing through market liberalization within the commission.

Mr. SHAYS. When you use the term "liberalization," just so I make sure I understand it, in other words, do they want to let the market forces work for themself?

Mr. DINAN. Yes.

Mr. SHAYS. They are not liberal in terms of more of a social—

Mr. DINAN. No. Bolkestein comes within the Netherlands from the right wing of the political spectrum on economic issues. He is an economic liberal. Not on social issues, I am sure, but economically he wants deregulation and further liberalization.

Mr. SHAYS. Got you. Is there any particular countries that have been the driving force behind—

Mr. DINAN. Yes. Some of the countries have, especially some of the bigger countries. France, for instance, the U.K., although the U.K. has certain concerns, and Germany too.

It is significant, for instance, at the moment the country in the presidency of the Council of Ministers is Spain and the Spanish prime minister is also an economic liberal. He wants deregulation. He wants market integration. And so there is an interesting conjunction right now of a strong commissioner pushing for this and a strong country and a large country in the presidency headed by a prime minister, Mr. Aznar, who is well respected, who is very experienced. And that is why I think that there is a considerable push right now for the implementation of the action plan.

Mr. SHAYS. My stereotype of the French, frankly, is that they, kind of, want to go it alone. And yet you are saying they are trying to bring Europe together on this issue.

Mr. DINAN. Yes. France has been a major player in European integration generally because France realizes that it cannot achieve its objectives alone. And it is trying to Europeanize France; to Europeanize and integrate the European Union along French lines that is consistent with French interests.

Mr. SHAYS. Yes, I understand, well said.

Mr. DINAN. But you are right in your perception because generally the French are protectionist. But on this particular issue, the French do not have very strong national interests to defend.

Mr. SHAYS. Okay, let me ask you this: Is the Financial Service Action Plan one of the, say, the strongest initiatives that the EU has undertaken? How would you rank it in terms of other agreements that they have tried to—

Mr. DINAN. Well, in my testimony, I mentioned the single market plan of the late 1980s, early 1990s. That is when the European community, as it then was, set itself a goal of achieving an integrated single market by 1992. Clearly, the European Union did not succeed in all of that otherwise there would not be a Financial Services Action Plan. The reason for this plan is that the European Union feels it didn't achieve that aspect on time. And also circumstances have changed and the technology is such that the European Union concept needs to legislate more.

And so compared to the single market plan, this is not as significant, but it is important nonetheless.

But the two big issues on the agenda of the European Union at the moment are enlargement, the enlargement of the European Union, and the possibility of a constitution for the European Union.

Mr. SHAYS. Well, that relates to my last question to you. Will the enlargement of the European Union affect the implementation of this plan?

Mr. DINAN. Yes, it will effect everything. The enlargement of the European Union is going to make the European Union much more difficult to run and to operate.

Mr. Chairman, if you think of this room, if you compare this to a similar room in the European parliament, a committee room in the European parliament, just imagine that by doubling the size of the European Union, the size of this committee would double.

But not only that. Here you operate in only one language. Currently, the European Union operates in 11 official languages. And with enlargement, even more. And that means that the sides of this room, or its equivalent in Brussels, is full of interpretation booths.

So if you look at just that rather mundane level alone, making decisions in the European Union, which already is difficult, is going to become even more so.

And that is why I mentioned earlier, one of the main agenda items for the European Union is to reform, not just the institutions, but the entire entity in order to be able to cope and to be able to manage on the one had efficient decision-making, but on the other hand, democratic openness.

Mr. SHAYS. Is there any question that you wished we had asked that you think should be part of the record? Or you could ask yourself the question and then answer it. That is one question.

And the other question is, is there any comment that was made by one of your colleagues to a question that you wished we had asked you?

Okay.

Let me just say that you have been excellent witnesses. I appreciate the staff putting together such a very fine panel. Thank you very much.

And this hearing is adjourned.

[Whereupon, at 12:42 p.m., the committee was adjourned.]

A P P E N D I X

May 22, 2002

Opening Statement

Chairman Michael G. Oxley

Committee on Financial Services

"The European Union's Financial Services Action Plan and its Implications for America's Financial Services Industry"
May 22, 2002

The Committee on Financial Services meets today to examine an issue that will have major implications for this Committee and for America's financial services industry: the total overhaul of Europe's financial services sector. Since 1999, the European Union has been working to implement an ambitious agenda known as the "Financial Services Action Plan." Targeted for completion by the year 2005, this plan includes major changes for EU regulators, financial services providers, and investors.

In late March of this year, I led a Congressional delegation to Brussels, London and Berlin to meet with political and business leaders about developments in the European financial services sector. Ranking Member LaFalce accompanied me on this trip, as did our colleague Mel Watt. In each meeting we attended, the primary topic of discussion concerned major changes being undertaken as part of the Financial Services Action Plan.

While Europe's move toward integration has been widely praised in the U.S. for the measures it takes to streamline the European financial marketplace, some concerns exist. These concerns include new rules for the supervision of financial conglomerates, international accounting standards, and corporate prospectuses. Unfortunately, the plan includes the divisive issue of expensing for stock options. I don't understand why the EU would choose this forum----which after all is supposed to be dedicated to harmonizing accounting standards---to raise this contentious issue.

In addition, the Action Plan is at the heart of the EU's stated goal of making the European Union, "the most dynamic and competitive knowledge-based economy in the world" by 2010. This Committee must do everything possible to give American businesses the tools they need to compete in the global economy, and we must continue to anticipate challenges to American competitiveness.

The global economy will benefit greatly if our friends across the Atlantic are able to streamline their markets and regulatory authorities, but it must not come at the expense of transparency and fair trade.

The U.S. financial services industry is the most innovative, competitive and transparent in the world. Coupled with the fact that Europe is both our most active trading partner and our most powerful ally, we are well-served by staying "ahead of the curve" with respect to the coming changes in Europe.

Oxley, page two
May 22, 2002

The Treasury Department, SEC and Federal Reserve are closely following the changing financial services landscape in the EU. I'd like to welcome representatives from each organization today. Governor Mark Olson, Assistant Secretary Randy Quarles, and Ms. Annette Nazareth will be testifying about their impressions of the Financial Services Action Plan and about their continuing dialogue with European counterparts.

I'd also like to welcome representatives from the private sector and from academia, who will go into further detail on implementation of the Plan and how it will affect U.S. interests.

Before the witnesses testify, I now turn to the distinguished gentleman from New York, the Ranking Member of the Committee (Mr. LaFalce) for any comments that he might have.

###

May 22, 2002

Opening Statement for Congressman Paul E. Gillmor
House Financial Services Full Committee Hearing
"The European Union's Financial Services Action Plan and its Implications for the American Financial Services Industry"

I would like to thank Chairman Oxley for holding this important hearing this morning to examine the European Union's (EU) Financial Services Action Plan (FSAP) for financial integration. It is very important that this committee investigate the probable impact of this European initiative on our domestic markets.

In today's global financial system the ramifications of substantive changes in European regulations will extend to the American market, just as the effects of the Enron collapse have been felt worldwide. In fact, several of the 40 measures composing the strategic objectives of the FSAP have been revisited and revised due to both the Enron situation and the September 11th terrorist attacks in the United States.

I applaud the overall goals of the EU's financial integration initiative but am very interested in hearing from today's witnesses on some areas of potential concern, and particularly those that will have a direct impact on American businesses and may impede overall market competitiveness. Today, I look forward to learning more regarding the FSAP's proposed changes in the supervision of financial conglomerates as well as additional capital and risk control requirements.

As this committee continues to focus on lessons to be learned from the Enron collapse, our witnesses' opinions on international accounting standards, specifically those promulgated by the International Accounting Standard Board (IASB), will be of particular interest to me.

Again, I thank the Chairman for holding this important hearing and look forward to a very informative session.

Rep. Stephanie Tubbs Jones

OPENING STATEMENT

The European Union's Financial Services Action Plan and its Implications for the American Financial Service Industry

Financial Services Committee
Rep. Stephanie Tubbs Jones
Cleveland, 11th District

5/22/02

Good Morning, Chairman Oxley, Ranking Member LaFalce and Members of this Committee. Mr. Chairman, I ask unanimous consent that my full statement be included in the Record.

The landscape of business is changing every day. More and more the norm, basic survival of any corporation must include a strategy that is not just national in focus, but inclusive of the entire world. Rapid advances in communications, transportation and infrastructure in once barely competitive economies abroad have turned the global economy towards full-blown parity. Coalition building and solidarity between like-minded nations with regard to financing, especially in Europe, have become prevalent. The creation and momentum of the European Union exemplifies this trend.

The EU has developed a strategy geared towards attaining competitive supremacy in the financial markets. Where will this initiative by the EU leave US businesses? The Financial Services Action plan, which was created by the EU to lay the foundation for this movement, will hopefully help to answer this question.

Rep. Stephanie Tubbs Jones

I embrace this hearing today not only as an opportunity to assess the impact that this plan could have on business here in the US but also as an opportunity for us to learn. It is no secret that this nation is engaged in a very public debate regarding the policies and procedures of our financial markets and relevant regulatory agencies. We have seen companies such as Global Crossing and Enron attempt to exploit our system for the benefit of a select few.

Given the EU directive of "becoming the most competitive and dynamic knowledge-based economy in the world" we must now, more than ever before, think of domestic cooperation as opposed to exploitation. We must endeavor to create infrastructure, policies and regulations that promote cooperation and healthy competition among our best and brightest so that this country can retain its competitive advantage in the perpetually expanding global economy.

I look forward to hearing about the EU's Financial Service Action Plan. I look forward to the testimony of these witnesses with regard to the impact that these EU policies may have on US based companies but most importantly, I look forward to learning how we can leverage our recourses, our knowledge and our policies to the advantage of every American corporation as they tirelessly defend our turf on the front lines of the global economy.

Mr. Chairman, I thank you for my time.

Opening Statement
Congressman Ed Royce (CA-39)
22 May 2002
The European Union's Financial Services Action Plan

Thank you, Mr. Chairman, for the opportunity to address the ongoing developments in the European Union's Financial Services Action Plan (FSAP). I appreciate the Chairman's efforts in calling attention to this topic, which will certainly have meaningful and far-reaching implications for many American financial services firms and for the broader relationship between the United States and the European Union (EU) for many years to come. Today's hearing should also establish an excellent foundation for the EU Internal Markets Commissioner Frits Bolkestein's upcoming visit to the US, and I look forward to discussing some of the issues which will presumably be raised by his visit with our panels here today.

The FSAP represents a three-year-long attempt by the EU to consolidate strategically-important proposed directives for updating and integrating the European financial services industry into a single measure. I applaud this effort, and I would like to take this opportunity to voice my support for measures to help bring consistency and transparency to the financial services industry in the EU. Many of the directives are important and necessary steps that must be taken to ensure that all firms -- especially those American firms who have the capacity and inclination to bring their expertise to the European market -- are treated fairly and equitably on a level, transparent playing field.

The EU is currently experiencing a structural metamorphosis in its financial services industry that closely resembles many of the changes that the American financial services industry has already realized over the last twenty years. As a result, many American financial services firms already possess the internal networks and product and skill sets necessary for success in Europe, and are in a unique position to transfer their expertise there with efficiency and acumen. As such, ensuring that these firms are allowed to compete fairly is in the interests of both the United States and the European Union, as the continuation of free trade in services will bring great economic benefits to both of these economic entities.

Although Europe's moves toward integration should have very positive implications for streamlining their financial marketplace, I strongly believe that this should not come at the expense of free trade or transparency. I am also concerned that a rush by the EU to create a timetable for achieving this integration may come at the expense of quality and adequate public comment on the proposed directives. Such a complex task as integrating Europe's financial marketplace to produce the best and most efficient product requires that full public comment be received from all actors in the market, and that it not just evolve as a top-down bureaucratic mandate from Brussels.

That being said, I look forward to learning more about this issue from our panels' insights here today, and about its potential impact on American firms and the American financial marketplace. I thank the chairman for this opportunity to speak, and I yield back the balance of my time.

Statement of
Mr. Sherman of California
Committee on Financial Services
May 22, 2002

Mr. Chairman, in addition to the statements that I have made at this hearing, I would like to express my deep concern for the mail room employees at the World Bank. They have endured a recent anthrax scare and I would be remiss if I did not express my concern for their safety and well being at this time.

Financial Accounting Standards Board
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EDMUND L. JENKINS
Chairman

April 29, 2002

The Honorable John J. LaFalce
United States House of Representatives
Washington, DC 20515

Dear Representative LaFalce:

Thank you for taking time out from your very busy schedule on April 22, 2002, to have dinner with me and Financial Accounting Foundation ("FAF") Chairman Manuel H. Johnson. I very much enjoyed our dinner discussion and, as you know, I share many of your views. I also want to thank you for your letter of April 18, about the accounting treatment of stock options. Below is my response to the issues you raised in that letter.

The Historical Accounting Treatment of Stock Options Was Limited by Lack of Valuation Methods

US accountants and accounting standard setters have long struggled with the issue of the best way to report expense when employees are granted stock options as part of their compensation. In 1972, the Accounting Principles Board ("APB"), the predecessor of the Financial Accounting Standards Board ("FASB" or "Board"), issued APB Opinion No. 25, *Accounting for Stock Issued to Employees.* Partly because techniques to estimate the value of options did not yet exist, the drafters of Opinion 25 created an exception to the normal financial reporting model. (That model encompasses the general principle that all of a company's costs should be included in the company's financial statements; otherwise, the company's income is overstated.)

Under the Opinion 25 exception, only options granted to employees that meet certain specified criteria are not reported as an expense. All other options—including those granted to nonemployees (other than members of the board of directors)—result in expenses to be included in the financial statements consistent with the general principle.

The FASB's Prior Effort to Replace the Historical Accounting Treatment Was Thwarted by Political Opposition That Threatened the Board's Very Existence

Many agreed that the Opinion 25 exception was not the best approach to transparent financial reporting for stock options, and in 1984 the FASB undertook a project to reconsider the issue. That project was expected to replace Opinion 25, but in 1995 when the FASB issued Statement No. 123, *Accounting for Stock-Based Compensation,* it permitted companies to continue to apply Opinion 25, while also requiring footnote disclosures of the fair values of stock options otherwise omitted from the financial statements.

The following paragraphs of Statement 123 summarize the basis for the Board's decision to only *encourage*, rather than *require*, that all employee stock options be reported as an expense and subtracted from income:

> The Board continues to believe that financial statements would be more relevant and representationally faithful if the estimated fair value of employee stock options was included in determining an entity's net income, just as all other forms of compensation are included. To do so would be consistent with accounting for the cost of all other goods and services received as consideration for equity instruments. . . . However, in December 1994, the Board decided that the extent of improvement in financial reporting that was envisioned when this project was added to its technical agenda . . . was not attainable because the deliberate, logical consideration of issues that usually leads to improvement in financial reporting was no longer present. Therefore, the Board decided to specify as preferable and to encourage but not to require recognition of compensation cost for all stock-based employee compensation, with required disclosure of the pro forma effects of such recognition by entities that continue to apply Opinion 25.
>
> The Board believes that disclosure of the pro forma effects of recognizing compensation cost according to the fair value based method will provide relevant new information that will be of value to the capital markets and thus will achieve some but not all of the original objectives of the project. *However, the Board also continues to believe that disclosure is not an adequate substitute for recognition of assets, liabilities, equity, revenues, and expenses in financial statements. . . . The Board chose a disclosure-based solution for stock-based employee compensation to bring closure to the divisive debate on this issue—not because it believes that solution is the best way to improve financial accounting and reporting.* [Paragraphs 61 and 62; emphasis added.]

In recent Congressional testimony, Dennis R. Beresford, who was the FASB Chairman at the time, shared his views about Statement 123 and the reasons for the Board's decision:

> As many of you may recall, the FASB had proposed that companies account for the expense represented by the

> fair value of stock options granted to officers and employees. The business community and accounting firms strongly opposed this proposal and a number of corporations engaged in a lobbying effort to stymie the FASB's initiative.
>
> Certain members of Congress were sufficiently influenced by the appeals from corporate executives that they were persuaded to introduce legislation to counter the FASB's proposal. The legislation would have prohibited public companies from following any final FASB rule on this matter. *More importantly, the legislation would have imposed requirements that the SEC repeat the FASB's process on any new accounting proposals, thus effectively eviscerating the FASB. Faced with the strong possibility that its purpose would have been eliminated by this legislation, the FASB made a strategic decision to require companies to disclose the effect of stock options in a footnote of the financial statements but not record the expense in the income statement.* [1]

Thus, while your letter is correct that the "FASB concluded that stock options should be expensed," the Board did not require that accounting treatment because of the very real concern that Congress would eliminate the FASB and independent, private-sector accounting standard setting.

<u>The Accounting Treatment for Stock Options Is Under Consideration Internationally</u>

Your letter makes reference to the International Accounting Standards Board ("IASB"). The IASB has an active agenda project on accounting for share-based payment. The IASB, however, has not yet reached any conclusions about the accounting treatment of stock options. The IASB's current plans are to issue a proposed standard for public comment in the fourth quarter of 2002.

The FASB is closely monitoring all of the IASB's projects, including the project on accounting for share-based payment. The Board plans to continue to vigorously promote convergence opportunities with the IASB and other national standard setters. As part of that effort, the FASB plans to pursue the elimination of significant differences in standards between the US, the IASB, and other national standard setters consistent with improving the overall quality of US standards.

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[1] Prepared statement by Mr. Dennis R. Beresford, Chairman, Financial Accounting Standards Board, 1987-97, at a hearing on "Accounting and Investor Protection Issues Raised by Enron and Other Public Companies: Oversight of the Accounting Profession, Audit Quality and Independence and Formulation of Accounting Principles," before the Committee on Banking, Housing, and Urban Affairs, United States Senate, page 5 (February 26, 2002).

Future agenda decisions of the Board, including any potential changes to the US accounting treatment of stock options, are subject to the Board's open due process procedures. Those procedures include consideration of input from constituents, public deliberation, and an affirmative vote of the majority of the Board before any new project can be added to the Board's agenda. Thus, an immediate revision by the Board to the US accounting treatment for stock options is not possible. We, however, will carefully consider your letter as input to any future agenda decision.

The Experience with Statement 123 Demonstrates the Danger of Greater Government Control of the FASB

Enron's bankruptcy has drawn attention to conflicts of interest in a number of areas, including the accounting profession. There has been a natural inclination to propose and legislate new structures to minimize such conflicts. The FASB's experience, however, with Statement 123 presents another lesson. As former Chairman Beresford explained further in his testimony:

> I have noted that two members of this committee are considering whether the federal government should take over responsibility for setting accounting standards. In support, a recent Wall Street Journal article refers to critics of the FASB, who claim in part that the FASB has been "too quick to cave in on critical issues." One of the examples given was the decision to scrap the proposal on accounting for stock compensation. I find this ironic. I am confident that the FASB could have and would have stood up to companies that disagreed with its conclusions on stock compensation. It "caved" only under congressional pressure that would have effectively legislated it out of business. *Contrary to being an argument for government accounting standards setting, this is one of the very good reasons for the government to stay out of the technical accounting standards setting business.*[2]
> [Emphasis added.]

I share former Chairman Beresford's concern that some current proposals that would essentially transform the FASB into a government-controlled entity would *increase* rather than decrease the potential for harmful political pressures on the standard-setting process. As evidenced by Statement 123, those pressures can inhibit objective, neutral, and timely resolution of important financial reporting issues that may be necessary to provide investors with the information they need to make sound economic decisions.

Thank you again for attending the FAF's dinner and for your consistent and longstanding support of the independence of the FASB and its role in our capital markets. I would be

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[2] Ibid.

very interested in meeting with you again in the near future and introducing you to the incoming FASB Chairman, and my successor, Bob Herz.

In the meantime, if you have any questions or if I can be of any assistance, please contact me directly, or our Washington, DC representative Jeff Mahoney (703-243-9085).

Sincerely,

Ed Jenkins

5/17/02 Dow Jones Int'l News 09:30:00

Dow Jones International News

Friday, May 17, 2002

World Bk, Over US Objections, Plans More Loans To Iran

By Joseph Rebello

Of DOW JONES NEWSWIRES

WASHINGTON -(Dow Jones)- **The World Bank, undeterred by President George W. Bush's condemnation of Iran as part of an "axis of evil, arming to threaten the peace of the world," is pressing ahead with a plan that would provide as much as $755 million in loans to the country over the next two years.**

Since the bank began preparing the plan, Iran has mostly disappointed Western expectations that political reformers would succeed in making it more democratic and liberal. Reformers were silenced, and public executions and public floggings increased last year, according to Human Rights Watch. Iran remained the world's "most active" state sponsor of terrorism, according to the U.S. government.

But inside the bank support for more loans to Iran has only grown, officials say. In January, just as Bush identified Iran as a key threat to U.S. security in his State of the Union address, a team of bank directors returned from a visit to Tehran. Its recommendation: "deeper and faster involvement of the bank" in Iran, said Jean-Louis Sarbib, the bank's vice president for the Middle East and North Africa.

Staff Expects To Seek Approval For New Loan By Dec.

"We have been quite impressed with the way they have gone about some of their macroeconomic reforms," said Sarbib, citing the country's success in building its foreign reserves, in reducing poverty and in ensuring basic education for all Iranian girls. "What we see on the economic side are people who are really trying to build economic democracy, who are trying to build a market system."

The bank's staff intends to seek approval for a new loan - worth about $150 million - by the end of the year. That loan is an element of a tentative plan, endorsed last year by the bank's board of directors, that advocates the approval of $755 million in loans to Iran in fiscal 2002 and 2003. Iran could eventually be eligible for more than $500 million a year, if it continues to satisfy the bank's requirements, officials said.

For the U.S. government, the bank's biggest shareholder, the courtship of Iran has been a lingering source of embarrassment. The U.S. contributes 29% of the bank's capital. It controls 16% of the votes cast by the bank's directors - usually a decisive share. It is forbidden by Congress from supporting loans to Iran. But it has been powerless to stop them in recent years.
U.S. Hasn't Been Able To Stop Loans To Iran Recently

Two years ago, the bank's directors ended a seven-year lull in lending to Iran and approved two loans worth $232 million. The U.S. objected strenuously. Madeline Albright, the secretary of state, lobbied leaders of other governments, asking them to oppose the loans because of Iran's human-rights record. She made little headway: the U.S. cast the sole no vote. Canada and France abstained.

James Wolfensohn, the bank's president, told U.S. officials at the time that the loans addressed "basic human needs" and were designed to support the reform efforts of Mohammad Khatami, a moderate cleric who had been elected Iranian president in a landslide in 1997. But any future loans, he told the bank's U.S. representative, would be considered only after a "review of all aspects of the economic and governance programs of his government."

Iran's performance since then has been mixed. Khatami was reelected to a second four-year term last June. His government briefly warmed toward the U.S. after the terrorist attacks of Sept. 11 - it offered, at one point, to rescue U.S. pilots downed in the war in Afghanistan. But Khatami's influence soon faded amid a crackdown by the country's conservative clerics, who control Iran's judiciary and security forces.

"Even after his sweeping election victory in June, when he increased his share of the popular vote, (Khatami) continued to shy away from open confrontation with his opponents and made no discernible progress in implementing his promised reforms," Human Rights Watch said in a report in January that warned of "mounting" social and economic problems. "Increasingly...he appeared to represent more of a safety valve than an agent of tangible change," it said.

The World Bank, however, measures Iran's performance differently. It considers itself apolitical: The bank's mandate, officials say, is simply to reduce poverty and promote sustainable economic development among poorer countries. In deciding to make loans, accordingly, it avoids making official judgments about the borrower's stance on human rights, terrorism or nuclear weapons. Instead it keeps a close eye on economic and social indicators and the speed with which governments improve those statistics.

By those measures, Iran has performed splendidly. The poverty rate has fallen to 15.5% from 47% in 1978. The infant mortality rate dropped to 26 for every 1,000 births from 47 in 1990. Iran has also built up $17 billion in foreign reserves, partly because of the recent rebound in oil prices and partly because it has paid off much of its debt. It has lowered tariffs, removed most non-tariff trade barriers and unified its system of multiple exchange rates - all well ahead of schedule.

"We are seeing concrete results - in terms of economic and social reforms," Sarbib said. Last year, the bank's staff completed the review that Wolfensohn and the bank directors had called for, and advanced a short-term plan calling for the launch of a half-dozen development projects in 2002 and 2003. With the exception of the bank's U.S. representative, all of the bank's 24 directors supported the proposal. The bank's staff plans to present a long-term lending plan to the directors next year.

"The general sense among executive directors is that they are supportive of the bank's engagement with Iran, with the exception of the U.S.," said one director who asked not to be named. "It's difficult to see how the U.S. position could influence other countries. My sense is there is not widespread support for the U.S. position."

U.S. Lawmaker Criticizes Bank; Says U.S. Lackadaisical

At least one U.S. lawmaker is incensed, saying the loans will merely bolster Iran's repressive leadership. "Money is fungible," said Rep. Brad Sherman, D-Calif. "The money that the World Bank is providing to Iran's government is not particularly benefiting its people. That government will engage in the minimum domestic expenditures necessary to maintain power. Whatever is left over they'll spend on terrorism and nuclear weapons."

Sherman said he has been trying to get the Bush administration to take a harder line with World Bank, with little success. "Nobody's blood pressure is up on this," he said. "The problem is the U.S. bureaucracy. They say, 'Oh, gee, we'll vote no. If we get outvoted, que sera sera.' It's as if they hadn't listened to the State of the Union address. It's as if they were unaware of what happened on Sept. 11."

A Treasury Department spokeswoman, Michele Davis, said the U.S. government has regularly expressed its displeasure with the World Bank's plans for Iran. "The U.S. opposes World Bank lending to Iran and has consistently communicated this position to Bank management, including in May of 2000, when the World Bank approved two loans to Iran despite U.S. opposition," she said.

World Bank officials, meanwhile, said they can see no reason why Iran should

Statement of

Mark W. Olson

Member

Board of Governors of the Federal Reserve System

before the

Committee on Financial Services

House of Representatives

May 22, 2002

Thank you, Mr. Chairman, for the opportunity to speak today on matters relating to the operations of U.S. banking organizations in the European Union. This is a time of significant change within the European Union with the ongoing efforts to complete the single market in financial services.

I join with my colleagues here today in welcoming the European Union's plans to make its market more efficient and transparent. The United States has always been a strong supporter of European unity as well as market reforms that eliminate unnecessary regulatory burden and promote better functioning of markets and financial systems.

The Financial Services Action Plan of the European Union includes proposals that are aimed at achieving these same goals. The FSAP involves a series of regulatory and legislative measures designed to achieve, among other things, a single wholesale European market; open and secure retail markets; and state-of-the-art prudential rules and supervision. To further these goals, a number of directives have been or will be adopted that deal with issues such as money laundering, investment services, implementation of new Basel capital rules and international accounting standards, and supervision of financial conglomerates. I will deal with the latter three areas later in my testimony. These directives, and all of the other measures being adopted in the FSAP, will affect U.S. financial services firms with operations in Europe.

The FSAP is intended to modernize and enhance the efficiency and structure of the regulatory regime for financial services within the European Union. To the extent that the FSAP achieves these goals, U.S. firms are well-positioned to offer innovative and efficient services to customers throughout Europe.

At the Federal Reserve, we follow with interest changes to foreign bank regulatory and supervisory systems and seek to understand how these systems affect the banking institutions for which we are responsible. This is especially important in the European Union, in which U.S. banking organizations have substantial operations. As of December 2001, 27 U.S. banking organizations operate in the European Union with aggregate EU assets of over $650 billion. Moreover, 66 EU banking organizations conduct commercial banking and other financial services in the United States with aggregate U.S. assets of over $1.7 trillion.

These figures demonstrate that globalization is not a new concept or recent process. As U.S. industry has expanded its foreign operations, U.S. supervision has had to evolve to take account of the fact that our banks operate in many different legal and regulatory environments. We have strengthened existing cooperative relationships with bank supervisors in other countries and established new ones as U.S. banks continue to expand their operations into other countries. At the Federal Reserve, we conduct bilateral consultations with individual authorities and participate in international groups of financial services supervisors. We engage our EU counterparts both bilaterally and through these groups.

The Federal Reserve and the other federal banking agencies participate regularly in the Basel Committee on Banking Supervision, which was formed in order to improve communication and cooperation among supervisors of internationally active banks. Some of the key achievements of the Committee include the 1988 Basel Capital Accord, which created for the first time an internationally accepted standard for assessing levels of bank capital. The Accord replaced an uneven system of national standards and has allowed banks to expand internationally on more competitive basis. Similarly, the Committee adopted its Minimum Standards for Consolidated Supervision in 1992, establishing the principle that a bank should be subject to a supervisory regime in which its financial statements are consolidated and subject to review by home country authorities. Both the Capital Accord and the principle of consolidated bank supervision have become the internationally recognized standards that bank supervisors should aspire to meet.

Nine of the member states of the European Union are also members of the Basel Committee and a representative of the European Commission participates as an observer. The Federal Reserve and eight of these nine EU countries, and a European Commission observer, also participate in the Joint Forum, a group established by the Basel Committee, International Organization of Securities Commissioners (IOSCO), and the International Association of Insurance Supervisors (IAIS). The Joint Forum discusses issues arising from the operation of financial services conglomerates and has developed principles appropriate to the supervision of entities that operate within financial groups. These group meetings, as well as many working group meetings on specific issues, provide regular opportunities for U.S. regulators to meet and discuss issues of common interest with European officials.

In addition to regular meetings of international groups, the Federal Reserve has longstanding relationships with both national regulators in the European Union and staff of the European Commission. For internationally active banking organizations with operations in both the United States and the European Union, national supervisors may participate in joint examinations of particular institutions, confer with each other on specific issues and meet periodically to discuss an institution's operations or financial condition. Ongoing communication is recognized as critical for effective supervision. Home and host countries' interests are both furthered by dialogue and strong supervisory relationships.

Regular contact with Commission staff goes back to the 1980s when the EU considered and adopted its Second Banking Directive, aimed at promoting the internal market by establishing the so-called "European passport" for banks chartered in the EU. Under the passport, a bank chartered in one EU country is entitled to establish branches in any other EU country under the authority and supervision of its home country rules. Since that time, several U.S. banks have taken advantage of this early EU regulation by establishing a local bank in a European member state, which then used the "passport" to establish branches in other EU member countries.

European subsidiaries of U.S. banks are able to take advantage of the passport under the principle of "national treatment." National treatment generally means that a country provides parity of treatment between domestic and foreign-owned firms, resulting in equality of competitive opportunity. National treatment has long been the prevailing practice with respect to foreign banks operating in the United States and this practice was incorporated into statute in 1978 with the enactment of the International Banking Act (IBA). This principle has also been incorporated in various trade agreements to which the United States is a party, such as the North American Free Trade Agreement (NAFTA) and the General Agreement on Trade in Services (GATS). The EU member states are also subscribers to the GATS and consequently to the national treatment principle it contains.

Implementing national treatment can be difficult precisely because one country is trying to adapt its own legal and regulatory structure to a foreign firm that is incorporated in a different home country environment. This is a challenge the Federal Reserve has faced over the years as we seek to apply U.S. laws that were adopted for a system of bank holding companies to foreign banks that generally do not have a bank holding company structure. The United States also requires that a foreign bank be subject to comprehensive consolidated supervision by its home country supervisor before it can buy a bank in this country. Under this law, the Federal Reserve must evaluate supervision systems that are different from our own and yet ensure that we are fairly applying the principle of national treatment.

U.S. private sector firms may be concerned about new regulatory and supervisory initiatives in the EU because such proposals may require changes in existing operations and/or reporting standards. There may also be a concern that initiatives designed for European firms or industries would not properly take account of home country supervisory structures or regulatory practices. Foreign banks have expressed similar concerns about U.S. regulatory initiatives in the past. At the Federal Reserve, we have found that our open and transparent regulatory process is crucial in helping us to understand how our proposals affect foreign banks and where problems arise, and gives us useful information for evaluating the merits of particular complaints. We have at times proposed regulations on which foreign banks and their governments, including the European Commission, filed adverse comments. These comments helped us to reevaluate our regulations and to determine whether our supervisory and regulatory objectives could be achieved in a different way, consistent with the principle of national treatment.

With respect to the implementation of the FSAP in the European Union, the European Union has an obligation to ensure that the rules adopted are consistent with the principle of national treatment. It is our expectation that the European Commission and the member states will seek to do so. Federal Reserve staff has met with Commission staff to discuss a number of matters, including the application of the financial conglomerates directives to U.S. banking organizations. The Federal Reserve is committed to continuing the dialogue with the Commission on matters of mutual interest, both bilaterally and as part of financial markets discussions led by the Treasury Department. We understand that the Commission has begun to engage in industry consultation as part of the rule writing process and we endorse a process that allows all affected institutions, including those that are foreign-based, to participate actively in the process.

The FSAP has a far reaching agenda. I will comment briefly on three issues of particular interest to U.S. banking organizations. With respect to the conglomerates directive, we understand that the impetus for the directive came from the Joint Forum's principles for the supervision of financial conglomerates. The three parent bodies of the Joint Forum (the Basel Committee, IOSCO and the IAIS) were concerned that, although individual financial companies within a group might be subject to prudential supervision, the consolidated financial group might not be subject to appropriate oversight. This in turn could lead to relationships or transactions that could pose financial risk to the regulated parts of the group. The Joint Forum's principles were developed to help assure that there are no material gaps in supervisors' understanding of inter-affiliate relationships within a financial group that could ultimately result in financial instability. We understand that the EU financial conglomerates directive is concerned with this same issue.

In the United States, U.S. banking organizations have long been subject to consolidated supervisory oversight. We believe that the Federal Reserve's supervisory programs and practices for bank holding companies, including financial holding companies, are fully consistent with the requirements that are contemplated under the EU's financial conglomerates directive.

With regard to the capital adequacy directive that is being developed for credit institutions and investment firms in the European Union, we also believe that the ultimate product will not present difficulties for U.S. banking organizations. The European Commission is mindful of the work that is underway in the Basel Supervisors Committee to replace the existing Basel Capital Accord with a more comprehensive risk sensitive framework for assessing an organization's capital adequacy.

When the EU issued its capital adequacy directive for public comment in 2001, commenters raised concerns about the regulatory burden that would be imposed on institutions that would be subject to both the EU capital rules and the Basel capital rules at the national level. The EU committee responsible for the capital adequacy directive has recognized this potential burden and has taken steps to ensure that the EU directive is as consistent as possible with the final revised Basel Accord. Technical working groups of the Basel Committee have been communicating with the EU technical drafting groups with the objective of harmonizing the two frameworks to the fullest extent possible.

The most sweeping changes in the Basel capital initiative are intended for internationally active banking organizations. The EU capital adequacy directive is intended to apply to a much wider range of institutions, both those with international operations as well as those that are purely domestic. Thus, the capital adequacy directive will likely address EU specific issues for smaller institutions. Internationally active European banks currently are subject to the Basel capital rules as they have been adopted in individual countries, as well as to the existing EU capital adequacy directive. Some differences between the two sets of rules do exist. Supervisors, however, are aware of these differences and continually strive to minimize the associated regulatory burden on institutions. Because the Basel revisions and the EU capital directive revisions are underway in tandem with similar estimated time frames for completion, there is a good likelihood that the final products will be substantively and significantly more consistent than the current Basel and EU capital rules.

The FSAP also contemplates mandating adherence to international accounting standards. Currently, banking organizations in the European Union may prepare their annual financial statements in accordance with the accounting standards of the International Accounting Standards Board (IASB), U.S. generally accepted accounting principles (U.S. GAAP), and/or national standards. The use of U.S. GAAP is usually limited to those banking organizations or other companies whose securities are publicly traded on U.S. stock exchanges and are registered with the Securities and Exchange Commission. In many cases, these companies will also provide separate financial statements based on their national accounting standards and disclosure rules. The European Union will require all EU companies listed on EU exchanges that are currently following national standards to follow IASB standards by 2005 and will require those EU companies that currently follow U.S. GAAP to adopt IASB standards by 2007. The EU is also working to adopt international auditing standards for external audits of EU companies, including banks.

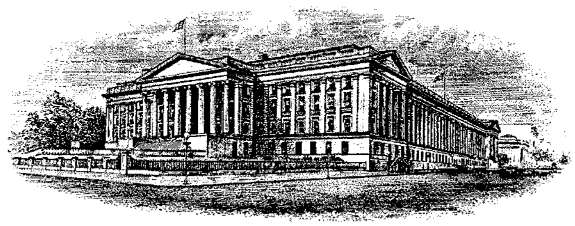
The IASB is now independent of the international accounting profession and independently funded. It has adopted many of the structural elements of the FASB in the United States, which are intended to promote an independent, objective standards-setting environment. Many senior American accounting experts serve on the IASB and its staff. IASB GAAP has many similarities with U.S. GAAP and the IASB plans to propose extensive enhancements to its standards later this year.

The Federal Reserve has long supported sound accounting policies and meaningful public disclosure by banking and financial organizations with the objective of improving market discipline and fostering stable financial markets. The concept of market discipline is assuming greater importance among international banking supervisors as well. The most recent proposal of the Basel Committee to amend Basel Capital Accord (called Basel II) seeks to strengthen the market's ability to aid bank supervisors in evaluating banking organizations' risks and assessing capital adequacy. It consists of three pillars, or tools: a minimum risk-based capital requirement (pillar I), risk-based supervision (pillar II), and disclosure of risks and capital adequacy to enhance market discipline (pillar III). This approach to capital regulation, with its market-discipline component, signals that sound accounting and disclosure will continue to be important aspects of our supervisory approach.

The Federal Reserve and the other U.S. banking agencies are also actively involved in the efforts of the Basel Committee to promote sound international accounting, auditing, and disclosure standards and practices for global banking organizations and other companies. For example, an official of the Federal Reserve Board is a member of the Standards Advisory Council that advises the IASB and its trustees on its projects, proposals and standards. The U.S. banking agencies have been active in supporting the Basel Committee in its work with the IASB's technical advisory groups to enhance the IASB's standards for financial instruments and bank disclosures and the Basel Committee's projects with other international groups to promote sound global bank auditing practices.

In conclusion, I believe that the European Union should be encouraged to continue its program to strengthen and modernize the rules under which financial services firms operate in Europe. This can only increase competition, enhance efficiency and contribute to economic growth in the EU and globally. We are pleased that the European Commission is broadening its consultation and comment processes on proposals being considered under the FSAP. Supervisory and regulatory measures benefit significantly from an open and transparent process in which affected companies may participate. We would expect that the European Commission and member state national authorities will apply the FSAP's measures to U.S. firms on a fair and national treatment basis.

U.S. banking organizations are dynamic and more than competitive with the rest of the world. Accordingly, we are confident that U.S. firms will benefit from a strengthened and more efficient European market for financial services.



DEPARTMENT OF THE TREASURY
OFFICE OF PUBLIC AFFAIRS

EMBARGOED FOR DELIVERY
May 22, 2002 – 10:00am

Contact Tony Fratto
at 202-622-2960

House Financial Services Committee Hearing
May 22, 2002

Statement by Randal Quarles
Assistant Secretary for International Affairs
U.S. Treasury Department

Thank you, Mr. Chairman.

It is a great pleasure to testify before the Committee on Europe's Financial Services Action Plan (FSAP). I welcome today's hearing in particular because the FSAP merits serious attention from U.S. policy-makers as it has the potential to be one of the key forces shaping global capital markets over the coming decades, with important ramifications for the operations of U.S. global financial institutions. Against this background, I commend you, Mr. Chairman, for the success of your March visit to Europe and for having the vision to hold this hearing at a timely moment.

What is the FSAP?

Several years ago, the European Commission adopted a framework to integrate Europe's capital markets by the middle of this decade. This framework was then translated into an action plan, consisting of 42 measures, which are now being fleshed out. These measures aim at creating a single, EU-wide financial market; establishing an EU legislative apparatus capable of responding to new regulatory challenges; eliminating capital market fragmentation; promoting closer coordination among supervisory authorities; and developing an integrated EU infrastructure for wholesale and retail financial transactions.

The measures themselves range from reports and recommendations to directives to be adopted by the European Parliament and Council of Ministers and transposed into national law. They include such issues as EU-wide directives on financial conglomerates, prospectuses, market abuse, investment services, clearance and settlement, occupational pensions and takeovers.

While these matters may sound arcane, there should be no mistake – they are critical underpinnings of financial markets.

Those measures leading to an integrated European securities market are to be completed by the end of 2003. This is an ambitious timetable, to be sure, and European officials recognized that it would not be achievable with a regulatory and legislative framework that was slow and cumbersome. So, the EU also adopted a framework and procedures to streamline decision-making, while ensuring that rule-making is undertaken transparently. To date, it is fair to say that the EU is moving quickly to prepare the measures and put them into effect in a timely manner.

U.S. Views on the FSAP

Well-managed, the FSAP offers a clear win-win opportunity for Europe, the United States, the world economy, and U.S. financial institutions.

The United States has strongly supported European integration for many decades. Today, the United States and the EU are the two largest economies in the world and share a special responsibility for promoting the sound management of the global economy. The policies pursued in the United States and Europe are thus critical not only for the citizens in each area, but for the world at large.

The experience of the United States teaches us that robust economic growth requires sound macroeconomic policies and structural reform , and that the latter in turn is best served by pursuing microeconomic reforms across a broad front with a view toward promoting flexible factor and product markets. It also teaches us that the creation of efficient and robust capital markets is among the single most important structural reforms.

The openness of the U.S. financial system, its depth and liquidity, and fierce competition have strongly contributed to our economy's growth potential and efficiency. Countless academic studies show that efficient capital markets are a potent disciplinary force that enhance productivity, strengthen consumer choice and welfare, and offer borrowers capital at costs best suited to promoting investment. Recently, a group of European industrialists commissioned a report on financial integration in Europe, which concluded that national borders in Europe still constituted a considerable de facto barrier for financial markets and that the integration of European financial markets could boost growth in Europe by at least ½% per annum.

The introduction of euro notes and coins earlier this year was an unqualified success for which European officials can rightly feel proud. The development of the FSAP now offers Europe the opportunity to build on this success and to strengthen the foundation for growth in Europe and the world at large. This could help Europe become a welcome, second engine of growth for the global economy.

And the opportunities are enormous. The Euro-area's equity market capitalization is about 89 percent of GDP, in comparison with over 150 percent in the United States. The European corporate bond market is less than a third of the size of the U.S. market.

The U.S. financial industry is the most competitive and efficient in the world. Over many years of intense competition, U.S. financial firms have become leading global players, offering products at the cutting edge of financial innovation and serving a network of customers throughout the world. For example, the experience of U.S. financial firms in offering mutual funds has critically aided the development of pension plans, which many analysts see as one of the keys for addressing the demographic challenges facing Europe. U.S. firms are thus well positioned to help Europe achieve its aspirations.

Of course, as the FSAP moves forward, the United States will need to continue monitoring this process closely. This monitoring is and should be guided by a number of fundamental considerations.

- No longer can rules and laws be crafted as if major firms operated exclusively within national borders. This reality is part and parcel of the process of globalization. In that same spirit, the framework that Europe develops for the FSAP will need to be consistent with the reality of an open, global financial system. Put differently, for the European economy to reap the full benefits from this undertaking, Europe must ensure that the FSAP creates not just an integrated European financial market, but an integrated European financial market that is firmly anchored in the global marketplace.

- Global financial firms are part of one of the most competitive and innovative industries in the world. Competitiveness and innovation should be rewarded. The FSAP should reward the most efficient firms operating in the European market, no matter the firms' country of origin.

- An integrated European capital market with institutions operating at the forefront of the global industry will present new challenges for supervisors to protect against risk. Thus, supervisory information-sharing and cooperation should be further strengthened not only just across the Atlantic but also through the international standard setting bodies such as the Basle Committee on Banking Supervision and the International Organization of Securities Commissions (IOSCO).

- Given the dynamism of the financial industry and the speed with which it can use technology to create new products, this industry will always be a step ahead of supervisors. Thus, as supervisors promulgate directives and strengthen regulation, they should consult closely with financial institutions, understand how the firms operate, and effectively incorporate the firms' perspectives. Further, this process should take place in a transparent manner, open to public comment, so that regulators can benefit from the perspectives of all and so outside participants can effectively offer inputs into the process. Recently, EU officials have been active in meeting this challenge and we strongly urge that the EU continue along this path.

Managing U.S.-EU Financial Market Issues

Of course, in moving forward with the FSAP, the decisions taken by European policy-makers will need to reflect many diverse interests – such as those of financial institutions, exchanges, policy-makers, and supervisors, and parliaments throughout the 15 EU member states.

Furthermore, the decisions should be taken against the background of Europe's traditions and cultures in the financial arena. Also, Europe will need to promote the safety and soundness of its financial markets. But again, the decisions should be taken in a manner that rewards innovation and competitiveness and does so in a manner that recognizes the ways in which global firms operate.

These are important points to be mindful of in many of the draft directives under the FSAP. For example:

- U.S. investment banks at times net out purchases and sales of securities; in other parts of the world such transactions are put through exchanges. This is an important issue raised by the Investment Services Directive.

- What is adequate capital for an investment bank will differ from what is adequate capital for a commercial bank, given the different nature of their businesses. This issue arises in the Financial Conglomerate Directive.

- Firms may wish to list securities in a given country even if their home base of operation is elsewhere; authorities in the firm's home country may prefer that listing take place there. This consideration relates to the Directive on Prospectuses.

Inevitably, there will be differences in the way that US and European authorities and financial institutions approach issues of common interest. These issues need to be well managed. It would not be appropriate, for example, for European officials to attempt to impose European regulatory standards on the rest of the world, to expect U.S. financial institutions to be identical in structure to European firms, or to deny these institutions the benefits of their leading edge technology and products. Naturally, the United States would be concerned about any proposals that might discriminate against the European operations of U.S. financial institutions or suggest U.S. supervision was not appropriate because it was not identical to Europe's way of doing business.

Rather, we need to put aside any formal differences, recognize that we share a common set of objectives, and ensure that these objectives are being achieved in substance. This will not necessarily be an easy task, but it is what U.S. and European officials are working to achieve.

Treasury, Federal Reserve, and SEC officials are in close contact with their European counterparts. Last November, the senior EC official responsible at the day-to-day level for the FSAP visited Washington for a round of discussions on the FSAP and financial market developments in the United States and Europe.

Earlier this year, a team of Treasury, Federal Reserve and SEC officials visited Brussels for two days of intensive meetings. This team discussed financial market issues with the responsible senior Commission officials, met with the European Parliament's Economic and Monetary Affairs Committee, and, at the invitation of the Commission, made a presentation to member state regulators on the supervision of financial conglomerates by the Federal Reserve and the SEC. Also at the end of this month, the EC Commissioner for the Taxation and Internal Market, Frits Bolkestein, will visit Washington and his chief lieutenants will then visit in mid-June for follow-up discussions.

It is also important to emphasize that this is not simply a "one-way" dialogue. Just as the United States is greatly interested in how the European financial market develops, European officials are also interested in how U.S. financial markets develop. Hence, while both sides hold active discussions about the FSAP, they also discuss such issues as accounting standards and disclosure requirements in the United States. Additionally, an area of critical importance that we discuss is the fight against the financing of terrorism.

The dialogue has been technical and professional. It is informal and free-flowing and both sides approach it in an open-minded manner, trying to develop an understanding of each other's perspectives. In our talks, we have found that European officials share our objectives.

Recognizing the win-win nature of Europe's efforts to integrate its financial markets for the world economy and the United States, President Bush and President Prodi at their May 2 Summit in Washington put this financial market dialogue at the top of the U.S.-EU "positive economic agenda."

Conclusion

Mr. Chairman, let me again thank you for holding this timely hearing. Let me also underscore in conclusion that the United States welcomes Europe's efforts to integrate its financial markets and that we fully intend to remain closely engaged with Europe to help ensure that the FSAP contributes to a strong and more robust international financial system.

TESTIMONY OF

ANNETTE L. NAZARETH, DIRECTOR
DIVISION OF MARKET REGULATION
U.S. SECURITIES AND EXCHANGE COMMISSION

CONCERNING
CERTAIN PENDING PROPOSALS BY THE EUROPEAN COMMISSION

BEFORE THE
COMMITTEE ON FINANCIAL SERVICES

U.S. HOUSE OF REPRESENTATIVES

MAY 22, 2002

U. S. Securities and Exchange Commission
450 Fifth Street, N.W.
Washington, D.C. 20549

TESTIMONY OF
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BEFORE THE COMMITTEE ON FINANCIAL SERVICES

UNITED STATES HOUSE OF REPRESENTATIVES

May 22, 2002

Chairman Oxley, Ranking Member LaFalce and Members of the Committee:

Thank you for the opportunity to testify before you today on behalf of the Securities and Exchange Commission ("Commission") on certain pending proposals of the European Commission ("EC"). My testimony will focus primarily on the EC's proposal for a directive on the consolidated supervision of financial conglomerates. I will also briefly discuss the adoption of international accounting standards, the proposed prospectus directive, and the capital adequacy directive.

Proposal for a Directive on the Consolidated Supervision of Financial Conglomerates

European capital markets have been undergoing a major transformation. One aspect of this transformation is the EC's commitment to integrate financial markets in the European Union ("EU"). The EC has stated that a single financial market will be a key factor in promoting the competitiveness of the European economy. An integrated market is being facilitated, in part, by the EC's development of the Financial Services Action Plan ("Action Plan"), a series of legislative proposals that would subject all financial services firms active in the EU to consistent standards of regulation. If properly implemented, the Action Plan could help Europe achieve economic growth and strength. U.S. securities firms can contribute to these goals.

One of the primary legislative proposals by the EC under the Action Plan is the proposal for a directive on the consolidated supervision of financial conglomerates ("Proposed Directive"), which would establish minimum requirements for group-wide supervision of "financial conglomerates" and "mixed financial holding companies" doing business in the EU. The Proposed Directive is the EU's response to containing and supervising risks arising in cross-sector groups containing securities firms, credit institutions, and insurance companies. The Proposed Directive imposes prudential supervision on a group-wide basis of financial conglomerates and mixed financial holding companies. It attempts to address concerns that there could be a threat to financial stability if any firm within the group were to face financial difficulty. The Proposed Directive would also attempt to align the rules for financial conglomerates with those for firms dealing in a single financial sector, and would require cooperation and information sharing among supervisory authorities.

Consequences of the Proposed Directive on U.S. Registered Securities Firms

Generally, the current form of the Proposed Directive would impose a series of quantitative and qualitative requirements at the holding company level of a financial conglomerate or mixed financial holding company, which would be applied by an EU Member State's home regulator designated as the "co-ordinator." If a financial conglomerate or mixed financial holding company operating within the EU does not have its "head office" within the EU, the Proposed Directive provides for the verification by EU authorities that the firm is subject to supervision that is "equivalent" to the EC's Proposed Directive. If an equivalence determination is not made, then under the EC's proposal, EU authorities could adopt other methods, such as imposing additional requirements on the firm to achieve the objectives of the Proposed Directive.

The Commission does not have direct consolidated supervisory authority over securities firm holding companies, except as described below. In substance, however, the Commission and EC approaches to group-wide supervision are based on the same principles. These principles focus on the importance of capital adequacy, regulatory scrutiny of the risk profile of the group, fit and proper or other qualification tests for key personnel, and information-sharing among supervisors of a financial conglomerate. Although the Commission does not conduct consolidated supervision precisely as described in the Proposed Directive, the Commission does undertake group-wide supervision that, like consolidated supervision, provides sufficient tools to identify the major risks of the entire enterprise.

Several U.S. securities firms have communicated to the Commission that they have serious concerns with the Proposed Directive. They fear that the EU authorities that will make the "equivalence" determination may take the position that the Commission's supervision of securities firms at the holding company level is not equivalent to the EC's standards. They conclude that the Proposed Directive would not only increase their cost of doing business in Europe, but would also place them at a competitive disadvantage with European-based firms. In particular, under the Proposed Directive, in the absence of an "equivalency" determination, a U.S. securities firm operating within the EU could be subject to higher capital and risk control requirements than an EU-based firm. Alternatively, a U.S. securities firm may be required to create a sub-holding company in the EU. The possibility also exists that the EC could impose more stringent requirements on the European activities of such U.S. entities than those imposed on EU-based companies. Further, the EC could require that the entire U.S. holding company be subject to European consolidated supervision.

At a time when we are carefully evaluating the impact of our U.S. rules and regulations on foreign entities, in an attempt to move to more global markets, we are concerned about the possible imposition of standards on U.S. firms by the European Community in the form of "equivalence" determinations. To the extent that "equivalence" signals an effort to harmonize both regulatory regimes, we welcome the effort. To the extent "equivalence" is really a means of having a "co-ordinator" in the EU evaluate the quality of our regulatory regime, we do not think that approach will be productive or add to investor protection. The Commission, of course, shares many of the EC's concerns about how to contain and supervise risks posed by financial conglomerates, and believes that our approach to the supervision of securities firms is as effective as that in the Proposed Directive. The Commission staff has discussed the issue of equivalence with EC representatives and how our respective approaches can best address the need for group-wide supervision of financial conglomerates in today's global markets. We believe that we have had productive discussions with EC representatives on this issue and look forward to continuing our dialogue with these representatives.

Commission Oversight

The U.S. capital markets are among the largest and most successful in the world. Our equity markets alone comprise almost half of the total global equity market capitalization.[1] Much of this success is attributable to the activities of the securities firms based here in the U.S., which contribute to economic well-being and capital formation in countries the world over. The U.S. capital markets are among the most well-regulated markets in the world. The Commission's mandate includes ensuring that our securities firms have the highest level of financial integrity and operate in a manner that promotes the protection of investors. Our regulatory regime has operated with remarkable success since the Commission's financial responsibility regime was implemented in 1975; very few large securities firms have failed, and in no instance has a failure had any significant impact on markets or required federal funding to liquidate a firm.

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[1] Data obtained from the Securities Industry Association ("SIA") reflects that, as of the end of the calendar year 2000, the capitalization of the U.S. equity market was approximately $15.1 trillion, which amounted to approximately 47 percent of the global equity market capitalization. The countries with the next largest equity markets outside of the United States were Japan (approximate size of $3.2 trillion), the United Kingdom (approximate size of $2.6 trillion), France (approximate size of $1.4 trillion), and Germany (approximate size of $1.3 trillion). The value of shares traded in the U.S. equity markets was approximately $31.8 trillion, which represented approximately 67 percent of the global value of shares traded.

Based on a joint survey between the SIA and the Investment Company Institute, an estimated 49.2 million U.S. households owned equity securities as of the end of the calendar year 2000. Further, with regard to foreign investor participation in the U.S. securities markets, gross activity (both purchase and sales) totaled approximately $7.8 trillion in U.S. Treasuries, $7 trillion in U.S. stocks, $1.3 trillion in U.S. agency securities, and $773 billion in U.S. corporate bonds.

Before discussing the Commission's regulation of securities firms, which serve the important role of intermediary between customers and other capital market participants, it is important to recognize that, unlike other types of financial services firms, U.S. securities firms generally maintain highly liquid balance sheets. Substantially all financial instruments used in a securities firm's trading and non-trading activities are carried at fair value or amounts that approximate fair value, and unrealized gains and losses are recognized in earnings. Secured financing transactions are margined daily, limiting credit losses to nominal amounts, and securities firm assets are generally highly liquid marketable securities or are short-term receivables collateralized by liquid securities. The highly liquid nature of these assets provides securities firms with flexibility in financing and managing their business.

Examples of liquidity policies implemented by U.S. securities firms include policies for diversifying funding sources, liquidity planning (e.g., structuring liabilities to avoid significant amounts of debt coming due within a certain time range), and relying on markets which have proven to be consistent sources of funding during periods of market stress (e.g., the repurchase agreement markets). A number of securities firms also maintain a liquidity cushion consisting principally of unencumbered U.S. government obligations.

Financial Responsibility Requirements for Securities Firms

The financial responsibility requirements imposed on registered securities firms are an important component of the Commission's supervision of securities firms.

All U.S. registered securities firms are subject to the Commission's financial responsibility program, which is designed to enhance the financial integrity of securities firms. This program requires that securities firms maintain prescribed amounts of liquid net worth (also referred to as "net capital"), safeguard customer funds and securities, keep and maintain accurate books and records, and regularly file detailed financial information with the Commission and the self-regulatory organizations of which the firm is a member. The most important financial responsibility requirements for securities firms are set forth in the Commission's "net capital" and "customer protection rules," Rules 15c3-1 and 15c3-3 under the Securities Exchange Act of 1934, respectively.

The net capital rule prescribes minimum liquidity standards for securities firms. The theoretical underpinning of the net capital rule is to ensure that each securities firm maintains sufficient net liquid assets to allow a securities firm, in the event the firm fails, to self-liquidate without the need for a formal judicial proceeding, and to satisfy promptly the claims of customers. In determining net capital, a securities firm first computes its net worth in accordance with generally accepted accounting principles and then adds to that amount subordinated liabilities. From that figure, the securities firm subtracts assets not readily convertible into cash, such as fixed assets, exchange seats, and most unsecured receivables. The securities firm then subtracts prescribed percentages of the market value (otherwise known as "haircuts") of securities owned by the securities firm to discount for market movement. The resulting figure is the securities firm's net capital, a figure that reflects the current liquidity status of the securities firm (i.e., its ability to pay promptly all liabilities). Any receivable from an affiliate of a securities firm must be deducted from the securities firm's net capital to the extent the receivable is not secured by marketable securities.

The customer protection rule is designed to protect customer funds and securities held by securities firms. Generally, the rule requires securities firms to maintain possession or control of all customer fully-paid and excess margin securities, and permits firms to use customer money only to the extent necessary to finance customer-related business.

To assist in monitoring securities firm compliance with the Commission's financial responsibility rules, the Commission requires, among other things, that securities firms file monthly, quarterly and audited annual financial reports, as well as notices in the event a firm's capital declines below certain levels or its books and records are not kept current in accordance with the Commission's books and records rules.

In addition, all large securities firms in the United States that hold customer funds or securities are subject to annual financial responsibility examinations by the self-regulatory organizations and periodic examinations by the Commission staff.

Risk Assessment Rules

Because of the potential harm to a securities firm that may arise from losses at an affiliate, in 1990, Congress amended the Securities Exchange Act of 1934 to provide the Commission with specific authority to obtain information regarding the financial activities of affiliates of securities firms. In 1992, the Commission adopted two rules under this authority, one for recordkeeping and another for reporting. Under these rules, often referred to as the "risk assessment rules," securities firms that are part of a holding company structure – which generally includes all major U.S. securities firms – are required to provide the Commission with comprehensive financial and operational information, on a periodic basis. This information allows the Commission staff to evaluate the material risks to securities firms posed by their affiliates.

Categories of information required by the risk assessment rules to be reported to the Commission on a quarterly and annual basis include:

- a holding company organizational chart (reflecting all affiliates);
- legal proceedings;
- consolidated and consolidating financial statements; and
- detailed financial and securities activity related data provided for every "Material Associated Person."

The Commission staff reviews these comprehensive filings for, among other things, significant balance sheet and income statement changes, double leverage, asset liquidity and capital structure, unusual positions or concentrations, and systemic trends.

Derivatives Policy Group

Information reported to the Commission under the risk assessment rules is supplemented on a voluntary basis by risk information provided by the Derivatives Policy Group ("DPG"). The DPG was developed in March 1995, and is intended to provide a framework for monitoring the activities of affiliates of securities firms. The reporting framework for DPG members has recently been changed so that DPG members now file with the Commission on a monthly basis certain internal financial and risk management reports at the holding company level. These reports generally contain extensive information regarding the firm's financial condition and risk exposures, including granular detail with respect to their value at risk computations and credit risk exposures. This detail typically includes value at risk breakdowns by products (i.e., equity, interest rate, currency, and commodity) and as well as by significant business units, such as merchant banking. As part of the DPG program, Commission staff also regularly meets with representatives of the firms with respect to the reports.

Investment Bank Holding Company Proposal

In 1999, when Congress passed the Gramm-Leach-Bliley Act, it created a new type of holding company called a "supervised investment bank holding company." A supervised investment bank holding company is generally defined as an entity that owns or controls one or more U.S. registered securities firms but is not affiliated with an insured bank, a savings association, or certain foreign banks. The Gramm-Leach-Bliley Act also authorized the Commission to create a regulatory framework for this new type of holding company, giving the Commission the ability to monitor more of the activities of both regulated and unregulated affiliates that may affect the financial stability of their affiliated securities firms.

The Commission staff is currently preparing draft rules for consideration by the Commission that would implement the regulatory structure for supervised investment bank holding companies. The regulatory structure the staff plans to recommend that the Commission adopt includes:

- requiring supervised investment bank holding companies to calculate and report capital on a monthly basis in accordance with the Basel Capital Accord;
- subjecting supervised investment bank holding companies to reporting and record keeping requirements, and to a thorough review of their group systems and internal controls; and
- Commission staff inspection of supervised investment bank holding companies and their unregulated affiliates.

The holding company would remain subject to all regular Commission disclosure reporting requirements for public companies, and the securities firm would remain subject to all current regulatory requirements and self-regulatory organization supervision.

International Accounting Standards

The EU has announced its intention to adopt International Accounting Standards ("IAS") as the official standard for EU listed (public) companies as of January 1, 2005. EU listed companies that currently prepare their primary financial statements under another country's accounting standards will be given an additional two years to implement IAS (e.g., German companies using U.S. GAAP).

The movement of the EU from many national accounting standards of varying quality and comprehensiveness to a single EU standard that is developed in an independent and transparent manner is a positive development both for issuers and investors. European issuers coming to the U.S. today can use (1) home country GAAP and reconcile to U.S. GAAP, (2) IAS with a reconciliation to U.S. GAAP, or (3) U.S. GAAP outright. Many issuers today use home country GAAP. The current complexities in reporting and in reviewing EU issuer filings would be reduced under a common EU standard. IAS, applied correctly and consistently, and enforced effectively, would provide a higher degree of quality and transparency in financial statements than the present systems in the EU countries. Comparability of financial data among EU issuers would also be improved.

It is important to note that the benefits of using a common set of accounting standards throughout the EU will be achieved only if there is also an effective infrastructure in place for consistent application, interpretation, auditing and enforcement of the standards. The EC and national securities regulators in Europe have recognized and acknowledged this, and have begun to set up the necessary structures and processes.

From a U.S. issuer standpoint, the effects appear to be generally favorable. In addition to the positive effects noted above, whereby U.S. acquirers or partners of EU companies would also receive better information, it is expected that U.S. companies will continue to be able to list in the EU using U.S. GAAP, as they do today. The EC has not indicated that it contemplates any change for non-EU listed companies, and it seems unlikely at this time that they would do so.

And finally, there is a potential that the benefits of IAS adoption in the EU may take on even greater significance if the U.S. Financial Accounting Standards Board and the International Accounting Standards Board make significant progress in achieving convergence in accounting principles. Both standard setting bodies have begun efforts to reduce the major differences between IAS and U.S. GAAP, many of which were noted in the Appendix to the Commission's February 2000 Concept Release on International Accounting. The Commission has been supportive of such efforts.

Prospectus Delivery Requirements

The proposed EU prospectus directive would permit EU companies that are offering securities and listing the securities on a regulated market in the EU to use one prospectus that would be accepted throughout the EU. Issuers would obtain approval of the prospectus by their home market regulatory authority, and the prospectus would be accepted throughout the EU based on a simple notification procedure to the host country regulator that would not require separate approval by that regulator. The disclosure requirements of the EU prospectus directive are based on IOSCO's International Disclosure Standards for Cross-Border Offerings and Listings of Equity, which were incorporated by the Commission into Form 20-F effective September 30, 2000. Form 20-F is the core disclosure document used by foreign private issuers to register and list securities in the U.S. markets. Generally, under the proposed EU prospectus directive, listed EU companies would be providing the same level of disclosure in their prospectuses that foreign private issuers currently provide to the SEC.

The Capital Adequacy Directive

The final capital adequacy directive will likely mirror the Basle Capital Accord. The Basle Capital Accord was developed by banking regulators primarily for commercial banks. It does not take account of the different business mix and balance sheet and off-balance sheet positions of the securities firms, as well as their accounting models. U.S. securities firms do not generally make unsecured loans and generally do not take deposits. Their assets and liabilities are fair-valued, which means, as to liquid securities, that they are marked to the market, whether in the trading book or otherwise. If the Basle Capital Accord were modified to more precisely reflect the risks of trading activities, it would not seem that its application should cause substantial problems for U.S. securities firms that do business in Europe.

Conclusion

The Commission firmly believes that its regulation of U.S. registered securities firms and their affiliates satisfy the Proposed Directive by providing "equivalent" group-wide supervision. Commission staff meet on a regular basis with foreign regulatory authorities to discuss regulatory issues and concerns relating to global securities firms. The Commission is committed to continuing its detailed discussions with foreign regulators regarding our regulatory regime in order to assist them in making a favorable equivalency determination under the Proposed Directive.

Thank you for the opportunity to testify before you today. I would be happy to answer any questions.

U.S. House of Representatives
Committee on Financial Services
The European Union's Financial Services Action Plan

Testimony by
Professor Desmond Dinan, School of Public Policy, George Mason University
May 22, 2002

1. The European Union's Basic Governing Institutions

The European Union's basic governing institutions are the European Council, the Council of the European Union (generally known as the Council of Ministers or simply the Council), the European Commission, and the European Parliament.

The European Council

The European Council, which came into existence in the 1970s, consists of the most important political leaders in the member states (either heads of state or government) and the Commission president. It meets at least three times a year, once in Brussels and at least once in the country holding the rotating Council presidency. Foreign ministers and a Commission vice-president accompany the heads of state and government to most sessions during the mostly two-day events, and an army of national and Commission officials hovers in the wings. Meetings of the European Council are major media events. The European Council discusses political and economic developments in the EU, reaches political agreements on contentious legislative proposals and important challenges confronting the EU (such as enlargement), and provides overall strategic direction.

Legally speaking, the European Council is not an EU institution. The EU treaty only acknowledges the European Council's existence and general political importance. The reason for this reticence is fear of formally tipping the EU's institutional balance in an intergovernmental direction. Composed almost exclusively of national leaders, the European Council is a forum for the negotiation of intergovernmental agreements on the basis of consensus (the informal rules of the European Council do not provide for voting, although on rare occasions voting has taken place there). The existence of such a high-level body, while necessary for the functioning of the EU, is at odds with the delicate balance between the need to share sovereignty and the desire to retain national control that underlies the institutional architecture of the EU.

The Lisbon Declaration of March 2000, in which the heads of state and government set the strategic goal for the EU to become "the most competitive and dynamic knowledge-based economy in the world, capable of sustainable economic growth with more and better jobs and greater social cohesion," is a good example of the European Council in action. While not legally binging, the declaration obviously carries great political weight. The European Council holds an annual spring meeting to review progress on the Lisbon strategy. It was at the first such annual review, in Stockholm in March 2001, that the European Council endorsed the report by the Committee of Wise Men (the Lamfalussy Report) on the regulation of European securities markets. The European Council prods and pressures the EU institutions to implement the Financial Services Action Plan, but does not have the authority to enact legislation itself.

The Council of Ministers

The Council of Ministers is the EU's main legislative decision-making institution. The Council consists of government ministers from the member states (usually national government ministers but, in the case of Belgium and Germany, occasionally ministers from the regions). Although, legally, there is only one Council, in practice there are sixteen Council formations. These range from the Council of foreign ministers (the General Affairs Council), to the Council of finance ministers (the Economic and Finance Ministers Council, or Ecofin), to the council of environment ministers. Each council discusses issues and enacts legislation within its area of responsibility. However, the General Affairs Council acts as a coordinating body and a decision-maker of last resort when the other councils are deadlocked on a legislative proposal. (If the General Affairs Council cannot break the deadlock, it sends the issue up to the European Council for a political decision). Ecofin is the key council formation with respect to financial services.

The presidency of the Council and of the European Council rotates among member states every six months. Each country tries to achieve something significant during its presidency. For instance, because of its center-right, pro-business ideology, the Spanish government, currently in the presidency, is eager to make its mark in the area of market liberalization in general, and implementation of the FSAP in particular. Hence the political push from Madrid to resolve the row between the Commission and the European Parliament (EP) over procedural aspects of the Lamfalussy Report (see point 2, comitology, below). The Council, and especially the presidency, is assisted by a secretariat of EU civil servants.

The EU's treaties provide for decision-making in the Council in most policy areas by qualified majority voting. Each member state has a number of votes, depending roughly on its population size. A qualified majority consists of about 73 per cent of the total number of votes. Clearly, it is easier to block than to enact a proposal in the Council. Proponents or opponents of a measure form voting alliances in order to block or enact a proposal. Larger member states, with the largest number of votes, are key members in such coalitions, the composition of which varies from issue to issue.

In practice, member states dislike voting in the Council. They prefer to reach agreement by consensus. This tends to slow down decision-making. Much depends on the expertise of the presidency, which chairs all Council meetings, at all levels. The presidency strives to reach agreement, declaring at the appropriate time that, as consensus has been reached, a formal vote may not be necessary.

Ministerial meetings of the Council, which take place in Brussels or Luxembourg about once a month (depending of the workload of the particular Council formation) and last for a day or two, form the tip of the Council structure. Below the surface lurks a mass of subordinate committees and working groups. Dozens of Council committee and working group meetings take place in Brussels on any given day. The Committee of Permanent Representatives (known by its French acronym, Coreper) is the most important committee. The Permanent Representatives are senior national officials, with ambassadorial rank, who reside in Brussels and meet regularly to prepare the Council's agenda. Often the PermReps reach agreement among themselves on legislative proposals, which the Council then endorses. In other cases the PermReps narrow the areas of disagreement as much as possible before passing the file up to the Council for a decision. Coreper is one of the least understood but most powerful bodies in the EU's decision-making system.

The European Commission

The Commission consists of the college of commissioners as well as the staff of European civil servants (the Eurocracy). Member states appoint the commissioners for five-year terms: two commissioners each from the large member states, one each from the others. (The Nice Treaty, the latest round of EU treaty reform, which has not yet been ratified, provides for one commissioner per member state). The EP must approve the member states' candidate for Commission president and also votes on the proposed college of Commissioners as a whole. The EP may throw the Commission out of office by a vote of two-thirds of the parliament's members.

Commissioners are usually senior politicians, often including former prime ministers (Romano Prodi, the current president, is a former Italian prime minister). Commissioners do not represent their countries of origin. On the contrary, they take an oath in the European Court of Justice not to take instructions from national governments and instead to pursue the "European" interest. Yet close ties to national governments and awareness of national political situations informs commissioners' decisions.

Each commissioner has responsibility for a particular policy area. The Commission bureaucracy is divided into departments (called Directorates-General or DGs) along similar functional lines. Frits Bolkestein, a veteran Dutch politician and an economic liberal, has responsibility for the internal market, including financial services, and is in charge of the Internal Market DG.

The Commission has the exclusive and jealously guarded right to enact legislation in economic policy areas. The Commission is also the EU's executive arm, although the Council (and increasingly the EP) oversees the Commission's implementation of EU legislation. The Commission acts as a watchdog to ensure that member states transpose Community legislation into national law, and may being member states to court for alleged non-compliance. Finally, the Commission is a think-tank and lobby for further European integration.

The European Parliament

The EP consists of 626 members, who are directly elected every five years (the next direct elections will be in May 2004). The turnout in EP elections is well below the turnout in national and local elections. This reflects voters' uncertainty about the role of the EP and general disillusionment with the institutions and policies of the EU. The EP meets in plenary session, mostly in Strasbourg but occasionally in Brussels, about twelve times a year. Plenary sessions last about a week and generally seem chaotic affairs, with crowded agendas and all eleven official languages constantly in use. When not in plenary session, Members of the European Parliament (MEPs) hold committee and party group meetings in Brussels and visit their constituencies. Committees in the EP are organized mostly along functional lines. The influential Committee on Economic and Monetary Affairs (ECON) deals with financial services. MEPs sit not in national groups, but in party political groups. The Socialists, Christian Democrats, and the Liberals are the largest of these.

The EP has considerable budgetary, legislative, and oversight authority. But neither the Council nor the Commission depends for its survival on having majority support in the parliament. In that sense the EP is unlike most national parliaments, from which most national governments are formed. Of course the EU is unlike most national political systems, not least because there is no single EU government. Uncertainty about the nature of the EU, and of its institutions, contributes to the increasing alienation of its citizens.

MEPs come from a variety of backgrounds and have many interests. A few are avowed Euroskeptics, elected to the EP in order to try to rollback European integration. Most advocate further European integration. The EP's leadership—the president, vice-presidents, committee leaders, and mainstream political group leaders—is determined not only to deepen European integration but also to strengthen the EP's role in the EU institutional and decision-making system.

2. The Decision Making Process

As mentioned above, the Commission has the exclusive right to draft and propose legislation, based on the principle that the Commission will always adopt a "European" rather than a national approach. DGs draft legislation in their particular functional area. They may do so on the basis of a specific treaty requirement (such as the construction of the customs union in the 1960s) or on the perceived need to achieve the treaties' general objectives (such as maintenance of the single market). Interest groups, national governments (either separately or collectively via the Council), and the EP may urge the Commission to introduce legislation. Similarly, interest groups may lobby the Commission to amend or to drop a draft legislative proposal. The Commission has various formal and informal networks for consultation on draft proposals. The Lamfalussy Report specifically called for wider, deeper, and quicker consultation at this stage of the legislative process. The college of the Commission discusses draft legislation before submitting a formal proposal to the other institutions. In rare cases the college takes a vote, but decides by a simple majority (the president has the casting vote).

There are two kinds of legislative decision-making procedures: consultation and co-decision. As the name implies, the EP has a limited role in the consultation procedure. However, most legislation (including financial services legislation) is enacted by codecision, in which the EP's role is equal to that of the Council.

Codecision

Codecision is a relatively recent procedure. The EU introduced it in the Maastricht Treaty in 1992 and revised and extended it in the Amsterdam Treaty in 1997 in order to enhance the organization's democratic legitimacy by strengthening the EP's legislative role. Some member states, as well as the Council secretariat, resented the EP's growing influence and doubted whether the cumbersome procedure would ever work. If only to dispel such doubts, the EP soon mastered codecision. Contrary to popular belief, codecision works well and relatively expeditiously.

In the codecision procedure, the Commission submits its legislative proposal jointly to the Council and the EP for a first reading. Each institution runs the proposal by its legal service to ensure that it conforms with the provisions of the relevant treaty article. The Council secretariat then sends the proposal to Coreper, which in turn sends it to the relevant working group. Similarly the EP's leadership sends the proposal to the relevant committee.

Based on a recommendation by the relevant committee, the EP (in plenary session) adopts an opinion on the proposal. This usually includes numerous suggested amendments. The EP communicates its opinion to the Council.

Subject to qualified majority vote (QMV), the Council may adopt the EP's opinion. More often than not the Council adopts a common position, which may include some of the EP's suggested amendments. The Council sends the common position back to the EP.

If the Council adopts a common position, within three months the EP must either approve the common position; reject it by an absolute majority of its members; or propose amendments to the common position by an absolute majority of its members and forward them to the Commission and the Council for a second reading.

If the EP amends the common position, the Commission delivers an opinion on the EP's amendments. Within three months, the Council must either approve the EP's amendments by QMV, except those amendments on which the Commission issued a negative opinion (the Council can approve these only by unanimity); or call a meeting of the conciliation committee, consisting of representatives of the Council and the EP, to work out a joint text.

Within six weeks of being convened, the conciliation committee either fails to agree on a common text, in which case the proposal is deemed not to have been adopted; or agrees on a joint text by a qualified majority of the Council's representatives and by a majority of the EP representatives.

If they agree on a joint text, the Council must approve it within six weeks by QMV and the EP must approve it within six weeks by an absolute majority of the votes cast (this is a lower threshold than an absolute majority of its members).

If either institution fails to approve the joint text, the proposal falls.

With respect to codecision, the Lamfalussy Report proposed that the EP and the Council expedite decision making by reaching agreement at the first reading stage. Both institutions seem amenable to that suggestion and have already enacted legislation without going to a second reading or convening the conciliation committee.

Comitology

Once enacted, legislation must be implemented. The Commission is the EU's executive arm. Thus the Commission issues approximately 2,000 directives, regulations, and decisions annually (see Point 4, below). Such measures are necessary in order to give EU legislation practical effect. Jealous of their national prerogatives, however, and suspecting that the Commission would alter EU legislation through its implementing measures, early in the EU's history member states devised a complicated procedure known as "comitology" to constrain the Commission's executive powers. The cumbersome comitology procedure includes three types of committees—advisory, management, and regulatory—all chaired by Commission officials but made up of national civil servants. Management and regulatory committees are able to send proposed implementing measures back to the Council for review. The Commission sees comitology as an affront to its executive authority.

Comitology has always been a bone of contention between the Council and the Commission. The EP entered the fray when it acquired legislative authority equal to that of the Council. If national officials sat on the comitology committees, the EP asked, why should parliamentarians (or EP officials) not sit there as well? Comitology became a battleground between the Commission, Council, and EP throughout the 1990s until they negotiated a truce in 1999. The most controversial procedural aspects of the Lamfalussy report pertain not to the codecision procedure but to comitology. By proposing changes to executive decision making and the establishment of a powerful European Securities Committee, Lamfalussy opened a procedural Pandora's Box. The EP endorsed the Lamfalussy Report in February 2002, almost a year after the report was issued, only when the Commission made various concessions with regard to implementing measures. The EP hopes to reopen the comitology debate and press for treaty changes in the forthcoming Intergovernmental Conference on EU reform.

3. **Role of Member States' Leaders and Parliaments**

Member states leaders play a key role in EU decision-making through the Council and European Council (see Point 1, above). National parliaments are generally excluded from EU decision-making, although some of them (like the Danish parliament) have elaborate arrangements with their national governments to monitor EU legislative proposals and influence their national leaders' actions in Brussels. Until 1979, when the first direct election to the EP took place, MEPs came from national parliaments, and were therefore only indirectly elected to the EP. There was then a close connection between national parliaments and the EU system. Since direct elections, national parliaments have been cut adrift. Moreover, with greater provision for the use of QMV in Council decision-making, national parliaments are less able to hold their governments accountable for their actions in Brussels. As long as unanimity was the rule, a national parliament could threaten to sanction its government if the government did not veto a legislative proposal. With QMV now the rule, national governments can reasonably claim that they were outvoted (or would have been outvoted if a vote had in fact taken place) in the Council. Once enacted in Brussels, EU legislation must be transposed by national parliaments into national law. As EU law is binding on the member states, transposition is a formality. National parliaments have little discretion when it comes to transposing EU legislation into national law.

Inevitably, this has engendered resentment on the part of national parliamentarians, some of whom have agitated since the early 1990s for a greater role in EU decision-making. National parliaments have devised various institutional links among themselves and with the EP, but still lack a formal role in the EU system. The role of national parliaments is a major issue on the agenda of the current Convention on the Future of the EU, which is preparing the ground for the next Intergovernmental Conference.

4. **Types of EU Mandates**

There are three main types of mandate:

- *Directives* are addressed to member states and are binding as to the results to be achieved. However, member states may decide themselves how to incorporate directives into national law.
- *Regulations* lay down binding rules that apply directly in all member states.
- *Decisions* lay down binding rules that apply directly in the member state to which they are addressed; decisions can also be addressed to individuals or enterprises.

Directives are the most common legislative instruments in the EU. They are usually used to lay down policy principles that member states are obliged to follow. Regulations and decisions are concerned more with the detailed application of EU law.

The Council (acting as the sole legislative decision-maker), the Council and the EP (acting jointly as legislative decision-makers), and the Commission (acting as an executive body) may issue directives, regulations, and decisions. The Council or

Council/EP generally issue directives; the Commission generally issues regulations and decisions.

The institutions may also issue non-binding reports, recommendations, or opinions. These are largely hortatory.

5. The Lamfalussy Reforms

Concerned about the state of market disintegration in the financial services sector, despite its inclusion in the original single market program, the Commission issued the Financial Services Action Plan (FSAP) in May 1999. The purpose of the plan was to draw attention to the financial services sector, thereby generating political momentum for the enactment of the forty-two measures that the Commission deemed necessary to integrate capital and financial services markets across the EU. The Commission proposed a deadline of 2005 for implementation of the plan.

The Commission's strategy was consistent with its approach to market integration generally in the EU. For instance, the single market program included a number of proposals (289) and a deadline (1992). Although the single market was not completed on time (as the existence of the FSAP proves), it generated considerable political, popular, and business support. The Commission hoped to generate similar support for the FSAP.

The European Council endorsed the FSAP in Lisbon in March 2000, incorporating it into the EU's "Lisbon strategy." Disappointed with the slow pace of implementation, however, France (in the Council presidency) proposed later in the year setting up a small committee to review the plan. The Commission and the other member states invited Alexandre Lamfalussy, a retired Belgian banker and former head of the European Monetary Institute (the forerunner of the European Central Bank), to chair a committee of "wise men" to give new impetus to the FSAP.

The Lamfalussy Committee presented its report in February 2001. The report highlighted three fundamental weaknesses in the legislative and regulatory process: it was too slow; did not allow swift adjustment to a rapidly changing market environment; and produced directives or regulations of poor quality. The report urged faster and more efficient securities market legislation, calling for implementation of these measures by 2003. In order to improve the quality of legislation, the report recommended that the EU institutions maintain a continuous flow of consultation with investors, issuers, and financial intermediaries throughout the legislative process, in complete transparency.

Specifically, in order to speed enactment and implementation of better financial services legislation, Lamfalussy addressed four levels of decision-making. Level One involves the codecision procedure. Here Lamfalussy recommended more consultation in the pre-proposal stage. As for the codecision process itself, Lamfalussy recommended that the Council and the EP reach a decision after the first reading stage (see Point 2, above). As was already the case, the ensuing legislation (in the form of directives or regulations) would set out general, framework principles.

Level Two involves technical implementation (the enactment of so-called "secondary legislation") at the European level. Lamfalussy proposed establishing two new committees: the European Securities Committee (made up of senior representatives of the Commission and the member states) and the European Securities Regulators Committee (made up of national regulators). Based on advise from market participants, end-users, and consumers, the European Securities Regulators Committee would advise the Commission on technical implementing measures. The Commission, in turn, would make a proposal to the European Securities Committee. The European Securities Committee would vote on the proposal within three months. The Commission would then adopt the measure. The EP would be kept fully informed and could adopt a non-binding resolution if the proposed measure exceeded the Commission's mandate.

In Level Three, the European Securities Regulators Committee would develop guidelines, recommendations, and common standards in order to ensure consistent implementation and application of the implementing measures through the EU.

In Level Four, as was already the case, the Commission would check compliance with EU legislation and take legal action against member states suspected of breaching EU law.

5. Key Legislative Obstacles to Implementation of the FSAP

There is always a big gap between rhetoric and reality in the EU. The European Council is prone to issue extravagant declarations and communiqués. The Lisbon declaration, with its lofty goal of turning the EU into "the most competitive and dynamic knowledge-based economy in the world," is a typical example. Day-to-day decision-making in the EU, by contrast, is far more prosaic. Even with the best will in the world, proposals are not always drafted on time, deadlines slip, and inter-institutional strains emerge.

The EP's negative reaction on comitology grounds constituted the biggest institutional obstacle to implementation of the Lamfalussy Report. At first the EP insisted on the right to "call back" a Commission proposal to the European Securities Committee. The Commission saw this as a threat to its executive authority. Only when the Commission reassured the EP that it would keep the EP fully informed of the European Securities Committee's work, review the Level Two process in due course, and support the EP's insistence on raising comitology in the forthcoming Intergovernmental Conference did the EP approve the Lamfalussy Report in February 2002.

In an article in the *Financial Times* in March 2002, Lamfalussy expressed confidence, following the EP's approval of the report, that EU securities legislation will be enacted more quickly than before and will be able to adjust more rapidly to changing market circumstances, but was less sure about the quality of legislation. The main obstacle now, according to Lamfalussy, is inadequate staffing in the Commission, the EP, and the new CESR. "Without sufficient and able staff," he wrote, "it will be virtually impossible to respect legislative deadlines while maintaining the adequate standards." Lamfalussy therefore called for more staff to be seconded from national regulatory authorities for two or three year periods. This is unlikely to happen, not only because national authorities are short-staffed, but also because the powerful staff unions in the Commission and the EP fiercely resist the secondment to their institutions of national officials.

TESTIMONY OF
MARC E. LACKRITZ, PRESIDENT
SECURITIES INDUSTRY ASSOCIATION

"THE EUROPEAN UNION'S
FINANCIAL SERVICES ACTION PLAN"

BEFORE THE
HOUSE FINANCIAL SERVICES COMMITTEE
MAY 22, 2002

Chairman Oxley, and Members of the Committee:

I am Marc E. Lackritz, President of the Securities Industry Association.[1] I am pleased to testify today about the implementation of the European Union's Financial Services Action Plan[2] ("FSAP" or the "Plan"), and the opportunities it presents for our firms, our clients, and the U.S. economy.[3] My testimony will: 1) give an overview of the Plan; 2) discuss the opportunities Europe presents to U.S. firms; and 3) focus on specific aspects of the Plan.

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[1] SIA represents the shared interests of nearly 700 securities firms. SIA member-firms (including investment banks, broker-dealers and mutual fund companies) are active in all phases of corporate and public finance. The U.S. securities industry manages the accounts of nearly 93 million investors directly and indirectly through corporate, thrift, and pension plans. In the year 2001, the industry generated $198 billion in U.S. revenue and $358 billion in global revenues. Securities firms employ over 750,000 individuals in the U.S.

[2] http://europa.eu.int/comm/internal_market/en/finances/general/action.htm.

[3] SIA thanks Houston Consulting Europe for their significant contribution to this testimony, which is in part based on their *Mid-term Review of the Financial Services Action Plan*, March 2002, http://www.houston-consulting.com/home.html.

I commend the Committee for your timely review of the FSAP. The E.U. adopted the FSAP 2-1/2 years ago, and as the Plan progresses, it is increasingly important that Congress, the Administration, and U.S. financial services regulators become engaged participants in this critical European development. The purpose of the FSAP is not only to outline the key legislative initiatives needed to integrate the E.U. financial markets, but also to give political guidance to E.U. member states, the European Parliament, and the financial services industry with respect to their involvement in the process. The objective of the FSAP is to develop a single, integrated capital market in the E.U. by 2005. Currently, with the exception of a number of institutional markets and the Eurobond market, Europe continues to operate as a collection of national markets.

Overview of The FSAP

The FSAP gives political coherence to the plan for European financial services market integration, and groups the various legislative proposals into three broad categories: 1) the development of a single E.U. institutional market; 2) open and secure retail markets; and 3) developing state-of-the-art prudential rules and supervision. In all, the plan calls for 43 separate legislative and non-legislative measures in banking, insurance and securities, as well as company law and taxation. Each of the measures in the FSAP has been set against an ambitious timetable -- benchmarks against which to check progress -- with an overall completion goal of year-end-2005.[4] These deadlines have helped create political momentum for the process, which was itself reaffirmed at the March 2002 Barcelona Summit.

The securities industry strongly supports the E.U.'s Financial Services Action Plan. SIA has worked closely with the Commission and national regulators to help ensure that the Plan's objectives are realized. We firmly believe the FSAP is in the best interests of the E.U., the U.S., and the global economy. Though much remains to be done, significant progress has already been made. The FSAP is a considerable

[4] The Stockholm European Council has added year-end 2003 as the deadline for the integration of the wholesale securities markets.

undertaking and we commend the continued commitment of governments, the European Parliament, and the European Commission to this endeavor.

The U.S. relationship with the E.U. is extremely strong. Notwithstanding the inevitable disagreements that occur in a close relationship, the U.S. and E.U. have deep and ever-growing political and economic ties. The health of our respective economies is inextricably connected, with trade and cross-border investment flows linking the transatlantic economies and capital markets. E.U. enlargement[5] will create an even larger marketplace. This relationship provides the global U.S. securities industry and its clients with tremendous opportunities.

The E.U. – with its 380 million consumers and Gross Domestic Product exceeding $7 trillion – is a key market for the U.S. securities industry. The two-way flow of trade, portfolio and direct investment between our two regions totals over $1 trillion annually.

At the end of 2000, E.U. companies had direct investments in the U.S. totaling nearly $803 billion, or 65 percent of the $1.2 trillion total invested in the U.S. by all foreign nations. Moreover, E.U. companies based in the U.S. accounted for roughly 3.4 million U.S. jobs in 1999. U.S. investment in the E.U. is also significant. U.S. direct investment in the E.U. totals $554 billion, and U.S. companies employ more than 3.3 million people in Europe. Two-way trade in 2001 for goods and services totaled $539 billion, and accounted for 23 percent of all U.S. trade volume. Clearly, the economic ties between our two continents are substantial.

Our respective capital markets also benefit from the cross-border purchase and sale of securities. In 2001, E.U. resident investors had transactions (purchases plus sales) in U.S. stocks and bonds of almost $9.9 trillion, resulting in their net acquisition of $279

[5] In March 1998 the E.U. formally launched the enlargement process for the following 13 countries: Bulgaria, Cyprus, the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Malta, Poland, Romania, the Slovak Republic, Slovenia and Turkey. Enlargement will represent a population increase of 105 million.

billion of U.S. securities. Total U.S. transactions in E.U. securities amounted to about $3 trillion, resulting in U.S. net acquisitions of E.U. securities of about $14.7 billion.

In comparison to the U.S., the E.U. financial markets are still considerably smaller. By year-end 2001, the market capitalization of the U.S. equity markets totaled nearly $14 trillion; almost double the E.U. total of $7.1 trillion. Indeed, since 1990, the E.U.'s percentage of the global total has actually declined from 23 percent to 21 percent in 2001. In sharp contrast, the U.S. share of the global total has soared from nearly 33 percent to almost 42 percent. This tremendous potential for growth helped lead the E.U. to conclude that integration of its financial markets should be a key political and economic priority.

Fundamentally, the U.S.–E.U. relationship relies on common social and political goals and the exchange of ideas, talent, and technology. These linkages are reflected in the market statistics and in the increasingly transatlantic nature of capital markets and the financial services industry. In light of these linkages, and the clear importance of the relationship, we commend the Administration for taking steps to open a specific dialogue with the E.U. on financial services issues. At the May 2, 2002, U.S./E.U. Summit in Washington, D.C., a "fact sheet" was released describing a "Positive Economic Agenda," which included financial services. We believe it is in the best interests of both the U.S. and the E.U. to discuss cooperatively the various issues that affect these increasingly linked capital markets.[6]

[6] Financial Market Dialogue: United States financial officials, including representatives from the Treasury Department, Securities and Exchange Commission, and the Federal Reserve, are engaged with their E.U. counterparts to ensure that European capital market liberalization is achieved in a non-discriminatory manner and are market transparent, efficient, and protect against risk. http://www.useu.be/TransAtlantic/U.S.-E.U.%20Summits/May0202WashingtonSummit/May0202U.S.E.U.PositiveEconomicAgenda.html.

The Benefits of An Integrated European Capital Market

U.S. securities firms have long participated in – and are committed to – the European capital markets. They and their customers have participated directly in the gains that have been made to date, and expect to be among the primary beneficiaries of a more integrated, efficient E.U. capital market. The securities industry is extremely optimistic about the future of those markets and is committed to helping achieve the FSAP.

Today, SIA's largest members engaging in a global business receive about 20percent of their net revenues (excluding interest) from European markets; about 35,000 European employees support these operations. This is yet further evidence that U.S. firms are, in the truest sense, global in nature. Moreover, their revenues from Europe are close to double that garnered from their Asian operations.

A more integrated European capital market is good for European consumers, investors, and companies. We also believe that careful, effective implementation of the plan will contribute significantly to Europe's economic growth in concert with many other restructuring initiatives. The specific "financial sector" proposals in the Plan are paralleled, for example, by others for accounting, reporting, auditing and acquisition rules consistent with corporate governance and shareholder value perspectives which are essential for making the European economy transparent and competitive.

For example, European demographic trends indicate a steadily aging population. By 2050, 35 percent of Europe's population will exceed 60 years of age. To meet expanding needs for retirement funding, and to relieve the burden on governments to fund these obligations, the E.U. will need to become increasingly reliant on privately funded pension schemes. As investors seek to raise returns and reduce costs, an integrated, efficient pension market will be critical. Moreover, progress on pensions will also create a pool of "domestic" capital and facilitate labor mobility through pension portability. Indeed, this critical area is part of the FSAP.

The complexity of cross-border capital raising in the E.U. has resulted in higher costs for large European companies than for their U.S. counterparts. For example, European companies must comply with the differing regulations of the member states. The European Commission itself has recently noted that despite promising growth in the E.U. venture capital market, investment in the U.S. is at least four times greater than in Europe, with the gap between the two jurisdictions actually growing. The E.U. also is pursuing a separate Risk Capital Action Plan designed to foster the development of an E.U. venture capital market.

Finally, while E.U. companies have traditionally been more dependent on banks for sources of financing through traditional loans, the integration of Europe's capital markets will stimulate the demand and supply of funds to be intermediated by securities markets. Indeed, there are signs of an emerging securities culture for retail investors. In the U.K., one out of every three adults now invests in equities. In addition, institutional investors are also increasingly looking to build a greater equity presence by substantially increasing their equity holdings. These trends and others bode well for E.U. consumers and providers of financial products and services.

A more integrated, single capital market in Europe will clearly benefit investors. An integrated market would improve capital allocation, reduce intermediation costs (thus maximizing the savings that is channeled to investment), and make the E.U. a more attractive environment for capital. A recent report commissioned by the European Financial Services Roundtable (the "Gyllenhammar Report[7]") identified the following potential benefits for consumers if the E.U. retail markets in financial services were liberalized:

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[7] *European Financial Services Roundtable, The Benefits of a Working European Retail Market for Financial Services*, The "Gyllenhammar Report", February 2002. http://www.iep-berlin.de/publik/sonstige/eu-market/index.htm.

- ⇨ Enhanced product choice;
- ⇨ Falling prices for mutual fund investors that could reduce costs by 5 billion Euros annually;
- ⇨ Lower interest rates;
- ⇨ Increased portfolio diversification;
- ⇨ Higher economic growth; and,
- ⇨ Growth in the role of the Euro.

Overall, the success of the FSAP is important for the global economy. The U.S. and E.U. play leadership roles in the international marketplace, helping to set best practices, advocating open and non-discriminatory trade, and acting as engines for global economic growth and job creation. Successful implementation of the FSAP – defined by its ability to create an integrated, deep, transparent, and liquid European capital market – is perhaps best viewed as a *perpetual annuity.*

How Are These Goals To Be Reached?

The E.U. has made important strides since the single market for financial services was first contemplated in 1973. But despite their enormous progress, the E.U. capital markets remain segmented, depriving investors and consumers of the benefits of a truly integrated market. Indeed, the Gyllenhamar Report noted that, "Particularly for *retail financial services* national borders still constitute a considerable de facto barrier. Even in the Euro age it is extremely rare for private individuals to compare domestic offers of, for example, life insurance or mortgages with offers from suppliers in other countries of the single currency area."

While it was clear that the Euro in and of itself would herald change by creating a more liquid market for securities, there was also realization that a "framework for action" would still be needed to further integrate and harmonize the disparate capital markets so that the full economic benefits would be maximized. Acting on that realization, E.U. governments adopted the "Financial Services Action Plan" in Cologne in June 1999 and the European Parliament subsequently endorsed it in February 2000.

To date, 11 measures have been adopted and are awaiting implementation by national governments[8]; 22 are under discussion by governments and the European Parliament, and six are expected to be published by the year-end 2002, or early 2003. In addition, the Commission is reviewing measures related to the plan, including clearing and settlement, corporate governance, and financial stability. The pace is impressive, however, significant work remains to be completed, especially on the key capital market directives.[9] In addition, the need to develop and implement the regulations successfully in each E.U. member state will take an enormous effort. Although the 2005 deadline is reachable, we are somewhat concerned that market discipline, achieved through open consultation, may be sacrificed in order to meet the deadline. This has, of course, always been the fundamental dilemma of the process – the need for prompt completion of the Plan balanced against the need for appropriate consultation to achieve the overall objective of creating deep, liquid markets.

One significant reason for slower progress than might have been hoped has been the challenge member states face in overcoming national and cultural differences when attempting to agree on the common rules and standards that will permit mutual recognition. Moreover, the need to implement E.U. legislation in national law has led to differing – and ultimately time-consuming – interpretations and implementation of rules (particularly where the "country-of-origin principle" does not apply). Finally, despite significant improvements in transparency, the process has been slowed by Commission proposals that were not drafted to reflect market realities due to insufficient consultation.

[8] The Directives include: Directive on the information exchange between competent authorities in the context of the ISD, insurance and banking directives; Money Laundering Directive; Directive on the Winding and Liquidation of Insurance Companies; Directive on the Winding and Liquidation of Banks; Recommendation of a Code of Conduct for Mortgage Lenders; E-money Directive; UCITS Directives; Settlement Finality Directive implementation (implementation deadline listed as a FSAP measure); Amendments to the 4th and 7th Company Law Directives to allow for fair value accounting; Commission Recommendation on the Disclosure of Financial Instruments; and Directive to amend solvency ratio margins for insurance companies.

[9] "This said, the essential merit of this ZEW/IEP-report is to show that in spite of a number of legislative decisions already made, much remains to be done. This clearly requires not only the swift implementation of the Financial Services Action Plan, but also a number of other actions by the E.U., its member states and the involved business actors. The list of the missing aspects is quite impressive and requires what, by the present operating standards of the E.U., could well be considered an almost unreachable target in the light of the pre-sent mood of soft legislation and subsidiarity."

By engaging in a review of the E.U.'s regulatory and supervisory practices, the FSAP has the potential of creating a coherent, consistent framework across the financial services sectors. The Plan has given essential political support to financial market integration and liberalization as a keystone of an efficient and competitive European economy.

In addition to addressing accelerating national and cross-border consolidation, the disintermediation of services, and the blurring of traditional roles of securities, banking and insurance firms, the FSAP must also account for the concerns of each member state and its prerogative to regulate matters relating to consumer protection and market integrity. Moreover, "The whole process needs to be speeded up and member states, notably the bigger ones, have to overcome their policies of maintaining market barriers or even re-establishing new ones because of a lack of a European perspective, old fashioned national standards and protectionist ambitions."[10] As the process of enlargement looms, the E.U. must have in place a comprehensive framework prior to accession.

Improving the Process – The Lamfalussy Report

No review of the E.U.'s recent work on the Plan is complete without praise for a new and essential feature of the FSAP since February 2001 – the Lamfalussy process. In the early stages of the Plan's implementation, the process was rightly criticized for its cumbersome procedures and its lack of consultation. Against that background, the European Commission, in cooperation with the French Presidency, established the Lamfalussy Committee in June 2000. The Committee's mandate was to review securities regulation in the E.U. and ascertain why the FSAP was not progressing as anticipated. One of the Committee's conclusions was that the current regulatory structure was "… too slow, too rigid, complex and ill adapted to the pace of global financial market change." This consensus view prompted the Committee to make a number of proposals (The "Lamfalussy Report[11]") on how E.U. securities legislation could be improved. It

[10] Gyllenhammar Report

[11] Final Report of the Committee of Wise Men on the Regulation of European Securities Markets, February 15, 2001. http://europa.eu.int/comm/internal_market/en/finances/general/lamfalussyen.pdf.

concluded that an efficient regulatory structure for securities markets, and capital markets more generally, requires a more flexible, transparent approach to legislation.

The Committee's main recommendation was to delegate the technical aspects of legislation to two new E.U. Committees (the E.U. Securities Committee, and the Committee of European Securities Regulators), and to prescribe a "four-level" approach to securities legislation. That approach was intended to address the full process of regulation from framework principles to implementing details, cooperation among regulators, and enforcement. Second, and of critical importance, was the Lamfalussy Report's call for regular consultation and dialogue with interested parties at all stages of the E.U.'s legislative process. This call for consultation opens the dialogue to any party in the interest of improving the quality of legislation. This process reflects the kind of positive interaction we are familiar with among U.S. financial regulators, the public, and legislators in formulating rules and ensuring Congressional oversight of implementation. The Lamfalussy Committee keeps open the possibility of even more extensive reform by recommending another review of the E.U.'s regulatory structures in 2004.

SIA strongly supports the goals of the Lamfalussy initiative because it establishes the principal mechanism on which a framework for efficient capital markets can be built – regulatory transparency. We believe that consultation at all stages of the legislative and regulatory process will lead to rules that balance the needs of investors, business, and the regulatory community. The Lamfalussy report demonstrates the determination of European institutions to innovate and to design new solutions for complex regulatory problems in a global environment. One of the immediate benefits of the Lamfalussy Report has been the creation of the Committee of European Securities Regulators ("CESR"). This new Committee will have the responsibility of helping to ensure consistent implementation of regulation at the national level. We are particularly pleased that CESR has enshrined a commitment to open and transparent consultation procedures in its charter, and we look forward to working and consulting closely with this new Committee.

Finally, while we are supportive of the FSAP and the Lamfalussy Report, it must be acknowledged that the proof of their coherence and effectiveness in practice will not be clear for some time. The test will be the extent to which member state financial regulators and supervisors make use of these legislative and regulatory process initiatives to rationalize residual barriers in areas such as conduct of business rules and consumer protection standards. In other words, the test will be the emergence of a vibrant, intra-E.U. cross border market, not just for wholesale institutional market participants, but for the full range of financial services and consumers. This will be a challenge for financial supervisors applying the FSAP directives in each of their jurisdictions to consult actively with one another, to have a kind of peer review check and balance geared towards liberalization, and to frame regulation to allow for technical and market innovation without constant need to change regulation as well as to be prepared to adapt and refine measures creatively so that responses to market innovations can develop without waiting years for passage of amending directives.

Specific Directives Of Interest To The Securities Industry

In this section we briefly cover those parts of the Plan that have the potential to create the most significant benefits in the short-run for U.S. securities firms and their customers. These include Directives that solely affect the efficiency of the European market – the Investment Services Directive, the Prospectus Directive and the Market Abuse Directive – and others that have a transatlantic impact – such as the Financial Conglomerates Directive. We also discuss the Data Protection Directive. Though not specifically part of the FSAP, this Directive is important because of its potential impact on U.S. financial services firms that do business in the E.U. We also note our interest in other important measures contemplated by the FSAP, especially the upcoming debate about private pension funds, and a number of other Directives that concern accounting, reporting, auditing, and corporate governance.

Financial Conglomerates Directive (FCD)

In April 2001, the European Commission presented a proposal – a priority measure under the FSAP – for a Directive that would introduce group wide supervision of financial conglomerates. The proposal was prompted by the continuing consolidation in the financial services sector that has created cross-sectoral financial groups with activities in both the banking/investment services and insurance sectors. SIA agrees with the overall objective of promoting financial stability, but we have strong reservations about some of the provisions in the Directive. We believe the provisions of the Directive that relate to third-country supervision of financial entities in the E.U. with parent undertakings whose head office is outside the Community[12] are inappropriate and should be removed from the proposed Directive. SIA is specifically troubled by the proposal's requirement that E.U. supervisors of a regulated E.U. entity of ultimate parentage outside the E.U. must determine whether the group is subject to consolidated supervision that is "equivalent" to E.U. regulation.

We question the apparent presumption underlying the proposal that any regulator would be able to design and apply consistent criteria that would take account of all or even enough of the characteristics of another regulatory environment to permit a single determination of "equivalence." We do not believe the issue of systemic risk is addressed by global consolidated supervision alone. In addition to capital adequacy, audit, public disclosure, and customer protection requirements, there are a range of other important considerations contributing to the safety and soundness of securities markets. Price transparency, stringent client suitability requirements, the efficiency and accuracy of clearance facilities, restrictions on the use of customer assets, limitations on the extension of margin credit, the market-mandated practice of the daily margining of secured financing transactions, the discipline associated with mark-to-market accounting, and the oversight role played by credit rating agencies all contribute to the protection of markets, market participants, and clients.

Each of these factors represents a complex subject matter, and all are important considerations in the development of any regulatory environment. The possibility (specifically contemplated in the Directive) that in the absence of an "equivalence" finding, a U.S.-based group might, as a condition to continuing operations in the E.U., be

[12] In particular, the provisions in Articles 14 and 25 (9).

required to establish an E.U.-wide holding company for their European businesses is also troubling. Such a requirement could force firms that are managed on a global basis to organize inefficiently and with potentially significant ramifications to their existing risk management and other internal functions.

Rather than using the "equivalence" approach taken by the draft Directive, we believe the concerns addressed by the proposal should be met through regular and flexible interactions among global regulators. U.K. Chancellor for the Exchequer Gordon Brown called for such a dialogue in a recent speech.[13] In this context, we are pleased that U.S. and E.U. regulators had an initial exchange of views in Brussels in March on the supervisory issues raised by the Directive, and we have high hopes that continuation of this dialogue will result in a smooth transition to the new E.U. supervisory regime.

Upgrading the Investment Services Directive (ISD)

The new review of the Investment Services Directive[14] provides an historic opportunity for Europe's markets to create an environment for innovative, efficient, fair, internationally competitive European markets. Together with the Capital Adequacy Directive, the Investment Services Directive establishes the fundamental "passport" which permits securities investment and trading services to be provided cross-border within the E.U. Both European and U.S.-based firms have criticized the existing ISD, which was agreed to in 1993, for its ambiguity in a number of key areas, in particular whether "home" or "host" member state conduct of business rules and regulation apply to particular transactions. In addition, the ISD has been implemented inconsistently (and incompletely) by member states. For example, the ISD's requirements for a "lighter-

[13]From a speech to the British American Business Inc., delivered on April 19, 2002, the UK Chancellor for the Exchequer said that "To take one example – in the area of financial services we should establish a new E.U./U.S. structure for regular consultation on bilateral issues. This "financial services dialogue" should promote better understanding, seek to avoid future conflicts, address bilateral market access and regulatory issues, and examine possibilities for mutual recognition, such as in the electronic delivery of financial services. And we must extend the transatlantic economic agenda to regulatory cooperation so that domestic regulations do not put up new barriers to trade. If we do not act now, regulatory disputes will become the greatest strain on our economic relationships."

[14] http://europa.eu.int/comm/internal_market/en/finances/mobil/isd/index.htm.

touch" regime for professional investors as compared to retail investors have not been fully implemented by a number of member states.

SIA welcomes the revision of the ISD to address these issues. The Commission embarked on a broad consultation exercise (as envisaged by the Lamfalussy Recommendations) in the summer of 2001. The latest round of consultation, launched in March, is focused on changing market structures (e.g., alternative trading systems) and is specifically concentrating on issues of: 1) trade transparency in market conditions where transactions occur other than on traditional exchanges; and 2) appropriate regulation for order flow internalized by investment firms. Other issues for consideration include the broadening of the scope of the ISD to cover commodity derivatives and approaches to the regulation of securities clearing and settlement systems.

We hope the Commission will produce a legislative proposal for a new ISD later this year that is targeted at addressing existing gaps in an efficient single market and does not impose undue new regulatory burdens on Europe's capital markets.

Prospectus Directive

The E.U. Prospectus Directive[15] is designed to address the currently uncoordinated regulatory framework for approval of prospectuses where securities are to be sold in more than one E.U. member state. The Directive is intended to: 1) harmonize essential definitions; 2) harmonize exemptions; and 3) standardize disclosure requirements. The Directive's objective is to create an effective single "passport" for issuers to facilitate capital raising and investing in the E.U. Much of the proposal is very useful. In some key respects, however, it does not accommodate satisfactory existing market structures – in particular those that have already created a robust cross-border E.U. market in debt securities and with respect to offers to institutional investors.

The most significant outstanding issue with respect to the Prospectus Directive relates to whether or not an issuer is able to choose in which member state its prospectus

[15] http://europa.eu.int/comm/internal_market/en/finances/mobil/prospectus.htm.

documentation is reviewed and vetted. Under the proposal, the current approach of requiring issuers to deal with the member state where the securities are to be admitted to trading (listed) or offered would be replaced by an approach requiring issuers always to deal with the member state in which they are organized (their "home" jurisdiction). A non-E.U. issuer would be obliged to deal with the member state in which the issuer first listed a security. The European Parliament has accepted the need to preserve choice; however, the Council continues to prefer the "home" jurisdiction approach. The Commission is expected to publish a revised proposal this summer. We hope the Commission's revision will address the "choice" issue, together with other issues, to ensure that the benefits of the Directive are achieved in a manner that permits Europe's successful institutional markets to continue to thrive.

Market Abuse Directive

The Market Abuse Directive is intended to restate (with some modification) the current Insider Dealing Directive and create a new offense of "market manipulation." This is similar to the approach recently taken by the U.K. under the Financial Services and Markets Act 2000. The industry's concerns have focused on: 1) the absence of an element of "intent" in the definition of the offenses, creating strict liability and raising the possibility of prohibition of current practice; 2) the proposed safe harbors, which were not sufficiently extensive; 3) the failure to acknowledge that effective information barriers ("Chinese walls") should constitute a defense to the principle of deemed knowledge (effectively, the proposal meant that if a firm provided financial advice in connection with a proposed merger, it could not also act as that company's broker or trade in its shares since it would have non-public information through its advisory role); and 4) the scope of the Directive, which creates competing regulatory jurisdiction within the E.U. The securities industry is particularly concerned that the lack of an intent standard will negatively affect the flow of information to investors and the market.

Significant, albeit insufficient, amendments were made in the European Parliament and the Council, where broad agreement on the proposal has been reached. The issue of the recitals (similar to U.S. legislative history) remains unresolved, leaving open crucial issues (including the acceptance of information barriers) that are addressed in the recitals by the European Parliament. Agreement on the directive is expected by summer.

Data Protection Directive[16]

As this Committee is well aware, the financial industry has, for some time, sought an adequacy determination from the E.U. so that flows of data between the U.S. and E.U. do not remain subject to the possibility of a data stoppage. Our competitiveness as a nation and an economy is strengthened by the vigorous open and fair competition among our financial services firms that include assuring investor and market confidence through the uninterrupted flow of data.

We commend Chairman Oxley and his colleagues for supporting a determination of adequacy for the U.S. financial service sector for purposes of the E.U. Data Protection Directive. We are also pleased to note that the Bush Administration has begun a discussion of this issue with E.U. officials and will be seeking a determination of "adequacy" for the financial services sector.

The U.S. privacy regime reflects a careful balancing of the needs and interests of consumers, financial institutions, government and the specific economic and security interests of the U.S. The export of European privacy standards through the threat of transatlantic data stoppages creates a dangerous precedent – one that is especially disruptive in the context of the globalized financial sector – that should be strongly resisted.

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The U.S. securities industry plays an important role in the E.U. capital markets and is fully committed to the integration of Europe's capital markets. Our

[16] http://europa.eu.int/comm/internal_market/en/media/dataprot/.

competitiveness as a nation and an economy is supported by the ability of our financial services firms to compete openly and fairly. We look forward to working with the U.S. and E.U. on a positive economic agenda to ensure that European capital market liberalization is achieved in a non-discriminatory manner, and is transparent, efficient, and protects against risk. We very much appreciate the Committee's serious interest in the deepening relationship between the U.S. capital markets and those of our closest trading partner – the European Union. We look forward to working with Congress and the Administration as we work to help create the best possible foundation for the global capital markets.

Thank you very much.

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Federal Financial Analytics, Inc.

EU FINANCIAL SERVICES ACTION PLAN:
Promise and Problems from a U.S. Perspective

Testimony Before the

Financial Services Committee

United States House of Representatives

May 22, 2002

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It is a pleasure to appear at a hearing scheduled in 2002 to consider a plan that the European Union believes will demonstrate its competitive impact by 2010. Ordinarily, Congress considers developments as complex and uncertain as the European Union Financial Services Action Plan (FSAP) only as their impact is fully felt — or sometimes even later than that. Congressional review now will ensure that policy-makers have a clear and anticipatory view of the potential costs and benefits of the Plan, allowing U.S. interests to be represented long before any confrontation with our good friends across the Atlantic might be necessary. This hearing also will help those in the U.S. who have yet to focus on the EU Plan from their own institutions' perspective or that of the financial services market more generally.

Today, I would like to highlight the likely benefits of transformation of the European Union into a single financial market. The changes proposed will, in general, make the EU financial system far more efficient, thereby serving consumer and economic development needs far better than the divided and often-anachronistic current system can do. However, it is vital that these reforms ensure the safety and soundness of the overall EU system to prevent systemic risk. Further, the proposed changes should promote EU competitiveness without creating implicit barriers to trade in financial services that harm the fair competitive power of U.S. companies. U.S. policy on trade in financial services has traditionally been set by several, sometimes competing U.S. government agencies, and the

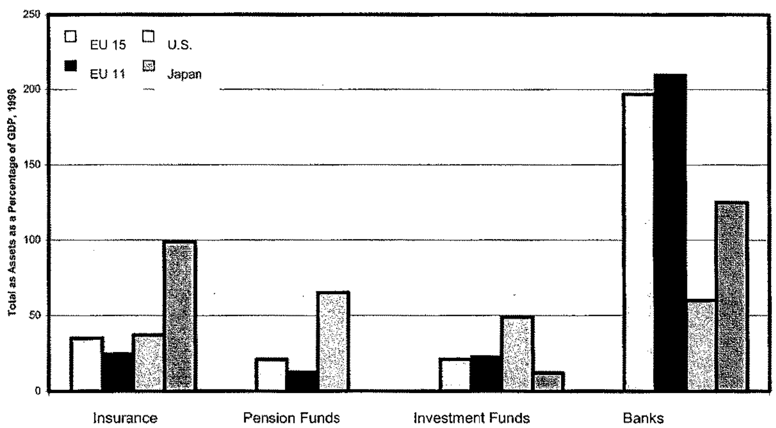
Committee would do well to look into ways to ensure that the U.S. interest is clearly represented in this critical segment of the U.S. economy.

I. The EU Plan

Other witnesses have already provided the Committee with a thorough description of the FSAP, as well as of the complex way in which the EU will consider and adopt it. One can only say that it makes the process of changing U.S. law look like a slam-dunk. The legislative and non-legislative measures under consideration (over 40 in total) cover the entire range of financial issues — spanning from dictating how on-line banking will be offered to standards redefining securities settlement, pension law and a wide range of associated technical and tax issues.

It is important to note that the EU plan envisions reform for a financial services industry structured in a strikingly different way from that in the U.S. Thus, as I shall discuss in more detail below, much of the EU plan is based on the dominant role of banks and the long tradition of bank regulation. The chart below demonstrates the dominant role of banks as financial intermediaries in the EU, in contrast to the far more balanced relationship between banks, investment houses, insurance companies and other providers of financial services in the U.S. As noted, industry structure in Japan is also sharply different than that in the EU and U.S.

Importance of Financial Intermediaries in the EU, US and Japan



Source: CEA, EFRP, FEFSI, and OECD

As is shown, relative difference in the role of banks can be seen by comparing bank-held assets to a country's overall economy. As measured as a share of GDP, a 2001 study of bank consolidation by the G-10 found that the banking industry has been relatively less important in the U.S. than elsewhere. In three of the European countries studied — Belgium, Netherlands, and the United Kingdom — banking assets were more than three times annual GDP during the late 1990's. In other EU member countries, France and Spain in particular, banking assets were about double GDP. However, banking assets in the U.S. did not exceed 100% of GDP at any time in the 1990s, generally remaining steady at around 70% of GDP.

The EU system is not only far more dependent on banks than the U.S., but banks are also far more consolidated. The G-10 study found that the United States had many more banks and lower concentration levels than European countries (with the possible exception of Germany). In 1998, the study found that about 36% of U.S. assets were concentrated in the largest 10 banks, while 59% of the United Kingdom's banking assets were in that nation's top 10 banks. In France, 85% of assets were concentrated in the top 10.

II. Potential Competitiveness Concerns

Given that the EU system is a big bank-dominated one, it's unsurprising that the FSAP implements a bank-like regulatory scheme. However, this can raise problems for U.S. institutions, some of which may result in effective trade barriers that limit the ability of U.S. firms to continue to compete effectively in the EU. Two principle areas of concern are the pending capital adequacy standards and the overall rule governing financial "conglomerates."

A. Capital Rules

The EU FSAP calls for implementation of a revised "Capital Adequacy Directive" as part of the overall harmonization plan. This Directive, in turn, is generally derived from the bank capital rules now under development by the Basel Committee for Banking Supervision, a panel currently chaired by the president of the Federal Reserve Bank of New York and one that includes senior U.S. regulators in numerous respects. As a result, one might think that the capital rules would have no potential adverse competitive impact, but indeed they have this, as well as a potential risk for the stability of the financial system more generally.

One especially controversial aspect of the pending Basel rules is a proposal to impose a new capital charge for "operational risk." This is the risk of human or systems failure, as well as that associated with natural or manmade disasters. The most clear and dramatic case of operational risk, of course, is the September 11 attack on the World Trade Center, but other cases include day-to-day systems problems and more costly cases of internal control failure (like the recent losses due to a rogue foreign exchange trader and those related to a fraudulent metal-trading scheme). All financial services firms, of course, have operational risk. The time-honored way to mitigate it is through effective risk management, contingency planning and — to absorb the cost— adequate reserves, revenues and insurance. To date, no bank has failed due to operational risk. The proposed capital charge could well create a perverse incentive against effective operational risk management, because institutions will not be able to invest both in proven forms of risk mitigation and the new, very high capital charge. Ironically, because the capital charge may be arbitrarily based on gross income, the banks that have made the necessary investments to mitigate operational risk and are the best managers of such risk may end up bearing the highest effective capital charge.

The overall idea of the operational risk-based capital charge arose in the EU. There, bank regulators depend far more on explicit capital charges than on effective supervision. Most EU regulators do not engage in the regular, in-depth examinations to which U.S. banks are subjected, and they must instead use capital standards to insulate taxpayers from the cost of bank failures. Further, EU regulators need not worry about the potential risk associated with a perverse capital charge because they can impose it on all regulated financial services firms, thus spreading the pain more or less evenly across banks and non-banks alike.

In sharp contrast, while U.S. banks are subject to much stricter supervision, our laws permit bank regulators to impose bank capital charges — including the proposed new operational risk one — only on banks. However, non-bank firms are major players in many of the lines of business — asset management and payment processing, for example — on which the capital charge will fall most heavily. They will have a significant capital advantage over their bank competitors, some of whom may choose to abandon their banking charters or move key lines of business outside a bank. This will increase the relative riskiness of the U.S. banking system, while also placing U.S. banks at a significant and unnecessary competitive disadvantage in the EU.

The EU is also pushing for capital charges against asset securitization that could create a serious competitive problem for U.S. institutions. In asset securitization, loans, mortgages, credit cards, etc. — are structured into securities that are then held by investors, freeing lenders up to make additional loans to new borrowers. The U.S. is the dominant provider of asset securitization services around the world, reflecting the high degree of technical innovation in the industry. Perhaps because of this, EU participants in Basel are working hard to enact a very high asset securitization capital charge, while at the same time pressing aggressively to lower the capital charge for certain whole loans held on their portfolios, not securitized. The risk is the same, with only the structure made different through securitization, but the risk-based capital charge would be very different.

Punitive capital charges on asset securitization and operational risk would permit EU regulators to substitute a capital requirement for effective supervision, while at the same time hindering U.S. competitiveness at home and abroad. They therefore should be omitted not only from the Basel risk-based capital rules, but also from the EU FSAP.

B. Conglomerate Rule

Another potentially problematic aspect of the EU FSAP is its proposed new regulatory structure for financial "conglomerates." Under the proposal, all companies doing business in the EU — including U.S.-based ones — will be required to meet holding company regulatory standards dictated by the EU. Home-country regulation will have to meet EU standards, or firms will be required to restructure all of their EU operations into a single entity with numerous barriers between them and their U.S. parent.

This conglomerate rule could create significant problems for all U.S. financial services firms not structured as financial holding companies (FHCs). Since passage of GLBA, many non-bank financial services firms have eschewed the FHC structure because of its very bank-like nature. This is particularly true with regard to the FHC capital standards, which would now bring non-banks into a capital framework potentially inappropriate for them — let alone pose the risk of the operational capital charge outlined above. Further, U.S. law requires insurance companies to operate under state regulation, without a parent holding company governed by any specific state or federal standards. Many Europeans are puzzled by the diversity of our regulatory structure, in which firms in essentially the same lines of business can select among a wide variety of charters at both the federal and state level. However, that is the way we like it — in large part because the diversity of competing regulators promotes precisely the competitiveness that has made U.S. firms such successful competitors in the EU. Any effort by the EU to force U.S. firms into conglomerates under a single regulator here, as well as in the EU, could have significant and adverse effects on the U.S. financial services industry.

Congress should therefore monitor the EU process to ensure that the rules solely govern business done in the EU, where the EU has the full right and privilege of deciding how things should be done. Trade in financial services has long been governed by the principle of "national treatment" — that is, financial firms in a foreign country are allowed to do everything home-country firms can do, even if these powers don't match up with theirs at home. In the U.S., for example, we have long allowed foreign financial services firms with impermissible activities in their own countries to operate in the U.S. as long as they abide by our market restrictions here. The EU should carefully adhere to this principle of national treatment as the FSAP is finalized.

This is not to suggest, however, that Congress could not do more to position U.S. institutions to compete successfully in the EU. In GLBA, for example, a new "investment bank holding company" structure was established, giving investment banks a "conglomerate" option if the FSAP proceeds, as well as certain potential benefits at home.

III. Trade in Financial Services

Finally, consideration of the EU FSAP provides an opportunity to review how the U.S. itself handles questions related to international trade in financial services. Currently, responsibility for this issue is split among various agencies, with the U.S. Trade

Representative responsible for insurance issues and Treasury handling the rest. While Treasury has worked hard on trade in financial services issues over the years, giving it responsibility in this area is like asking the State Department also to handle trade negotiations. Congress rightly split trade negotiations for other industrial sectors from the State Department into the USTR to give the U.S. an agency that could take on trade issues without having to downplay disputes because of larger diplomatic or military concerns. A similar problem arises with trade powers in Treasury, given the Department's larger responsibilities.

In this Congress, responsibility for financial services legislation was rightly consolidated into a single panel, reflecting the increasingly indistinguishable structure of the industry itself. The same should be done with trade in financial services. A single agency — preferably one without competing responsibilities — should be charged with representing U.S. interests in international financial services matters, drawing on the expertise of bank regulators, the SEC, state insurance regulators and all other parties with a rightful voice in this important issue.