

EPFSF Briefing

EU-US Financial Market Dialogue: the cooperative approach gains steam

Introduction

The transatlantic financial services industry supports nearly 7 million US and EU jobs, nearly €2.8 trillion in direct investment and stock, and bond flows in excess of €35 trillion. It accounts for 80% of global financial services business, and maintains a collective consumer base of 800 million people. Growth in EU-US cross-border trading, increasing demand by investors and issuers to non-domestic products and services and growing recognition that nationally differentiated -and often conflicting rules, are out of step in the transatlantic financial marketplace, have all signalled a turning point in the financial markets regulatory dialogue between the EU and the US.

A year ago, Commissioner McCreevy¹ said *"We should get rid of as much regulatory duplication as possible. If US regulators offer an equivalent standard of regulation and equivalent enforcement, we should have the courage to rely on them. And vice-versa"*. That view was echoed by Christopher Cox², Chairman of the SEC, who said in May last year *"At the same time, as our markets become increasingly interconnected, the regulatory friction from different national regimes becomes more significant"*. Also, the US Treasury holds a similar viewpoint. In its request for public input, in preparation of a blueprint for an improved US financial regulatory structure, it is asking market participants whether *"the US economy and capital market competitiveness would be better served by pursuing greater global regulatory convergence"*³.

The growing US recognition of the need for a more outward-looking approach, coupled with the deepening of the EU's internal single market through the implementation of the Markets in Financial Instruments Directive (MiFID), and the regulator-to-regulator dialogues that exist between CESR with each of the SEC and CFTC, together with the dialogue between CEIOPS and NAIC, have all created the ideal background for advancing the EU-US dialogue on the foundations of a strengthened, cooperative approach.

At the overarching political level, this renewed impetus to work together is evident in the Framework for advancing Transatlantic Economic Integration (FTEI), adopted in April 2007 to strengthen the economic relationship between the EU and US, and encompassing a broad work programme of cooperation to remove barriers to transatlantic trade and investment. The framework states in its Annex on Financial Services that the leaders of the EU and the US are committed to take steps towards the *"convergence, equivalence or mutual recognition"*⁴, where appropriate, of US and EU financial regulatory standards. The Transatlantic Economic Council (TEC), which was established by the FTEI to oversee, guide and accelerate the implementation of the transatlantic work programmes in the different economic sectors, provides a strong political dynamic to transatlantic integration and ensures that legislators and stakeholders are lined up to achieve that objective.

At the financial services sector specific level, the work of organisations like IOSCO at global level and the transatlantic Financial Markets Regulatory Dialogue (FMRD) have directly addressed specific technical issues, and thereby helped to establish a more coherent regulatory approach to cross-border financial services business. Since its launch in 2002, the EU-US Financial Markets Regulatory Dialogue (FMRD) has been successful in resolving differences in a number of areas and has become more effective in forward looking pre legislative consultation and discussion. It encouraged relationship building between key officials in both jurisdictions. The ECON dialogue with their US Congressional counterparts has also established good relationships and made important contributions regarding financial regulatory issues of mutual concern.

¹ <http://europa.eu/rapid/pressReleasesAction.do?reference=SPEECH/07/187&format=HTML&aged=0&language=EN>

² <http://www.sec.gov/news/speech/2007/spch050907cc.htm>

³ <http://www.ustreas.gov/press/releases/reports/federalregisternoticehp602.pdf>

⁴ http://ec.europa.eu/enterprise/enterprise_policy/inter_rel/tec/doc/framework.pdf

For its part, the industry strongly endorses and has contributed to this cooperative approach by politicians, legislators and regulatory authorities and believes that streamlining the regulation of cross-border business and reducing regulatory conflict, duplication and cost is a “win-win” for all the stakeholders in the transatlantic marketplace. There are various routes to achieving these objectives, e.g. *regulatory recognition* as a means of harmonising regulatory policy and outputs, *exemptive relief* for cross-border wholesale business, and *rules’ standardisation* where it can deliver enhanced compliance and trading efficiencies. In this respect, the industry particularly welcomes the strong commitment given by the EU Commission and the SEC in their February joint statement to “develop a framework for mutual recognition discussions” in the area of securities regulation, based on “a common interest in developing a cooperative approach to reducing regulatory friction and increasing investor access to investment diversification opportunities and enhancing investor protections”.

Selected current priorities in the Transatlantic Agenda

a) Financial reporting

In April 2007, the President of the European Council, the President of the Commission and the President of the United States agreed to promote and secure conditions for US GAAPs and IFRSs to be recognised in both jurisdictions without the need for reconciliation. The SEC decided last November to allow foreign issuers to file accounts under IFRS without reconciliation to US standards - with estimated savings for EU companies at €2.5bn. Similarly, the EU needs to implement the Transparency Directive requiring foreign issuers to prepare their consolidated financial statements in accordance with IFRS or equivalent foreign GAAPs. The EU will decide whether US-GAAPs can be considered as equivalent. In order to encourage the use of IFRSs and to minimise disruption to markets in the Community, the Commission’s Regulation of 21 December states that the EC will take into account commitments of foreign authorities to develop a convergence programme with IFRS.

b) Securities Trading

Mutual recognition for exchanges/broker-dealers between the EU and the US in securities trading is now beginning to materialise, as the early February joint statement between the European Commission and the SEC indicates. A speech by SEC Chairman Cox⁵ a few days later (8th February 2008) confirms that the SEC will consider in early 2008 proposals for both mutual recognition for exchanges and greater exemptive relief for broker-dealers.

The joint statement between the EC and the SEC in appears to be respectful in particular of one of the five “red lines” that Commissioner McCreevy⁶, after consulting Member States and stakeholders, spelled out late in 2007 regarding a possible EU-US deal on mutual recognition for securities: unilateral action by the SEC or bilateral deals between particular Member States and the US are not acceptable insofar as these could fragment and distort the single market. 2008 will likely see discussions on McCreevy’s remaining red lines for any possible deal: (i) prioritisation of professional/wholesale markets and securing a regulatory basis for giving investment firms (broker-dealers) and stock exchanges improved rights of access; (ii) the use of common assessment criteria when determining whether to grant access to firms and markets established in other jurisdictions; (iii) consistent application across the EU; and (iv) avoidance -where possible and prudent- of extraterritoriality.

c) Banking Regulation

The approval of the final implementation of the Basel Capital Accord rules for big core banks in the US offers supervisory authorities across the Atlantic a key opportunity to apply the principle of mutual recognition in the sphere of banking regulation by recognising EU implementation of Basel II by US banking subsidiaries of European banks and vice versa.

⁵<http://www.sec.gov/news/speech/2008/spch020808cc.htm>

⁶<http://europa.eu/rapid/pressReleasesAction.do?reference=SPEECH/07/776&format=HTML&aged=0&language=EN&guiLanguage=en>

So far, the US implementation rules still include deviations from the Basel Accord (e.g. lack of access to the advanced approaches by significant subsidiaries of EU banks, if it occurred, would be a concern). In addition, some points still need to be clarified, including the recognition of home-country Basel II implementation by European banks under the Federal Reserve's well-capitalized requirement for financial holding companies, as well as US Basel II implementation by smaller banks.

d) Insurance regulation

For the past several years, European reinsurers have pursued changes to current US reinsurance collateral rules on the basis that they are highly discriminatory, unfair, very costly, forcing EU reinsurers to lodge billions of dollars unnecessarily in the US, and fail to take account of the financial strength of individual reinsurers or the quality of their domiciliary regimes.. Unfortunately, no progress has been made.

The EU and US should remove existing barriers - and avoid future ones - that discriminate against well-regulated, financially strong, firms trading in and into their markets.

e) Current market volatility

The recent credit squeeze and sub-prime crisis have underscored the interdependence between European and American financial markets, and the urgent need for a close cooperation between monetary, regulatory and supervisory authorities.

Some areas for immediate joint EU-US reflection as recently identified by Commissioner McCreevy⁷ are: (i) addressing liquidity issues in interbank markets; (ii) strengthening prudential requirements or risk management; (iii) improving transparency (iv) credit rating agencies; and (v) finding ways to develop early warning and crisis management tools at global level. Work in these areas is going to be mainly pursued at international fora such as the IMF, IOSCO, the FSF and the G8.

Conclusion

In a time of financial turbulence and more integrated transatlantic economies, greater regulatory coherence and cooperation will enhance market integrity and the capacity to withstand and mitigate shocks. Acceptance of US GAAP equivalence, progress in regulatory recognition in the area of securities and Basel II implementation, improved information-sharing and an efficient framework for regulatory cooperative action will enhance regulatory efficiency, reduce trading costs, deepen market liquidity and deliver wider choice for investors and issuers. It is generally accepted that 2008 will be a "pivotal year" in which swift progress can be made, particularly regarding securities. In this respect, it is noteworthy that Chairman Cox and Commissioner McCreevy, in their early February joint statement "*jointly mandated their respective staffs to intensify work on a possible framework for EU-US mutual recognition of securities in 2008*". To bring this initiative to fruition, the strong, consistent mutual support and coordination among interested industry representatives, government officials, regulators and politicians in the transatlantic dialogue will continue to be crucial.

⁷<http://europa.eu/rapid/pressReleasesAction.do?reference=SPEECH/08/54&format=HTML&aged=0&language=EN&guiLanguage=es>

Briefing notes are prepared by the Financial Industry Committee to the European Parliamentary Financial Services Forum. For further information on the subjects raised in the briefs please contact the Chairman, Members or Secretariat of the Financial Industry Committee.

Chairman Financial Industry Members

Guido Ravoet, *EBF Secretary General*
Rue Montoyer 10, B-1000 Brussels
Tel: +32 2 508 37 11 / Fax: +32 2 502 13 30
E-mail: g.ravoet@ebf-fbe.eu

Secretariat

Catherine Denis, *EPFSF Director*
Rue Montoyer 10, B-1000 Brussels
Tel: +32 2 514 68 00 / Fax: +32 2 514 69 00
E-mail: cdenis@epfsf.org

Steering Committee

Zsolt László Becsey MEP
Pervenche Berès MEP
Jonathan Evans MEP
Robert Goebbels MEP
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Piiia-Noora Kauppi MEP
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