SPEECH/07/187

Charlie McCreevy

European Commissioner for Internal Market and Services

The Future of the Transatlantic Capital Market – Regulation, Risk, Governance

Finance Dublin 8th Annual Conference

Dublin, 26 March 2007

Good morning ladies and gentlemen,

and thank you for inviting me to this illustrious event in Dublin Castle. It makes a change for a political figure from Ireland to speak in this room rather than across the courtyard! And congratulations to all in the IFSC for reaching this landmark 20th birthday. The IFSC can regard itself as one of Ireland's greatest success stories. Something we could only dream of back in the mid-eighties. The talent, energy and determination of the people in this room have made a big contribution to that success.

Current Context

It speaks volumes that, as the IFSC looks forward to its future, the theme you have chosen to concentrate on is that of Transatlantic Financial Services Markets. Back in 1987, you were ambitious if you aimed to be a player on the wider European market. In 2007, no-one can afford to ignore the global market. And with over 70% of that market, the EU-US partnership is by far the most important.

I was in the US just two weeks ago, meeting my counterparts at the various regulatory and supervisory authorities. The reception that I got there, and the level of discussions that we had, are highly indicative of how the balance in the EU-US relationship has shifted. As recently as five years ago, the very idea of building a transatlantic market for financial services would have been for the funny farm. And the thought that some extremely influential global figures would be wringing their hands in despair at how New York's dominant position in financial markets is being threatened by competitors in the EU and elsewhere would have been dismissed as loony.

Yet here we are in 2007, and the first transatlantic securities exchange merger is a reality, with global alliances surely around the corner. And there is a lively debate in the US about whether current regulations, regulatory structures and regulatory philosophies are appropriate for today's markets or whether lessons can be learned from Europe. Separate findings by the Capital Markets Competitiveness group led by Harvard Professor Hal Scott, the Mayor Bloomberg - Senator Schumer - McKinsey report, the US Chamber of Commerce Commission on the Regulation of U.S. Capital Markets in the 21st Century and speeches made by Treasury Secretary Paulson all ask whether it would not be beneficial for the US to move to a more principles-based regulatory framework. Is this evidence of a meeting of minds on both sides of the Atlantic?

On this side of the pond, too, the transatlantic relationship is at the top of the agenda. German Chancellor Merkel is leading an initiative to give fresh impulse to the integration of the transatlantic economy through the establishment of a "new transatlantic Economic partnership". I am very supportive of this initiative, and believe that there is definite scope to do more to strengthen EU-US ties, not only on strategic financial markets issues but also in other areas such as intellectual property and government procurement. It was good to see during my trip to the US that the US side is also positively engaged.

Progress in recent years

At the same time, it is of the utmost importance that any new initiative, while contributing to enhanced EU-US cooperation, does not interfere with successful existing mechanisms such as the Financial Markets Regulatory Dialogue. Since its inception over five years ago, this Dialogue has proved to be a very successful co-operative platform where informality, flexibility and ex-ante regulatory discussion are the watchwords. We engage in upstream dialogue to avoid costly downstream repair.

This approach is really bearing fruit. Take some examples:

- We now have cooperation on financial conglomerates, on which you will hear more from Arnold Schilder later today;
- We have cooperation on accounting standards, with work on convergence ongoing and a roadmap towards abolishing reconciliation requirements on both sides of the Atlantic by the end of 2008. I am confident that we and the US will meet our joint deadline;
- Some progress has been made on making changes to US reinsurance collateral requirements. We hope we will see a move towards a much more risk-based approach that better reflects the global insurance environment;
- On US securities deregistration rules – the SEC has just agreed to an open, far-sighted approach that should benefit both US markets and foreign issuers. Thanks to the strenuous efforts of individuals like Paul Atkins, I believe the end result is a win-win situation for all.
- In banking, following from our Capital Requirements Directive, the US has come forward with its Notice of proposed rule-making on the implementation of Basel II. Basel II implementation in the US will be a major step forward in bringing a coherent risk-based approach to capital regulation around the world. Our discussions with our US partners focus on the need to minimise any differences on implementation of Basel II – in timing and in substance, and in minimising the regulatory burden for business.
- There is broad consensus on the approach to be taken with Hedge Funds. A US President's Working Group recently published a report which is sceptical about direct regulation of hedge funds, but focuses on counterparty risk management as the best course of action. I fully agree.
- And on my recent visit to the US, PCAOB Chairman Olson and I announced that we would launch roadmap discussions on equivalence of each other's audit oversight bodies, to build on what has been achieved in accounting. Our goal is that, by 2009, we will have a system in place based on mutual trust, in which each jurisdiction will be able to rely on the independent and rigorous inspections of audit firms active on their territory by their home country public oversight authority.

All of these areas indicate just how far we have come. And I would like to commend the efforts and vision of my US counterparts, very much including Paul Atkins who has been among the most forward looking. But the work to be done in the months and years ahead represents an even bigger challenge.

The Challenges Ahead

We have to adjust our thinking, and our actions, to the reality of the market. A market that is not just local. Not just transatlantic. But global.

One major new development is, of course, on capital markets, the NYSE-Euronext merger. As you know, there have been many differing views on this merger. I have been called upon many times to intervene and to interfere, as has my Competition colleague Neelie Kroes. Some people thought this deal stood in the way of the creation of a European Champion. Some viewed it as the back door through which Sarbanes Oxley would be imported into Europe.

I vehemently reject the idea that I should intervene and block any commercial proposal, simply because it brings together an EU business with a non-EU one. Not because I favour one business model over another, but because I believe that such issues are for the markets and shareholders to decide, not for politicians. Regulators must ensure that the terms of any deal are consistent with competition rules, securities laws and the public interest. But they should steer clear of determining what constitutes the best value in any particular case. Protectionist markets cannot compete with open ones. Today's world is interconnected. Business and capital will flow where the best value is to be had. Competitive markets, those that are open to receive it, will be the ones that win the race.

And historical precedent can guide us. In an impressive article last week in the Financial Times, its distinguished economics columnist Martin Wolf wrote: *"The EU's greatest successes have been those of liberalism: the customs union; the competition policy; the single market; the abolition of exchange controls; and the creation of a single currency managed by an independent central bank."* I agree. Where the EU has been liberal, we have advanced. We have every incentive to be open, because it works!

I do not think that anyone on either side of the Atlantic seriously thinks that the NYSE-Euronext deal as it currently stands is the end of the line for this merger or indeed, that other mergers and alliances will not take place. At some point, we are likely to see moves towards a common pool of liquidity. The regulatory system will be pushed to the limit. The extent of what markets may push for may go beyond anything that we currently expect.

So how do we respond? I'm sure that Paul (Atkins) will agree when I say that regulators and supervisors on both sides of the Atlantic all acknowledge that we need to adapt to the new realities. Change our perspectives. Our thinking. Develop new models of cooperation. Be proactive and anticipate events. One thing is sure. In the coming years, a core requirement in our work will be that we learn to rely on each other in a regulatory sense. Because it will be imperative. The new reality.

Building Blocks for the development of a Transatlantic Market

But how can this be done? Let me suggest a few building blocks in this process:

First, observe, monitor but avoid clumsy, knee-jerk reactions. Think things through. Regulators should only step in when needed. Only when absolutely necessary. Only when there is market failure. Only when the benefits of action unambiguously outweigh the costs. We call this better regulation. This is a misnomer. It is smart regulation. And because we are smart, business will grow strongly.

Second, wherever possible, any action should be taken in a co-ordinated multilateral manner, rather than by foundering through a glut of bilateral agreements and understandings.

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.

This equivalence recognition should be based on global understandings and global standards. Recently, the G7 called for greater free trade in securities, based on mutual recognition of regulatory regimes. We also need to bring in our partners in China, India and elsewhere.

Let transatlantic markets serve as the leading light of globalisation. Financial market integration runs deepest between the EU and the US. So we should lead by example. Demonstrate to the world how regulators, supervisors and legislators can cooperate effectively. If we fail to do this, there is little hope of "exporting" our methods to emerging markets. If we succeed, we can lay down many of the parameters of 21st century financial regulation.

Finally, underpinning these principles, there needs to be consistent implementation, information sharing and enforcement at technical level. Enforcement based on the laws of each others' respective jurisdictions. Tentacular extra-territoriality has no place in this co-operative environment.

Let me be clear. We should not be aiming for a "one-size-fits-all" solution. Regulation does not need to be of an identical shade in every jurisdiction. Choice of regulatory framework and competition between states can be healthy. But the principles should be similar.

Embracing risk

And, in this newly forged co-operative framework, what kind of regulation should we be developing on both sides of the Atlantic? We need a balance. A balance between a regulatory framework that guides peoples' actions and economic freedom that allows them to innovate, experiment and take risk. And we should make sure that the regulatory tools we apply are measured and appropriate. Fit for purpose. Flexible. Adaptable. Economic sense.

There's a famous French expression that goes "To win without risk is to triumph without glory". I agree. Innovation and development always entail risk. Life is risky. We cannot and should not legislate risk away. Manage it. Graduate it to different types of investor, yes. Every transaction on every capital market in the world contains risk. Without risk-takers, there would be no rewards. Without rewards there would be no risk-takers. Risk takers provide liquidity. Finance innovation. Back new ideas. And create new opportunities. Like hedge funds and private equity. Please, let us have a rational debate. Not of the hysterical, megaphone variety. Let's debate economic facts. Not unresearched rhetoric.

Risk is essential. People must take risks responsibly – and be educated to do so. If people believe that regulation is insulating them from risk, then instead of doing what they believe to be right or sensible they will take no chances. They will simply follow the rules. Tick the boxes. Let someone else take the blame for any negative outcome.

In developing our regulatory frameworks in the light of the globalisation of the financial industry, we need to focus on some key principles and objectives. Open access. Compatible regulatory approaches. A sensible balance between investor protection and economic freedom. Market participants and investors want choice. We should give it to them. And ensure a level playing field.

Conclusion

I have set out some ideas today on how the regulatory framework will develop to embrace the transatlantic market. Many issues remain unresolved. How will it work in practice? How can we achieve the compatibility of approach and respect for equivalent systems that we are aiming for? How can we extend the transatlantic model of co-operation to other countries? Are our regulatory structures ready to deal with all this or do we need to reform them? How do we ensure that there is sufficient legislative oversight and democratic accountability in the system?

These questions do not come with easy answers. But we have no choice but to try to respond. Quickly, thoroughly, and in a co-operative framework. Moving forward together, not clinging to the heritage of the past. Reacting positively to the opportunities. Dealing with the real issues.

Thank you