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Testimony of

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Chairman Oxley, members of the Committee on Financial Services, thank you for inviting me here this morning to testify on behalf of the European Commission on the informal EU-US Financial Markets Regulatory Dialogue and more generally on relations between the European Union and United States on financial services and markets.

I greatly appreciate the interest of the Committee in this matter, and in particular the very great personal commitment that you, Chairman, have brought to this area right from the start.

I have been able to observe these issues over the past two years as EU Director-General for the Internal Market and financial services, the senior official in this area under Commissioner Frits Bolkestein.

Economically we are by far the two biggest players, and with that comes a heavy responsibility for leadership and cooperation. It is therefore of particular importance if we can open up new areas of cooperation in mutual trust and understanding. Cooperation is not an optional extra, it is an economic, political and regulatory necessity.

If cooperation does not take place, all our businesses and consumers will suffer – 290 million in the US and 450 million in the EU.

I. Why? Transatlantic Regulatory Cooperation is essential in a globalising capital market

i. Economic interdependence

In the modern global **economy,** the EU and US are each other's biggest partner. Capital markets (bonds, equities, and bank assets) amount to over $50,000 billion in both the EU and US, equivalent to 6½ times and 5½ times GDP respectively. EU and US equity markets together represent 80% of global stock market capitalisation. 15% of the total capital raised by EU equity issuers through primary offers was raised in the US. This interdependence can only intensify as technology expands the possibilities for overseas trading and remote provision of services. In 2002, two-way cross-border trade in goods and services amounted to more than €650 billion (€412 billion in goods and €238 billion in services). Transatlantic trade represents 39% of EU and 35% of US total cross-border trade in services.

EU and US companies invest more in each other's economies than they do in any other area of the world. The EU and US accounted in 2001 for 49% and 46% respectively of each other's outward FDI flows. The EU accounted for 54% of US inward FDI and the US for 69% of EU inward FDI. These figures will expand even further now that the EU has enlarged from 15 Member States to 25. The fact is that a large number of EU and US jobs are dependent on developments in the other's economy and regulation.

This interdependence has been achieved despite regulatory differences and barriers. There is strong evidence that the removal of barriers would unlock many new economic benefits to both sides. Research published in 2003 by the British Treasury and Dutch Finance Ministry estimates that liberalisation of EU-US trade in goods and services would (permanently) boost EU GDP by 1-2% per annum and US GDP by up to 1% - significant potential improvements to growth and welfare on both sides of the Atlantic.

A further study estimates that true integration of financial markets has the potential to lower trading costs on both sides of the Atlantic by 60% with a consequent 50% increase in trading volumes, and a 9% decline in the cost of equity capital. It would make it far easier for US companies to raise money on European markets and for US investors to profit from investment opportunities in the EU and vice versa.

ii. Regulatory spillover

In global high-tech capital markets, our regulations inevitably spill over on each other. The EU and US have to work together to handle this.

This is true of regulation on both sides.

Over the last five years, the European Union has been engaged in a process of integrating its financial markets, with a view to tackling the uncertainty, unnecessary bureaucracy, and excessive costs for European firms, intermediaries and investors looking to operate cross-border. It has been doing so on the basis of a Financial Services Action Plan with a framework for action of 42 measures.

Such an integrated financial market will be of huge potential benefit to the EU. Two recent studies have pointed to the benefits of integrating the capital markets of the current 15 members of the EU alone. The first estimates potential benefits from static improvements in the cost of capital alone of around one per cent of GDP and an increase in employment of half a per cent, whilst the second foresees a sustained 0.7 – 0.9% increase in manufacturing growth.

An integrated, deep and efficient single market also forms a major opportunity for US service providers. It offers more choice to investors, who could enhance their portfolio allocation and increase their returns. It would also be a major additional source of liquidity and financing for US companies, reducing their costs of borrowing and capital. In short: it is in the US' interest, as well as the EU that the FSAP succeeds. All US firms I talk to fully recognise this. I want to underline that we are building our capital market in a fully open way. There are no fortresses, castles, walls or frontiers to foreign competitors. On the contrary, we believe that increased competition leads to increased strength and depth.

Yet despite these good intentions, in implementing the plan, it has proved impossible to contain all the regulatory effects of the measures to the EU. In providing Single Market freedoms, legislation must make some provision for businesses, investors and intermediaries from third countries looking to operate in the EU: it cannot simply ignore them.

Equally on the US side, Members of the Committee will be only too aware how the Sarbanes-Oxley Act has had far-reaching consequences on auditors and listed companies outside the US, despite its laudable aims and provisions. This regulatory spillover is an inevitable part of finance in the 21st century and requires upstream cooperation, particularly by the two biggest players: the EU and the US. We have a duty to tackle issues together rather than trying to go it alone. We need to do this early rather than late. If we fail in this duty, we risk penalising investors and companies, with a consequent impact on jobs and economic growth.

iii. Regulatory Best Practice

Early cooperation can also have a positive effect, by promoting best practice and so benefiting businesses and investors.

Legislators and regulators on both sides of the Atlantic are constantly looking at how they can improve the regulatory environment for businesses and investors. The US clearly has a wealth of experience in financial regulation, and we have been keen to learn from that. In developing our Prospectus Directive for example, we were very mindful of the benefits to US investors from high levels of information on companies.

iv. Politically Possible

Some have suggested though that even if desirable, such cooperation is simply not possible or far too difficult. They have suggested that the regulatory and economic mindset on the two sides of the Atlantic is simply far too different: we have our way of doing things and you have yours and never the twain shall meet.

I feel that we can and do cooperate. Why do I say this?

We have proven within the EU that such cooperation is possible between countries. Some over here might underestimate the sheer difficulty of what we have been attempting in the EU. Sometimes we make it look too easy. Anyone who follows the internal debate will tell you that finding a way through is far from easy.

But we have had to find a way. The EU has spent the past forty years – and particularly the last five - developing approaches to resolve the access of service providers from one jurisdiction to potential customers in another across 25 different jurisdictions. The EU has had to find regulatory accommodations between independent countries to ensure that services can be offered

without regulatory friction but also without any lowering of regulatory standards. We have had to develop approaches that ensure complete confidence in high standards of regulation and supervision right across the Union, including in the ten new States that joined 12 days ago. Investors and governments in Member States with long established financial traditions would not have accepted the right of companies from new market economies to offer their services in their jurisdiction unless they had been absolutely convinced of that.

Secondly, I believe that regulatory cooperation in this area is possible because I have seen it at first hand in other areas. Some of you will know that I spent eight years as Director-General for our Competition DG. In that area, we developed an unspectacular but quietly efficient partnership between the EU and US on hundreds of competition cases, despite the very high potential difficulty of cases involved.

II. So how can we cooperate together?

How do we cooperate in this area?

The first thing that we have had to do is to throw away the textbook and start from scratch. Whatever the merits of the concepts and their merits in other areas, my sense and that of my Commissioner has been that if we spend our time in discussions about terms such as "reciprocity", "national treatment" and "mutual recognition", we will not get anywhere. We have to make a fresh start and look at what will work in any particular case without getting obsessed by labels. We need to have the full tool kit and be flexible in the way that we treat each issue. They are very different.

i. Mutual understanding

To do this, we need first to understand each other, each other's approaches, systems and legislation. It is not good enough to dismiss each other's systems as not being good enough: we have to sit down together and compare approaches, and see how they are different, but also how they are alike.

Let me add that this process is becoming considerably easier the more that the EU integrates its financial markets, because instead of having to look at 25 sets of rulebooks, US authorities are able to look at one broad set of rules and principles. As European regulators and supervisors cooperate with each other and converge their day to day approaches, as they are doing in the Committee of European Securities Regulators – CESR – and the two new committees that we have recently set up in banking and insurance, so even the comparison of the details of the rulebooks will become far more simple.

Let me add that if you look at the two areas of EU-US regulatory cooperation which are the most advanced, audit firm oversight and Financial

Conglomerates, you will see that there was no way in which we could have made progress without a deep study of each other's systems.

In some cases indeed, that mutual understanding can lead to an appreciation of where one system or the other has developed a more sophisticated approach and promote the regulatory best practice that I mentioned earlier. We should not be afraid to go back and amend our rules if that is the case.

ii. Information Flow and Transparency

Mutual understanding of existing rules is not enough, though. We also need to ensure that as we develop new rules or regulatory approaches, we consult each other upstream and ensure proper **information flow and transparency.** The more that we talk to each other at an early stage, the more that we can pick up any expertise or thoughts that the other might have, that we can avoid unpleasant surprises and critically that we can avoid the downstream problems or regulatory repair.

Can I mention in this context, the excellent agreement between the SEC and CESR to consult each other at an early stage on draft rules?

Even at later stages of regulation, we need to encourage each other and each other's businesses to comment on proposed regulations. In the past five years on financial services, the European Commission has moved to unprecedented levels of consultation and transparency as it draws up its proposals. The Internet offers a major opportunity for all sides to be consulted without having to do as we did in the past and targeting all parties who we thought might be interested by proposals. We have strongly encouraged comments from businesses, regulators and governments not just within the EU but beyond. Let me mention for instance, the very constructive role played by the US Securities Industry Association in this respect.

What we should absolutely aim to avoid from now on is intentionally trying to establish a type of first mover regulatory advantage: setting a standard and then compelling the other to match it. This is a recipe for uncertainty and many long term problems. Again cooperation on the basic principles is the name of the game.

iii. Convergence

Mutual understanding and information flow are two key elements, but they are no substitute for some degree of **convergence** of approach. We have to be sure that we are aiming at the same basic goals. Investors want to be clear that they are getting the same level of protection in another jurisdiction that they are getting in their own. If so, they will be more outward looking and trade across borders more. Intermediaries operating out of one jurisdiction want to be sure that they are on a level playing field with intermediaries in another. Businesses do not want to be faced with a

multitude of different approaches and aims. We both want to avoid regulatory arbitrage.

May I add though, that this issue is exactly the one that we have been grappling with at a European level over the past few years. What we have found is that ultimately the question is not whether you converge your approaches, but how high you set the bar. In negotiating the Financial Instruments and Markets Directive for instance, we were faced with fierce discussions between those on one side – notably from the United Kingdom - who said that we should establish basic principles, but leave the choice of systems to the market, and let investors decide for themselves which was the best, and those who wanted a much more harmonised or "one size fits all" approach.

The arguments of both sides have considerable merit and our experience has been that you need to take a case by case approach. Take, for example, the new **Basel** agreement on capital requirements for international banks, the European Commission is very supportive of this process. 'Basel 1' has been of major benefit to global financial stability, to fair competition and to the reduction of unnecessary burdens on internationally active banks. However, like others, I consider that the 1988 agreement is in the winter of its natural life and that the need for its replacement with something suitable for the 21st century has now become very pressing.

The process to develop the new framework has been at times a difficult one. But it has also been an important one with many benefits flowing from the process itself. These include enhancement of banks' risk awareness and management as they move towards implementation of the expected new framework, and further improvement in the understanding between and discussion amongst supervisors, something which is very important in the increasingly globalised market in financial services.

Concerning the product itself – the new Basel agreement – I consider that the unprecedented level of consultation and the very significant efforts and commitment of all concerned are now on course to deliver high quality results. I think that this agreement between supervisors as to what standards represent the appropriate minimum for international banks will form a very good basis for the regional and domestic processes that will now take place to establish modern capital requirements rules in the different jurisdictions.

In the EU, the Commission is in the final stages of completing its proposal for the new European framework. This will result in our implementation of the new framework by the end of 2006. Of course, in the EU and the US different approaches are being taken to implementation. In the EU, for example, we intend to apply the new framework to all institutions whatever their size or level of complexity. Moreover, given this wide application, we will not be applying the Basel framework unthinkingly, but with modifications where

necessary to reflect this wide application. Given the very flexible nature of the planned Basel framework, such modifications will be limited.

We have recently published a report into the likely effects on the economy of the new capital rules. This indicates that there will be beneficial long-run consequences for the European economy, no automatic disadvantage for smaller banks or indication that Basel II will force M&A's and consolidation in the banking sector, and no negative impact on the availability and cost of finance for SME's in most EU Member States.

In other areas, however, it is more appropriate to establish the core objectives to be achieved, but leave details to be fine-tuned at a later stage or allowing slight variations of approach.

Ideally if we are to remove regulatory barriers to each other, we should use such thinking on new issues or rules to move forwards at the same time and to converge our approaches as we do so. The parallel approach on audit firm oversight that PCAOB Chairman Bill McDonough and my Commissioner have been able to develop is a good example and I hope a useful precedent for the future.

I appreciate that this is not always possible: some issues become more salient for one party at a particular time than for another, so one side has to move forward while in the other there is no momentum for a change, but we should certainly do this whenever possible.

iv. Equivalence

But what all this comes down to in our view is that convergence alone is not the solution. In many cases convergence of details may not be practicable, not just between the EU and US, but even intra-EU and between States of the US. If we are to go forward, we will have to recognise that in some cases what is important is not that we take identical approaches, but that we agree that we have broadly **equivalent** approaches and that we share the same goal.

Before compelling service providers or businesses to comply with the full set of local rules – including ones which may even contradict those which they are asked to meet in their home jurisdiction – regulators and supervisors should follow a "rule of reason" approach. They should ask themselves whether the ways in which those companies are regulated in their home jurisdiction meet comparable or equivalent prudential and investor protection standards to those achieved by local rules. If there is indeed equivalence, it would not add to the quality of regulatory protection to insist on compliance with local rules; it would simply create an unnecessary hurdle to services being offered to those investors. That cannot be in the interests of either the EU or the US.

Working on the basis of equivalence is not an admission of defeat: it is a healthy recognition by both sides that there can be more than one way to

achieve a common objective. In many cases, there is no perfect solution to a regulatory problem. In some cases, the regulatory solution used in one jurisdiction might not work in the other. We need an organised and cooperative coexistence: a managed competition of equivalent systems based on common underpinnings.

What do we do if we are equivalent? How do we recognise that equivalence and manage a particular issue? These are early days in this sector, but it seems to us that no one solution will work for each and every issue. We have to take a case by case approach tailored to each situation. We need to use the full regulatory toolkit and ensure that there is enforcement.

In some cases, what we can do is to cooperate and work share on the basis of parallel approaches. This is the kind of approach that we have developed on auditing, where we have discussed our approaches, converged wherever possible, but got to a stage where the Commission has recently proposed a modernised Eighth Company Law Directive on auditing which will be flanked by a parallel forthcoming PCAOB rule on oversight of non-US accounting firms. The two proposals are broadly equivalent to each other's aims.

Under the co-operative approach, Member States may conclude co-operative working arrangements in relation to inspections, investigations and oversight of foreign audit firms, provided that the EU has recognised the other system as equivalent. In the case of equivalent third country authorities and where the third country authority is doing the same, Member States can exempt foreign audit firms from registration, inspection, investigations, etc.

That is one approach. Another is to say that companies headquartered in third countries can operate in the EU without further requirements provided that their supervision is deemed equivalent to that set out in a particular law. That is broadly speaking the approach that we have taken on Financial Conglomerates where the EU is in the process of adopting guidance on whether and to what extent regulation of these entities is equivalent.

This list is not exhaustive, and we will need to be ready to innovate on both sides, but it does at least give a flavour for some of the approaches that can be taken. Only by going down this route can we truly resolve the regulatory spillover and eliminate the regulatory frictions that I have referred to.

III. What are we doing and how should it go forward?

What are we doing in practice to take this approach forward?

i. Regulatory Dialogue

The most obvious thing is talking to each other in the Financial Markets Regulatory Dialogue. I am sometimes asked what the Dialogue is, who it involves, how often it takes place. My response is quite simple: there is no magic to the term "Financial Markets Regulatory Dialogue", it just refers to the fact that the two sides are talking to each other frequently. It does not matter whether that takes place face to face, by telephone, or by videoconference. What matters is that it happens in a constructive and effective way which achieves the objectives that I have set out of removing hurdles from unnecessary duplication of regulation, converging where possible and preventing new ones from occurring. The term describes, it does not prescribe. It is solution driven.

The core of the Dialogue and what most people commonly associate with the term "Dialogue" is a regular meeting between Directors from the European Commission and their opposite numbers from the Treasury, SEC and Federal Reserve. This effectively acts as a "review group" to systematically go over all issues of interest to each side and check that progress is being made or that each side is properly informed.

This Dialogue has been going on for just over two years since March 2002. These review meetings take place roughly every four to six months, most recently in March this year.

The first thing that we agreed, and something that has in our view been critical to its success, was that we should meet informally, and on an "as and when" basis. We believe that that informality and discretion has been crucial, by allowing differences and concerns to be aired openly and directly. Both sides know that they can explain and discuss things honestly without being quoted in public the next day. This has been helped by growing familiarity with each other.

It has also been helped by a commitment on both sides, not to particular results, but to particular processes to discuss or resolve issues. Every year we sit down and agree what we are going to do, and how to do it. For instance, on Financial Conglomerates, the European Commission was able to set out the whole process by which the EU would reach its equivalence determination. This allows both sides to see that issues are being taken seriously. From our point of view in the EU, it has also enabled us to check with our Member States that we are tackling the issues of importance to them.

We are continually looking with our US counterparts at how we can improve the Dialogue still further.

A first observation is that the Dialogue has been a victim of its own success: as we have started to discuss issues together, so new issues have emerged or been suggested. This is testament to its perceived use, but if these issues are to be tackled properly, we believe that we will have to organise our work more effectively by grouping issues together and delegating work to more detailed meetings on specific subjects. We have done this to a certain extent on Conglomerates and insurance and are looking to extend it still further, by involving our regulators and supervisors to a greater degree. To keep costs down, videoconferences can help.

There is also scope for separate and more detailed cooperation between EU and US supervisors. We welcome the recent launch of a Dialogue between the SEC and CESR, and between the NAIC and the new Committee of European Insurance and Occupational Pensions Supervisors (CEIOPS).

We are also continually looking to ensure that our Member States and the European Parliament are involved effectively in the process. The European Commission already makes strenuous efforts to keep them informed and consulted. We discuss relations with the US at nearly every meeting with Member States on financial services. Tomorrow for instance, I am seeing our Financial Services Committee, and will update them on my appearance here, and discuss how to go forward. With this in mind, we are keen that our Member States finance representatives should be able to meet US counterparts at least on an annual basis.

We have also encouraged contacts between our Parliament and this Congress, and in particular, contacts between the Economic and Monetary Affairs Committee and this Committee. We were very heartened at the videoconference which you held last year Mr Chairman and hope that this committee and the Senate Banking Committee will build on this with the new Parliament to be elected next month.

If we are to go forward though, it will need to be with the full support and involvement of industry, businesses and end-users. We recognise that it is not enough to be talking and resolving issues together; we have to communicate this more effectively, and ensure that we are resolving the right issues. We are currently looking at how we can best improve feedback to the private sector without jeopardising the informality of the Dialogue which has worked so well. There is also a valuable role to be played from industry on both sides sitting down together and defining together the problem areas and priorities. We are strongly supportive for instance of the relaunch of the Trans-Atlantic Business Dialogue (TABD), and of the recent roundtable between the FSR and EFR.

The Dialogue though, is only the vehicle for results and regulatory cooperation. We will need to show that using the methods that I listed earlier, we really are tackling specifics.

ii. *Ex post* conflict resolution

Our first priority is to resolve those issues that are already of concern.

I have mentioned the cooperative approach that we are taking on **audit firm oversight.** Well ahead of Ahold and Parmalat, the European Commission was clear that what had happened in the US over Enron, Worldcom and others could have happened to us. We had already identified a number of areas that needed to be improved as part of our Financial Services Action Plan. In taking forward work on these areas, we tried to learn from Enron and Worldcom. The result was our Company Law and Corporate Governance Action Plan last year, and our draft Eighth Company Law Directive this year. We welcome the cooperation with the PCAOB. We also welcome the very constructive approach taken last year by the SEC in minimising some of the unintended effects of Sarbanes-Oxley on European companies and audit firms. We hope that this approach can continue.

Equally, I have referred to the equivalence issue for **Financial Conglomerates**. It was never our intention to penalise American companies. In reaching guidance on equivalence, we have put the United States at the head of the queue, and hope to announce the results shortly. We welcome the increasingly constructive approach of US agencies on this issue.

A third issue on which we and our regulators need to working harmoniously with American counterparts is on the equivalence of regulation of exchanges and securities and the possibilities of remote access of investors to **trading screens** of exchanges based in the jurisdiction of the other. We recognise the difficulties in this, but believe that there are real potential benefits to investors and businesses on both sides from progress on this issue. We welcome the statement by SEC Chairman Donaldson that he will look at this issue later in the year.

In the **insurance** field, we have had fruitful regulatory cooperation with our American counterparts. The transatlantic insurance market is by far the world's most important. It is crucial that remaining obstacles to markets are removed. One important area where we could make more progress is the removal or lowering of collateral requirements on reinsurance companies. We hope that it will be possible to work together with the EU and US insurance industries to find a suitable solution that reduces the costs linked to the current collateralisation requirements. We are currently preparing an EU directive on reinsurance supervision that will further increase the regulatory standards of EU reinsurance companies. Furthermore we look forward to further international reinsurance cooperation with the US in the International Association of Insurance Supervisors (IAIS).

iii. *Ex ante* upstream cooperation

Equally however, we will need to cooperate upstream to prevent new conflicts emerging.

A priority here is on the implementation of any new Capital Accord. It is essential that supervisors continue to work closely together over the coming period. In general terms this is necessary to maximise the benefits and efficiencies flowing from the process and to address the further issues that will inevitably arise from the implementation process. More specifically, it is important that there is close co-operation to ensure that banks do not find the benefits of the new framework undermined by the different approaches to implementation being adopted in, for example, the US and the EU.

It is also extremely important that we cooperate effectively on the introduction of **International Accounting Standards** in the EU from next year. The more that there can be convergence in both directions between IAS and US GAAP, the better for all. We are therefore encouraged by the cooperation between the FASB and IASB. Nevertheless, we believe that such convergence can only go so far: ultimately the EU and US will have to cooperate on recognising the equivalence of each set of rules. This is an issue on which more progress is needed over the coming six months, but we are cautiously encouraged by some of the recent moves of the SEC. We hope that the SEC will draw up a road map towards recognition of IAS. The EU will be fully transparent about the equivalence recognition process in our Prospectus and Transparency Directives.

Beyond this, areas such as the ongoing work on both sides on Credit Rating Agencies, Financial Analysts, Mutual Funds and Hedge Funds offers an excellent opportunity for upstream cooperation and convergence.

Conclusion

Mr Chairman, Members of the Committee, the Dialogue between the EU and the US is very much an evolving process. It is built on serious engagement by both sides to minimise the negative effects on our companies, intermediaries and investors from regulatory differences. It is built on recognition that we are living in a world where we either cooperate or damage each other needlessly. We have too much in common to be able to afford to do that.

The rewards to us in terms of jobs and growth if we can cooperate are significant. The benefits of cooperation will not just be felt by us, but by our other commercial partners such as Japan, China, Canada and Australia, with whom we also need to engage effectively.

Such cooperation will not be easy for either side. Our regulatory systems have grown in splendid isolation from each other and making accommodations to

different approaches will sometimes be politically difficult. But we have to recognise as mature economies that the blind exercise of regulatory autonomy will penalise us both, and undermine global capital markets.

I welcome the support that you have brought to this process and ask that this committee supports us as we proceed, providing a favourable political wind to blow through our sails and push us both forward in what we believe is a noble task.

Thank you.