TESTIMONY OF

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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

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[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-

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[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

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[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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