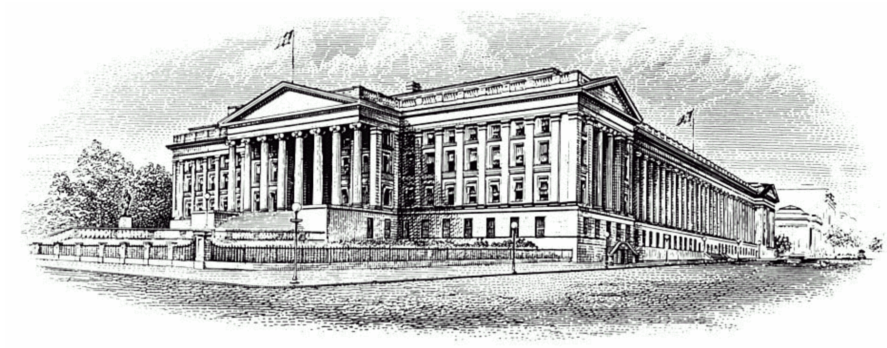

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May 22, 2002 – 10:00am

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House Financial Services Committee Hearing
May 22, 2002

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

Thank you, Mr. Chairman.

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

What is the FSAP?

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

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

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

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

<u>U.S. Views on the FSAP</u>

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

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

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

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

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

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

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

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

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

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

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

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

<u>Managing U.S.-EU Financial Market Issues</u>

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

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

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

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

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

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

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

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

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

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

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

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

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

Conclusion

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