

**STATEMENT
BY**

**STEVE JUDGE
SENIOR VICE PRESIDENT, GOVERNMENT AFFAIRS
SECURITIES INDUSTRY ASSOCIATION**

**BEFORE THE
SUBCOMMITTEE ON INTERNATIONAL MONETARY POLICY AND TRADE
HOUSE COMMITTEE ON FINANCIAL SERVICES
UNITED STATES HOUSE OF REPRESENTATIVES**

**HEARING ON TRADE IN FINANCIAL SERVICES — CURRENT ISSUES AND
FUTURE DEVELOPMENTS**

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Mr. Chairman and Members of the Subcommittee, my name is Steve Judge and I am senior vice president, government affairs, of the Securities Industry Association (“SIA”)¹. Thank you for giving me this opportunity to present the securities industry’s views on trade issues that impact the financial services industry, particularly the securities industry.

The US capital markets are the deepest, most transparent and innovative in the world. The securities industry’s unique functions — matching those who have capital with those who will use it productively, and advising clients and investors on how to manage their investments — are vital to world economic growth. It is critical that we continue to pursue access to all markets worldwide. Open and competitive financial services markets reduce financial transaction costs, increase the efficient allocation of resources, and enhance the competitiveness of U.S. firms. Barriers to entry and discriminatory treatment stifle the innovation and creativity of the securities industry, in turn harming the ability to provide the products and services our customers demand.

¹ The Securities Industry Association brings together the shared interests of more than 740 securities firms to accomplish common goals. SIA member-firms (including investment banks, broker-dealers, and mutual fund companies) are active in all U.S. and foreign markets and in all phases of corporate and public finance. The U.S. securities industry manages the accounts of more than 50 million investors directly and tens of millions of investors indirectly through corporate, thrift, and pension plans. The industry generates approximately \$270 billion in revenues yearly in the U.S. economy and employs more than 380,000 individuals.

The Financial Services Sector is a Catalyst for U.S. Economic Growth

The U.S. securities industry — with its unrivaled and innovative products and services — plays an integral part in powering the global economy. U.S. based securities firms are world leaders in raising capital, helping investors develop and manage their investments, and counseling companies in buying, selling, and forming strategic alliances with other businesses.

The U.S. financial services sector's continued strength depends on unfettered access to foreign markets. Whether firms are raising capital for a new business, extending credit for a corporate acquisition, managing savings for a retail customer, or supplying risk management tools to U.S. multinationals, this sector touches all aspects of the U.S. economy. In light of the financial service sector's unique role in the U.S. economy, its health is essential if the U.S. economy is to continue to show the rates of economic growth and job creation that it has over the last 10 years.

The U.S. financial services industry's strength is impressive. Financial services firms contributed more than \$750 billion to U.S. Gross Domestic Product (GDP) in 1999, nearly eight percent of total GDP. More than six-million employees support the products and services these firms offer. The securities industry alone raised \$17 trillion for U.S. businesses from 1990 to 2000 — an amount that far surpassed the total raised during the first two centuries of U.S. history. Perhaps most striking is how the securities industry has increased its relative importance to the U.S. economy. From 1980-1997, U.S. securities firms' contribution to total output of the U.S. economy increased by 8.4 times — three times the increase of the overall economy.²

It is important to underscore that financial services firms are also exporters. In 1999, financial services exports topped \$20.5 billion, with a record trade surplus of \$8.8 billion. Clearly the cutting edge services and products U.S. financial services firms offer are eagerly sought by foreign individuals, institutions and governments. The continued well being of this sector is directly linked to its ability to sell its products in foreign markets.

The reason for the U.S. financial services sector's increasing commitment to foreign markets is clear. Over the last decade, the U.S. economy and securities markets — while still the largest in absolute terms — have seen their share of the global pie shrink. Approximately 80 percent of the world's GDP and half of the world's equity and debt markets are located outside the U.S. Moreover, over 96 percent of the world's population resides outside the U.S., with India and China alone accounting for 2.3 billion people. Many of the best future growth opportunities lie in "non-U.S." markets. U.S. investors and corporations have already begun to tap these new markets. U.S. investors hold approximately

² U.S. Department of Commerce.

\$2.5 trillion of foreign stocks and bonds, and U.S. corporations invested nearly \$800 billion in the 1990s alone to acquire foreign corporations and to supplement their foreign operations. U.S. securities firms continue to expand their already substantial foreign operations in order to serve the existing and growing international focus of their U.S. and foreign clients.

Expanding Business Opportunities for U.S. Financial Services Firms

It is a long-established U.S. policy to promote economic growth through open financial services markets. Increased competition improves efficiency and provides consumers with the broadest range of products and services at the lowest cost. Many of our trading partners, though, continue to have barriers that keep foreign firms out of their markets, or prevent U.S. financial services firms from competing fairly upon gaining entry. Yet foreign firms have virtually unlimited access to the U.S. market.

SIA supports efforts to eliminate protectionist barriers, whether through the World Trade Organization (WTO) financial services negotiations or through bilateral and regional pacts. To continue to meet the credit and investment needs of issuers and investors in global markets, U.S. financial services firms must be allowed open and fair access to foreign markets. SIA's objective is to achieve substantial liberalization of financial services markets in developing and developed countries.

U.S. broker-dealers often find it difficult to enter or work effectively in foreign markets because of discriminatory, punitive, and costly barriers. Even when they successfully gain entrance into some foreign markets, they often experience unfair treatment in the form of high startup costs, nontransparent laws and regulations, and impediments to introducing innovative products. In other cases, the barriers may either limit the ability of U.S. investors to acquire local shares or restrict U.S. firms from underwriting and distributing securities.

Multilateral and bilateral trade agreements are effective tools for gaining access to closed markets. Such agreements aim for binding commitments from participants to remove specific barriers in their financial services markets so that U.S. firms gain tangible commercial benefits. The U.S., in turn, offers national treatment and full, immediate market access, guaranteeing foreign firms the ability to benefit from new opportunities arising from changes in U.S. law. The multilateral financial services agreement reached in 1997's WTO negotiations, for example, was a good first step toward reducing or eliminating many of the most egregious barriers that firms and their clients face in the 102 participating countries. It also guaranteed the current levels of access for foreign financial services firms in developed countries. We believe this provides an excellent platform upon which the current WTO financial services negotiations should build.

The economies of all the participating countries will reap the benefits of the WTO pact: increased competition, more choice, greater efficiency, a broader range of products and services, and lower costs. More work must be done during the current round of negotiations to achieve regulatory transparency and to expand cross-border activities, as described below.

WTO Financial Services Negotiations: What Needs To Be Done

SIA strongly supports the inclusion of financial services in the Year 2000 Round. We believe this offers a tremendous opportunity to build upon the 1997 WTO accord, which was laudable for being the first multilateral accord on financial services. Though that agreement did not achieve the elimination of a number of barriers which the securities industry sought, it did create a strong basis for further liberalization. Since 1997, many countries have recognized the value of open markets to their own economies and have voluntarily reduced barriers to entry and made great progress on national treatment in financial services. SIA's objectives for the upcoming round include convincing countries to turn those voluntary liberalizations into binding commitments and to build on those voluntary efforts to make additional binding commitments. As a result, as the negotiations progress, we will recommend that our U.S. negotiators reject deficient offers, such as those that codify only the legal status quo or that do not fully grandfather existing investments and operations.

In addition, SIA strongly believes that substantial liberalization of financial services markets in developing and developed countries can only be achieved if countries make strong commitments to improved regulatory transparency.

SIA has consulted closely with the Administration on its WTO financial services proposal, and we believe that it is strong and includes important language on regulatory transparency commitments. We look forward to working with the Congress and the Administration on making these proposals a reality. We believe the Administration's proposal will move us towards the securities industry's goals and objectives for the negotiations, which are based on the following core considerations:

1. Binding Commitments to Open Markets

In the 1997 Agreement, many of the commitments made were to "lock-in" current practice or then — current law. While some progress was made on efforts to reduce and eliminate existing barriers, much work remains to be done. For example, in the case of Malaysia, foreign ownership of local securities firms is limited to minority ownership. To meet the GATS goal of "Progressive Liberalization" (Appendix A) the Year 2000 Round negotiations must result in substantial binding commitments by countries to remove specific financial services barriers.

Unless specific barriers are lifted, the agreement will provide little tangible benefits to the U.S. Importantly, any agreement reached during the Year 2000 Round must grandfather existing investments and not create new restrictions. This is particularly important given that during the last two years, many countries have opened their markets beyond the commitments they made at the conclusion of the last Round. Current access must be made part of any final agreement.

2. *Freely Established Commercial Presence*

Establishing and developing relationships are critical elements in providing financial services. Increasingly, services must be delivered by having a business presence in the host country. Despite the progress made during the last Round, many developing nations still deny foreign investors the right to structure their businesses efficiently, or prevent them from establishing a commercial entity at all. In many cases, establishment is limited to minority joint venture, or hindered by an “economic-needs test.”

The ability to operate competitively through a wholly-owned commercial presence or other form of business ownership must be a fundamental element of an agreement. Non-residential financial services companies must be given every opportunity to establish a viable business presence outside their home country. Once established, companies in foreign markets should receive the same (i.e., national) treatment as domestic companies.

3. *Elimination of Investment and Equity Limitations*

U.S. institutional and retail investors hold nearly \$1.2 trillion of foreign stocks. Increasingly, U.S. investors are acquiring securities from developing markets to diversify their holdings. U.S. investors, however, are often constrained by ceilings and limitations on the purchase of these securities, which artificially raise their costs. Additionally, these limitations also have costs to the local markets, reducing liquidity and increasing volatility. These restrictions should be reduced and, eventually, eliminated.

4. *Transparent Laws and Regulations*

In negotiating greater access for goods, reductions in tariffs provide a easily measurable way to reduce barriers to trade; i.e., tariffs on widgets can be reduced from 50 percent to 10 percent over a five-year period. Financial services firms, however, are confronted with non-tariff barriers. These barriers come in two forms – regulatory shortcomings and lack of transparency in the implementation and application of regulations – and prevent access in the same way as tariffs do. Unlike tariffs, however, no quantitative mechanism exists to reduce regulatory barriers.

During the last two years, SIA has undertaken a major effort to improve global regulatory transparency. We have met with and made presentations to representatives from APEC, the OECD, IMF, the WTO, and regulators in North America, Europe, Asia, and Latin America. Indeed, just earlier today, SIA spoke to members of the International Organization of Securities Commissions on the importance of transparency, and will give a major presentation to this international organization on Friday on the same issue. The securities industry has been a leading advocate on this issue, and we hope that the Congress will support this critically important effort.

In this regard, we would urge negotiators to work on provisions that would, *inter alia*, eliminate preferential access to regulatory proposals; require public availability of proposed regulations; provide an adequate public comment period on new regulations; and mandate the enforcement of regulations in a non-discriminatory manner.

From a business standpoint, ensuring a high level of transparency is as essential to a successful financial services agreement as tariff cuts are to an agreement on trade in goods. Lack of transparency in the implementation of laws and regulations – including limited public comment periods on proposed regulations, non-transparent approval mechanisms for firms and financial products, or other practices which are not dealt with pursuant to written regulations – can seriously impede the ability of securities firms to compete fairly.

Regulatory prohibitions also limit the ability of U.S. firms to compete in foreign markets. In some cases, the sale of specific products requires regulatory approval. In other instances, the ability to establish a commercial presence is impaired because of redundant restrictions on new licenses. Elimination of these barriers is complicated, especially when countries claim that the barriers are "prudential" in nature; that is, they exist to protect the safety of consumers and soundness of the marketplace. We believe, however, that many of these restrictions go beyond any legitimate prudential objective.

5. *Reasonable Transition Periods*

The securities industry understands that local financial services firms in developing markets will need time to adapt to new competitive pressures. In this regard, reasonable transition periods should be considered, with remaining restrictions progressively eliminated throughout the transition. The transition time frames, however, must be accompanied by an initial down payment that results in immediate liberalization. Permanent restrictions on market share, activities or geographical location are unacceptable. NAFTA's sector specific transition periods is a useful model to study.

6. *Increased Cross-Border Access*

The cross-border provision of financial services should be an important element of a WTO financial services agreement. Cross-border provisions should, for example, include the right to buy and sell financial products cross-border and the right to participate in and structure transactions. We believe this can be accomplished while addressing appropriate prudential concerns.

Bilateral and Regional Pacts

SIA is extremely supportive of Administration efforts to forge bilateral trade accords with Chile and Singapore and, on a regional scale, the Free Trade Area of the Americas. We believe that these trade agreements will be viewed as models for other upcoming negotiations, and therefore should result in quality, high-level, and forward-looking trade pacts.

These more targeted negotiations (as compared to those at the WTO) provide an opportunity to negotiate groundbreaking financial services agreements. Specifically, we believe that such bilateral and regional agreements should be negotiated using a “top-down” model. That is, the agreements should proceed from the premise that market access and national treatment should be guaranteed, except for narrowly-defined explicit exceptions that would be reduced and eventually eliminated at fixed future dates.

Trade Promotion Authority (TPA)

SIA supports Trade Promotion Authority for the President as an essential tool to negotiate good trade agreements. TPA gives the U.S. the ability to take a leadership role in trade liberalization. As Ambassador Zoellick noted in his recent testimony to the Senate Committee on Finance, "By leading, the United States adds to its ability to shape the future trading system. By leading, the United States is guiding the merger of regional integration within an open global system. By leading, the United States helps create models of liberalization that we can apply elsewhere. As a result, the United States can add to its leverage on behalf of America's farmers and ranchers, industries and service providers, workers and families."

European Privacy Directive

SIA has been actively seeking a declaration from the European Union (E.U.) that Title V of the Gramm/Leach/Bliley Act (GLBA), in combination with the Fair Credit Reporting Act (FCRA) and other US laws and rules, together with the robust enforcement regime that prevails in the United States, constitutes “adequate” protection for personal data handled by U.S. financial services sector for purposes of the E.U. Data Protection Directive. Moreover, especially because it is of particular concern to the EU, we note that the SEC, the securities self

regulatory organizations (SROs) and the Federal Reserve have extensive authority to receive customer complaints about, and take action against, firms that fail to comply with the comprehensive federal regulatory scheme, or fail to fulfill their representations under the privacy policies which Title V mandates that they develop and regularly notify to their customers. Such a determination is critical for the financial services sector and, by guaranteeing the uninterrupted flow of data, will ensure continued investor and market confidence. We are well aware that the privacy debate in the United States continues to evolve, and that a U.S./E.U. agreement on adequacy will not preclude further developments in privacy law in either the US or Europe. An EU adequacy determination would, however, allow the US financial services industry to move forward in implementing compliance with the extensive legal regimes in place on both sides of the Atlantic, without the threat of costly and disruptive data stoppages.

Capital Markets Sanctions

SIA is increasingly concerned by the proposed use of the U.S. capital markets to achieve foreign policy goals. The U.S. capital markets are the preeminent in the world, attracting investors and companies from all over the world, and regularly serving as a safe haven in times of crisis. Denying access to U.S. capital markets is not an appropriate tool for addressing complex foreign policy issues. Doing so could seriously disrupt investor confidence – both domestic and foreign – in the U.S. markets, thereby jeopardizing their continued vibrancy. Moreover, in today's marketplace, issuers have access to capital on a global basis. If issuers are denied access to the U.S. markets through unilaterally imposed sanctions, they will simply find capital in other markets where U.S. firms are less likely to be competitive.

Capital markets sanctions will have the unintended effect of redirecting business out of the U.S. In this highly competitive, global environment there are few products and services for which the U.S. is the sole supplier. Closing the U.S. capital markets to influence the behavior of foreign countries sets a poor policy precedent which might easily provoke other countries to pursue their own foreign policy objectives through a similar mechanism. In sum, we believe it is a mistake to unilaterally try to resolve complex foreign policy issues through an untested formula that would greatly impair the U.S. capital markets.

America's capital markets played an enormous role in fueling the record U.S. economic expansion, and are unrivaled in their depth and liquidity. These attributes, however, should not be taken for granted. The continued health of these markets is dependent on economic and political certainty and predictability. The historic U.S. commitment to open and fair markets has been fundamental to these developments. Moreover, the economic and political certainty provided by the U.S. capital markets has been a key component of the U.S. financial service sector's ability to nurture and establish a substantial foreign client base. Supported by foreign business opportunities, the U.S. financial services sector

accounts for nearly 8 percent of U.S. GDP and employs nearly six million Americans.

Legislation limiting, or eliminating access, could easily erode the certainty and predictability that has been the hallmark of the U.S. capital markets.

Conclusion

As world leaders in providing innovative products and services, U.S. financial services firms are essential to the international competitiveness of the U.S. economy. Access to foreign markets is more important than ever as our customer base continues to invest and establish operations in foreign markets. U.S. employment and economic output depend on open markets and the free flow of capital worldwide.

Congressional leadership will be a critical factor in deciding the framework for ongoing negotiations within the WTO and other upcoming market opening trade accords. SIA stands ready to work with policymakers as an active participant in these important trade issues.