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EPFSF Briefing
"Transatlantic financial dialogue: convergence or divergence?"

Introduction

The increasing globalisation of financial markets and services, the spread of branches and affiliates, the pace of cross-border consolidation and mergers and the vulnerability of the financial system to contagion risk all call for greater regulatory coherence and cooperation. The recent crisis certainly provided stark evidence of this need for closer inter-reliance in information-sharing, monitoring, supervision, investigation and enforcement.

Post-crisis, the transatlantic marketplace continues to be the world's largest financial services trading area insofar as the EU and the US, between them, account for over 47% of all world trade, 80% of global financial services business and, in 2010, 40% of the world's GDP. Coherent regulation of this market is critical to its efficiency and maintaining its global standing.

Unfortunately, despite the good work of international groups and standard-setting bodies, financial services rules, processes and priorities continue to be nationally differentiated, particularly in the detail. This lack of regulatory coherence will materially increase the cost and complexity of cross-border business not just for intermediaries, market infrastructures and their customers, but also for the regulatory authorities themselves which are under pressure to deliver regulatory reform on slender resources.

In April 2007, the US and EU regulatory authorities agreed to accelerate "*convergence, equivalence or mutual recognition where appropriate, of regulatory standards based on high-quality principles".* However, the subsequent emergence of the crisis in 2008 meant that discussions on recognition dropped down the agenda in order to enable regulators to concentrate on the overarching priority of redesigning, reforming and strengthening regulation in both the EU and US to correct weaknesses and gaps in the regulatory framework. The post-crisis regulatory momentum to accommodate extra-territoriality, differentiated approaches and increased barriers to market access, conflicts with (a) the G20 objective of *"rejecting protectionism and not turning inward at times of financial uncertainty"*[1]*;* and (b) the European Commission's warning that "*protectionism and a retreat towards national markets can only lead to stagnation, a deeper and longer recession and lost prosperity*"[2]. (which was, in effect, a reiteration of the concerns that drove the pre-crisis programme for regulatory recognition).

One of the pre-crisis negotiating tensions over transatlantic regulatory recognition was between the EU's political "redline", which required regulatory recognition of all member states, and the US supervisory "redline" which required operational differentiation across the EU's regulators. As to the first, the emergence of the new European Supervisory Authorities and the greater harmonisation of EU rules, practices and priorities (taken together with Commission oversight and its intention to issue a report on the performance of the ESAs in early 2014) should strengthen the EU's case against the "cherry picking" of individual member states for recognition purposes. At the same time, differentiated levels of operational dependency, potentially significant in some cases, between individual EU and US regulatory authorities are inevitable if regulatory recognition is to be achieved safely and confidently without any significant exacerbation in regulatory risk.

The concept of regulatory equivalence has cropped up in a number of areas of EU financial services policymaking and it is vitally important that it serves as a tool to enhance cross border activity with 'equivalent' jurisdictions rather than create a new market access barrier. In this regard the focus should remain on uniformity/consistency in policy objectives, priorities and outcomes rather than rules (because regulatory systems, overarching legal frameworks and market practices will vary significantly from jurisdiction to jurisdiction) .As European Commissioner Barnier put it in a speech in Copenhagen on 29 March 2012 "*The co-existence of different national standards… is not a requirement of identity but of comparability*".

[1] The Communique from the first G20 Leaders' Summit (14th-15th November 2008)
[2] "Driving Economic Recovery" (March 2009)

However, it is important to bear in mind that a positive equivalence determination of a third country is not just of benefit to the third country involved but it is also vitally important to some European companies who will, for European regulatory purposes, then be able to treat third country operations located in 'equivalent' jurisdictions in a similar manner to those located within the EEA. To these ends some believe that it is important that equivalence is not conditional on 'reciprocal' market access or used as tool to achieving it. In their view, access should be a matter for comparable regulatory standards and no more. Others believe that reciprocal rights of access are necessary to ensure an even-handed approach to inter-jurisdictional competitiveness and more generally to promote EU interests. Either way, lawyers are divided as to the validity of imposing such a pre-condition to regulatory recognition.

There is no doubt that the advantages of regulatory recognition (whether unilateral, bilateral or multilateral) will benefit all those engaged in carrying on or supervising cross-border business in terms of:

- enhancing regulatory efficiency and avoiding duplicative regulatory costs, particularly in the areas of reporting, supervision and enforcement;
- mitigating legal risk and compliance complexity by reducing regulatory conflicts/duplication and conflict of law problems;
- facilitating the comprehensive and timely pooling of information;
- avoiding the establishment of duplicative infrastructures;
- facilitating business recovery and enhancing customer choice through enlarging access to a greater range of products and services for investment, risk management and raising capital at a time of economic crisis; and
- increasing transparency of various financial transactions through mutual understanding/recognition of products and services offered.

1. Markets

The EU and US programmes for market repair share common objectives and operate largely within principles and standards set by a variety of international organisations, but there are key differences that are beginning to emerge in the detail of the implementation of those principles and standards. They include differences in the approach to ownership of market infrastructures, exemptions for non-financial end-users, segregation of client money/assets, the derivatives business of banks, intra-group dealings, position limits/management, business conduct in financial services, etc. Some of these differences are not reconcilable, either because of fundamental legal differences between the relevant jurisdictions or because they need to be preserved in the interests of market functionality / economics, but most of them are founded on common objectives and should therefore be perfectly capable of mutual regulatory recognition.

2. Insurance

The insurance sector is an important part of transatlantic trade and investment with bilateral trade and investment exceeding $185bn/€140bn a year, and the EU-US insurance and reinsurance markets representing over two thirds of current global premium volume. We, therefore, welcome the establishment of the EU-US workplan at the beginning of this year aimed at increasing the mutual regulatory understanding of this sector. It is our hope that through a better understanding of each other's regimes increased regulatory convergence can be achieved over time and market access barriers removed.

Key to this dialogue is the involvement of the US Federal Insurance Office (FIO) established under the Dodd-Frank Act. Although, the Office has no regulatory power, it is mandated to represent the US on international insurance matters and, following the US government entering into a 'covered agreement' on prudential measures, it is empowered to pre-empt state insurance regulatory measures which are inconsistent with the 'covered agreement'. This not only provides the EU with a federal counterpart in the US with which to engage but the FIO's pre-emption powers also potentially provide an avenue for addressing the discriminatory collateral requirements for foreign reinsurers doing business in the US.

3. Asset Management

The extra-territorial application of rules poses a growing challenge to asset managers. As an example, the Dodd-Frank legislation in the US and the Alternative Investment Fund Managers Directive in Europe impose significant new reporting obligations to asset managers with considerable differences. Most major asset management firms will need to report under both regimes with significant costs and yet the comparability of the results for regulatory purposes will be questionable. The implementation of the Volcker rule will have a significant impact on European asset managers and will contradict some of the EU rules. As asset management has become a more and more globalised industry, so achieving returns to investors is increasingly dependent on global investment activity and the ability to access the best local expertise available. Growing divergence between US and EU rules and their extra-territorial application challenge this development and make it more difficult to provide returns for the long-term savings of European consumers.

4. Conclusion

Notwithstanding the impact of the crisis, the trend towards a more global marketplace and a consequential increase in cross-border business as well as the capability of enhancing end-user choice is critical in terms of facilitating growth and business recovery. However, this will call for a much higher degree of regulatory coherence and cooperation between regulatory authorities as most prominently stated by Commissioner Michel Barnier, responsible for Internal Markets and Services at the European Commission, at a conference in Copenhagen on 29th March 2012, *"The best way to avoid overlap would be common agreements between the EU and key jurisdictions on the recognition of each other's regulatory and supervisory systems. I know that this approach can be a lengthy process, but I do think it is a way we must explore. We should work towards a transatlantic financial alliance with the US to stimulate our financial integration"*. In the same speech, he called for *"an integrated market not only within the EU, but worldwide"*.

The transatlantic partnership should, not just be viewed in isolation. Amidst substantial growth, particularly in Asia, it is also important that steps taken to improve our transatlantic working relationship also facilitate our working together at the global level to the mutual benefit of our respective economies.

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EUROPEAN PARLIAMENTARY FINANCIAL SERVICES FORUM

Briefing notes are prepared by the Financial Industry Committee to the European Parliamentary Financial Services Forum. For further information on the subjects raised in the briefs please contact the Chairman, Members or Secretariat of the Financial Industry Committee.

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