European Financial Services Round Table

TRANS ATLANTIC BUSINESS DIALOGUE

"The Future of Transatlantic Financial Market Policy"

Wednesday, October 17, 2012

Summary

The TransAtlantic Business Dialogue (TABD) and the European Financial Services Round Table (EFR) both have a vision of a barrier-free transatlantic market to better engage and compete in the global economy. A lot of progress has been made over the years to this end, but there still remain significant challenges obstructing opportunities for closer regulatory cooperation and compatibility to facilitate more integrated U.S.-EU financial markets. The programme of this event focused on two key issues: 1) the state of U.S.-EU financial services regulation and 2) the impact of developments in the transatlantic financial markets on jobs and growth. A key message conveyed during the discussions included an urgent call from business not to separate financial services from potential trade negotiations. The inclusion of financial services is crucial for a successful transatlantic economic and trade agreement given their significance to the real economy.

Charlie Heeter, Managing Director, Global Public Policy at Deloitte and Co-Chair of TABD's Joint Policy Committee, emphasised in his opening remarks that the establishment of the High Level Working Group (HLWG) on Jobs and Growth is a signal event as it holds the potential for completing the goal of a barrier-free transatlantic marketplace. Charlie noted that regulatory divergence adds to inefficiencies and increased costs, inevitably transferred onto customers and clients.

Philippe Brahin, Head Governmental Affairs & Sustainability, Managing Director at Swiss Reinsurance and Chair of EFR Associates, added that the goals of the HLWG should be both ambitious and pragmatic in order to ensure progress in all chapters, including financial services. Regardless of the structure the negotiations may take, business and government will need to be willing to break out of entrenched positions and develop creative thinking to overcome established barriers.

Panel 1: US-EU Financial Services Cooperation

Moderator: Karel Lannoo, CEO, Centre for European Policy Studies

- Klaus Deutsch, Director, Deutsche Bank
- Alastair Evans, Head of Government Affairs, Lloyd's
- Susan Baker, Representative for Europe, U.S. Department of Treasury, U.S. Mission to the EU
- Martin Merlin, Head of Unit - Financial Services Policy, Relations with the Council, DG Markt

Moderator Karel Lannoo briefly outlined the developments of transatlantic financial services cooperation and highlighted the different approaches of the EU in terms of third country provisions for financial services rules. They evolved from a call for 'reciprocity' in the early 1990s to 'Mutual Recognition Agreements' (MRAs), and in the post-crisis environment the concept of 'equivalence' has been supported.

Martin Merlin noted that there are still difficult issues with respect to financial markets regulation, but trust in each other's authorities and regulatory approaches is slowly building up. Given the complexity of financial regulations it is difficult to achieve a single set of rules, let alone MRAs. On the EU side the member state dimension adds complexity due to different views between regulators on investor protection. At the same time Martin recognized the importance of a set of common rules for business to ensure a level playing field. It will take time to achieve this goal and both, politicians and regulators, have to be supportive and maintain the current momentum.

Susan Baker underscored the independence of U.S. financial regulators and differences between the EU and the U.S. systems. In the EU the European Commission holds the power for ultimate approval and can initiate legislation. In the U.S. regulatory boards are appointed by Congress to develop rules and regulations. She added that free trade agreements (FTAs) always include issues such as market access, underwriters and equity caps. In contrast, prudential issues are never included because regulators cannot be influenced by government or legislators, let alone trade negotiators.

Klaus Deutsch started on a positive note highlighting some of the consistent actions taken in the EU and U.S. since the financial crisis evolved. Both, the EU and the U.S. are frontrunners in the implementation of G20 rules. At the same time the he noted that the transatlantic marketplace is still confronted with substantial challenges. From the industry perspective Klaus called for the inclusion of financial services in a potential EU-U.S. trade agreement. To do so, careful definitions and a structured approach to the numerous financial regulatory issues are a crucial stepping stone. Such a categorization into traditional trade issues, horizontal issues that cut across services sectors, prudential matters, and issues falling in between these categories, will help to identify ambitious but realistic goals. TABD's Capital Markets Working Group is working on this classification.

Alastair Evans noted that there are fundamental differences between financial services sectors. At a global level the insurance business is covered in multilateral platforms such as the G20 and FSB. In the EU, the review of the prudential regime for insurance and reinsurance undertakings led to the 2009 agreement on Solvency II. It includes equivalent measures but supervision mechanisms are different. In the U.S. a state-based system prevails. The newly established Federal Insurance Office (FIO) does not have direct supervisory powers but can represent insurance in international bodies. A report from the FIO is expected after the U.S. presidential elections. On a bilateral basis the Insurance Dialogue has been on-going for over ten years. Great transparency and a more stream-lined process would be welcome by industry. Two hearings in Washington and Brussels took place in October, and a report to compare on-going work on each side is expected. The ultimate goal of this dialogue should be MRAs or equivalence of outcomes.

In the discussion that followed, the concept of equivalence was considered by government as a workable solution. Under the system of national treatment all parties are subject to the same set of WTO rules. It was seen as tool to foster open markets, at the same time it has been 'demonised' by some. Government speakers re-emphasized that only horizontal issues could be included in trade negotiations due to the independence of regulators on the U.S. side. Business called for a reflection of past and up-coming negotiations to define the potential for moving forward.

Panel 2: The Transatlantic Financial Market, Jobs and Growth

Moderator: Paul Adamson, Editor-in-Chief, E!Sharp

- David Devlin, Partner, PricewaterhouseCoopers
- Pascal Kerneis, Managing Director, European Services Forum
- Peter Skinner, MEP
- Rupert Schlegelmilch, Director - Services and Investment, Intellectual Property and Public Procurement, DG Trade

The second session aimed to establish the link between financial services and the real economy, and the impact on economic growth and job creation. David Devlin described the lack of confidence of the transatlantic business community despite liquidity injections and low interest rates. Many large scale investors today tend to invest outside the EU and U.S. markets. The flood of divergent transatlantic regulations facilitates this development. Regulators around the world undertake numerous regulatory changes affecting financial services which are extremely difficult to absorb by business. Common accounting rules would substantially streamline efficiency. Even though this will be a tedious process it is worth looking at. Equivalence is a beneficial and practical way to deal with differences, yet the ideal goal should be common standards.

Pascal Kerneis spoke to the impact that new financial regulations have on the real economy, the significant impact on SMEs, and the important problems created for trade finance. Access to finance and liquidity have a major impact on inter-bank lending as well as lending to business. The disruptions caused by the financial crisis as well as due to regulations reduce investments in other sectors (e.g. consultancy, advertising etc.), and have thus a direct impact on jobs and growth. With regard to trade finance Pascal noted that it was low-risk but that regulation drives users toward more risky and profitable financing models. He added that trade liberalization would open up possibilities for new market access and the development of a broader services market.

Peter Skinner emphasised how together the EU and U.S. could still influence the course of financial services regulation globally. Joint high standards of regulation that reflect transatlantic values could be successfully promoted vis-à-vis third countries if EU and U.S. governments and legislators agree on a joint approach. Peter added that the internal view the EU took following the financial crisis was insufficient. Instead it is crucial to consider the big picture of regulatory actions.

In his remarks Rupert Schlegelmilch said that the EU and U.S. should not be approaching these negotiations as a traditional FTA. Services will be a crucial element and regulation is key to progress on services. The transatlantic market place is already a highly integrated market but an EU-U.S. trade deal should be striving for something broader and more profound than a traditional agreement. Rupert recognized the challenges with the federal and sub-federal level in the U.S. and member state competencies in the EU. Notwithstanding these obstacles he called for ideas how to deal with and overcome such differences.

In the Q&A the question of audit reform was raised. 70 per cent of the consultation submissions on this topic opposed mandatory rotation. It was noted that a proper impact assessment of such legislation is crucial to ensure that the implications, particularly on the real economy, are fully understood. When asked about the fairly thin interim report of the HLWG, Rupert replied that careful analysis is important before negotiations could be launched. He added that an EU-U.S. trade pact could be a game changer. At the same time he took a cautious stance bearing in mind the challenges of such negotiations.

The discussion closed with the observation of the significantly different dynamics of the two sessions. While the first discussion focused on whether or not financial services should be included and if so how, the second panel underscored the fundamental importance of financial services without questioning their inclusion. The potential carve-out of financial services is a real concern considering the different positions of DG Trade, DG Markt and the Treasury Department, and continued pressure from business is needed to ensure their proper inclusion.

Conclusions & Outlook

The discussions provided insights that can help motivate future negotiations to include financial services and offer some prospect of success. The key outcomes of the discussions are outlined in the following:

1. Differences between the EU and U.S. regulatory systems: Both regulatory systems are fundamentally different with the European Commission writing financial services rules, while in the U.S. independent regulators develop rules, based on the legislative mandate from Congress. It should however be noted that U.S. regulators are not entirely exempt from outside influence. Congress provides the legislative mandate for regulators' work, oversees the agencies' activities, and provides the funding for their budgets. Congress further has the constitutional authority to regulate interstate and foreign commerce and provides the mandate for the President to negotiate, as well as approves the results of those negotiations.

2. Creative solutions: The discussions showed the need for creativity. Innovative ideas of how to break out of entrenched positions is essential to make progress. Ways to bring authorities together and encourage regulatory progress in a coordinated way with trade negotiations needs to be fostered. A positive example is in accounting and auditing and the mutual recognition of professional qualifications. Licensing of accountants and auditors in the U.S. is a state matter. State regulators have gotten together through their own association and worked with foreign accountancy bodies on the principal that 90 per cent is better than nothing. These MRAs may not extend to all U.S. jurisdictions, but they are accepted by the vast majority. This was made possible by trade agreements – the U.S.-Canada FTA, then NAFTA, followed by the provisions of the GATS agreed in the Uruguay Round.

3. Window of opportunity: With emerging markets on the rise, now is the time for transatlantic action to shape the global regulatory framework. The point is that our window of opportunity is closing. Rupert Schlegelmilch mentioned that the EU and U.S. together account for two-thirds of global finance. Only a few years ago both markets accounted for some 80 per cent, and other estimates state that the transatlantic share has already fallen to a 50 to 60 per cent range. These numbers are a warning shot that the window of opportunity for a joint transatlantic approach is closing. EU-U.S. trade negotiations in 2013 would provide a solid basis to ensure transatlantic standards are recognized at a global level.

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