

EIN - 'Meeting of Transatlantic Group'
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Hotel Sofitel Lafayette
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Round Table: ***EU-US regulatory level playing field: Differences in regulatory responses to the financial crisis and impact on financial sector competitiveness.***

Chairman: Burkhard Balz, MEP, *Member of the EPP Group in the European Parliament, Vice-Coordinator of the EP Committee on 'Economic and Monetary Affairs'*

Panellists:

Karel LANNOO, *CEO of the Centre of European Policy Studies (CEPS)*

Tom QUAADMAN, *Vice President of Center for Capital Markets Competitiveness, US Chamber of commerce*

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Introduction / Welcome the Chair, MEP Burkhard Balz:

The chair welcomed the opportunity to host this round-table that addresses a very important and challenging topic in the area of financial markets regulation. He opened the session by welcoming the participants. Business in global financial markets is still dominated by the EU-US transatlantic area. On this backdrop a closer integration and harmonisation of financial market regulation would lead to less regulatory arbitrage and create the potential for more integrated and liquid capital markets with substantial business and welfare effects. Only if the EU and US ensure a deeper regulatory coordination, which so far is dealt with under the Financial Markets regulatory Dialogue (FMRD) between the EU Commission and the US Treasury, there is chance to become a global standards setter. The G20 and FSB have initiated many regulatory measures to render financial markets more stable and resilient, but the implementation of such measure still belongs to regional and national legislators and governments. In this sense the Dodd-Frank Act in the US on the one side and the regulations initiated by the EU Commission on the other side form the legal basis for the transatlantic market. Although both sides agreed on a closer coordination, many differences still exist, resulting in negative side-effects and leading to a suboptimal market conditions.

The following areas were addressed during a lively debate. Discussants overall agreed that more needs to be done to ensure a *EU-US regulatory level playing field. Only more harmonization in legislative measures would help avoid negative impacts on the competitiveness of financial sector participants.* In some areas, though, there were divergent views from the EU and US side.

1) EU-US lost market share in global financial markets

The share in financial services activities between both continents is still high achieving more than 70% of global financial transactions. However, as a result of the financial crisis the EU-US share in different areas (see annexe) has dropped with a negative impact on the business in financial services. Combined GDP share was reduced from 56.6% in 2006 to 45% in 2012. And bank assets

achieved only 53.5% in 2012 after 66.3% in 2006 of total global assets. Stock market capitalisation dropped from 61.8% (2006) to 54.7% (2012). On that basis it was discussed, what impact would have a closer regulatory harmonization on the overall financial services between both sides. There was a clear view that there exists a positive correlation between regulatory harmonization and business in this area. A level playing field would result in deeper and more liquid financial markets encouraging at the same time 'trade' in financial services. There was also agreement that in international financial and capital markets the EU and US will only have the chance to play an important role as international standard setter for global regulatory measures if both continents will work closer together in defining common rules and avoid regulatory arbitrage.

2) What has been achieved on current regulatory reform in EU and US?

Right after the financial crisis that peaked in 2008 with the Lehman crisis the G20 via the FSB immediately initiated regulatory measures to help recapitalize banks and stabilize financial markets. The discussion focused on the question whether the US has delivered more rapidly and consequently not only in the area of bank recapitalisation (through the TARP program) but also with consequent and rapid agreement on the Dodd-Frank act. The US banks restored competitiveness right after the crisis achieving today a better profitability and a more solid bank capital base. On EU side there was a less stringent or no commitment to an overall obligatory re-capitalisation program. Each member state was handling its own recapitalisation program on a more voluntary level, being at the same time subject to a EU-wide competition policy. The pressure for the EU competition authority led to competitive disadvantages for those banks that took public money. It was also discussed to what extent the different austerity measures in the EU (in the context of the Sovereign debt crisis) had a negative impact on overall growth, compared to the US. The US emerged stronger from the crisis with positive growth rates approaching the 2% (although high public debt ratios), whereas the EU is still confronted with very modest growth.

Some have argued that the EU lies some (three) years behind the US on regulatory measures and that the EU has still not concluded important legislations in major regulatory areas like "resolution and recovery procedures", "bank structures" and also "Financial Transaction Tax (FTT)". Much hope lies in the implementation of the Banking Union, but still the first pillar of the Banking Union, the SSM Single Supervisory Mechanism, has yet to be implemented. The divergences in content but also in the time schedule are often related to the institutional structure in the EU. Whereas the US has a well integrated regulatory system the EU has to go through many institutional challenges bringing together the views of 28 individual member states. It was also underpinned that on both sides of the Atlantic extraterritorial provisions in the legislation (e.g. FTT and FATCA) have a negative impact that leads to unnecessary tensions and costs for the sector that need to be avoided.

There was a general consensus that the implementation of the Banking Union in the EU must have full priority with a view to stabilize the banking sector and break the vicious circle between banks and the sovereign state.

As main areas of divergence were identified: Basel III (no binding leverage ratio in the EU, partial exemption from IRB, CVA), accounting standards and OTC derivatives (see annexe). It was also discussed that the legislative process between the EU and the US is different. Whereas the US has a more principle-based approach, the EU would be more rules-based, with the EU being in general more legislated. This results also from a larger discretion in the US for the supervisory

agencies that are in charge of defining and implementing the rules. The question on “enforcement” was also addressed: Is the EU following a “laxer” enforcement policy compared to the US? These different issues led to the conclusion that a “regulatory level playing field” is far from being achieved. On the contrary, there exists a danger of balkanisation

3) Danger of balkanisation

Based on different institutional structures and related legislative processes but also what regards overall reaction to the financial crisis (obligatory banks recapitalisation program in the US versus national responses and a strict EU competition policy / deficit spending and quantitative easing versus austerity policy), the EU and US responses to the crisis led to diverging regulatory measures. These divergences currently show a clear tendency to a balkanisation-process that will have detrimental effects for the integration of the EU-US financial market. One of the most challenging measures is the discussion about a mandatory “leverage ratio”. Whereas the EU is currently implementing CRD4 on the basis of the Basel III agreement (incl. the 3% leverage ratio) with an observation period from 2015 to 2018, the US is pleading for a mandatory implementation of such a non-risk based ratio. In the US the debate is also focussing on a much higher leverage-ratio with immediate implementation, which is in some sense prejudging the international Basel agreement. Another area of divergence is the implementation of US capital rules for Foreign Banking Operations in the US (FED NPR on FBO), which is not in line with the Basel agreements and can be considered as "regulatory protectionism".

It was also discussed that divergences in bank structure and business models may have led to other regulatory measures and preferences. The EU banks are considered to be in general “bigger” from a balance sheet perspective than US banks and that the universal banking model, a more continental business approach, has resulted in stronger vertically integrated banks.

This fact may be related to different procedural and institutional structures in the US compared to the EU. Whereas from a legislative point of view the US Treasury is somehow comparable to the EU Commission, in many cases the setting of (prudential and conduct of business) rules in the US is not in the responsibility of the Treasury but with the independent US agencies (FED, SEC, or CFTC). Therefore divergences between the Dodd-Frank act and the EU legislation results also from this institutional divergence. There was a view that in some sense dialogue on regulatory matters should be rather directly with the independent US agencies than with US Treasury.

In this context the role of the FSB was discussed. So far, under the guidance and leadership of the G20 the FSB is operating as a secretariat of the G20 proposing international regulatory measures. The power and the justification of the FSB to help implement harmonized international standards will depend on the question how far the FSB can access and influence implementation and enforcement of regional legislation, the FSB itself not being a legislator/standard setter.

4) Financial Services in TTIP

There was a general agreement about the importance of concluding successfully and within a foreseeable future the TTIP (Transatlantic Trade and Investment Partnership). However to which extent financial services should be included into the TTIP remained open. There were different views between the EU and US side. Whereas the EU representative was more favourable to the

financial services sector being part of the TTIP, the US view was more cautious, based on the fact that the Dodd Frank Act should not be undermined or even changed, as it is very difficult to make changes to the Dodd-Frank Act. The legislative achievements would have to be protected.

The business community in general supports financial services to be part of negotiations as this could be a means to help achieve a regulatory level playing field. Beyond traditional trade and investment provisions, horizontal issues (like cross-border, intra-corporate use of data, legislation related to data protection and security, and also consumer protection issues) are of general importance and should be dealt with in the TTIP.

Areas that should be more in the responsibility of the FMRD between the US Treasury and the Commission are (i) financial regulatory issues that address differences in mutual market access and conduct of business (e.g. legislation on derivatives), and which need closer regulatory cooperation and (ii) prudential regulation, which is dominated by financial stability, investor and/or client protection considerations. The FMRD should pursue measures that would limit to the extent possible negative spillover impacts of regulation in these areas to avoid regulatory fragmentation of EU and US financial services markets.

Regulatory cooperation between the EU and the US should play a significant role in the process of setting international standards and best practices related to financial markets regulation and oversight. It is essential that the EU and the US continue to coordinate and collaborate on finding the best approaches to financial markets regulation in order to drive down regulatory duplication costs for the sector on both sides of the Atlantic.

TTIP could be a useful avenue for pursuing deeper transatlantic cooperation in financial services regulation. Improving the dialogue to enhance compatibility between the EU and US financial regulatory environment would help decrease the opportunities for regulatory arbitrage and reduce the cost of duplicative regulation and provide more legal clarity on prudential, market infrastructure and product issues for financial market participants on both sides of the Atlantic.

There was also a brief discussion on possible mandates for agencies of financial regulation on both sides of the Atlantic to strive for EU-US regulatory cooperation with the objective to reach common standards, equivalence or mutual recognition. Such a mandate could be anchored in the TTIP (as a principle based approach) to encourage regulators on EU and US side to consider the impact on the transatlantic financial. The TTIP could also encourage governments and regulators in the EU and US to establish working programs to identify regulatory divergences how market access issues arising from inconsistent legislation or implementation can be rectified.

Conclusion

There was common agreement that more needs to be done to foster the level playing field between EU and US regulatory measures. More harmonization needs to be achieved through common standards, equivalence or mutual recognition with a view to avoid regulatory arbitrage and help integrate financial markets. This would be a precondition to intensify the business relations, create deeper and more liquid markets, and with this foster real growth.

Change 2006-2012 in overall size of EU and US financial markets and share of global

In € bn		World	EU	%	US	%
GDP	2006	37,596	11,156	29,7%	10,110	26,9%
	2012	55,720	12,938	23.2%	12,199	21.9%
Gross nat savings	2006	8,701	2,358	27,1%	1,622	18,6%
	2012	13,317	2,492	18.7%	1,602	12.0%
Bank assets	2006	53,804	27,822	51,7%	7,748	14,4%
	2012	85,307 ^a	35,472	41.6%	10,175	11.9%
Stock market cap	2006	40,528	10,285	25,4%	14,750	36,4%
	2012	41,362	8,090	19.6%	14,523	35.1%

Current regulatory issues

G-20 themes	Dodd-Frank (US)	EU legislation
Credit Rating Agencies	Upgrade of NRSRO regime	CRA 1, 2, 3
Hedge funds	Upgraded with exemptions	AIFMD, draft UCITS V
OTC derivatives, CCPs, trade repositories	Clearing and exchange trading of most OTC deriv's	EMIR
Price transparency OTC deriv's, commodities	(idem)	Draft MiFID II and MiFIR
Short selling	-	Short selling regulation
Basel III	Implementation ongoing	CRD II, III, IV
Bank tax	Initially, but scrapped	Draft FTT (11 ms.)
Remuneration rules	-	CRD III, AIFMD, CRA 1
Bank resolution	Orderly Liquidation Authority (FDIC)	Draft directive (RRD), Mechanism (ESM-ERM)
Bank structure	Volcker rules	Vickers, Liikanen, etc.
Institutional aspects	FSOC, Fed, Consumer Bureau	ESAs, ESRB (and soon ECB)