SYMPOSIUM ON BUILDING THE
FINANCIAL SYSTEM OF THE 21ST CENTURY

AN AGENDA FOR EUROPE & THE UNITED STATES

ARMONK, NEW YORK • NOVEMBER 14-16, 2003

FRIDAY, NOVEMBER 14

6:00–6:50 Cocktail Reception in the Main Lobby
6:50 Dinner in the Main Dining Room

GREETINGS
HAL SCOTT, Director, Program on International Financial Systems (PIFS), Harvard Law School
PHILIP WELLONS, Associate Director, PIFS, Harvard Law School
STANLEY FISCHER, Vice Chairman, Citigroup; President, Citigroup International

KEYNOTE ADDRESS
RANDAL QUARLES, Assistant Secretary for International Affairs, U.S. Department of Treasury

SATURDAY, NOVEMBER 15

7:00-8:30 Breakfast in the Main Dining Room
7:00-8:30 Breakfast Meeting of Facilitators and Reporters in the Main Dining Room

8:30-8:40 **WELCOME & OPENING REMARKS** in Room H
HAL SCOTT, Director, PIFS, Harvard Law School
PATRICK MAILLOUX, President and CEO, Swiss Re America Corporation
MICHAEL KLEIN, Chairman & CEO, Europe, Middle East and Africa, Global Corporate and Investment Bank, Citigroup

8:40-9:00 **SESSION 1: (DIS)HARMONIZATION OF REGULATION** in Room H
PANELISTS:
DANIEL HELLER, Head, Financial Stability & Oversight Division, Swiss National Bank
ERNEST PATRIKIS, Senior Vice President & General Counsel, AIG

9:00-10:25 Small Groups discuss the topic

GROUP	FACILITATORS	RAPPORTEURS
A	ANNE-MARIJKE MORGAN DE RIVERY & ETHIOPIS TAFARA	HAL SCOTT
B	ANDREW KURITZKES & RICHARD O'TOOLE	PHILIP WELLONS
C	JOHN OLCAY & RANJIT SINGH	ERIC MORGAN DE RIVERY
D	EMILY ALTMAN & CHARLES STONEHILL	JACOB WEINSTEIN
E	ERIC LOMBARD & RICHARD MEDLEY	BRANDON BECKER

10:25-10:40 Refreshment Break

10:40-11:00	**SESSION 2: MANAGEMENT OF THE U.S.-EU FINANCIAL RELATIONSHIP** in Room H PANELISTS: MARK SLAUGHTER, COO, Goldman Sachs International JENS THOMSEN, Member of the Board of Governors, Danmarks National Bank
11:00-12:30	Small Groups discuss the topic

GROUP	FACILITATORS	RAPPORTEURS
A	KENNETH BENTSEN & PAUL LEE	HAL SCOTT
B	PAUL ARLMAN & MARK SOBEL	PHILIP WELLONS
C	BARRY JOHNSTON & THOMAS KRANTZ	ERIC MORGAN DE RIVERY
D	WILLIAM BLAIR & FRANÇOIS BUJON DE L'ESTANG	JACOB WEINSTEIN
E	KAREL LANNOO & THERESE VAUGHAN	BRANDON BECKER

12:30-1:45	Lunch in the Main Dining Room **KEYNOTE ADDRESS** ALEXANDER SCHAUB, Director-General, Internal Market, European Commission
1:45-2:45	**SESSION 3: CAUSES OF THE BREACH OVER FINANCIAL ISSUES** in Room H PANELISTS: JEAN-RENE BERNARD, Member Policy Council, Banque de France CHRISTINE CUMMING, Executive Vice President & Director of Research, Federal Reserve Bank of New York PETER TILS, Managing Director and Global Head of Relationship Management Financial Institutions, Deutsche Bank AG
2:45-6:00	Free time
2:45-6:00	Meeting of Rapporteurs from Small Group Sessions in Room G
6:00-6:50	Cocktail Reception in the Main Lobby
6:50	Dinner in the Main Dining Room **KEYNOTE ADDRESS** ROEL CAMPOS, Commissioner, U.S. Securities and Exchange Commission

SUNDAY, NOVEMBER 16

7:00-8:00	Continental Breakfast in Room H
7:00-8:00	Breakfast Meeting of Discussion Chairmen in Room H
8:00-8:50	**PRESENTATION & DISCUSSION:** **DIS(HARMONIZATION) OF REGULATION** in Room H CHAIR: RAINER BODEN, Delegate, Board of Managers for European Affairs, Deutsche Bank Reporter: PHILIP WELLONS, PIFS, Harvard Law School
8:50-9:40	**PRESENTATION & DISCUSSION:** **FOUNDATIONS FOR RESOLUTION** in Room H CHAIR: MICHAEL KLEIN, Chairman & CEO, Europe, Middle East and Africa, Global Corporate and Investment Bank, Citigroup Reporter: HAL SCOTT, PIFS, Harvard Law School

9:40-9:55 Refreshment Break

9:55-11:00 **PRESENTATION & DISCUSSION:**
MANAGEMENT OF THE U.S.-EU FINANCIAL RELATIONSHIP in Room H
CO-CHAIRS:
JACQUES MISTRAL, Minister, Financial Counselor, Embassy of France
PAUL SALTZMAN, Executive Vice President & General Counsel, The Bond Market Association
Reporter: ERIC MORGAN DE RIVERY, Partner, Jones Day

11:15-1:00 Closing Brunch in Main Dining Room

SYMPOSIUM REPORT

BUILDING THE FINANCIAL SYSTEM OF THE 21ST CENTURY:

AN AGENDA FOR EUROPE & THE UNITED STATES

November 14-16, 2003
Armonk, New York

Final Report: U.S.-E.U. Symposium

The second Symposium was held at the Executive Planning Center of Citigroup in Armonk, New York during a period rife with transatlantic financial issues. This paper reports the discussion among participants in the symposium. A gap in financial policy appeared to have opened between Europe and the United States. The two regions have adopted different approaches to the same issue, sometimes impeding transatlantic financial transactions. Is the gap serious? Is it growing? How should it be dealt with? These were the basic topics for discussion throughout the Symposium. The debate about these substantive issues is presented below in (Dis)Harmonization of Regulation.

The participants discussed what could be done to bridge the gap. This depends in part on its cause. Recent events, such as the Iraq War could explain it. If so, an important issue was whether financial relations could be insulated from political differences. The gap could, alternatively, be structural. The economies compete, the regions have different political goals, and certainly cultural differences persist. Given these assumptions, the prospects for the regions to find common substantive ground could be poorer. This discussion is reported below in Foundations for Resolution of Differences.

The process of making and implementing financial policy transatlantically may have contributed to the gap and may need repair or redirection. After all, on neither side of the Atlantic is there a single financial policy authority. How can the policy coordination process be improved. The last section of this Report – Management of the U.S-E.U. Financial Relationship -- addresses this issue.

(Dis)Harmonization of Regulation

The degree of dis-harmonization in many issues was apparent to participants. Those issues attracting the most attention were Sarbanes-Oxley and corporate governance, accounting differences between IAS and U.S. GAAP, the Financial Conglomerates Directive, and the debate over trading screens and the cross-border activities of both stock and derivative exchanges. They are presented serially below. Other topics were also discussed, including takeover rules, Basel II, PCAOB, the role of SROs, and data protection; some are summarized below.

General themes cut across the discussion of individual issues. Most of the problems that suggest the gap between the U.S. and Europe, noted a participant, involve distributing services across borders rather than through locally incorporated subsidiaries. Cross-border transactions may raise difficult issues of investor protection. Sales of securities issued in another country and not registered in the host-country market are an example. In fact, the most intractable differences between the U.S. and Europe tend to be in the securities industry. The clearest example in this Symposium is the debate about screen trading. Because banks and insurance companies sell their products or services much more through locally incorporated subsidiaries, they can comply more easily with local regulation and supervision.

Participants cautioned against advocating uniformity in regulation, as discussed in Part II of this Report. Many did not assume that complete uniformity should be a goal, and so they expected to find gaps among jurisdictions.

The increasing cost of regulation was an issue. Several participants, noting that new regulation adds to supervisors' and firms' costs, asked if efforts to eliminate transatlantic regulatory gaps would end up reducing market liquidity by increasing costs.

More generally, however, was the possibility raised by one participant that most of these topical issues – including even the debate over screen trading – were misplaced. Perhaps the critical matters are more long term, such as the continued governmental bailouts by some European governments that undermine markets.

Overall, participants asked if the gap is growing. That discussion is presented in the last part of this section.

Sarbanes-Oxley

Although everyone agreed that Sarbanes-Oxley was intended to be domestic, it had significant extraterritorial effects. Sarbanes-Oxley highlights transatlantic differences in rules about corporate governance because it applies to foreign firms listed on a U.S. exchange, and therefore registered with the SEC. The new U.S. law presents many important issues for Europeans, according to participants, including board structure and executive compensation, liability of directors and senior executives, loans to bank executives and directors, certification of financial statements by CEOs and CFOs, auditor independence, and standards related to audit committees.

Since a law enacted so quickly was bound to have unforeseen consequences, regulators moved fast to mitigate the impact when possible, said participants. The SEC accommodated foreign market players when implementing the law. One participant noted that the SEC adjusted for foreign concerns in a variety of ways. These include, for Europeans, a more flexible definition of independence for membership in the directors' audit committee, a longer rotation period for audit partners, defining acceptable services by auditors to include legal services, and lifting the prohibition against loans to insiders in certain cases.

A learning process was at work, according to participants, that may have reflected consensus on the underlying ideas. The E.U.'s initial criticism blossomed in late 2002 when a Commissioner criticized Sarbanes-Oxley as over-reacting. But over time, the initial hostility between the U.S. and Europe diminished. One sign of compromise or even convergence, said a participant, is that there is now less or no talk about how Sarbanes-Oxley imposes trade barriers on foreign firms. At first, European critics argued that the U.S. law made entry and operations by foreign firms in U.S. financial markets more difficult. For example, Sarbanes-Oxley set standards based on U.S. forms of governance, such as a single board, rather than on forms that are common in Europe, such as the two boards – management and supervisory. This bias, it was said, was unfair to European firms. Participants said that they do not hear such criticisms now.

Overall, some participants see a trend in which the U.S. and E.U. approaches to corporate governance have become more alike. The U.S. is giving more power to outside directors while the E.U. is increasing the relative authority of the supervisory board (which has the outside directors) compared to the management boards (with only senior executives). The important commonality, said participants, is that both regimes require a board structure that distinguishes between control and day-to-day management. Neither the U.S. nor the European structure is seen as better than the other.

Participants did not uniformly accept the trend to convergence as good, but many participants from financial firms supported it. They see common corporate governance rules as an important goal. Common rules would allow firms to manage their own ownership structure more efficiently across borders. Now firms cannot harmonize their own internal corporate governance across borders.

A contrary view emerged that Sarbanes-Oxley has been bad for Europe. Participants noted that Europe has more than 35 corporate governance codes, some binding and others

voluntary. The diversity and regulatory competition is healthy, said participants, and the E.U. was for many years prepared to let each survive. But Sarbanes-Oxley, coupled with Europe's own problems, such as Royal Ahold NV, prompted the Commission to propose that it set minimum standards of corporate governance for all member states and require codes to be mandatory rather than voluntary. Some noted that by adopting rules that are consistent with Sarbanes-Oxley the Commission augmented its own power relative to national governments in the E.U.

In adopting techniques that are consistent with Sarbanes-Oxley, European regulators will encounter problems that would not arise in the U.S., said a participant. The U.S. forms of corporate governance rely on courts and litigation in ways, such as shareholders' suits, that are uncommon in Europe. Absent these institutions, U.S. techniques of corporate governance cannot be expected to work as effectively in Europe as the U.S.

Accounting: IAS vs. U.S. GAAP

On accounting issues, the gap between the U.S. and Europe appears to be big, said participants. The U.S. is committed to U.S. Generally Accepted Accounting Practices (U.S. GAAP). Europe is moving toward adoption of International Accounting Standards (IAS). In 2002, the E.U. adopted its Regulation on International Accounting Standards. E.U. companies will be subject to IAS by 2005, though the E.U. must approve the standards before they apply to E.U. firms.

It is not a foregone conclusion, said participants, that the European countries will implement IAS on schedule. Not much time is left. Some groups are already exempt from the 2005 deadline, such as European insurers, who had feared that IAS would increase their cost of capital. They will not have to comply with the general guidelines until at least 2007.

Does the gap between IAS and U.S. GAAP matter, however? Some participants suggested that we do not need a single accounting standard, since analysts can convert between the two.

The impact on U.S. firms of Europe's adopting IAS is unclear to participants. Will those using U.S. GAAP after 2005 be able to list in Europe? If not, said one participant, the effect would be serious. Participants foresaw three possible outcomes. First, Europe might allow U.S. GAAP. If so, U.S. firms could issue in Europe with relative ease. But why would Europe be so

accommodating if the U.S. does not allow IAS? So the second option is that the SEC accepts IAS. Participants questioned if this was conceivable. If neither of these options occurred, participants foresaw a third in which continued segmented markets impose greater costs due to their inefficiency.

Participants who acknowledged important gaps did not all agree that the gaps were transatlantic in nature. Some did, contrasting the U.S. enthusiasm for the use of market values with the European distrust of them. But others said cultural differences that divide Europe ally some European countries more with the U.S. than with others in Europe. Some Europeans do not want the volatility that accompanies market valuation, a participant explained. This is not a simple matter of Europe versus USA. Regulators in Anglo-American (e.g., SEC, FASB) and Northern European countries are ranged against those in the Continental Roman-Catholic countries of Southern Europe. It is the latter who prefer prudence and stability to the volatility of mark-to-market standards which, they said, augment irrational exuberance. This is almost a theological debate, said one participant.

Yet participants found signs of compromise and even hints of convergence: An SEC report in July 2003 acknowledged problems with the rule-based approach of GAAP, and moved beyond simply reiterating that principles-only would not guide firms adequately. Instead, the SEC sought what a participant called objectives-oriented standards, with adequate detail and commitment to reporting the economic substance of the transaction. Moreover, the Convergence Project between FASB and IASC continued to try to resolve key accounting differences.

Financial Conglomerates Directive

The Financial Conglomerates Directive, adopted by the E.U. in 2002 and in the process of being implemented in member states, is of concern to some participants. The problem, they said, is that the directive requires supervisory regimes for foreign holding companies operating in Europe to be equivalent to those in European financial markets. This would have particular importance to U.S. securities companies that were not part of a bank holding company structure, since such firms are unregulated at the holding company level; the U.S. only supervises the broker-dealers.

The SEC has sketched its own approach to regulating financial conglomerates. It is very different even in level of detail from the E.U. Directive. Participants asked whether, or even how, the SEC proposal could be found to be equivalent to the E.U. rule.

Screens and exchanges for stocks and derivatives

The debate about the operations of foreign exchanges in the U.S. was pointed. It coalesced on two topics. One was the entry and establishment of a regulated subsidiary of a European derivatives exchange, Eurex. The second topic was the access to U.S. markets for the cross-border screens of the European stock exchange, Euronext.

Eurex, participants noted, planned to enter the U.S. and was catapulted into open political warfare with its U.S. competitors. Lobbying by the Chicago Board of Trade (CBOT) and Chicago Mercantile Exchange (CME) preceded an investigation by a House subcommittee and the decision by the Commodity Futures Trading Commission to take the Eurex application off the fast track. Eurex counterattacked by suing CBOT and CME for anti-competitive behavior. Participants expected the politics at most to delay Eurex but not stop it. Politics, they noted, had again become a form of protection from competition.

A separate and even more significant debate was over Euronext's desire to open trading screens in the U.S. Divisions between some participants from Europe and some others from the U.S. were deep. Euronext, said its advocates, should be allowed in without having to register with the SEC and should be allowed to sell securities without the issuers registering them. In this view, exchanges like Euronext, and the securities they trade, are already well regulated in Europe. U.S. regulators should accept the equivalency of European regulation. To do otherwise is micro-management by U.S. regulators and a form of double jeopardy for the European exchange, which would be subject to two supervisors, one in the U.S. and the other in Europe. More seriously, some said, requiring registration looks like protectionism by the U.S. government. Some participants were very concerned that the matter had continued unresolved for years. They saw it as a crucial test of financial relations between the U.S. and the E.U.

The contrary view, taken by other participants, was that Euronext should comply with U.S. law and register. Compliance is a normal consequence of doing business in a foreign country, not double jeopardy. It would be unfair for Euronext to do business in the U.S. if it were subject only to European regulation that gave it a competitive advantage, they said.

Registration was essential because it would give the U.S. supervisor not only oversight but also the ability to hold the foreign exchange responsible if it violated U.S. law. It looked, instead, as though Euronext was reluctant to submit to U.S. jurisdiction, they said.

Participants differed about the value of Euronext's potential services to U.S. investors, both in additional access and reduced costs. Supporters of Euronext argued that U.S. investors were being deprived of direct access to instruments it trades. But others questioned whether there was much demand for Euronext's service in the U.S. U.S. investors already have relatively easy access to securities traded on European exchanges through brokers that are remote members of most of those exchanges. What, these participants asked, makes Euronext's entry so urgent?

Euronext's potential cost advantage to U.S. investors was also debated. Supporters of Euronext asserted that access by the end user -- the investor -- to screen trading would reduce costs. By implication, having to trade through remote members is an expensive substitute. They cited studies substantiating this. But, rejoined other participants, those studies took place before fixed commissions ended and before widespread internalized trading in brokerage firms cut trading costs by eliminating a step in the transaction. It is not obvious, these participants said, that Euronext will bring additional cost savings to the U.S. investor.

Participants raised, without resolving, the question of how to address the possibility that U.S. firms would list abroad under lower standards and be traded in the U.S. through the cross-border screens. One solution, said a participant, is to allow foreign issuers to use the trading screens in the U.S. but prohibit U.S. issuers abroad from using them. The foreign issuers' securities could then be traded in the U.S. without registering and U.S. issuers would have no opportunity to engage in regulatory arbitrage.

Basel II

The implications of Basel II need more attention, according to participants, because it will not level the playing field. Its language is often so vague that countries will easily apply different interpretations. Supervisors will find it very difficult and costly to validate the IRB approach taken by individual banks. As a result, supervisors of all but the largest financial systems will need to pool their data for bench-marking, for example. This will raise serious issues of confidentiality, said participants. These problems will exacerbate differences in approach to capital adequacy regulation.

These Basel II problems are not peculiar to the transatlantic relationship, but regulators on different sides of the Atlantic reacted to them in different ways, said participants. They said that the reaction has been more negative from U.S. regulators than European ones. Not long before the Symposium, the U.S Comptroller of the Currency indicated that he favored a slower timetable and a review of basic inadequacies. In contrast, Germany's supervisors supported the faster timetable. Participants discussed the effect of the different approaches to implementing Basel II being taken by U.S. and European supervisors.

Participants noted that the U.S. government will mandate Basel II only for the ten largest banks and allow a small number of other banks to use Basel II as well. European regulators object to the limited application, fearing that it would segment financial firms. Some participants asserted that this difference in policy between the U.S. and Europe was more apparent than real. The largest U.S. banks account for most U.S. international banking activity. In this view, the gap between Europe and the U.S. is imaginary. Another perspective also suggested that the different approaches were not significant. Even if nothing more happened, said a participant, most of the goals of Basel II have already been achieved because the senior managers of banks are now much more attuned to risk and international banking has weathered the downturns of the last few years quite well.

Reaction to Basel II was relatively consistent among private sector participants regardless of their home continent. They were critical of many of its provisions and predicted that the application of different capital rules to an international financial firm would affect the firm in a negative way. For example, a firm's European operations would be subject to Basel II even though its U.S. operations were subject to Basel I because the firm failed to meet the standards required to use Basel II.

How committed, asked participants, is the U.S. to Basel? Could the U.S. withdraw from Basel and let Europe go it alone? One participant reminded others that a committee of the U.S. House of Representatives recently criticized regulators for building a major set of financial rules -- the Basel capital accord -- by excluding legislators. The House committee asserted that the issues were too significant for legislators to be excluded from the process. Other participants said that this did not signal a substantially lower support for the Accord by the U.S. President. Some participants argued that the U.S. did not even enforce Basel I at critical points. For

example, U.S. regulators did not take action against Japanese banks in the U.S. when the headquarters certainly lacked adequate capital.

Signs of compromise were noted by participants. An apparent divide over whether to hold capital against expected losses was resolved, for example. The U.S. Comptroller of the Currency argued that banks should not have to hold capital against expected losses since they already have loan loss provisions and such a rule would particularly hurt big banks with credit card business. Meeting in Madrid in mid-October, the Basel Committee agreed.

Public Company Accounting Oversight Board

Regulators and firms in Europe are concerned, said participants, about the powers of the Public Company Accounting Oversight Board (PCAOB, known colloquially as "Peekaboo"), which was established by Sarbanes-Oxley, to inspect the major auditors of listed issuers annually and the smaller ones every three years.

Participants noted that PCAOB has the power to license European audit firms when they audit a European firm's U.S. subsidiary. It can examine the firms' quality and credibility, and enforce rules against them. The E.U.'s major concerns, said a participant, relate to auditor registration. The E.U. and its 25 finance ministers opposed PCAOB's requirement that E.U. auditors register with it. PCAOB could, other critics said, even raid the auditor in its home country. This extraterritorial reach created serious concerns for E.U. regulators, said participants.

More generally, some participants said, PCAOB is mired in excessive detail. It should not try to examine all of each major firm's audit activities. It needs to be selective if only because it lacks the staff to do otherwise.

Structural divisions remain. The relation between external auditors and bank supervisors are still at issue, according to a participant. The spectrum in approaches is wide, with the U.S. relying on many internal examiners while other countries such as Switzerland only use external auditors. France and Germany do both. Will this gap be closed?

Signs of compromise are heartening, according to participants. The E.U. and PCAOB have begun to discuss the issues bilaterally. PCAOB would probably have to work through the foreign firms' home accounting regulators. The U.S. and E.U. planned to let European auditors for U.S. listed firms register jointly with U.S. and home regulators. The EU would adjust its

registration rules to conform to this.

Overall Assessment of the Gap

The big issues for discussion were about how serious the problems are and whether they are getting better or worse. Among the most notable observations was the different perspective of public and private participants. Public sector participants on both sides of the Atlantic were relatively positive about the modest size of the gap and the trend. Their evidence tended to come from relatively narrow technical problems. Private sector participants, however, tended to be gloomier, emphasizing broader concerns, including even systemic risk. Many from the private sector, though far from all, voiced the sense that over the last two years regulatory and policy cooperation has become much less than before.

On whether the transatlantic rift is serious and growing, participants' reasoning ranged from sanguine to a litany of serious problems. Some denied that there was a significant rift. In their view, regulators share a common view surrounded by a lot of noise. For example, the European regulators writing the Financial Conglomerates Directive based it on earlier discussions of conglomerate regulation in the Joint Forum, in which Americans and Europeans take part. Of course differences exist, say these participants, but U.S. and European regulators are solving them as they arise. The system is not broken and the two regions are not moving apart. Certainly in some sectors, such as insurance regulation, urgent and divisive problems do not exist. Financial regulators should continue in this cooperative mode by being flexible and taking a functional approach to problems. The strongest articulation of this positive view was by Randal Quarles, who said in his keynote speech that "in the financial sphere, the U.S.-European relationship is strong and cooperation is excellent."

A second optimistic perspective on the gap is that we should take a longer view than the last two years. Compared to ten years ago, noted a participant, the process has improved substantially. In banking ten years ago, there was a Fortress Europe mentality. This is no longer true. In securities markets, regulators on both sides of the Atlantic worked well together to implement Sarbanes-Oxley. It is true that in some areas, such as Basel's capital adequacy rules, differences are so great and the issues are so heterogeneous that resolution does not occur. Differences such as these do not, however, undermine the fundamental trend toward transatlantic cooperation, in this view.

Somewhat more muted approaches to the gap recognized problems but warned that they are not major now. These participants warned that one can exaggerate the differences. Some gaps have an arbitrary genesis, and once the policies are made they are just difficult to change. Examples drawn from the everyday world are the electrical wall plugs or cell phone systems that vary across countries. They started out differently, and persist. They do not indicate major problems among the countries. The same has been true in finance. In some cases, there may be no best system.

A more nuanced view was that there is not a major gap but the situation is not optimal either, and could worsen if it is not addressed. Although analyses relating the geopolitics of the Iraq war to regulatory differences are overstated, according to these participants, difficult issues face regulators on both sides of the Atlantic and relations are not the best. However, as long as the players can tackle issues as they arise, the system will continue to work. This is important, said participants. Transatlantic financial services are substantial, and if their regulatory costs and uncertainty rise, the supply of services will fall.

The alarm of others was greater. They saw many examples of an increasingly serious gap. Getting agreement among regulators seems increasingly difficult, said one participant. According to others, until 2 years ago there was no gap to speak of. The major problems between Europe and the U.S. appeared to be solved. The last two years saw the U.S. and Europe take increasingly divergent positions. The reason this happened is not clear, said some participants, but others catalogued major changes in the environment. Geopolitics, said some, mean that senior U.S. officials became involved more than before (although this point was challenged by others) and the E.U. seems to look increasingly inward. Certainly the number of issues over which the U.S. and Europe differed increased substantially, said these participants. The FSA told London-based banks that it would no longer line up with the U.S. view automatically. European governments are still sponsoring bailouts of big firms, which the U.S. government would not do. Up to now, the gap has not had serious consequences in the sense that the international financial system has survived difficult times, but this is not a good reason to ignore the situation.

Foundations for the Resolution of Differences

To close the gap, some participants offered new concepts. In place of the traditional principles of national treatment, harmonization, and mutual recognition, the ideas of equivalence and convergence were presented. Any approach to dealing with substantive differences in policy must also deal with the threat of excessive politicization.

Objectives

Regulations have different objectives, participants noted, that can undermine efforts to narrow the gap. Objectives vary depending on which side of the Atlantic the regulator inhabits, according to some participants. The U.S. regulator has been typically wedded to market wisdom, which means leaving to transactors how they do business, said a participant. European regulators are more concerned about effects on the broader economy or society. A short-term versus long-term dichotomy may also exist. The U.S. regulator is more willing to accept volatility. In addition, European regulators are more risk averse than those in the U.S.

Structural differences across countries contribute to different objectives. For example, because mid-cap firms in Germany create substantial wealth, and loans to them are small, German banks find it difficult to use mark-to-market accounting for the banks' loans to the firms. Loans to large cap issuers, with publicly traded securities, can be marked-to-market more readily. The situation in the U.S. is quite different from Germany, said a participant, who thought that large cap issuers account for a much larger share of loans by U.S. banks than by European banks.

Participants also noted that objectives differ because U.S. markets are more retail than E.U. markets. This difference matters because rules for disclosure are less important for wholesale markets than retail. The strength of the retail market leads to more emphasis on disclosure and protection of individual investors in the U.S., and to more private enforcement in U.S. Yet the simple dichotomy was questioned. Europe lacks institutional investors, compared to the U.S., so Europe should be less wholesale, noted one participant.

Recent events, participants said, exacerbate difference in objectives. The U.S. focused on the fallout of the bubble burst, which created a crisis of investor confidence. This means that the U.S. has focused on corporate governance issues. The E.U., in contrast, has focused on building its internal market. The focus is therefore on removing Member State obstacles to cross-border

activities. Also, because in Europe many countries take part in the institution building, Europe takes time to compose and implement policy, which is difficult to change, said one participant.

Yet this dichotomy between a U.S responding to crisis and a Europe in construction was disputed as too simple by some participants, who noted that the bubble burst hit both sides of the Atlantic. The $14 trillion swing world-wide from top to bottom was like a tsunami for everyone. Europe suffered more than the U.S.

Methods of achieving the objectives

The choice of methods to achieve regulatory objectives, either by a country or a group of countries, may affect the principles chosen to guide regulation. In the abstract, participants identified three methods of possible action.

1. The first is to try to resolve differences between rules at the regulatory level.
2. The second is to let supervisors agree on principles to guide their actions.
3. The third is to rely on market discipline.

Participants were divided about whether the U.S. or Europe preferred one of these methods over the others. Many participants from Europe liked the second, supervisory principles. A range of participants asserted that the U.S. favored each of the three methods.

The implications of adopting a method could be important, said participants. It may be easier to reduce the gaps between the U.S. and Europe by relying on supervision (method 2) or market discipline (method 3) rather than regulation (method 1) because legislation allows for less discretion and is more difficult to change.

Principles for dealing with these regulatory differences

During the Symposium, relatively novel principles emerged to guide policy makers who must deal with the gap. These principles attracted attention because while most participants wanted more than simple reliance on market forces to drive toward convergence, they did not want or expect complete uniformity of rules and did not seek refuge in traditional principles of national treatment, harmonization, and mutual recognition.

Complete uniformity is not desirable, participants said. It should not be an automatic goal. One participant argued that regulatory arbitrage is not invariably bad. It may make sense for different institutions offering the same product to be regulated differently, and if this results

in competition advantages, so be it.

A single approach on each side of the Atlantic is also not essential or even to be sought, said others. Neither the U.S. nor the E.U. is monolithic. Consistency is difficult, given the various levels of regulators, particularly in Europe.

Traditional concepts

Guiding regulatory policy now, said participants, are three traditional principles: national treatment, harmonization, and mutual recognition. Their comments about each principle follow.

National Treatment Plus/Minus. Although they debated whether a country gave national treatment plus (the foreign firm—subject already to foreign regulations—gets better treatment than domestic firms) or minus (the foreign firm is less well treated), participants said that the basic principle may be outdated. National treatment, which one participant defined as in "you can play in my markets if you play by my rules," is no longer adequate to regulate transatlantic provision of services, noted a participant. It would seriously inhibit the flow of services, he said.

*Harmonization***.** This principle has an equally dubious track record, according to participants. While it is effective for technical market practice rules, such as those by The Bond Market Association and ISDA, Europe could not harmonize its national rules in 40 years. If harmonization did not work there, how could it succeed on a broader canvas? Standing in the way of harmonization are different domestic concerns, issues of national sovereignty, and the different methods used to formulate rules, namely principles in Continental civil law countries and more specific regulations in Anglo-Saxon common law countries. Why push for unachievable harmonization, asked a participant, in U.S./E.U. financial relations?

The few proposing harmonization said it may be feasible to harmonize minimum standards or regulations only for global activities, while one should not try to harmonize matters that are only local. Of course, drawing the dividing line between global and local could be difficult.

Mutual recognition Participants said that mutual recognition means the host recognizes the regulation of the home country and does not impose its own rules on the foreign firm. Europe found that mutual recognition is the best way to depoliticize issues and differences, according to a participant. But even the E.U. may be moving away from mutual recognition.

Two additional concepts

Two additional principles emerged during the Symposium to deal with regulatory differences. They are equivalence and convergence. The differences are one of emphasis, said a participant, since it is too simple to say that a country must have either equivalence or convergence. Both forces are at work at the same time. Two keynote speakers, Alexander Schaub and Roel Campos, contributed to the discussion of both concepts.

Equivalence. Regulations in two countries may be equivalent even though the substantive rules or their enforcement are not identical, said a participant. Equivalence exists when the rules and enforcement in the two countries are equally effective achieving the objectives of policy, such as protecting investors.

Equivalence requires national regulators to be reasonable when they apply their rules to foreign firms, said a participant. If the home regulation has rules that are equivalent to the host's, even if not identical, then the home rules should be adequate for the host. Thus a degree of diversity is acceptable. Regulatory diversity does not inevitably distort competition, said a participant; indeed, it may actually promote it. Equivalence amounts to pooling national sovereignty.

The concept of equivalence finds it roots in antitrust, or competition, rules. Participants found cross-fertilization from other regulatory fields useful. Equivalence is now embodied in the Financial Conglomerates Directive, as reported above. European financial supervisors who apply the Financial Conglomerates Directive, such as the FSA, must determine if U.S. regulation of the conglomerates is equivalent to European regulation.

Although U.S. authorities have been reluctant to use such a concept in dealing with foreign countries, including even the E.U., the concept finds echoes in U.S. financial regulation, according to a participant. He explained that examples exist of an analogous test where the U.S. regulator makes judgments about other systems of supervision. FDICIA looks for "effective consolidated supervision" for foreign bank entry. The 1940 Investment Company Act requires "equivalent protection" to register foreign funds. But it may be easier, said a participant, to apply the equivalence test to transactions, as in the U.S. laws now, than to systems of regulation, as proposed at the Symposium.

What, more specifically, is equivalence, participants asked. The answers indicated that the concept requires further work. One simple answer was "We will know it when we see it."

For others, the approach had to be incremental. We can only decide about equivalence item by item. The first test of this incremental approach is underway in governmental reviews of the Financial Conglomerates Directive. Participants said that some objective criteria of equivalence are needed.

Another set of observations concerned implementing the principle. What is needed for equivalence to work effectively, asked a participant. Can it, for example, work without harmonization? Participants also noted the danger of conflicting decisions across Europe. These conflicts could happen because also in Europe the lead national regulators (e.g. the FSA in the U.K.) will decide equivalency, not the E.U. Is this good, participants asked. They foresaw a situation in which two European countries, working with the same rules, reach opposite conclusions, one regulator deciding that the U.S. rule is equivalent and the regulator in the other country deciding that the U.S. rule is not. This led participants to entertain the value of a central decision-maker for Europe who could ensure consistency.

Convergence. Participants articulated and then debated the concept of convergence as an alternative to equivalence. Two regulatory standards converge as they produce, at a high level, nearly identical regulatory principles, according to a participant. A converged standard would be, for example, that an independent audit committee should oversee an outside auditor. In method of application, the standard could vary, he said. Germany may put an employee on the audit committee. Japan may use a separate statutory board of auditors. There would be no convergence, however, if a country allows executives or managers to select the auditor. There might be equivalence if a second independent auditor reviews the first but there is no convergence because the link between managers and auditor has not been severed, and severance is fundamental to the regulatory principle. In this view, the test for convergence is less subjective than for equivalence. Enforcement is part of convergence, but it is not essential to agree on sanctions or penalties.

The discussion of this concept as a regulatory principle concerned how one thinks about the quality of convergence. The problem that participants identified is the lack of consensus about what needs to converge. To identify principles as “nearly identical” one must know what “identical” means, they said. Some participants thought the concept too close to uniformity, which they saw as neither desirable nor possible. The U.S.-E.U. financial market regulatory dialogue, described in the third part of this report, could address what makes principles identical,

helping the regulators and firms hammer out a set of agreed rules, said participants.

Politicization

Most participants agreed that, whatever the guiding principle, it was dangerous to politicize its application. They discussed at least two questions. First, can financial issues be handled in a purely technical non-political manner? There was no consensus among participants. Some said that officials at the more technical level in government agencies were left by their political superiors to decide issues without political interference. Others found this difficult to believe. After all, it is the job of political leaders to lead in both policy making and implementation.

The second question that participants discussed was the extent to which foreign policy differences and economic competition between the U.S and E.U. affect the resolution of these issues. The test case, according to some, was the effect of the differences between the U.S. and countries in Europe over the Iraq war. Had the profound and vocal disputes about the war, they asked, spilled over into financial policy and contributed to the gap? Opinion divided. For some, the fact that the financial policy gap grew in the last two years as the war was planned and prosecuted was compelling. Others doubted that the war explained the gap. They saw the inertia of longstanding differences. Those who saw the gap as small found the impact of the Iraq war on financial relations insignificant.

One way to moderate politicization is to require transparency in rule making, according to a participant. Transparency is, or should be, a goal for regulators, he said. Others disagreed. Transparency might let Congress play a role, which would politicize what has been until now a technocratic process.

Management of the U.S.-E.U. Financial Relationship

The process of the transatlantic financial relationship is important and must be managed well, according to participants. The financial markets are international now. The deteriorating quality of this relationship, participants said, hurts markets so that, for example, non-U.S. companies are more reluctant now to seek capital in the U.S. Europeans are tired of following the U.S. lead. Today, according to participants, the centerpiece of the transatlantic financial relationship is the young U.S.-E.U. Financial Markets Regulatory Dialogue.

The dialogue process now:

Existing mechanisms for the relationship work well now, in the view of some participants. Among regulators, the process is multi-faceted and effective, said some. The 55 U.S. jurisdictions regulating insurance work well together and with their European counterparts. Traditional fora are useful, such as the Basel Committee, and the IASB and FASB convergence project. But no one argued that the process should be limited to these traditional fora. The E.U. already has the Committee of European Regulators (CESR) for securities markets, said a participant, and counterparts for banking and insurance are being set up. They will learn to cooperate, to agree on guidelines for matters that were previously solved in different ways by each country. The SEC and CESR have met twice already over areas of joint activity. They are involved in joint examinations of firms in both Europe and the U.S., noted a participant.

The U.S.-E.U. Financial Markets Regulatory Dialogue is a relatively new forum for policy makers on both sides of the Atlantic to work out differences in a flexible process. The Dialogue, said a participant, pulls officials on both sides of the Atlantic together to resolve extra-territorial effects caused by law or regulation. Technical teams from both sides started to meet in April 2002. The U.S. team is from Treasury, the Fed, and the SEC. The U.S. team's concerns include potentially thorny issues in the 42 measures of the E.U.'s Financial Services Action Plan. Both sides used this forum, according to participants, to resolve issues that arise over, for example, the implementation of the Financial Conglomerates Directive. The Dialogue allowed the E.U., said a participant, to articulate successfully its major concerns about Sarbanes-Oxley, such as questions about auditor registration with PCAOB. Participants described it as an excellent forum for government officials. Participants from the E.U. observed that the Financial Market Regulatory Dialogue is developing close regulatory cooperation.

Many other dialogues are underway now, according to a participant. These include the Trans-Atlantic legislative dialogue, the Trans-Atlantic business dialogue, the PCAOB-European Commission dialogue, and the formation of IFAC to deal with International Standards of Auditing. All these improve cooperation and convergence.

Participants divided over whether these apparently abundant fora were adequate. One group was positive, noting that senior and middle level government officials on both sides of the Atlantic knew their counterparts and either had ways to talk or the fora were being set up now. Others were more skeptical.

We need better processes, said a number of participants. On the official side, initial efforts to improve should take a narrow problem-oriented focus while recognizing that the long term goal is fuller integration of the rules. In the meantime, regulators should accept different rules rather than assume automatically that differences distort competition. Regulators should be willing, said a participant, to pool regulatory sovereignty. This is already done for crisis management. It needs to extend to prevention. Regulators should look for existing, or create new, bi-lateral or multilateral solutions to problems.

The U.S. team may need to become more inclusive, said others. It does not represent the full range of financial regulators. Now, the leading U.S. government participants are the Treasury, Fed, and SEC. The CFTC and state insurance regulators should be represented, suggested participants. At a more fundamental level, a participant asked if the U.S. regulatory system is now so fragmented that it poses a problem for dialogue. His question implied that the U.S. itself would benefit from consolidating its financial supervisors. But another participant responded that no strong political support exists for combining the many financial regulators into an Über-Regulator. U.S. culture supports the fragmentation.

On the private side are many examples of private sector consensus building, said participants, such as The Bond Market Association and ISDA. This fact did not lead participants to conclude that private initiatives were now adequate, however. Market players can do much, said a participant, when trade associations and firms take the lead. Informal mechanisms, such as this Symposium are needed, not more formal ones.

A major initiative should be to increase substantially market awareness of, and involvement in, the process. We need, said a participant, to involve the private sector directly in the U.S.-E.U. financial dialogue. Others worried that such inclusion would be difficult and could impede the process. Instead, both sides should widely consult with the private sector.

Market awareness of the official players varies, according to some participants. The Basel Committee is widely known as the author of the biggest single effort to coordinate regulation across boundaries. Virtually no one in financial firms knows about IOSCO or CESR, or the new dialogue process. Market participants need to be informed about the many players on both sides of the Atlantic. They need to know whom to call. The process should be more visible.

The dialogue process in the future:

Should there be a core group of countries that manages the relationship? Two options are a "G1" run by the U.S. alone or a "G2" in which the U.S. and E.U. have a more formal and clearly dominant role.

Toward a "Group of 1"? To the extent the U.S. appeared to want to take the lead unilaterally in finance, participants were critical. The U.S. is already very effective imposing its views or needs on the rest of the world, said one participant, much more so than European countries. For example, the U.S. has a crisis, tells the rest of the world to change their systems of corporate governance to conform with the U.S. approach, and the others change. Sarbanes-Oxley started in this mode, according to many, but the general view was that with the passage of time U.S. regulators have become less assertive. The tone among participants was not hostile to the U.S. Although some participants criticized the extraterritorial application of U.S. rules and enforcement, others recognized that the U.S. government could not simply let financial firms whose activities impacted the U.S. escape regulation in the Bermudas of the world.

Toward a "Group of 2"? A possible entente of E.U. and U.S. policy makers drew comment from participants. While they saw the dialogue as very important, no one advocated that this G2 should make all important decisions. A powerful G2 is ill advised, they said. The world is not ready for this yet. While the rest of the world might accept a G2's decisions about technical issues in finance, provided these were not serving a political purpose, it would be dangerous to institutionalize this relationship further. Others, including emerging markets, should be included.

Instead, the nature of each problem should determine whether to activate this G2 level, according to some participants. A foreign exchange matter puts U.S. financial regulators in touch with the European Central Bank. A matter of supervision draws in the national supervisors in relevant European countries, and may also involve the E.U. The appropriate level varies issue by issue, in this view. Some participants noted that it would be good for a G2 group to help harmonize rules, because the cost of multiple rules is high. What topics are important now? They are, in one view, periodic reporting, continuing disclosure, and enforcement. But regulators should look to industry to identify priorities, said a participant.

The tendency now to focus on immediate short-term issues, such as access of trading screens, while ignoring serious problems like market distortions from bailouts, needs to change,

according to some participants. And market players need to do a better job educating regulators and coordinating their own information and analysis.

Asked whether the process would benefit from involving the World Trade Organization, participants answered with a resounding “No.” Keep financial services apart from the WTO debates, and from the international financial architecture debates, both of which are politicized, said several participants. Keep the resolution of disputes about financial services out of the WTO framework, said another.

SYMPOSIUM ON BUILDING THE
FINANCIAL SYSTEM OF THE 21ST CENTURY

AN AGENDA FOR EUROPE & THE UNITED STATES
ARMONK, NEW YORK • NOVEMBER 14-16, 2003

LEAD SPONSORS

CITIGROUP INC.

SWISS REINSURANCE COMPANY

SPONSORS

AMERICAN INTERNATIONAL GROUP, INC.

THE BOND MARKET ASSOCIATION

DEUTSCHE BANK AG

GOLDMAN SACHS INTERNATIONAL

MERCER OLIVER WYMAN

SWISS NATIONAL BANK

TELECOM ITALIA S.P.A.

TIAA-CREF