

Regulating Capital Markets

Newspaper article by Commissioner McCreevy (05.03.2007)

Are the lights being switched off on Wall Street and lighting up in Frankfurt, Paris and London? Is the water draining out of the East River and straight into the River Thames?

You might think so judging by recent speeches, reports and articles on America's and in particular New York's competitiveness from Treasury Secretary Paulson, Mayor Bloomberg, Senator Schumer and others.

I don't disagree with them that change is underway. EU capital market revenues are growing by an impressive 20% a year, with 7% in the U.S.¹. The U.S. share in global IPOs has fallen from 57% in 2001 to 16% in 2006, while Europe's has gone up from 33% to 63%².

Many seem to see the regulatory burden of the Sarbanes-Oxley Act, such as section 404, as a significant reason for reduced U.S. capital market competitiveness. Some in London have gone so far as to meanly suggest erecting statues for Sarbanes and Oxley. This is silly talk.

For one thing, anything that hurts U.S. capital markets also hurts European companies and our economy. Economic integration runs deep, particularly in financial markets. Companies active across the Atlantic are affected by both our rules. Competitiveness is a two-way street.

We have improved the competitiveness in our financial markets in Europe by integrating, changing our financial regulatory structures, adopting best practice with open policy making, and avoiding intervening except where we have to.

As European Commissioner in this area, my approach is simple: we should not and cannot prescribe rules for every conceivable situation. I was trained as an accountant. There is a difference between accountancy and rocket science. The latter is science. The former is not. And shouldn't be. Regulation must allow and encourage new ideas and innovation. As an accountant by profession one might expect I emphasize with the urge to control every detail, but I think that box ticking alone doesn't work. Responsible judgement and disclosure does.

This is why I strongly favour a principles-based approach. Eliminating all risk is an illusion and will lead to unwanted consequences: less innovation and growth; a false sense of security and reduced pressure to behave responsibly. That is why I reject the siren calls for tougher regulation of hedge funds in Europe and why I strongly agree with the recent report of the President's Working Group on

¹ Bloomberg/Schumer report page 41

² Bloomberg/Schumer report page 44

this issue. We must not endanger the benefits hedge funds and private equity have brought: increased efficiency and liquidity in our capital markets. And keeping company managers on their toes. Are the regulatory hawks not trying to protect weak management from shareholder activism?

What the EU and U.S. both need is top-class regulation, based on best practice, sound investor protection, balanced with giving our markets freedom to act.

But if we want to have competitive and open capital markets in the U.S. and EU, we need to do something else: cooperate with each other. To build on the pillars of U.S., EU and other mature economies, based on equivalent but not identical standards that work for our investors and our markets.

Over the past few years, I have worked with Christopher Cox, Ben Bernanke, John Snow, Hank Paulson, Mark Olson and others to build this new cooperation. For example: Moving towards equivalent and comparable accounting standards so that we can avoid costly IFRS - U.S. GAAP reconciliation. Reducing the regulatory burden of Sarbanes-Oxley by introducing more flexible timelines for the implementation of section 404 for foreign firms. And getting rid of the Hotel California problem on foreign deregistration where - under SEC rules - companies were welcome to enter the U.S. stock market but could (almost) never leave again. The new SEC proposal has the potential to markedly improve this situation. On its Financial Conglomerates Directive and MiFID the EU has accommodated regulatory concerns by the U.S. side.

But we need to do more. And the need to do so is growing every day as transatlantic markets integrate. So we have to shift up a gear and chart a route to reliance on each other's audit oversight bodies; implement the Basel II banking accord in a way that benefits banks and customers on both sides, and move to a risk-based system of reinsurance regulation that benefits homeowners and policyholders alike. I am in Washington and New York this week to promote that.

Transatlantic regulatory cooperation in capital markets should lead from the front. If we can show that it works then others – like Japan, China, India, Russia and others - will join us. This would be a big win-win for the global economy. And guarantee that the boats will keep bobbing in the East River.