Financial regulation in the US and EU: integration or fragmentation?

Workshop, 3 July 2013

The workshop provided an excellent opportunity to discuss EU-US relations in the area of financial services. The panel involved an introductory speech by Nadia Calvino who stressed the need of a deeper cooperation between regulators and supervisors across the world, and especially between the largest financial centers. Another key point highlighted by the Deputy DG was the strong believe that "equivalence" and "substituted compliance" must apply as a matter of principle between responsible international regulators of financial markets. Finally, she concluded recognizing how responsibly and seriously US and EU have been regulating the financial system, but also calling for more cooperation to manage the risks and further integrate financial systems.

Doug Elliott agrees on Nadia Calvino's point that that both US and EU are advancing forward in terms of financial regulatory integration. Significant parts of the finance industry are getting more global, but not all of it. What we need is set of rules that do not create too much inefficiency. As stressed in a recent report of his, a lot of agreement on how to deal with these problems has been achieved. The Basel III rules came at satisfying speed and, in general, we did set up mechanisms to enhance cooperation. The G20 summit played a significant rule in this direction, just like the Financial Market Regulatory Dialogue did. His view turns rather pessimistic when pointing out the difficulty of disentangling complicated financial matters to policy makers, in particular when it comes to get into details. Even among regulatory agencies within the US this is a major cause of frictions. But this is also why he believes trust being an essential point. For instance, we could think at the introduction of leverage ratio standards and the debate over the option of fixed limit, as opposed to the risk weighted one. Moreover, he deems useful to have a mediation (rather than an arbitrage) mechanism, while taking into account the political costs of making and implementing such decisions.

Corrado Camera had the chance to express his perplexity about how the introductions of a new mediating mechanism at this stage could actually add momentum toward stronger transatlantic cooperation.
Alastair Wilson shares his more optimistic view by drawing the attention to the actually very high level of integration between EU and US, along with the remarkable convergence of policies in place from the 90s. Notwithstanding the negative shock after the crisis, we still witness integrated developments in both trade and growth. Moreover, there is a great US-EU overlap in terms of policy objectives. Mostly, discrepancies in view are coming from self-interested incentives over the short run, more than from a long term global view. The assumption today is that fragmentation is a problem, but much communality can be envisaged.

Elliot Posner, who has been lately interested in economic and financial cooperation when sovereign authorities are involved, presents a more "cynical" standpoint. Some developments of EU in terms of internal authority structures are likely to affect the way a stronger EU-US cooperation will be achieved. Likely, finance is going to be more decentralized and still there is lots of capacity for facilitating integration. He then moves onto the point of equivalence requirements, part of Nadia Calvino's keynote, and about which he suggests the EC should provide more clear definitions. Nowadays, we have a bi-polar situation, in the sense that control on firms on one side of the ocean can easily affect trade with firms on the other side. Hence, having "mutual capacities" is not enough to assure an impactful cooperation given this "power to retaliate". Moreover, there are two main problems with equivalence requirements: first, they must be credible to work; second, they risk to be used as protectionist tools. In this sense, a possible solution would be to delegate supervision to an independent third party, hence assuring an outside peer review.

Nadia Calvino makes some additional remarks: first, both EU and US are successfully implementing commitments from the G20 summit; second, the transatlantic cooperation has been very satisfactory so far, but the results have been week because challenges are now greater than expected (for instance, derivatives were not regulated before the crises, but after, it became necessary to create the tool of derivative legislation); third, we need a regulation above the parts to achieve an upgraded level of cooperation; finally, the way equivalence standards are interpreted has its weight, in fact the very EU has been built with the idea of accepting foreign supervision without additional requirements, and it is with this idea that the cooperation with US should be built.

In the following Q&A session a trade-off between transatlantic and global cooperation has been raised. Nadia Calvino clearly welcomes any support to a multinational agenda, while recognizing the EU-US bilateral dialogue to be a first and necessary step in building the basis for a broader kind of cooperation.
Concerning this multinational dimension, Doug Elliott goes back on the issue of equivalence standards, stressing the difficulty of creating a tool that can make everybody better off while keeping wide borders. He then recalls Basel III to be welcomed by US partly for the exclusion of emerging markets from the engineering process. He also stresses the difficulty for US political leaders to accept a foreign control over internal financial matters, bringing as example the way Basel III was much more of a success than Basel II because of the lines along which it was developed and which happened to be shared by US as well.

Finally, a reference to the low level of financial integration with China, notwithstanding the high level of exchanges, came up and added to the argument in favor of a dialogue with more than two players. In fact, even if the belief that EU and US are financially more advanced and integrated than the rest of the world is commonly shared, this is still a backward looking standpoint, given the pace at which financial markets integrate today.

Event notes by Giuseppe Daluiso