Thank you, Mr. Chairman, for the opportunity to speak today on matters relating to the informal U.S.-EU Financial Markets Regulatory Dialogue. I would like to focus my remarks on the Dialogue's role in helping us to monitor European-wide regulatory developments in financial services and understand the effects on U.S. banking organizations operating in the European Union.

Background to the Dialogue
As has been noted, the Dialogue was initiated by the Treasury Department in 2002, at a time of significant regulatory developments in both the European Union and in the United States. At that time, the European Union was continuing its efforts, begun in 1999, to establish a single market in financial services by implementing the "Financial Services Action Plan" (FSAP). The FSAP consists of a number of regulatory and legislative measures designed to achieve, among other things, a single wholesale European market; open and secure retail markets; and state-of-the-art prudential rules and supervision. On our side of the Atlantic, U.S. regulators were continuing to implement provisions of the Gramm-Leach-Bliley Act and Congress was considering reforms that led to the adoption of the Sarbanes-Oxley Act. These developments, which affected European financial services firms with U.S. operations, naturally were of interest to staff of the European Commission.

From the outset, the Dialogue's purpose has been to foster a better mutual understanding of U.S. and EU regulatory approaches and to identify potential substantive conflicts in approach as early in the regulatory process as possible. The Dialogue consists of an informal discussion or explanation of regulatory approaches, developments, and timetables, conducted at an experts level. This format has served us well during the past two years. Although the Federal Reserve has regular contact with staff of the European Commission in other groups on a range of issues, the Dialogue is the only venue dedicated specifically to U.S.-EU regulatory issues.

Federal Reserve's Interest in Monitoring Foreign Regulatory Developments
As the umbrella supervisor of U.S. bank holding companies and financial holding companies, the Federal Reserve has a strong interest in the regulatory environments in which these firms operate outside the United States. We have an established program of working with foreign supervisors at both bilateral and multilateral levels. Through regular contact, we track changes to foreign bank regulatory and supervisory systems and seek to understand how these systems affect the banking institutions we supervise.

This is especially important in the European Union, where U.S. banking organizations have substantial operations. As of September 30, 2003, thirty-four U.S.
banking organizations operated in the European Union with aggregate EU assets of more than $747 billion. As of December 31, 2003, sixty-eight EU banking organizations maintained active banking operations in the United States, with total third-party banking assets in their U.S. offices of $937 billion. As these figures suggest, institutions from the United States and the EU are major participants in each other's markets.

The Dialogue as an Additional Forum for Monitoring EU Regulatory Developments

As the EU seeks increasingly to harmonize financial services rules across its internal market, the regulatory role of the European Commission has grown correspondingly. In this environment, the Dialogue complements the Federal Reserve's ongoing relationships and discussions with EU national regulators.

The Dialogue, moreover, fills a role not presently served by any one of those ongoing relationships and discussions. As the market for financial services becomes increasingly integrated, the interests of banking, securities, and insurance regulators correspondingly are becoming more common and intertwined. The Dialogue provides a forum for discussion of issues in each of these areas. The regulatory discussions benefit from this sharing of different substantive perspectives. For this reason, too, the Dialogue is an efficient forum for information exchange, which has great utility for supervisors of large complex financial services organizations.

Global companies operate across many countries and must adapt their business and strategy to local regulatory and supervisory requirements. It is now generally accepted in the U.S. and internationally that a foreign firm that conducts business in a local market should receive national treatment, that is, the foreign firm should be treated no less favorably than a domestic firm operating in like circumstances. The United States adopted a specific policy of national treatment for foreign banks operating in this country with the enactment of the International Banking Act of 1978.

As we have previously testified, implementing a policy of national treatment can be challenging. Although large financial services companies operate in a globalized world, each is based in a specific country whose economic regulation or supervisory approach will differ from those in other countries. The challenge of providing national treatment arises as we seek to adapt our own regulatory system to a foreign banking organization that operates under a different legal and regulatory structure. We believe the Federal Reserve has successfully met the challenge in its treatment of foreign banking organizations operating in this country. Part of that success can be attributed to our work with foreign regulators and supervisors in seeking to understand the operating environment of the foreign banks we regulate. The Dialogue contributes to that knowledge.

We are equally concerned that U.S. banking organizations receive national treatment in their foreign operations. The Dialogue provides us the best opportunity to understand EU directives that affect those operations and provides us with the ability to raise concerns directly with the staff that has responsibility for the preparation and presentation of such directives.

The Dialogue provides a useful forum for information exchange between U.S.
regulators and the European Union over Europe-wide matters that have the potential to affect the application of national treatment in particular situations. In implementing the FSAP in the European Union, the European Union has an obligation to ensure that the rules adopted are consistent with the principle of national treatment. It is our expectation that the European Commission and the member states will continue to seek to do so.

**Select Issues Discussed During the Dialogue**

The Dialogue has touched on a variety of issues in the past two years. Of particular interest to the Federal Reserve and to U.S. banking organizations operating in the EU is the issue of the application of the EU's Financial Conglomerates Directive to U.S. financial firms. This Directive, and others that have been amended in connection with its adoption, establishes various supervisory requirements for EU firms. Among other matters, it requires that the consolidated group be subject to supervision and minimum capital standards by a member state authority. For firms that are headquartered outside the EU, such as U.S. banking organizations, the directives require that the foreign financial firm operating in EU markets must be subject to supervision at the holding company level by a competent home country authority, which supervision is equivalent to that provided for by the provisions of the Directive.

The EU's national supervisors will be responsible for making equivalency determinations on a group-by-group basis, in accordance with guidance issued by the European Commission. In the absence of an equivalence determination, U.S. financial firms with EU operations could be subject to higher capital and risk control requirements or be required to create an EU sub-holding company.

The European Commission is preparing guidance on what might constitute equivalent supervision by third countries. In preparing this guidance, committees working under the auspices of the Commission convened a technical group comprised of member state supervisors to provide input on issues to be taken into account in verifying equivalence. The group sent questionnaires to home country supervisors of financial organizations having operations in the EU, inquiring about the measures those supervisors take to ensure that the entities they supervise are subject to consolidated supervision at the top-tier level. The Federal Reserve and the Office of the Comptroller of the Currency prepared a joint response on supervision of U.S. banking organizations with EU operations. We understand that the EC's guidance is expected to be issued in the summer.

Member state lead regulators are expected to rely on the European Commission's guidance in verifying equivalent supervision with respect to individual institutions. We anticipate that the European Commission will keep us informed of member states' progress in this regard during the Dialogue and also will alert us to the existence of and procedures for addressing any disparities in member states' approaches. We fully expect that U.S. banking organizations will be found to meet the supervision standard of the directive.

Another topic of discussion relating to banks has been the status of work on revisions to the Basel Capital Accord (Basel II). The discussions within the Dialogue have not focused on technical issues that have been under consideration within the Basel Committee on Banking Supervision (Basel Committee), but rather have
addressed the scope of application and implementation and timing concerns. Specifically, the Dialogue has served as a useful venue for both the EU representatives and the Federal Reserve participants to gain a better understanding of the implementation procedures that are anticipated to be applicable in each jurisdiction. Staff has been able to ask questions about the EU legislative process, and to explain in detail how the U.S. regulatory process functions. Understanding the requirements and limitations of each others' legislative and regulatory processes has helped both sides achieve, in my view, a better sense of the implementation challenges we all face and of the commitment to see the process through.

With regard to the scope of application of the proposed new Accord, the Federal Reserve representatives were able to provide information for the EU participants about the reasons the U.S. banking agencies proposed to require only a core set of banks to apply the advanced approaches for both credit risk and operational risk. As you know, one of the primary drivers behind this decision was the U.S. banking agencies' collective view that complex, sophisticated organizations should be using the most advanced risk measurement and management practices available and those techniques and practices are recognized in the Basel II advanced approaches. The U.S. agencies also proposed permitting other institutions to move voluntarily to the advanced approaches subject to the same rigorous risk measurement and management requirements as core banks. Through the Dialogue, the participants were able to discuss the U.S. approach and to compare it with the EU proposal to apply Basel II to all of its banks and investment companies. These different implementation strategies will raise some issues, and that is why the Basel Committee has created the Accord Implementation Group to coordinate implementation across jurisdictions and work through home-host issues.

As noted, issues are not resolved during Dialogue discussions; that is not the purpose of the Dialogue. But open communication that fosters understanding can feed back into the decision-making discussions when they are held in other appropriate forums. With respect to Basel II implementation and the Dialogue, in my view, the current structure will continue to serve a useful purpose— as implementation issues are identified, the Dialogue can be a venue for candid, informal communication. Participants can take back to their constituents the results of those discussions and the subject matter experts can determine how best to address issues that are raised or respond to particular questions or concerns.

The Dialogue has been useful in diffusing tensions over matters that have a direct impact on global firms. This has been especially true with respect to issues under the Sarbanes-Oxley Act, a discussion of which I shall leave to my SEC colleague. The Dialogue has also been helpful on less high profile matters. Through discussions at Dialogue meetings, we were able to keep EC staff apprised of developments relating to asset pledge requirements applicable to foreign banking organizations having U.S. offices.

For more than forty years, federal and state bank licensing authorities have imposed an asset pledge or capital equivalency deposit requirement on U.S. branches and agencies of international banks, primarily for safety and soundness reasons. This requirement obligated such institutions to hold certain negotiable securities at American custodian banks. In recent years, foreign banks were of the view that such requirements were more onerous than necessary and sought a reduction in the level
of assets to be pledged. The matter was brought to the attention of European Commission staff who raised it at the Dialogue. We were able to inform Commission staff of progress being made on this front by state authorities in New York and elsewhere over a two-year period. New York changed its asset pledge requirement in 2003, generally satisfying the concerns of foreign banks. The Dialogue was a useful forum to keep Commission staff apprised of developments during this period.

**International Accounting**
The FSAP also contemplates mandating adherence to international accounting standards. Currently, banking organizations in the European Union may prepare their annual financial statements in accordance with the accounting standards of the International Accounting Standards Board (IASB), U.S. generally accepted accounting principles (U.S. GAAP), and/or national standards. The use of U.S. GAAP is usually limited to those banking organizations or other companies whose securities are publicly traded on U.S. stock exchanges and are registered with the Securities and Exchange Commission. In many cases, these companies will also provide separate financial statements based on their national accounting standards and disclosure rules. The European Union will require all EU companies listed on EU exchanges that are currently following national standards to follow IASB standards by 2005 and will require those EU companies that currently follow U.S. GAAP to adopt IASB standards by 2007. The EU is also working to adopt international auditing standards for external audits of EU companies, including banks.

The IASB is now independent of the international accounting profession and independently funded. It has adopted many of the structural elements of the FASB in the United States, which are intended to promote an independent, objective standards-setting environment. Many senior American accounting experts serve on the IASB and its staff. IASB GAAP has many similarities with U.S. GAAP and the IASB issued extensive enhancements to its standards last year and this year, with additional improvements also issued as a proposal this year. For example, in recent months the IASB issued major revisions to its standards for financial instruments, which are similar to U.S. GAAP and cover many areas of banking activities. One aspect of these revisions by the IASB significantly improved the guidance on loan loss allowances in ways that could lead to better bank reserving practices around the world.

The Federal Reserve has long supported sound accounting policies and meaningful public disclosure by banking and financial organizations with the objective of improving market discipline and fostering stable financial markets. The concept of market discipline is assuming greater importance among international banking supervisors as well. Basel II seeks to strengthen the market's ability to aid bank supervisors in evaluating banking organizations' risks and assessing capital adequacy. It consists of three pillars, or tools: a minimum risk-based capital requirement (pillar I), risk-based supervision (pillar II), and disclosure of risks and capital adequacy to enhance market discipline (pillar III). This approach to capital regulation, with its market-discipline component, signals that sound accounting and disclosure will continue to be important aspects of our supervisory approach.

The Federal Reserve and the other U.S. banking agencies are also actively involved in the efforts of the Basel Committee to promote sound international accounting, auditing, and disclosure standards and practices for global banking organizations and
other companies. For example, an official of the Federal Reserve Board is a member of the Standards Advisory Council that advises the IASB and its trustees on IASB projects, proposals and standards. The U.S. banking agencies have been active in supporting the Basel Committee in its work with the IASB's technical advisory groups to enhance the IASB's standards for financial instruments and bank disclosures. The Federal Reserve Board has also been active in supporting the Basel Committee's projects with the International Federation of Accountants (IFAC) and other international regulatory organizations, such as International Organization of Securities Commissions (IOSCO), to promote substantial enhancements to global standards and practices for audits of banks and other companies.

Although the Federal Reserve Board has been actively involved in addressing international accounting and auditing issues primarily through our involvement in the Basel Committee's projects, the Securities and Exchange Commission has had the primary role in discussing these matters with the EU representatives as part of the Dialogue.

Cooperation on Anti-Money Laundering and Counter-Terrorist Financing Issues

While not historically part of the U.S.-EU Dialogue, recent anti-money laundering and counter-terrorist financing regulatory initiatives on both sides of the Atlantic have had a significant impact on banking organizations, many of which operate globally. Because of the potential consequences of differences in regulatory approaches in this area, governments have been in frequent contact. In the end, the anti-money laundering provisions set forth in the USA PATRIOT Act and those contained in the EU Anti-Money Laundering Directive are generally in harmony.

Part of this can be attributed to the Federal Reserve's and other U.S. and EU regulatory authorities' mutual involvement in multilateral policy efforts to improve regulatory systems so to prevent these crimes, such as the Financial Action Task Force and the Basel Committee's cross-border banking group. On a practical level, supervisory dialogue and cooperation on anti-money laundering and counter-terrorist financing also has been necessary due to the role the Federal Reserve frequently shares with its EU counterparts as "home/host" supervisors of global banking organizations. However, this cooperation is typically focused on providing assistance in order to fulfill supervisory mandates, not to conduct money laundering or terrorist financing investigations, the authority for which typically falls with law enforcement authorities.

While Bank Secrecy Act requirements, including the provisions added by the USA PATRIOT Act, generally do not extend to foreign operations of U.S. banking organizations, the Federal Reserve is interested in understanding the global operations of the banking organizations under Federal Reserve supervision as a matter of safety and soundness. In this regard, the Federal Reserve relies upon communication with supervisors from foreign jurisdictions, including EU member states, in which banking organizations subject to Federal Reserve supervision have material operations.

Critical information obtained in the course of an examination, which may impact a banking organization's operations in the foreign jurisdiction, is typically exchanged among relevant supervisors. For example, when a Federal Reserve Bank conducts an
on-site examination of a foreign banking organization in the United States, and significant problems are identified with regard to its anti-money laundering program, the Federal Reserve contacts the home country supervisor to discuss the findings and to develop corrective action plans.

Moreover, the Federal Reserve may provide information to European Union member bank supervisors when administrative penalties have been imposed or any other formal enforcement action has been taken against a U.S. banking organization (whether or not it is related to anti-money laundering requirements) if the Federal Reserve believes such information will be important to the host country supervisor. The Federal Reserve expects the same from its counterparts.

**Future of the Dialogue**
As is evident from the tenor of my remarks, the Federal Reserve has found the Dialogue to be a useful vehicle for monitoring the rapid regulatory developments in the European Union and exchanging information. We are committed to continuing discussions with the Commission on matters of mutual interest, both bilaterally and as part of the financial markets regulatory discussions led by the Treasury Department. The regulatory landscape in the European Union is certain to continue to develop rapidly in the coming years, particularly with expansion of the European Union, member states' implementation of the numerous FSAP measures needed to create a single market for financial services, and the growing integration of our capital markets.

We at the Federal Reserve have an obligation to keep apprised of these developments on a timely basis in order to fulfill our supervisory function and to ensure a level playing field for U.S. banking organizations operating in the European Union. We are confident that continuing the Dialogue in its present form would facilitate these objectives.

We are equally confident that other existing multilateral and bilateral exchange mechanisms are appropriate venues for discussing policies and attempting to resolve disputes. In our view, formalizing the Dialogue--for example, by elevating it to the principals level or expanding its mandate to include policy-setting or dispute resolution functions--would be unnecessary and may impair the Dialogue's utility.

The Federal Reserve believes that U.S. banks are second to none in their ability to compete when they are given the opportunity of operating on a level playing field. Providing strong supervision at home and participating in international regulatory and supervisory groups such as the Dialogue helps assure that our banking organizations will continue to have such opportunities.