TESTIMONY OF

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BEFORE THE
HOUSE COMMITTEE ON FINANCIAL SERVICES
SUBCOMMITTEE ON
DOMESTIC AND INTERNATIONAL MONETARY POLICY,
TRADE AND TECHNOLOGY
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HEARING ON INCREASING EFFICIENCY AND ECONOMIC GROWTH
THROUGH TRADE IN FINANCIAL SERVICES

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Madam Chairwoman and Members of the Subcommittee:

My name is Marc Lackritz, President of the Securities Industry Association (SIA).[1] I appreciate the opportunity to testify about the securities industry's goals and objectives for the Doha Development Round of the World Trade Organization (WTO) negotiations. With the Hong Kong Ministerial set to begin in less than a month, we commend the subcommittee for holding this timely hearing. Indeed, this subcommittee has been a forceful, persuasive advocate for open and fair international markets, and we are

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[1] The Securities Industry Association brings together the shared interests of approximately 600 securities firms to accomplish common goals. SIA's primary mission is to build and maintain public trust and confidence in the securities markets. SIA members (including investment banks, broker-dealers, and mutual fund companies) are active in all U.S. and foreign markets and in all phases of corporate and public finance. According to the Bureau of Labor Statistics, the U.S. securities industry employs nearly 800,000 individuals, and its personnel manage the accounts of nearly 93-million investors directly and indirectly through corporate, thrift, and pension plans. In 2004, the industry generated $236.7 billion in domestic revenue and an estimated $340 billion in global revenues. (More information about SIA is available at: www.sia.com.)

confident that you will continue to work with U.S. negotiators in securing a commercially meaningful package of financial services commitments in the Doha Round.

The Doha Round provides U.S. negotiators with an opportunity to remove obstacles in foreign markets that impede the competitiveness of U.S. firms and hamper U.S. economic growth and job creation. Importantly, trade liberalization will result in real benefits in developing countries, by enhancing and strengthening capital market efficiency, increasing financial sector stability, bolstering economic growth, and raising the standard of living. By liberalizing trade in financial services, WTO members will help suppliers of goods and services capitalize fully on the new market-opening opportunities created by a Doha Round agreement.

My testimony will address the following key points: 1) the importance of financial services – and open global markets – to the U.S. economy; 2) the benefits of liberalizing financial markets for developing countries; and 3) the securities industry's objectives for the Doha Round.

The Financial Services Sector: A Catalyst for U.S. Economic Growth

The U.S. financial services sector is a key component of the U.S. economy. Financial services firms touch all aspects of the economy, from raising capital for new businesses, to extending credit for corporate acquisitions, to managing finances for retail customers, to providing risk-management products and services to U.S. multinationals. In playing this unique and critical role in the U.S. economy, the financial services sector has contributed tremendously to the country's strong rates of economic growth and job creation over the last decade. A strong, vibrant, financial services industry is essential to continued job growth and expansion in the U.S. economy.

The U.S. securities industry has fueled the nation's – and the world's – economic engines. The securities industry is on track to raise a record $3.8 trillion in new capital for our growing economy in 2005 – for new plants, new technologies, new schools, and new jobs. That is the fifth consecutive year the industry has raised more than $3 trillion in a $12 trillion economy. In the last six years securities firms raised nearly $16 trillion for U.S. businesses, an amount that already surpasses the $12.4 trillion total raised in the previous 30 years. Impressively, the U.S. securities industry's contribution to total output of the U.S. economy increased by nearly four times from 1989-2004–double the rate of increase of the overall economy.[2]

More broadly, the U.S. financial services industry[3] contributed $972 billion to U.S. Gross Domestic Product (GDP) in 2004, about 8.3 percent of total GDP.[4] More than 6.1 million employees support the products and services these firms offer.[5]

Financial services firms are also exporters. In 2004, exports totaled a record $27.4 billion, and generated a trade surplus of about $16.2 billion. Foreign individuals, institutions and governments eagerly seek the multitude of innovative, unrivaled

[2] U.S. Department of Commerce.
[3] Includes securities firms and related activities, banks, and insurance companies.

[4] http://www.bea.doc.gov/bea/pn/GDPbyInd_VA_NAICS.xls

[5] http://www.bls.gov/news.release/pdf/empsit.pdf

services and products U.S. financial services firms offer. The continued vitality of the financial services sector is directly linked to its ability to sell its products in foreign markets.

U.S. financial services firms have increased their presence in foreign markets because both the U.S. economy and securities markets – while still the largest in absolute terms – have seen their share of the global pie shrink. A number of market share indicators illustrate this trend. According to the International Monetary Fund, approximately 70 percent of the world's GDP, for example, and more than half of the world's equity and debt markets are located outside the United States. Similarly, more than half of the $15.3 trillion in global pension assets are outside of the United States.[6]

In addition, many of the best growth opportunities are in non-U.S. markets. By some projections, markets such as China, Brazil, and India will be among the largest in the world by 2050. U.S. investors and corporations have already tapped these new markets, and U.S. securities firms will need to have open and fair access as well to serve the international focus of their clients.

Benefits of Liberalizing Financial Markets

Liberalization of trade in financial services in general – and in capital markets-related services in particular – is central to achieving the Development Round's goals of

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[6] International Financial Services, London, Fund Management – City Business Series (p.5) http://www.ifsl.org.uk/uploads/CBS_Fund_Management_2005.pdf

economic growth. The development and expansion of the financial sector indisputably advances economic growth in both developed and developing countries. In turn, the more open a financial sector is to competition – whether from inside or outside the country – the greater the benefits are to that economy. For example, in 2001, the World Bank estimated that by 2015 the developing world would gain more than $300 billion in annual output, or an additional two percent of GDP, from financial sector liberalization.

As capital markets "deepen" – that is, as additional, and more varied, securities are issued and more participants trade – they further strengthen the financial systems of developing countries. The World Bank has found that more liquid local bond markets enhance the effectiveness of domestic monetary policy, reduce economies' exposure to foreign currency-denominated debt, and contribute to the overall soundness of domestic financial systems.

In addition, leading regulatory authorities in both the developed and developing worlds concur that an important lesson from recent financial crises is that a wider range of nonbank financial institutions, including viable debt and equity markets, can minimize the danger of overburdening the banking system. Overall, liberalization yields benefits at all levels of an economy: existing financial institutions are able to diversify their investment portfolios, thereby enhancing their stability; and local businesses gain greater access to capital and to new and more flexible means of financing from both domestic and non-domestic investors. More investment, in turn, leads to the formation of new local businesses and to the expansion of existing ones – i.e., economic growth, which benefits all citizens by creating jobs, and generating more and better products and services at more competitive prices.

Securities Industry Goals and Objectives for the Doha Round

The GATS and the commitments made in the 1997 financial services negotiation represented an important first step in establishing international rules in financial services. However, this first step will prove to be of fleeting value unless Members move decisively to expand their commitments. Unlike other WTO agreements, the most important market access rules in GATS apply to a Member *only* in those service sectors and "modes" of supply in which the Member agrees to be bound (the so-called "positive list" approach to trade liberalization). In other words, the value of GATS as a market access tool is only as good as the specific commitments that individual Members agree to undertake.

Although the 1997 financial services negotiation increased Members' specific commitments beyond where they were in 1995, it left many sectors and modes of supply with no coverage or only limited coverage under GATS rules. As a result, securities firms continue to face a number of discriminatory barriers that impede their ability to meet the demands of their clients.

To overcome these difficulties, the global securities industry has drafted a "Model Schedule" of GATS commitments for capital markets-related services. The Model Schedule reflects the industry's view of the types of commitments that would enable securities firms to serve the global customers most efficiently while safeguarding important regulatory objectives. The Model Schedule is indeed a global initiative, as it is now co-sponsored by the leading securities associations in Europe, Canada, and Australia, and we are actively consulting with our counterparts in other jurisdictions, including Japan.[7]

In the Doha Round, the industry seeks commitments that reflect the global nature of the modern financial services markets and the way U.S. firms actually provide the capital markets services that their global customers demand. Those services include: 1) *trading* of debt and equity securities and other financial instruments; 2) *underwriting* and placement of securities; 3) *asset management*, including investment advice and financial planning, and 4) *advisory* services on all types and on all aspects of financial transactions, including mergers and acquisitions, corporate restructurings, and privatizations.

In each of these subsectors, the industry seeks commitments in all four “modes of supply,” meaning: 1) cross-border supply, for example, when customers and suppliers conduct business by telephone or e-mail without either leaving their home territory (mode 1); 2) customers traveling abroad to consume services (mode 2); 3) suppliers establishing a subsidiary in the home territory of the consumer (mode 3); and 4) suppliers sending their professionals abroad to provide services in the home territory of the consumer (mode 4).

[7] The organizations include, for example, the International Capital Markets Association, the Investment Dealers Association of Canada, and the International Banks and Securities Association of Australia.

We seek these broad commitments because a single capital markets transaction today often necessitates more than one securities activity that involves all four modes of GATS “supply”. For example, a debt underwriting may require in-person meetings with an issuer’s management, as well as electronic and telephonic exchanges of information. In addition, the issuer may enter into a derivatives contract with the underwriter to hedge its interest rate risk. Commitments in all capital-markets related activities and in all four modes of supply are essential to securing the benefits of capital-markets liberalization and to sensibly integrating consumers into the global financial markets.

Trade Liberalization Is Consistent With Sound Regulation

A Member’s commitments to liberalize trade in capital markets-related services must be undertaken in the context of a fair, effective, and transparent regulatory regime. Sound regulation is essential to healthy, competitive markets because individuals and companies must be confident that markets in which they are seeking to invest or raise funds are well regulated.

Financial services regulations typically include standards that a supplier must meet in order to be authorized or licensed to do business in a market. Such standards – collectively referred to as “authorization requirements” – include the supplier’s knowledge, resources, skills, and risk management procedures. Similarly, regulations known as “conduct of business rules” apply to suppliers doing business in a market and address disclosure of information (including risk warnings) to customers, disclosure of information about the supplier, order execution, and the protection of customer assets. Finally, “market conduct rules” relate to fraud, insider dealing, and market manipulation.

When drafting the Model Schedule, our objective was increase market access while not undermining financial regulation. The Model Schedule, therefore, preserves fully intact two important regulatory exceptions provided for in the GATS: 1) the prudential measures clause, which allows Members to protect investors and ensure the integrity and stability of their financial systems; and 2) the balance of payments clause, which allows Members to impose restrictions on capital transfers to address balance of payments or external financial difficulties.

The following three core objectives underpin the securities industry’s Model Schedule:

1) **Commercial Presence** – securities companies should be permitted to establish or expand a commercial presence and should be accorded national treatment (i.e., the same treatment as domestic suppliers):
   - by acquiring an existing company or establishing a new company, and
   - by choosing its corporate form (e.g., wholly owned subsidiary, branch, or joint venture with local partner);

2) **Cross-Border** – securities companies should be permitted to provide services cross-border to sophisticated investors without the obligation to establish a local presence and without local authorization:

   - which reflects the practice of a number of key financial regulators, and
   - does not exempt securities companies from conduct-of-business rules, such as measures to protect against and punish fraud and market manipulation; and,

3) **Transparency** – financial regulations should be developed, adopted, and enforced in a transparent, non-discriminatory manner.

1. Freely Established Commercial Presence

Establishing and developing relationships are critical elements in providing financial services. Often, it is essential to have a business presence in the host country to effectively deliver services. Despite the progress made during the last Round, many developing nations still deny foreign investors the right to structure their businesses efficiently, or they prevent them from establishing a commercial entity at all. In many cases, establishment is limited to minority joint venture, or is hindered by an "economic-needs test."

A fundamental element of any WTO agreement is the ability to operate competitively through a wholly owned commercial presence or other form of business ownership.

Members should permit foreign suppliers of capital-markets related services to establish a new commercial presence or acquire an existing commercial presence in the Members' territories. Such suppliers should be able to choose their corporate form (e.g., a 100 percent-owned subsidiary, a branch, or a joint venture) and be treated no less favorably than domestic suppliers (i.e., national treatment).

2. Increased Cross-Border Access

In today's capital markets, services are increasingly being supplied electronically, without the consumer or the supplier leaving its home territory. WTO Members, however, have made virtually no commitments with respect to cross-border supply in three of the four sectors of greatest interest to our industry – trading, underwriting, and asset management. The absence of such commitments leaves securities firms unable to supply services cross-border in those markets where it is not permitted by domestic law. Likewise, securities firms cannot supply their services in markets where cross-border supply is currently permitted by domestic law, but not guaranteed by an international commitment.

The Model Schedule calls for Members to make basic commitments to permit cross-border supply without quantitative limits, or so-called "economic needs tests," and to accord such suppliers non-discriminatory treatment. The industry also recommends that Members embody in their GATS commitments one of several types of domestic regulatory regimes that have been developed to promote well-regulated cross-border trade. As described in a report of the International Organization of Securities

Commissions, these regimes exempt foreign suppliers under certain circumstances from local authorization requirements, taking into account one or more of the following factors:

- Whether the investor is sophisticated (as defined in local law), thereby recognizing that the securities laws need not protect sophisticated investors in certain circumstances;

- Whether the foreign supplier is well regulated in its home jurisdiction (i.e., unilateral or mutual recognition of other regulators);

- Whether the foreign supplier solicits customers, or actively markets its services, in the local jurisdiction; and

- Whether the securities transaction is "intermediated by" (i.e., conducted through) a locally authorized supplier.

Even when a domestic regime exempts such suppliers from authorization requirements, the provision of the services typically would remain subject to the conduct of business and market conduct rules.

The securities industry hopes that the United States will work to increase cross-border access commitments. U.S. negotiators should encourage other Members to increase their cross-border commitments so that their consumers can reap the benefit of innovative financial services to which they might otherwise be denied. Similarly, the

United States should itself make commitments that, at the least, bind the United States to current (and not inconsiderable) levels of cross-border access into this country.

3. Transparency

Regulatory transparency is as much a market access issue for securities firms as tariffs are for manufacturers. A non-transparent regulatory system can skew competition in favor of domestic suppliers even where a market is technically open to foreign suppliers.

That is why regulation must be transparent: both suppliers and consumers of capital markets-related services must know what the rules are and have confidence that the rules will be applied consistently and fairly. Although there are different ways to achieve this objective, in general, regulators should: i) propose regulations in draft form and provide interested parties the opportunity to comment on such draft regulations, where practicable; ii) make publicly available the requirements that suppliers must meet in order to supply a service; and iii) enforce laws and regulations according to fair and transparent criteria.

Binding Commitments to Open Markets

Many Members currently provide market access that is consistent with some or all of the previously described recommendations. In most cases, however, this level of access is not reflected in Members' GATS commitments. At a minimum, therefore, both developed and developing Members should upgrade their commitments to reflect the level of market access afforded under their domestic laws. This will provide the legal certainty and predictability that stimulate economic activity.

Conclusion

Madam Chairwoman, the Doha Round negotiations offer Congress and the Administration another opportunity to secure open and fair access to foreign markets for U.S. firms and their clients. The U.S. securities industry is the world leader in international technology, finance, and innovation. If we are to retain our preeminence, however, we must be able to meet the demands of both our U.S. and foreign clients.

SIA would like to take this opportunity to express its appreciation to both the Treasury Department and USTR for their continued efforts as forceful advocates for open and fair global financial markets. Congressional leadership will be a critical factor in making sure that Hong Kong produces a negotiating framework for the Doha Round negotiations that create substantial new market opportunities. SIA is eager to work with your subcommittee and the Administration to ensure that these important trade talks achieve favorable results for the financial services industry.