Chapter 3
A Single Market in Financial Services

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In this volume dedicated to examining overall market integration between the United States and the European Union, I was asked to address the question "A Single Market in Financial Services?" In preparing this chapter, it quickly became clear that there were three ways of understanding this question, each of which was an appropriate topic for discussion. The first was a simple question of fact: "***Is*** there an integrated market in financial services between the U.S. and the EU—or is such a market inevitably and speedily evolving?" The second is a question of norms: "Whether or not there is such a market, ***ought*** there to be a single market in financial services between the U.S. and the EU?" And the third and final question is one of means: "***How*** might such a single market be brought about?" Looked at in this way, of course, the third question does not arise until the first and second have been answered—we needn't consider how to create a single market in financial services unless we conclude that this integration is desirable, but will not evolve in a timely fashion without help.

Progress toward a Single Market in Financial Services

Let me begin, then, with the first question: "Is there already effectively a single market in financial services, or is the rapid development of such a market inevitable?" At first, it might seem that the simple answer to this question of fact is, "Yes." Gross transactions in U.S. equities by investors from the European Union were over $3 trillion last year, up from $144 billion in 1990. Similarly, transactions in EU equities by investors based in the United States were well over $2 trillion, up from $141 billion in 1990. Well over half of all foreign portfolio equity investment both in the U.S. and in the European Union is held in the stocks of companies headquartered in the other's jurisdiction, and the percentages are nearly as high for bond assets. Nearly 30 U.S. banks operate in the European Union with aggregate assets in the EU of over $650 billion; 66 EU-based banks with U.S. assets of

over $1.7 trillion conduct commercial banking operations in the United States. The increasingly ambitious efforts to combine financial exchanges across borders between the U.S. and the EU in the last few years are a demonstration both of the degree of integration that participants in these markets find them to have and of the further integration that these participants proximately expect.[1]

Yet, notwithstanding these facts, there are still significant obstacles to cross-border financial transactions between the United States and the European Union, and those obstacles impose substantial costs—or in some cases create impenetrable barriers—that prevent a truly single market in financial services from evolving between these two jurisdictions. There are different and sometimes conflicting frameworks for licensing financial firms and financial instruments, not only between the United States and the EU, but also (particularly in the United States) between different local jurisdictions on the same side of the Atlantic. There are differing rules governing access to market infrastructure and the conduct of trading activities. There are different practices of prudential regulation and supervision. Last, but certainly not least, there are different tax regimes, which can create substantially different incentives for traders in one jurisdiction versus another, even when their economic position is virtually identical. While the degree of integration that has managed to develop despite these obstacles is significant, it does not amount to a single market, and cannot grow into one without positive and difficult action taken to address these obstacles.

Benefits of a Single Market in Financial Services

Which brings us, then, to the second preliminary question: *should* we make the effort to create a single transatlantic market in financial services? Or is the existing degree of integration sufficient? While it is difficult to quantify the economic benefits that would result from further market integration between the U.S. and the EU, credible estimates by various observers suggest that the gains to be realized are substantial. Creation of a single market between the U.S. and the EU could reduce

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[1] Securities Industry and Financial Markets Association; Treasury International Capital Data; *Transatlantic Financial Market Integration: Ambition Needed*, Deutsche Bank Research, November 2005; "A Look Into the Future," *The Economist*, March 22, 2007; "Looking for Options," *The Economist*, April 15, 2007

transaction costs by 60 percent, increase trading volume (and thus the efficiency of asset re-allocation) by 50 percent, and reduce the cost of equity capital by roughly nine percent.[2] This certainly suggests that the existing market linkages still preserve substantial inefficiencies and are by no means "close enough for government work."

Whatever the precise validity of these efforts to quantify the economic benefits, it is conceptually clear that there would be structural advantages to further integration. Increased competition would reduce cost and improve the quality of financial services, just as it does for any other product or service. In addition, facilitating the trading of assets across a broader jurisdiction would assist diversification and thus risk reduction, increasing the stability of the financial markets generally. Finally, a single market would promote more efficient asset allocation in the real economy, with attendant benefits for economic growth.

Concerns about a Single Market in Financial Services

If the benefits of a single transatlantic market in financial services are both clear and material, however, why has it not yet come about? The chief obstacles appear to be regulatory, but this is not just a question of bureaucratic inertia or shortsightedness, although those certainly play a role. Rather, there are legitimate regulatory concerns arising from transatlantic market linkages that merit careful consideration. These fall into three principal categories:

1. investor protection,
2. systemic risk, and
3. regulatory choice.

Let us look at each of these in turn.

To sum up one of the major investor protection concerns in one phrase, it would be that "The bigger the stream, the harder it is to find

[2] "The US-EU Economic Relationship: What Comes Next?", Testimony of Marc E. Lackritz, President, Securities Industry Association Before the Subcommittee on Domestic and International Monetary Policy, Trade and Technology, June 16, 2005; "The EU-US Financial Markets Dialogue: From Damage Control to Pro-active Integration", European Parliamentary Financial Services Forum, October 2005; Ben Steil, "Building a Transatlantic Securities Market," Council on Foreign Relations, New York 2002.

the fish." Certainly the most blatant types of fraud and deception could be made both easier and more profitable by the larger field of activity that would be covered by a truly single financial services market in the United States and European Union (the same technology that facilitates cross-market integration can facilitate cross-market fraud), and effective enforcement could be made correspondingly harder by the simple geographic scope of the jurisdiction. On top of that, there are fair grounds for concern about differing levels of enforcement standards and resources, particularly with the enlargement of the EU to include not just the markets of London and Frankfurt, but newly acceded countries where capital markets and their regulation are—if not in their absolute infancy—still in early adolescence. There is also the mundane but important problem of information overload: the sheer volume of activity that would affect—and therefore require assessment by—each participant in an integrated market would inevitably require market participants to rely even more heavily on information aggregators and processors, with attendant potential conflicts of interest. This would place an even greater emphasis on reliably effective supervision and regulation of those entities.

With regard to systemic risk, I have noted above that financial stability is enhanced by the improved scope for diversification of an integrated market, but this is not a one-way street. Ours is not a world where all good things are compatible, and while integration can facilitate diversification, it will almost certainly also facilitate further consolidation among financial services firms themselves. While this brings theoretical benefits of efficiency and cost reduction of its own, it is also true that the increased prevalence of extremely large, systemically important financial institutions is one of the characteristics of the system that gives pause to those responsible for promoting financial stability.[3]

Finally, some differences in regulatory approach will inevitably result from differing views on the most effective way to achieve regulatory goals, even where those goals are shared. In the same way that the federal governance structure of the United States as a whole is

[3] "Remarks to the Global Association of Risk Professionals," Randal Quarles, March 1, 2006; "Changes in the Structure of the U.S. Financial System and Implications for Systemic Risk," Remarks before the Conference on Systemic Financial Crises at the Federal Reserve Bank of Chicago by Timothy Geithner, President of the Federal Reserve Bank of New York, October 1, 2004.

often described as creating a beneficial "laboratory of the states" to test differing pragmatic approaches to the attainment of objectives that might be broadly shared among the nation's citizens, differing regulatory approaches of various financial market jurisdictions can result in valuable lessons about which measures are most effective and least burdensome in attaining shared regulatory goals. While there are certainly short-term efficiency costs to regulatory variation, it is at least conceivable that the long-term benefit could offset those costs.

Is the tension between the pros and cons of transatlantic market integration reconcilable? Given that there seems to be substantial and increasing integration already, given the clear benefits of further integration, and given that the principal obstacles to a truly single market are regulatory (and thus addressable by government action), can a cross-border regulatory framework to facilitate this result be formed that still addresses the genuine concerns outlined above?

Regulatory Framework for Further Market Integration: Harmonization vs. Mutual Recognition

Conceptually, there are two basic approaches to creating a regulatory approach that addresses this tension: 1) harmonization, and 2) mutual recognition. Each of these is pretty much what it sounds like. Harmonization aims, through cooperation of governments and regulatory bodies between the U.S. and the EU, to create a set of rules in the two jurisdictions that are in important ways largely identical—similar not merely in objective but in detail. The substance of those harmonized rules would be negotiated to address each side's concerns in the regulatory areas of investor protection, enforcement, and financial stability described above, and also negotiated to leave some scope for each jurisdiction to have a modest choice of means in certain areas deemed compatible with a single market.

Mutual recognition, on the other hand, presupposes that each jurisdiction will maintain separate regulatory regimes that may in some cases materially differ from each other, but that are designed and administered in a way that gives each jurisdiction comfort that the other's rules are adequate to address the investor protection and financial stability objectives that both jurisdictions share. In a mutual recognition regime, the choice of regulatory means—and thus the

benefit of the "laboratory"—is more clearly maintained than in a harmonized regime, but at the cost of a higher degree of discomfort in each jurisdiction about the adequacy of the other's regulation of activities that have substantial cross-jurisdictional effects.

In the modern history of cross-border financial regulation, we have examples of each of these two types of regulatory approach. Traditionally, banking regulators were more open to a "mutual recognition" approach: banks in developed countries have generally been able to open branches in other developed jurisdictions rather than separately incorporated subsidiaries, and while a branch is generally subject to some host country regulation it is not a separate legal entity from the parent bank, and supervision of the branch's safety and soundness is therefore fundamentally dependent on the home country regulatory regime. Securities regulators, on the other hand, have historically been more insistent on harmonization as a condition of cross-border market access—particularly in the United States, where the standard to which harmonization was required to converge was always that of the U.S. itself.

Recently, however, these traditional positions seem to have been reversed. Banking regulators in the developed world have been spending nearly a decade seeking to harmonize an extremely complex and sophisticated system of capital regulation across the bulk of the systemically important financial jurisdictions in the so-called "Basel II" process. Securities regulators, on the other hand, now seem open, at least rhetorically, to a form of mutual recognition (or "substituted compliance", as the preferred phrase now seems to be) in the licensing and supervision of exchanges and broker dealers. This approach has been laid out in detail in an article by Ehtiopis Tafara, who heads the International Office of the SEC's staff, together with his Senior Counsel Robert J. Peterson, in a recent issue of the *Harvard International Law Journal*.[4] The securities regulators are also now open to what amounts to mutual recognition of differing accounting regimes in the U.S. and the EU once a certain point of incomplete convergence has been reached.[5] If we want to consider the relative effectiveness of har-

[4] Ethiopis Tafara and Robert J. Peterson, "A Blueprint for Cross-Border Access to U.S. Investors: A New International Framework." *Harvard International Law Journal*, Vol. 48, No. 1, Winter 2007.

[5] "Chairman Donaldson Meets with EU Internal Market Commissioner McCreevy," SEC press release announcing "roadmap" to elimination of U.S. GAAP reconciliation requirement, April 21, 2005; "U.S. and EU Edge Closer on Accounting Rules", *International Herald Tribune*, April 23, 2005.

monization as against mutual recognition in fostering financial market integration, then, we have at hand recent examples of both approaches to compare against each other. With Basel II representing harmonization on the one hand, and "substituted compliance" representing a form of mutual recognition on the other, these two examples may provide lessons about how the approach each exemplifies might help or hinder increased market integration between the U.S. and the EU.

Basel II: Harmonization without Harmony

The genesis and content of the draft Basel II Accord have been described in great detail by others, and are too well known to require much review here.[6] In brief summary, the principal bank regulatory authorities of the world's major financial jurisdictions—meeting in a regular forum called the Committee on Banking Supervision, known popularly as the Basel Committee because it meets at the headquarters (though not actually under the auspices) of the Bank for International Settlements in Basel, Switzerland—have developed a harmonized framework for the measurement and maintenance of bank capital, generally referred to as "Basel II." This framework is designed to replace the earlier capital accord agreed by the Basel Committee in 1988 ("Basel I"), which required banks to assign specified assets to one of a handful of categories and then weighted the capital to be held against those assets by a fixed percentage that had been agreed to account roughly for that category's perceived risk. While Basel I was straightforward in both concept and application, it did not account for various important risks facing banks (such as market and operational risk), did not cover all off-balance sheet assets, and was subject to gaming because of the relative crudeness of the available categories.[7] Basel II is designed to address these deficiencies by requiring banks to

[6] The most comprehensive discussion of the development of the Basel II Accord will be found in a forthcoming book by Daniel Tarullo tentatively titled *Banking on Basel*, manuscript on file. See also Hal S. Scott, ed., *Capital Adequacy Beyond Basel: Banking, Securities and Insurance*, Oxford University Press, 2005.

[7] To take only the most well known example of gaming, Basel I required substantially more capital to be held against loan commitments of more than one year than for short-term commitments. Within only a few months after adoption of the accord, it had become virtually universal market practice for all loan commitments to have an initial term of one year less one day, which the bank would then routinely extend for an unlimited number of identical periods. Although the economic and practical effect was essentially the same as a longer-term commitment that could be cancelled if certain financial covenants were not met, the regulatory capital held against these exposures in the aggregate was now actually less than had been usual before the Basel I accord.

hold capital against a broader range of risks, and by providing for the measurement of an asset's risk (and thus the appropriate capital charge) through materially more sophisticated methods than the handful of "capital buckets" of Basel I.

Basel II achieved these aims, however, at the cost of a substantially more complicated mechanism than the original Basel I accord. The Basel I capital rules spanned about five pages in the Federal Reserve Regulatory Service. The Basel II framework is several hundred pages long, and has taken roughly a decade to develop and negotiate. In addition to the sheer complexity of the framework, Basel II appears to illustrate a variety of other lessons about regulatory harmonization efforts, particularly those involving increasingly sophisticated financial measures.

First, and perhaps most obviously, much time can be spent on harmonizing rules, but if the implementation of the rules is not uniform, the effect of this effort can be significantly undermined. As an example, there has been much controversy over the decision by the U.S. and EU regulatory authorities to apply the Basel II framework to different groups of banks. The EU authorities decided they would apply Basel II to all banks in their jurisdiction, while the U.S. authorities decided to limit application to the 20 largest U.S. banks. This has caused much angst—particularly in the EU—about competitive inequity between the two jurisdictions because of differences in implementation of elaborately harmonized rules. While I think the angst over this particular difference is overdone on the part of the Europeans (Basel II is intended to apply to "internationally active" banks, which is a very small number of banks in the U.S.—far fewer than the 20 largest to which the U.S. authorities will apply Basel II), it is an example of how the harmonization of standards among many banks actually exacerbates the effect of inconsistent application between jurisdictions, and thus magnifies any competitive inequity that inconsistent application may cause. In that way, a harmonization effort can end up increasing rather than reducing concerns about a level playing field. Moreover, the more complicated the regulatory standard in question, the greater will be the likelihood of inconsistent implementation or application across jurisdictions. There will just be too many interpretive questions that arise in a complicated regulatory scheme for cross-jurisdictional interpretation to be uniform.

Second, the Basel II process shows that political obstacles to harmonization can be substantial. Many members of the U.S. Congress—both Democrat and Republican—have been suspicious of the Basel II process almost from the outset. Some of this concern has been directed at the potential creation of a competitive disadvantage for small banks in the U.S., who will not generally have their capital measured under Basel II. Ironically, while the Europeans have been concerned that the small banks in the U.S. might have some competitive advantage because they were not required to measure capital under Basel II, those small banks themselves fear that they will be at a disadvantage versus banks that can use the more sophisticated capital measures. These banks have used their considerable political clout to generate concern on Capitol Hill over the details of the Basel II accord, raising the threat of direct political intervention in this complex regulatory process. On top of these competitive equity issues are additional concerns about the overall safety and soundness of the banking system, measured by the rough standard of aggregate systemic capital. Some of the preliminary quantitative impact studies of the prospective effect of Basel II suggest that aggregate capital in the system could decline quite substantially once risks in the system are evaluated by Basel II measures, and this has raised concern among some—particularly at the FDIC—that the system as whole could be less resilient to unexpected stress if Basel II were implemented as designed. While some of these concerns would exist even absent a harmonization effort (the competitive equity issue is raised even more starkly in a mutual recognition regime), the necessary degree of technical complexity involved in harmonizing a sophisticated regulatory regime inevitably produced an almost gnostic level of arcane detail that was fully understood by only a small number of apolitical technicians, which magnified the distaste and suspicion of the politicians who dealt with it.[8]

The political issues surrounding harmonization are not merely on the U.S. side, however. The Europeans believed that they could not begin implementing the Basel II Accord without approval from the European Parliament, and once that approval was granted they have consistently maintained that obtaining it was so politically difficult

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[8] On more than one occasion, members and senior staffers of the relevant Congressional committees have spoken with disdain of the Basel II framework as appearing to be what happened when "the Math Club went to Switzerland."

that they could not and would not bring the issue back to Parliament again. This stance has made the necessary flexibility in the final stages of preparing a complex harmonized regulatory framework extremely difficult.

In addition to these risks of politicization, the fragmented structure of the regulatory institutions on each side of the U.S.-EU divide makes reaching a harmonized stance almost impossible—and certainly very time consuming. These institutional complexities are a large part of the reason that the Basel II effort has so far taken roughly a decade. To take only the most recent example, the tension between the FDIC and the Federal Reserve on certain implementation safeguards—most specifically the so-called 10 percent threshold[9]—has resulted in such divergence between the United States and the rest of the world that some large banks have suggested they want the ability to opt out of the relevant provisions of Basel II.[10] But while the differing views of the U.S. regulators have been more public and consequential, the EU institutional framework is similarly fragmented, with the European Commission, various member state regulatory authorities, and certain of the principal finance ministries and central banks all having views, and similar tensions over interpretation and implementation are operating there as well.

Finally, on top of these practical obstacles to harmonization, it is not clear that harmonization is a theoretically desirable goal, even were it obtainable as a practical matter. Regulatory competition—like competition in any area—is a good thing. If there were one single regulator—or one outcome of a single regulatory process involving multiple regulators—it could end up imposing needlessly onerous (but bureaucratically convenient) regulations without practical recourse. If the regulatory framework of a single market allows at least some regulatory choice, however, overreach by any one regulator could be met with migration of regulated entities to another supervisory entity. This is something with which U.S. financial institutions are quite familiar having operated for over a hundred years in a regu-

[9] The FDIC, as a result of concerns that the Basel II framework might allow aggregate capital in the system to decline substantially, has insisted that the U.S. should place a limit on the amount to which bank capital can decline, requiring at the very least a thorough review of the framework if capital would otherwise fall by more than 10 percent.

[10] "Settled Issue on Basel Now a Roadblock," *American Banker*, July 31, 2006.

latory system with a quite complex institutional structure. The issue in the transatlantic context is similar to the one that arises when considering harmonization or consolidation of this domestic structure—the goal must be to limit as much as possible the costs of regulatory fragmentation, while preserving the benefits of regulatory competition.

Substituted Compliance: Mutual Recognition with a Twist

This review of the Basel II harmonization process provides a good context in which to examine the Tafara/Peterson proposal for cross-border access to U.S. investors for non-U.S. exchanges and broker-dealers. As I noted at the outset, this proposal is a departure from the long tradition at the SEC of allowing only very limited flexibility for foreign financial firms in their compliance with U.S. rules as a condition for entering our markets. Under this proposal, non-U.S. exchanges and broker-dealers could obtain exemptions from registration with the SEC if they complied with "substantively comparable" non-U.S. securities regulations and were supervised by a "substantively comparable" non-U.S. securities regulator.[11] The SEC would determine whether the regulations and the supervisor were "substantively comparable" by a review of several factors, including:

1. exchange oversight,
2. broker-dealer oversight,
3. issuer requirements,
4. general legal and enforcement comparability,
5. reciprocity, and
6. the negotiation of a supervisory and enforcement memorandum of understanding with the SEC.

Since regimes and enforcement practices that are comparable at one time might not be in the future, the exemptions thus obtained would be subject to a five-year "comparability review."[12] While only an unof-

[11] Tafara and Peterson, "A Blueprint for Cross-border Access to U.S. Investors," op. cit.
[12] *Ibid.*

ficial proposal at this stage, this approach is similar in concept to mutual recognition regimes that have been instituted by other U.S. financial regulatory agencies.[13]

This approach would have a number of advantages over a harmonization effort, as illustrated by our review of the Basel II process above. Most obviously, it requires substantially less effort from all the regulatory entities involved. It is an enormous amount of work to harmonize differing regulatory regimes, and returns on this investment of resources diminish rapidly—much of the time in any harmonization project tends to get spent in areas with only a modest benefit when looked at from the standpoint of the regulatory regime as a whole. Merely ensuring comparability of principles while allowing for differing practical mechanisms, however, requires far fewer resources and is therefore more likely to get done.

As important as that it get done, however, is the speed with which it is done, and a mutual recognition regime is faster to implement than harmonization. Speed of implementation is particularly important in the area of financial regulation, in order to allow regulators to keep up with the continual rapid innovation in the financial sector without imposing rules that stifle innovation because they are obsolete by the time they can be formulated.

One of the principal benefits of a well-designed mutual recognition approach is that it maintains useful aspects of regulatory competition. By allowing firms supervised by different regulatory institutions to be active across the entire geographic market, it imposes discipline on the ability of those regulatory institutions to impose rules with costs that greatly exceed benefits. Firms might either reorganize so as to be subject to a different regulator or, more likely, market activity will migrate to firms that are regulated more responsibly. At the same time, the requirement of "substantive comparability" and "comparability

[13] Before embarking on the Basel II process, for example, the Federal Reserve implemented a requirement that foreign bank branches seeking access to the U.S. market be subject to "comprehensive consolidated supervision" by their home regulator, allowing access after a determination by the Fed that the home country regulatory regime and the foreign regulator provided this level of supervision, even though the means each regulator chose to achieve this goal might be quite different. The Tafara/Peterson proposal is conceptually very similar to this precedent. In addition, the Commodities Futures Trading Corporation's "Part 30 Rules" may grant an exemption from various U.S. registration requirements when a comparable regulatory system exists in a subject firm's home country.

review" in the Tafara/Peterson proposal seems a satisfactory way of limiting the potential for a race to the bottom and other costs of regulatory fragmentation.

Mutual recognition does, however, have its own set of drawbacks. For example, precisely because it maintains the possibility of regulatory competition, it could be even more vulnerable to politicization. Firms subject to regulation they believe burdensome compared to that applicable to other market participants, but unwilling or unable to take the necessary steps to change regulators, can be expected to seek political intervention. While it is logically conceivable that this intervention could be entirely beneficial, experience tells us that getting legislators involved in the details of complicated financial regulation runs a high risk of shipwreck. A healthy system of mutual recognition (even when limited by "substantive comparability") would require strong commitment from the U.S. financial services industry to prevent these political reactions.

Another potential drawback of the Tafara/Peterson proposal is that —like the Federal Reserve "comprehensive consolidated supervision" regime on which it appears to draw—the SEC would be required to act only as requests for exemption were received. When the Federal Reserve was implementing the CCS regime in the early 1990s, for example, it became a huge bottleneck for several years as it dealt with the initial wave of CCS determination requests, and it was over a decade before firms based in some jurisdictions were able to obtain the necessary imprimatur.

Next Steps?

What can we conclude from these comparisons? I believe that recent experience has shown us that cross-border regulatory frameworks based on mutual recognition are more likely than those based on harmonization to be fruitful in furthering transatlantic financial integration—both for reasons of practicality and for reasons of policy design. They require fewer resources to implement, are more nimble in a fast-changing financial services sector, and preserve the important benefit of regulatory competition. With the publication of the Tafara/Peterson proposal, there are indications that the SEC is willing

to go further along the road of a type of mutual recognition that it has ever been willing to before. This should be encouraged.

In addition, the Basel II experience in particular makes clear that regulatory cooperation of the sort necessary for either harmonization or mutual recognition is hindered by the overly fragmented regulatory structure on both sides of the Atlantic. While regulatory competition is a benefit, excessive regulatory fragmentation imposes costs that can exceed that benefit, and policymakers must continually be looking to ensure that the balance between the two is being struck appropriately in light of changing circumstances. Both the U.S. and the EU made progress in the 1990s in regulatory reform that permitted needed industry consolidation. But the U.S. has lagged the EU in reforms that further reduce fragmentation costs, and the consequences have been thrown into relief in the negotiations between the U.S. and the EU on an entire range of cross-border financial regulatory issues, of which the convolution in implementing Basel II arising from infighting between the various U.S. regulators is merely one example.

An important element in creating a regulatory framework that will promote further transatlantic integration, then, is for the United States to make a serious effort at further domestic regulatory consolidation. An obvious first step would be to rationalize our kaleidoscopic insurance regulatory regime with the creation of an optional federal insurance charter. Europeans have increasingly complained that our state-centered insurance regulatory regime is not just a burden on the industry as a whole, but a particular barrier to foreign firms. An optional federal charter would streamline this system and reduce the regulatory burden, while maintaining the benefit of regulatory competition from the continuing ability of any particular firm to choose a state charter rather than a national one. A second step would be some rationalization of the four federal banking regulators—at least a merger of the bank and thrift charters, and ideally a merger of all bank supervisory functions in one federal regulator. Finally, the jurisdictional lines between the SEC and the CFTC are increasingly arbitrary and counterproductive. Until now, merger of any functions between the two agencies has been impossible because of turf battles between the relevant committees of jurisdiction in the Congress (the SEC answers to the Financial Services and Banking Committees; the CFTC to the Agriculture Committees), but if this becomes one ele-

ment of a comprehensive effort at regulatory consolidation with the vision of a single transatlantic financial services market, there may be more scope for creativity.

Conclusion

A truly integrated transatlantic financial services market is a worthy and achievable goal. Much remains to be done, however—particularly making some fundamental choices about basic approaches to regulatory interaction. In the contest between harmonization and mutual recognition, mutual recognition (along the lines of the Tafara/Peterson "substituted compliance" proposal) seems the better approach, avoiding harmonization's resource drain and mire of detail, and maintaining a healthy scope for regulatory competition and innovation.

There is, however, important groundwork to be laid for either harmonization or mutual recognition, particularly in attitude and structural changes in our own regulators. The proffer of the Tafara/Peterson proposal suggests that the attitude change at least is underway. Structural change in our regulatory institutions will be more difficult and would almost certainly be the work of many years. This change would, however, be among the most concrete and consequential steps we could take to further transatlantic regulatory cooperation in the financial services area—which would in turn inevitably further market integration. In light of the benefits we would expect from that integration, we should begin those changes now.