European Union
Financial Services Committee

The Secretariat

Brussels, 6 December 2004

FSC 4169/04

REPORT

From :	Secretariat
To :	Members of the FSC
Subject :	Inter-Institutional Monitoring Group: - Third Report monitoring the Lamfalussy Process

Please find enclosed the final version of the Third Report monitoring the Lamfalussy Process elaborated by the Inter-Institutional Monitoring Group, an interim version of which was included in the agenda documents of the 28th October's meeting of the FSC.

Annex

Inter-Institutional Monitoring Group

Third Report monitoring the Lamfalussy Process

Brussels, 17 November 2004

Inter-Institutional Monitoring Group

Third Report Monitoring the Lamfalussy Process

Walter Van Gerven (Chairman)
Graham Bishop (Rapporteur for this Report)
Mario Draghi
Dominique Hoenn
Kari Lotsberg
Norbert Walter

Secretariat

Patrice Aguesse, Ian Vollbracht (European Parliament)
Tomas Brannstrom, Jean-Luc Filippini (Council)
Simon Jowers, Jürgen Tiedje (European Commission)

This Report is the third report of the Inter-institutional Monitoring Group. It is addressed to the European Parliament, the Council and the European Commission and is publicly available for comment. The opinions expressed in this report are solely those of the members acting independently and do not necessarily reflect those of their employers or their nominating institution.

The cut-off date for full consideration of new events was mid-October.

Obviously, new developments have taken place and further papers have been published after that date. The Group noted in particular that CESR published its final views on its role at Level 3, following the consultation paper in April, and that this addresses some of the issues raised in this report.

Invitation to the public to comment

The Group is convinced that the practical use and the process of optimising the Lamfalussy process would benefit greatly from the public's comments on this report – as has, indeed, been the case with our previous reports. As the Group's mandate runs only until the end of 2004, the Group, as such, will not itself be able to review comments received. However, we are sure that the Institutions will give any comments their careful attention. The interested public is therefore invited to send written contributions by **31 January 2005** to the same e-mail address as that for the consultation on the Commission's recent staff working paper on the Lamfalussy process:

MARKT-LAMFALUSSY-REVIEW@cec.eu.int

The Inter-Institutional Monitoring Group's Mandate

The three Institutions agreed in July 2002 to set up the present Group. Each Institution nominated two independent experts.

According to the mandate agreed between the Parliament, the Council and the Commission, the Monitoring Group should:

- Assess the progress made on implementing the Lamfalussy process to secure a more effective regulatory system for securities markets; and

- Identify any possible emerging bottlenecks in this process.

This mandate may be revised as part of a full review in 2004 without prejudice as to whether the Group might continue or not after 2004. The Group should report results to the Institutions twice a year and publish them on the Internet.

Source: Press Release at launch of Group, 10 October 2002

Foreword by Chairman and Rapporteur

Our third report is a reflection on the achievements of the Lamfalussy Process during its near three years in existence. This may be a useful tool for the new Parliament and Commission to continue the "learning by doing with goodwill and trust" process that has characterised the developments so far.

In 2000, the Lisbon Strategy included financial services as a key element and the 2001 Report of the Committee of Wise Men made the strong point that "the European Union has no divine right to the benefits of an integrated financial market. It has to capture those benefits by building an integrated European market… If it does not succeed, economic growth, employment and prosperity will be lower, and competitive advantage will be lost to those outside the European Union."

A single financial market should be defined broadly for all users across the EU – savers, users of equity and fixed income funds, retail, wholesale, intermediaries –but the specific challenge of securities was taken up at the 2001 Stockholm Summit: "The regulation of securities markets needs to be sufficiently flexible to be able to respond to market developments, while recognising the need for transparency and legal certainty."

The "Kok Report" has just given an assessment of progress on the Lisbon Strategy and highlighted the need to complete all the transposition of the FSAP measures by 2005 as one of its key recommendations. The political commitment of all the institutions to enact the Level 1 measures has been impressive but the Kok Report also points out that "one of the most persistent obstacles is the failure of too many Member States to act on the commitments they make in the Council within the agreed time limit". Our report also highlights the absolute need for Member States to honour the transposition deadlines - underlining that the deadlines should be realistic – otherwise this may turn out to be a significant bottleneck to the whole Lamfalussy Process.

The entire philosophy of the Lamfalussy Process is to avoid excessive detail at Level 1 as any subsequent changes are difficult and time consuming. Yet the Group has had to report that there are continuing pressures from stakeholders to put much detail into the primary legislation. This tendency may decline as confidence in the flexibility of the process builds up, but all stakeholders should constantly be aware that Level 2 legislation is the place where detail should be. Another permanent concern is the need for coordination and supervisory convergence at Level 3, in which respect the Group fully supports the efforts of CESR and others to achieve consistency in implementation and application of Community rules. In the absence of consistency, the playing field throughout the Union will not be level. One key area remains untested: enforcement at Level 4. It is essential, therefore, to focus from now on full attention, and resources, on how to improve the scope of existing enforcement mechanisms, and possibly to create new ones.

Finally, the Group would like to record its gratitude to our secretariat as they have undertaken a heavy burden of research, organisation and drafting.

Walter Van Gerven (Chairman) **Graham Bishop (Rapporteur)**

16 November 2004

Table of Contents

Executive Summary

1. The Lamfalussy Process is working well overall and has led to swifter preparation of legislation. There is better inter-institutional working and transparency, but some aspects of consultation procedures can still be improved, in particular the range of external stakeholders needs to be broadened. Timely Member State transposition of Directives will be key to maintaining momentum, and further attention will need to be given to setting appropriate implementation deadlines in the future.

2. Some progress has been made in striking the right balance between the speed of the legislative process, delivering high-quality legislation and ensuring adequate adaptability in response to changes in market organisation. In this context, and as the Lamfalussy Process becomes better established, excessive detail at Level 1 should increasingly be avoided so as to allow the necessary flexibility to enable rapid changes in legislation at Level 2.

3. The single reading "fast-track" approach should be used where there is clear ex-ante political agreement between the Commission, Parliament and Council of Ministers. It should be used when the circumstances so require, but should not be seen as the norm.

4. Parallel working between Levels 1 and 2 can usefully increase the time available for consultation and for CESR to draft guidance, but should not pre-empt the position of the Council and European Parliament.

5. The Commission's new practice of requesting "articulated" texts from CESR regarding its advice on Level 2 measures is to be welcomed; however, when there is a serious divide in opinion, this should be reported and the different options presented.

6. CESR's recent initiative to clarify the role of Level 3 is to be welcomed. There should be as clear a distinction as possible between CESR's regulatory co-ordination of Member States' rules and practices at Level 3 and CESR's advisory function concerning the application and future development of Level 2 legislation. The creation of quasi-Level 3 standards before impending Level 1 and Level 2 legislation has been passed is not optimal in the wider Lamfalussy context. Whilst, on a general basis, there appears to be no support for an endorsement mechanism for CESR's decisions at Level 3, the limitations of soft-law techniques from a viewpoint of legal certainty and institutional accountability should be recognised. Furthermore, CESR's proposal for a mediation mechanism should be worked up more fully.

7. There is as yet no experience of Level 4. Proper enforcement of Lamfalussy measures is essential if implementation and application of the legislation in the Member States is not to become a bottleneck. Late adoption of Level 2 measures may also leave the private sector with insufficient time to test technological changes to market-wide infrastructure. Measures taken to facilitate better and more timely transposition (such as transposition workshops) may help reduce the need for more active enforcement. On the Ombudsman proposal, the Group considers that the arguments are not sufficiently compelling for it to serve as a valid alternative to use of the Commission's powers of enforcement, but there is scope to improve enforcement mechanisms.

8. The recent expansion of the competences of the ESC and CESR to encompass UCITS is welcomed. The regulation of UCITS at EU level could be improved by full application of the Lamfalussy approach. However, the Group reserves judgement on the possible application of the Lamfalussy process to company law.

9. The enlargement of the EU to 25 members and 20 official languages is already slowing the flow of documents between Institutions and putting additional pressure on transposition deadlines. Sufficient resources must be made available to deal with these issues in the European Institutions.

Part I: Achievements and developments: 2001-2004

1. Achievements at Level 1

The European Council's deadline of April 2004 for adoption of the four securities Directives was substantively met. Three Level 1 type Directives were adopted within a three-year timescale (May 2001 to May 2004), whilst political agreement was reached on a fourth:

- The Commission published its proposal for a Market Abuse Directive (MAD) on 30 May 2001. A Directive was adopted 20 months later on 28 January 2003;
- The Commission also published an initial proposal for a Prospectus Directive on 30 May 2001. Following the publication of an amended Commission proposal on 9 August 2002, a Directive was adopted 15 months later on 4 November 2003;
- A Directive on Markets in Financial Instruments (MiFID) was proposed by the Commission on 19 November 2002 and adopted 18 months later on 21 April 2004;
- Political agreement was reached on 12 May 2004 on the Transparency Directive, which the Commission proposed 14 months earlier on 26 March 2003. The "fast-track" procedure was applied in this case.

The full details of the legislative timings are set out in Annex 4.

Negotiation of the four framework Directives, from the proposal stage to adoption (or political agreement in the case of the Transparency Directive[1]), averaged just 16.5 months. This average uses the amended Commission proposal as the reference in the case of the Prospectus Directive. Even if the negotiation period for the Prospectus Directive is measured from the time of the initial Commission proposal, the average lengthens only slightly to 20 months.

For Market Abuse and Prospectus, 18 months were allowed for negotiation of the detailed Level 2 measures. 24 months were allowed for MiFID and Transparency. Given that mandates were issued by the Commission to CESR in advance of the date of adoption of each of the Level 1 measures, there was parallel working between Levels 1 and 2. The complete legislative time-span from Commission proposal to the implementation deadline was 41 months for Market Abuse and 35 months for Prospectus, based on the amended Commission proposal.

As a rule of thumb comparison, based on the timespan from Commission proposal to publication in the Official Journal, this compares to 4.5 years for the 1993 Investment Services Directive[2], 2.5 years for the 1989 Insider Dealing Directive[3], 9 years for one of the forerunners of the Prospectus Directive[4], and 3 years for the Interim Reports Directive[5], which predated the Transparency Directive, and around 3.5 years for the 2002 UCITS Directives.

---

1 Adoption of Directives usually follows within a few months of political agreement. This will not however be the case for the Transparency Directive, due to on-going difficulties relating to the translation of official documents following the EU's most recent enlargement.

2 Council Directive 93/22/EEC of 10 May 1993 on investment services in the securities field, proposed on 14 December 1988.

3 Council Directive 89/592/EEC of 13 November 1989 coordinating regulations on insider dealing, proposed on 18 April 1987.

4 Council Directive 89/298/EEC of 17 April 1989 coordinating the requirements for the drawing-up, scrutiny and distribution of the prospectus to be published when transferable securities are offered to the public, proposed on 23 December 1980.

5 Council Directive 82/121/EEC of 15 February 1982 on information to be published on a regular basis by companies the shares of which have been admitted to official stock-exchange listing, original proposal published in the Official Journal on 1 February 1979, with a revised proposal published on 16 August 1980.

Based on the 4 above-mentioned legislative projects, in which the Lamfalussy Procedure has been applied, in one case even in conjunction with the so-called "fast-track" procedure, progress in passing Level 1 legislation relating to securities markets has been swifter than in the past. This is likely to have resulted from a combination of a number of factors:

- Political momentum due to the FSAP deadline set by the European Council;
- The use of earlier and more systematic consultation mechanisms;
- The application of the four-level approach, with the aim of limiting Level 1 to the key framework principles. There are, however, concerns that it has not always been possible to limit Level 1 legislation to framework principles – see Part II section 4(a).

All the four Directives contain – sometimes extensive – delegation for the Commission in order to flesh out Level 1 principles with detailed Level 2 rules, the aim being to adapt legislation to take account of new developments on financial markets. In addition, all the four Directives contain a sunset clause, which means that the delegation of implementing measures to the Commission in the areas specified in the Level 1 text will expire after four years following their entry into force unless renewed prior to the expiry date, at the proposal of the Commission, by the European Parliament and the Council under the co-decision procedure.

The European institutions thus have now completed their legislative processes with respect to Level 1 legislation, but it remains to be seen to what extent the Member States succeed in showing the political will to transpose this legislation into national law on time.

The dates by which the four Lamfalussy Directives will have to be implemented in the Member states are as follows:

- Market Abuse Directive – 12 October 2004;
- Prospectus Directive – 1 July 2005
- Financial Markets and Instruments Directive – 30 April 2006;
- Transparency Directive – 24 months after entry into force, i.e. 20 days following publication in the Official Journal (text currently in translation).

In practice, none of the 25 Member States have notified transposition of the Market Abuse Directive (which entered into force in April 2004) by the implementation deadline of 12 October 2004. This is clearly not the most positive first indication of timely transposition by Member States, which will be a key test of whether the Lamfalussy approach can ultimately deliver legislation that is transposed and applied in a timely manner. The reasons for the transposition delay should be examined further, but it is perhaps also an indication that care needs to be taken in setting appropriate transposition deadlines.

2. Achievements at Level 2

Level 2 measures implementing the Prospectus Directive and the Market Abuse Directive were adopted within the European Council's deadline – by the end of April 2004 (see Annex 4 for full details). Progress was facilitated by close cooperation between the Commission, the European Parliament and the Member States.

Level 2 measures remain to be agreed to complete the Directive on Financial Markets and Instruments Directive (MiFID) and the Transparency Directive during 2005. Two mandates (one provisional and one formal) have been given to CESR by the Commission on MiFID.

Insofar as these implementing measures consist of Directives (Regulations are directly applicable), they also will have to be transposed by the Member States within the period of time foreseen in the Directive concerned. The dates fixed for the Member States to transpose Level 2 Directives are the same as those for transposition of the Level 1 measures (see Annex 4).

An important test of the Lamfalussy process will be its flexibility: the extent to which it is possible to use Level 2 measures to adapt Community legislation rapidly to take account of new developments in financial markets. Another important test will be to judge the extent to which the Lamfalussy approach has increased the speed at which legislation can be agreed and transposed by the Member States (see below).

3. Developments at Level 3

Whilst progress is good in general as regards the adoption of Level 1 and Level 2 legislation, the transposition of Directives by Member States may become a serious bottleneck for the success of the Lamfalussy process.

To assist the Member States in the transposition process, the Commission has held technical meetings with the Member States on the transposition of the Market Abuse and Prospectus Directives, and similar meetings will also shortly be held on the Financial Instruments and Markets Directive. The aim is to reach a common understanding of the Directives' provisions and thus to secure even and consistent implementation across the Member States. The Commission also issues interpretative tools such as in the UCITS area.

It must be emphasised that for the Lamfalussy process to be a success, timely, correct and consistent transposition by the Member States of Level 1 and Level 2 Directives will be crucial. If transposition in all Member States does not occur within the timetable fixed for it, the playing field will not be level: in the Member States that have not complied with their transposition duty, the Directives concerned will only be applicable against Member State public authorities but not between individuals, within the limits of the case law of the ECJ.

This underlines the need for both the Commission and CESR to undertake all efforts to make the Member States comply with their duty not only to transpose Directives on time but also correctly and consistently. The point has been strongly emphasised by the Securities and Asset Management Expert Groups, in their recommendations - see Annex 2 - delivered to the Commission in May 2004 as part of the Commission's stock-take of the state of integration of Europe's financial markets (the so-called "post-FSAP" agenda). The Securities Market Expert Group considered that Member States needed more effective incentives to comply with Community law, such as publicity or pressure through peer reviews. It argued for the provision of an early warning mechanism so that concerns could be raised with the relevant Member States before implementation had been finalised.

The Group reviewed potential Level 3 activities extensively in the second report (Section II.2.2 on pages 31-32). Meanwhile, CESR has been rather active in this regard. Activities include the "Standard No. 2 on Financial Information - Co-ordination of enforcement activities" (Ref 03-317c), the "Recommendation for additional guidance regarding the implementation of International Financial Reporting Standards (IFRS)", (Ref 03-323e) and the setting-up of the score-board. Importantly, with an eye to ensuring global competitiveness, CESR has also taken up formal dialogues with the US Securities and Exchange Commission (SEC) and the US Commodity Futures Trading Commission (CFTC) respectively.

4. Developments at Level 4

Level 4 is still under consideration but the reports of the Securities and Asset Management Expert Groups, delivered to the Commission in May 2004, underline the importance of enforcement for the Lamfalussy Process to succeed. They make recommendations aimed at the smooth and efficient operation of the Process at all levels (see Annex 1). Thus, the Securities Expert Group advocates that mechanisms be established to facilitate complaints from market participants, including the setting up of a European Ombudsman Service. Participants at the High-Level Conference held in June 2004 were broadly supportive of these recommendations.

The Commission has set in train a number of initiatives to underpin effective implementation and enforcement at Level 4. It has held a number of discussions with Member States within the ESC, aimed at:

- The creation of a network of single contact points in Ministries of Finance;
- Early technical meetings with Member States and CESR to facilitate common readings of the Directives
- The setting up of a reporting system on on-going transposition of Directives;
- The publication of concordance tables explaining final transposition in each Member State.

Many market participants and commentators have indicated they are highly concerned that inadequate implementation (Level 3) and enforcement (Level 4) will undermine the effectiveness of the rules established under Levels 1 and 2. Further discussions between the Commission, CESR and Member States within the ESC context have taken place (in September) on the various mediation mechanisms and out-of-court-settlement schemes that are being proposed by regulators or the industry as well as the interaction with similar mechanisms already existing at EU level.

In Part II, section 8, the Group has carefully reviewed the proposal for a private Ombudsman.

Part II: Salient issues after the second report of the Group

1. Meeting the deadlines set by the European Council

a) How did the process work amongst the institutions?

- **The issue**

Working with deadlines was one of the recommendations of the Lamfalussy Committee of Wise Men. The Stockholm European Council in March 2001 indeed suggested 2003 as the target date for the completion of all legislative work stemming from the FSAP and envisaged to be passed using the Lamfalussy Process. As set out in the Group's previous reports, subsequent Summits of Heads of States or Government finally recommended that this should have been completed by April 2004, including negotiations on the Directives on Markets in Financial Instruments and on Transparency.

Obviously, such deadlines do not legally bind the Council of Ministers or the European Parliament; setting deadlines may create time pressure, but this can only be successful if the participants – the ECOFIN Council and the European Parliament – are willing to act accordingly. In fact, the end of the legislative term of the European Parliament turned out to be a major driving force that, together with the effect of the deadlines set by the European Council, created the necessary political momentum to reach agreement on these key Directives in the securities market area.

- **Assessing the issue**

In its interviews with representatives from the European Parliament, Member States and Council Secretariat, and the Commission, the Group has identified a number of factors explaining why it was possible to work with this momentum and deliver on deadlines:

In overall terms, the **co-operation between the three Institutions** – Council, Parliament and Commission – has improved significantly in the last three years. The sustained pace of negotiations brought about by the Lamfalussy Process is testament to this. For example, conscious efforts have been undertaken between the Secretariat of the Economic and Monetary Affairs Committee (ECON) of the European Parliament and DG Internal Market on the Commission side to work closely together and pick up emerging difficulties well in advance. The Group was informed that a positive new experience has been holding monthly meetings between the two services – thereby concretising the "systematic contacts on informal basis" suggested in the original report of the Wise Men.

The role of the Chair and the Rapporteurs of the Economic and Monetary Affairs Committee in this respect has been vital – strongly determined as they were to work within reasonable deadlines agreed with the Council for the adoption of Level 1 measures. The method has built trust between the Institutions.

A strong co-operative climate amongst Member States in the Council resulting in a clear decision-making process has also been reported. The process was further promoted through regular meetings of the European Securities Committee chaired by the Commission. Once the Council had taken a position, this would not subsequently be revised. As pointed out by representatives from Member States, the same was not always the case in the European Parliament where political support may shift right until the decisive vote in the Plenary has taken place. That, to be sure, simply reflects the constitutional fact that the Parliament cannot be bound formally until it has pronounced itself as a whole. Nevertheless, respondents from the Member States also paid great tribute to the particularly constructive role played by the Chair and the Rapporteurs in the Economic and Monetary Affairs Committee

Distinguishing between Level 1 framework principles and Level 2 details – as recommended by the Committee of Wise Men in 2001 – proved to be a successful method to speed up the legislative process. On balance, all stakeholders felt that, without the Lamfalussy Process, the current degree of detail would not have been agreed as quickly through a single legislative enactment between Parliament and the Council.

However, the fact that the ECOFIN Council and the European Parliament would be able to match the deadlines was realistically not certain from the outset. In fact, this success is in sharp contrast to some other past endeavours in the securities field and in other sectors of the Internal Market (e.g. for the Community Patent Directive, still unresolved after being mooted in 1997). Strikingly, the Securities Committee Directive failed in conciliation, and had to be withdrawn by the Commission in 1998, in part for a perceived lack of **safeguards for the European Parliament**, which was unwilling to accept the circumstances under which powers would have been delegated to the Commission. By contrast, under the Lamfalussy process, powers are delegated under a specific set of conditions negotiated with the European Parliament. These conditions include specific safeguards for the Parliament[6] which complete the overall framework brought about by a 1999 tri-institutional agreement on Comitology.

Based on the analysis in Part I it should be expected that, from conception to implementation of Level 1 and Level 2 measures, the complete legislative cycle would exceed **five years**:

- the **preparation** of a Commission proposal, including pre-consultation, follows a variable timeframe, and may even take more than **2 years** in some complex cases (e.g. for the preparation of the would-be Markets in Financial Instruments Directive);
- the **negotiation** of the Level 1 text itself has so far taken an average of **20 months**;
- the **implementation** period is usually set at **18 or 24** months. This is the deadline by which Level 2 implementation measures have to be finalised, adopted through Comitology, and to be applied in the Member States.

The Lamfalussy process is aimed at achieving time savings at the Level 1 negotiation stage **and**, where possible, at the implementation stage by streamlining the preparation of Level 2 implementation measures. It is, however, primarily aimed at securing **further time savings** at a later stage, i.e. when Level 2 measures need to be adapted or updated. However, some Member State representatives expressed caution about deadline setting in that latter context.

This said, the real test of implementing new EU legislation under the Lamfalussy process has only started, - with the Market Abuse Directive implementation deadline set at 12 October 2004, and three more implementation exercises on-going or soon to start on other Directives. It already appears that the most serious **bottlenecks** may arise precisely at the stage of implementation by Member States (see above, Part I Section 3 and below, Part III Section 4).

[6] These safeguards are the following: a Sunset Clause in each Level 1 legislative act; a three-month period for the European Parliament to react to draft implementing measures; full-transparency vis-à-vis the Parliament up to the adoption of Level 2 measures; a market participants' consultative panel established by CESR – see p.15 of the first Report of this Group.

All this should be seen in contrast with the conventional co-decision procedure as it stands. However, under that procedure, swift legislation has also been achieved in the past, suggesting that the Lamfalussy Process by itself is not a necessary condition for a speedy political process. As difficult as it is to compare such different instances[7], the Regulation on payments in Euro or the Financial Collateral Directive – 2002/47/EC – are two cases in point, adopted as they were in a very short time span but outside the Lamfalussy framework. They were adopted swiftly thanks to a rather specific convergence of strategic planning by Presidency, Commission and Rapporteur/ECON/Parliament, which will probably remain exceptional. Similarly, certain matters considered politically urgent have also been dealt with rapidly – for example the Money Laundering Directive in the aftermath of the 9/11 attacks. Indeed, in cases where there is a convergent political will to achieve speedy adoption of an act, the co-decision procedure provides an option to speed up the institutional side of the legislative process even more: the "fast-track" procedure (see Section 3 below).

In conclusion, the Lamfalussy Process could be seen as purporting to **institutionalise** this trust-and-momentum building process and the evidence confirms that it significantly eases decision making and promotes relatively rapid legislative action.

- **The Group's conclusions**

The Group's central conclusion is that the Lamfalussy Process seems to have fostered additional momentum and speed for a series of Level 1 Directives which has, in turn, speeded up agreement on the Level 2 texts from the Commission – despite the expansion of the scope of these laws. This momentum has been built by the setting of deadlines; intensive and early consultation; the Lamfalussy Process itself and the spirit of co-operation that it has engendered between the Institutions. The Group is convinced that, while the institutional structure created by the Lamfalussy process is a necessary condition and instrumental in achieving the objective of speeding up legislation, the key drivers are (a) fostering the mutual understanding, trust and close co-operation between the Institutions and (b) efficiently canvassing outside expertise by means of consultation. It remains to be seen whether the Member States will follow suit through timely transposition of Community Directives into their national laws. If that does not occur, as the non-transposition of the Market Abuse Directive by its deadline would unfortunately suggest, the momentum gained as a result of the Lamfalussy process will be seriously put at risk.

b) Reaction from market participants: speed and quality

- **The issue**

The Group was confronted with increasing criticism from market participants on the speed with which the European Institutions have driven the process in the last three years. In fact, a concern – as expressed by a number of market participants – had progressively emerged amongst them that the speed of the process could well become detrimental to the quality of the legislation to be adopted.

---

7 The single most important determinant of the speed with which a dossier is adopted in Council and Parliament is the degree of political agreement prevalent in the two legislative bodies. In the cases cited here, political agreement existed from the very outset or could be reached easily. In more controversial cases, this may not be the case, with the Take-over directive as the most prominent counter-example.

Although this statement may, in a number of cases, mask the dissatisfaction of a number of institutions as to the matching between the actual legislative action and their own individual expectations and interests, the criticism should not be dismissed *a priori*. Given that, initially, most market participants had stressed the importance of speedy legislation to keep regulation in line with the fast pace of market innovation, the concern over quality voiced now might be seen as an about-turn in the consensus view since the Lamfalussy report was first produced – although it would seem highly questionable that a number of market participants were formerly ready to accept "low quality" legislation as a price to pay for speed. In fact, it would rather seem to illustrate a shift in focus in market participants' concerns, as they come to grips with the practical issues arising from the implementation of Lamfalussy-type Directives, including their impact on the timetable.

- **Assessing the issue**

The Group notes, on the one hand, that its mandate does not cover judging quality of the legislation in substance[8]. On the other hand, given that one of the core objectives of the Lamfalussy process is to speed up the legislative process, the Group has deemed it worthwhile to focus its assessment of the "speed versus quality" issue on **whether quality of legislative outcomes has rightly been a matter of concern** for financial market participants and/or the Institutions.

Views from market participants based on the second report of the Group were clear: meeting the deadlines set by the European Council would not be their primary objective. In their view, **quality of the legislative result should always take precedence** over speed. In contrast, speed would be important if adaptations were necessary **after** the completion of the FSAP in 2005. Whilst, in the past, market participants seemed to put emphasis on speed, to-day, they would seem to argue that quality should always prevail over speed in order to, *inter alia*, allow sufficient time for proper **consultation**. This concern may abate at Level 1 as the main measures are now enacted but already seems to be re-appearing **at Level 2** where the implementation deadlines may become tight (see below).

As a response to that concern, and in order to clarify their commitment to the quality of legislation, Member States Representatives admitted that acting quicker would not typically lead to higher efficiency. Separately, the potential risk of **overregulation** would deserve a more in-depth debate in the future. In general, examples of legislation that, in the eyes of either market participants or national authorities, give rise to such concerns, are unlikely to surface before full implementation. Nevertheless, concerns are already being expressed about certain provisions in the Directives framed according to the Lamfalussy procedure. In the first one, the **Market Abuse** Directive, the delicate implementation of some intricacies has emerged, e.g. those linked to differing definitions of "inside information" in different contexts at Level 1 and Level 2.

A more delicate issue has, seemingly, arisen with the complex **Markets in Financial Instruments** Directive (MiFID), which poses a different set of problems in implementation, and for which **Level 2 measures** are yet to be proposed. Here, market participants expressed concerns of a different scale, since some provisions, e.g. Article 27 (pre-trade transparency), may require significant re-engineering of market-wide IT systems by the implementation deadline in order to allow a seamless continuation of trades. The Group was informed by trade associations that the absolute minimum time required to make these technical changes is around eight months, with some estimates rising up to 20 months. Actually, market participants may only have around six months (see Annexes 4 and 5) from the possible date for finalising regulatory texts to the legal deadline to implement them on 30 April 2006 - provided that extreme pressure is kept on the timetabling. The Group notes that the Commission is currently attempting to solve this problem.

[8] Although there is no easily identifiable and clear-cut benchmark, the Group would note that there are, *inter alia*, several Commission papers on improving the quality of Community law.

Notwithstanding the above, the Group was not informed of any concrete allegations of poor legislation so far. Certainly, subjective dissatisfaction with individual provisions has been expressed by a number of market participants, but that does not necessarily mean that the quality of the whole act should be put in doubt. Nevertheless, the Group would note in a more general context that quality of legislation may be affected by two factors. First, the more consultation and the more lobbying an enactment is subjected to, the more amending of the original text will ensue. That in itself may lead to a loss of internal logic of the original text and a reduction of the intrinsic quality of a piece of legislation. Second, with the implementation, application, and enforcement of recent securities-market legislation, EU and national authorities will be faced with a substantial amount of work which, in the long run, may affect quality if authorities at all levels are not able to devote increased resources to the regulatory process, both in quantitative and in qualitative terms.

- **The Group's conclusions**

Compared to the outset of the Lamfalussy Process in 2001, the Group notes that views of market participants seem to have evolved towards less priority on speed, as issues related to the contents and timing of some Level 2 measures have emerged. It could well be that this change in attitudes could be reversed if more buoyant market conditions stimulated a major round of innovation and/or re-structuring of market infrastructure.

Moreover, as illustrated by the strong and rising concerns expressed, for example, about the aforementioned Level 2 measures for the MiFID the Group anticipates that all actors – the Institutions, market participants and end-users – will need to invest more time and resources to meet the overall objectives of the Lamfalussy process. In this context, when setting transposition deadlines, lawmakers should pay due attention to the constraints market participants face in terms of time and resources. All stakeholders in the Lamfalussy Process should also be aware that excessive lobbying and amending of legal enactments may affect the quality of the legislative product.

In the more exceptional case of the aforementioned Level 2 measures for the MiFID, the Group welcomes the initiative by the Commission to use any possible flexibility under the implementation stage to provide market participants with a sufficient time to prepare. Extension of transposition deadlines should only be seen as a last resort.

2. Fast Track facility for Level 1 legislation

- **The issue**

"The European Council takes a positive view of the possibility within the co-decision procedure of allowing for speedy adoption of acts (fast track procedure*)*" (Resolution at Stockholm Council meeting, 2001). In its last report, the Group echoed this positive view which was also that of the original Committee of Wise Men and recommended making more systematic use of the fast track procedure according to which a legislative measure could be approved by the Council on the basis of a single reading in the European Parliament. Thus far, the procedure was followed - in the course of the FSAP - only for the Transparency Directive.

What is the fast-track procedure?

Under Article 251 of the Treaty, a legislative measure can be approved by the Council on the basis of a single reading in the European Parliament. This means that the Council has to accept every amendment put forward by the European Parliament and make no further amendments of its own (beyond those that it has persuaded the European Parliament's Rapporteur to include). If it rejects any of the EP's amendments, a second reading becomes inevitable. So reaching agreement after a single reading would require that EP and Council also agree in advance technical amendments – which have to be put forward by the EP to accommodate Council wishes expressed informally.

The usual legislative procedure, that is without "fast track", is designed around two readings in Parliament, rather than one. It may be argued therefore that, in general, there is a lack of clearly articulated formal rules to operate the fast-track procedure; in particular, the issue arises of which Institution – Parliament or Council – should take the lead or whether parallel working should take place.

- **Assessing the issue**

The fast track procedure raises false questions as well as true problems. Absence of formal rules, mentioned in the box above, falls within the first category: in practice, experience (e.g. with the Transparency Directive) has shown that this is a matter of upstream negotiations between the two legislative bodies.

The true problems appear to lie more in terms of constraints and consent to necessary cooperation between all players in the game – first and foremost, the **Rapporteur** and the **Representatives from the Council and the Commission**.

Indeed, the success of a fast track procedure depends on the legislative authorities that have to operate it. As a matter of fact, the EP has to draft, and then negotiate, a mass of all possible amendments with the Council in advance of Plenary Sessions. In particular, Rapporteurs risk facing delicate explanations to the other Members of Parliament regarding the need to take over a significant number of technical amendments for which the Council expressed a strong preference, but which the Council on its own could only propose in a common position after a single reading. In addition, it imposes considerable constraints on policy stakeholders when negotiating compromises which might lead to frustrations at the political level.

It is therefore all the more important, on the one hand, that representatives from the Council and the Commission closely cooperate with the parliamentary Rapporteurs from the very outset – as happened successfully during negotiations on the Transparency Directive. On the other hand, according to the evidence received, the fast track procedure carries the risk of not being transparent to the public, in particular on who opted for which solution and for which reasons during the critical negotiating phase. However, this threat need not necessarily materialise – the Group welcomes the fact that it did not manifest itself in the context of the Transparency Directive negotiation.

The Group had the opportunity to interview both representatives from the **Council** and from the **European Parliament** on this topic. **Neither of them, nor representatives of the Commission, seem to be in favour of a more generalised use of the fast-track procedure** now that they have had concrete experience of it in action and despite the fact that, during the last Parliamentary term (1999-2004), **28 %**[9] **of all co-decided legislative proposals** were agreed after a single reading. That should not come as a surprise since extensive use of the procedure, as a matter of principle, would considerably affect the constitutional balance between the Institutions.

The Group also notes there are strong concerns amongst the Members of Parliament that widespread use of fast-track would reduce opportunities to intervene and to explain positions clearly.

[9] Source: EP report on conciliation

As for the Council, representatives from Member States explained there is **no unique pattern** for running a fast track procedure. Sometimes, as in the case of the Transparency Directive, the Council took the lead in its general approach of November 2003 whereas the European Parliament was more in an open and reactive position; sometimes, the EP takes the lead with a Committee vote; and sometimes, fast track is a joint initiative, EP and the Council working really in parallel. Member States representatives also noted that, in overall terms, there might be transparency problems for outside market participants connected to the use of the fast track procedure. However, the Group received no evidence that the market participants felt any disadvantage from the fast-tracking of the Transparency Directive.

- **The Group's conclusions**

The Group recognises that the use of the fast-track procedure has its merits in terms of speed. As experience with the Transparency Directive shows, however, using fast track is only likely to be operated when there is strong political commitment between the institutions to enact legislation, for example because of an external deadline (such as the end of the European Parliament term) and/or widespread agreement on the content of pending legislation. Moreover, strong reasons of institutional balance preclude the fast-track procedure from becoming the general norm.

3. Parallel working between Level 1 and Level 2

- **The issue**

The Group already explained this method in previous reports. It is worthwhile recapping that parallel working was not expressly foreseen, or even recommended, in the report of the Committee of Wise Men in 2001. It developed during the implementation of the Lamfalussy Process and led to a clear response from market participants, in particular, on potential risks to efficiency as well as to pre-empting the views of the European Parliament during a second reading.

- **Assessing the issue**

In its second report, the Group accepted that "parallel working" may be inevitable in some cases. In the responses to the report, some concern was again expressed that the wording of Level 2 mandates might influence decision making at Level 1 (in particular in the case of the Directive on Financial Instrument Markets) but no concrete examples were provided. These concerns would be assuaged by the Commission's adherence to the core recommendation issued by the Group in its second report – that provisional mandates should only be issued when the subject matter is known to be acceptable to the EP.

The Group had the opportunity to gather the views of the Chairmen of the CESR expert groups which prepared CESR's advice on the Level 2 measures for market abuse and prospectuses in the course of 2003. Both Chairmen unequivocally stated that there was no real issue from a practical point of view. They felt that the provisional mandates which the Commission had drawn up had been carefully drafted to avoid any problems with the Council and the European Parliament; in addition, CESR experts were always aware of crucial and unsettled Level 1 issues on which they should not touch.

However, the case on MiFID may not be as clear. Some market participants expressed a forceful view that the Commission should not have even considered including Articles 19 and 21 of MiFID in its first provisional mandate which CESR received in January 2004 and which was confirmed on 25 June. But they welcomed the Commission's decision, after representations, to postpone these to the second mandate. Commission representatives qualified this view by pointing out this was, first of all, a learning-by-doing process. In general, there appeared to be a difficult trade-off to be made between cutting out too much from the provisional mandate on the grounds that it might prejudice the Level 1 negotiations on the one hand, and allowing CESR sufficient time to consult on its Level 2 advice on the other. In any event, they stressed that the Commission had responded swiftly and positively to the points made and changed the mandate.

The inevitability of parallel working arises when Level 1 framework Directives have to be complemented by technical details such that Member States can transpose both within a timeframe that is fixed at Level 1 and cannot subsequently be changed at Level 2. However, the same reasoning is not valid for issues where existing and already implemented legislation needs to be adapted to take account of new developments in financial markets. Modifying existing EU law through Level 2 measures should therefore not require "parallel working" in the future.

- **The Group's conclusions**

The Group considers that parallel working has been a necessary proceeding on occasions in the past and has functioned in practice. Despite some reported unwelcome side-effects, "parallel working" has offered the opportunity of leaving more time to CESR for public consultations. Had it not been applied by the Commission and CESR, there would have been very little time for broad consultation by CESR once the Level 1 measure had been adopted. Moreover, parallel drafting makes it possible for the draftsmen to have a better insight into the practical implications of Level 1 principles. Nonetheless, parallel legislative action should be avoided when it threatens to pre-empt the views of Parliament.

4. Degree of detail in Level 1 and Level 2 legislation

a) Distinction between Level 1 framework principles and technical details left to Level 2

- **The issue**

The Committee of Wise Men recommended that legislative authorities should respect a new approach when devising legislation in the area of securities markets: only framework principles should be adopted at Level 1 under the co-decision procedure whereas technical details should be adopted by the Commission at Level 2. Whilst the issue has already been briefly touched upon in Section 1 above, the focus here is on whether the split between principle and detail is perceived to have worked in practice.

- **Assessing the issue**

Feedback received from most respondents is positive overall. Even if some market participants assert that more thought on the method for distinguishing between Levels 1 and 2 should be given across all Directives, the representatives from the Institutions felt that the pragmatic case by case reasoning which the Institutions applied in the last three years had proven broadly successful. But this generally positive view is not without some caveats.

In discussions with representatives from the three Institutions, it became clear that the risk of excessive Level 1 detail persists, though the Commission did not feel that it was an overwhelming problem. Several factors explain why detailed solutions are preferred at Level 1, whilst these – ideally – should have been left to Level 2 legislation.

In particular, members of the European Parliament are confronted with a great body of technical expertise from lobbyists. As these lobbyists are in constant fear of losing out on technical details at Level 2, - possibly fearing the perceived predominant influence, through CESR, of traditionally more restrictive players, i.e. supervisory authorities, in the preparation of Level 2 measures – it appears difficult to limit the debate at Level 1 to fundamental policy questions. Moreover, the understanding of what constitutes principles may differ considerably among the Members of Parliament, as well as amongst other policy stakeholders and market participants.

Representatives from the Commission confirmed this phenomenon: the identification of a politically and commercially important issue induces all the stakeholders, in particular market participants, to lobby hard for a detailed technical compromise at Level 1. In addition, it is possible that an excessive level of detail at Level 1 may sometimes demonstrate a residual element of mistrust amongst political stakeholders. Thus even if market participants generally propose a system of dropping details from Level 1 to Level 2, it may sometimes prove to be difficult to implement this in practice. In the particular case of MiFID, the Commission representatives argued that more details on the prominent issue of pre-trade transparency for systematic internalisers[10] should have been left to Level 2.

As for the Council, representatives from Member States also confirmed that the weight of a political problem put forward by market participants ultimately leads to detailed compromises at Level 1. Furthermore, such detailed compromises do not preclude further detail being added at Level 2 – thus raising concerns of over-prescriptive regulation (see under b) below) – which means that a simple trade-off between Level 1 and Level 2 is far from easy.

It is fair to point out that positions are not always clear-cut. The market participants represented in the Commission's post-FSAP Securities Expert Group were clear that Level 1 should be restricted to framework principles and that Level 2 should be as lean as possible. However, some of the respondents to the core recommendations in the Group's second report made the point that even high level principles need to be shaped in a precise and unambiguous manner, implying that more detail would be necessary.

- **The Group's conclusions**

Considering the ambitions in terms of speed and flexibility that are expected to be the hallmark of Level 2 in the future - i.e. amending existing Level 2 rules more swiftly than under the co-decision procedure at Level 1 - it may seem paradoxical that market participants cling on to the proven mechanisms of inserting their detailed requirements in the legislative sequence at the first opportunity, that is at Level 1. In so doing, they would appear to hamper future regulatory responses to market needs. The absence of experience so far in Level 2 "second generation" amendments may contribute to this problem – some may also fear that supervisory authorities will have too restrictive an influence on the drafting of Level 2 measures, now or in the future. The Group expects that practical experience of using Level 2 in the future to amend existing legislation *and* of using Level 3 to co-ordinate detailed implementation will foster sufficient confidence that stakeholders would be prepared to accept less detail at Level 1.

Nevertheless, the consensus view that it is useful to restrict Level 1 measures to framework principles does not seem to sit well with the current degree of detail at Level 1. This could jeopardise the Lamfalussy Process. Looking ahead, the proposal for a Directive on clearing and settlement is likely to test market participants' commitment to support restricting Level 1 to principles, as the public policy choices may have profound commercial implications.

---

[10] See Article 27 of the Directive on Markets in Financial Instruments: Directive 2004/39/EC of the European Parliament and of the Council of 21 April 2004. A 'systematic internaliser' means an investment firm which, on an organised, frequent and systematic basis, deals on own account by executing client orders outside a regulated market or an MTF (Article 4.1.7 of the Directive).

b) Too much regulation in general?

- **The issue**

Apart from expressing doubts as to the success of differentiating between Level 1 framework principles and Level 2 details, some market participants believe that the Lamfalussy Process has a further negative spill-over effect, that is, that in total it may result in too much regulatory detail in EU legislation at Level 1, but also, it is argued, through extensive and detailed CESR advice, at Level 2.

- **Assessing the issue**

Member States represented in the European Securities Committee acknowledged in January 2004 that concerns about excessive details in European legislation should be taken into account. The Group also noted in its meeting with Member States representatives their awareness of a potential risk of over-regulation, which will deserve a more in-depth debate in the future.

The Group discussed with CESR representatives the concern that CESR advice might include too many details - leading inevitably to excessively detailed Level 2 legislation. However, these representatives' evaluation seemed to be rather different. As an example, under the Market Abuse Directive, the first consultative papers were much less detailed. But in their responses to this paper, market participants showed a clear preference for more regulatory detail and clarity in order to have more legal certainty, i.e., in that case, to create safeguards against prosecution for insider dealing or market manipulation. The opposite experience occurred in the case of prospectuses where the first consultative papers were criticized as far too detailed and where CESR followed up financial markets' requests so that its final advice amounted to only 34 pages. However, a consultation paper of 88 pages was published in June about consistent implementation so the final recommendations threaten to be voluminous.

There is not a uniformity of views amongst market participants, nor is there amongst associations from different Member States. Some ask for more Community legislation to ensure a playing field that is "level" from their specific point of view, while others prefer more "flexibility," that is, leaving more discretion in the application of rules to the national level.

In that context, due recognition must be given to the change in function of EU legislation. In previous decades, the task was mainly to regulate the proportionately modest amount of cross-border activity in financial markets. The advent of the single market, and especially the single currency, was designed to create a step change in the nature of these markets and is already well along the route to a single European capital market. So EU level legislation must now provide for much of the detail that was formerly found in national legislation and regulation. Moreover, depending on the issue, views as to the need for more detail differ. Thus, as mentioned above, there is likely to be a high demand for legal certainty in areas such as definitions of a "safe harbour" where significant penalties may be exacted for transgressions.

This new climate accounts for more detailed EU legislation. The evolution can be measured crudely by looking at the second generation of Directives. For example, the original 1993 Investment Services Directive of the Single Market programme had 32 Articles and ran to about 15,000 words. According to a CEPS analysis, the ISD II draft of 2002 had expanded to 67 Articles and 26,000 words. But the enacted MiFID grew further – to 73 Articles and 31,000 words. However, the ISD was the complete legislative text whereas MiFID will be fleshed out with major Level 2 measures. Also, Regulations are likely to be more detailed as they take direct effect and cannot be fleshed out by national detail.

CESR's contribution to detailed legislation must be seen in this perspective. Thus, the June 2004 MiFID mandate from the Commission to CESR contains seven pages of request for advice – excluding the preamble comments. It requests CESR to be "detailed and precise in order to allow for a harmonised and uniform definition of the financial instruments that fall under the scope of this Directive", as the Group requested in its second report. Moreover, CESR is charged with "providing comprehensive advice on all subject matters covered by the delegated powers". The document that fulfils this request is unlikely to be short or general as the subsequent consultation document itself ran to 147 pages.

- **The Group's conclusions**

"Over-regulation" and, more specifically, "over-prescription" do not constitute a risk specific to the financial markets sector. Excessive rule-making is characteristic for all sectors and is difficult to remedy in spite of many well-intentioned pleas. However, in the context of the internal market, levelling the playing field is of crucial importance which can only be achieved through a consistent body of uniform or at least harmonised rules. That is particularly the case for financial markets, which are of a global nature. Obviously, that should not prevent public authorities from asking the question, at the occasion of any law-making initiative, whether a particular market activity should be regulated and, if so, with how much detail – e.g. by weighing the case for a self-regulatory or "behavioural" approach versus a more "supervisory" approach based on more active and prescriptive supervisory intervention. There are surely activities where resorting to detailed rules could well appear to be less efficient.

In practice, a case-by-case analysis is likely to remain necessary – whereby the potential risk of over-prescription at Levels 1 and 2, as well as the role of secondary EU legislation in generally supplanting national details, will have to be taken into account.

c) The form of CESR's advice

- **The issue**

The shape which CESR's advice should take is a continuous issue. A first question is whether CESR's concrete proposals should take an articulated form, notwithstanding the Commission's prerogative under the Treaty to draft and present Community legislation. A second question is whether, as advocated by some market participants, CESR's advice should contain more options instead of expressing a preference for a single solution.

- **Assessing the issue**

In their reactions to the second report of the Monitoring Group, market participants felt that CESR advice should be more concrete, more purpose-oriented as regards the subsequent preparation of legal instruments and of future implementation. The Commission's request to CESR on 25 June 2004 for advice on MiFID Level 2 measures seems to take account of this criticism as it requests CESR to provide an "articulated" text. That seems to be a reasonable approach. For CESR to formulate an articulated proposal – which helps the proposal to be more specific - does not affect the Commission's legislative prerogative as it does not prevent the Commission from disagreeing with the proposed formulation.

As for the second question, that is whether CESR's advice may contain more than one option, the Group is of the opinion that, where appropriate (for instance because of a genuine divide in the views of the market), CESR's advice may and should contain a discussion of policy options, provided that, in the end, it presents the Commission with a clear and properly argued preference for one or another option.

- **The Group's conclusions**

The Group welcomes the Commission's new practice of requesting "articulated" texts from CESR regarding its advice on Level 2 measures. As to whether CESR's advice may contain several options, the Group believes that there is no single answer for all occasions. When there is a serious divide in opinion, it should be reported in the advice and the different options should be discussed on their own merits and presented to the political level for further consideration. That should not prevent CESR, quite the contrary, from expressing its own preference for one or the other option.

5. Use of Regulations or Directives at Level 2

- **The issue**

In its second report the Group recommended that "Regulations should be used more systematically". This proposal followed the recommendation of the European Council at Stockholm in 2001.

- **Assessing the issue**

There was not unanimous support for a greater use of Regulations amongst respondents. The Commission is generally in favour of using Regulations at Level 2 which, for being directly applicable, do not need to be transposed into national law and can thus be made operational at the same time as Level 1 Directives, i.e. by the deadline for the entry into force of national transposition measures for these Directives. Moreover, they can be expected to bring about a higher degree of harmonisation than Level 2 Directives – thus achieving greater legal certainty throughout the EU. However, the Commission representatives also appeared sensitive to the argument that a Level 2 measure should rather take the form of a Directive when national discretion is desirable or possible, or when national differences are too huge to be made uniform. As for market participants, the majority favoured case-by-case solutions whereas the Member States (as represented in the ESC) remain divided on the use of Regulations at Level 2.

That said, the Group notes that the use of Regulations at Level 2 has become a more common practice -so far, without any evidence of criticism from market participants or other stakeholders. Indeed, the Commission adopted a Regulation on buy-back and on stabilization programs implementing the Market Abuse Directive in December 2003 – however, in both these cases the choice of a Regulation reflected the market participants' desire for legal certainty. Furthermore, a single Regulation (Commission Regulation (EC) No 809/2004) implementing all necessary aspects of the Prospectus Directive was enacted in April 2004. It remains to be seen whether Regulations will also be used when implementing MiFID or the Transparency Directive. However, the Group notes that the Commission – in its mandate to CESR on 25 June 2004 – made a strong point about using Regulations whenever possible. Furthermore, the Groups has noted (see Part III, Section 4) the looming bottlenecks in the transposition and implementation of Level 1 and Level 2 Directives – which is a forceful argument in favour of Regulations.

- **The Group's conclusions**

The Group attaches much weight to the significant threat which Member States' non-compliance with the obligation to transpose Directives on time may have for the whole Lamfalussy Process. Therefore, as of now, the Group sees no reason to change or qualify the recommendation in its previous report: the need for a level playing field (uniformity) is better served by Level 2 Regulations than by Level 2 Directives, which require timely transposition in the laws of the Member States. So far, the experience with the implementation by Member States of Level 2 Directives on Market Abuse does not negate that statement. That may change over time when experience with the implementation of Lamfalussy Directives builds up – the second Directive in the series, the Prospectus Directive, being due to be fully implemented by Member States in July 2005.

6. Consultation practices at Level 1 and Level 2

- **The issue**

One of the prime objectives of the Lamfalussy Report was to involve more closely all market participants and end-users of financial markets in the consultations at all stages of the legislative process – pre, during and post. This would improve the information available to policy makers. This should hopefully, in turn, lead to better legislation, as well as greater support for the legislation in question, in particular from the regulated community.

The Group was made aware of concerns about the EU's processes at the very beginning of its work and devoted much attention to the topic in its second report (see pages 20-29 and the summary below). So, comments here are mostly an update, especially in the light of the Group's Hearings.

CESR informed the Group that, regarding their consultative expert groups, lack of consumer representation was a continuing concern. They would also like to secure more active participation from other end-users such as issuing companies. Moreover, the ESC invited the Group to give further thoughts to a closer involvement of companies in the consultation processes.

- **Assessing the issue**

Reactions from market participants to the second report of the Monitoring Group were clear-cut:

- They continue to call for a more systematic dialogue between markets and political institutions (including CESR) – despite the acknowledged learning process in the last couple of years. In particular, they want more transparency with regard to the Council and the European Securities Committee; two rounds of consultation; and more extensive and convincing feedback statements so that consultation is demonstrably a genuine dialogue;
- There is also a wish for more forward-looking timelines on future work by the Commission and CESR, supporting the suggestions made by this Group in its second report. CESR has responded to this by publishing its "Indicative Work Plan for MiFID mandates". In our hearings, this was welcomed – but it underlined how tight the timetable really is. It was also made very clear that agreement on the regulatory texts in time for them to come into force by the deadline can in some cases (for example the MiFID), still leave the industry with the technical problem of being able, only then, to start to design the technological platforms that deliver the newly-mandated structure.

The Group's recommendations on consultation

- CESR should be given twelve months for completing pieces of technical advice, as a general rule.
- CESR should if possible allocate three months to market consultation for each given mandate.
- Commission and CESR should consult intensively, especially for input on overall need for market regulation, specific rules as well as expected costs and benefits of legislative and regulatory action.
- Commission and CESR might hold more than one round of consultation, provided that there are clear indications of benefits from additional input.
- Market participants and end-users should make available all relevant information at each first round of consultation and avoid duplication of information provided.

Source: IIMG second report, December 2003

The organisation of consultation processes raises several questions. The first is how to improve consultation practices; the second is how to involve all interested parties, including users and consumers; and the third is how to rationalise the whole consultation process.

(a) Improving the consultation process

The Commission has committed itself to improving the quality of feedback. Since the written responses to the Group in the spring, the Securities Market Expert Group has produced its report (see summary in Annex 2) and there is recognition that feedback statements have now improved very significantly. In addition, it is recognised that transparency has been enhanced by the new practice of publishing summary reports of European Security Committee (ESC) meetings.

The Member States represented in the ESC supported the Monitoring Group's call (in its last report) for a more cautious line on the number of consultation rounds. Nevertheless, in the concrete example of the MiFID, CESR has timetabled the possibility of two rounds of consultation on the MiFID mandates if necessary, which seems justifiable given the complexity of the issues involved.

(b) Involving all stakeholders

The Member States also invited the Monitoring Group to give further thoughts to a closer involvement of end-users, especially companies, in the consultation process as responses seem to be dominated by intermediaries. Following that suggestion, it appears to the Group that the corporate sector does indeed recognise the need to be more involved, even if it is not formally invited, and that it is now organising itself so that it can have an impact on the consultation process. But there is a structural problem: only a few major companies are active in the markets continuously, whereas most are infrequent users and therefore have little incentive to monitor events continuously. Instead, they regard it as part of the function of their professional advisers to follow-up the process.

Following the Member States' advice, the Group also invited some representative associations of end users to its hearings, and invited more specifically FIN-USE to comment on behalf of consumers and small businesses. In its hearing, the Group found that the FIN-USE representative's main concern was how to marshal resources in order to have more of an impact on the consultation process. A specific problem in that regard is the production of consultation documents only in English, often making use of technical language, which presents SMEs and consumers with more problems than it does organisations representing market participants and larger businesses.

The Group fully recognises the fundamental problem of creating a representative body to speak on behalf of these users. FIN-USE only began its operations in April 2004 so it will require some time to build up its reputation as an effective advocate of consumer/SME interests in the consultation process. FIN-USE's first report was published on 12 October[11].

The Group was informed during its hearings that consultations pose many problems for smaller organisations, whether associations or companies, due to their magnitude and to compressed timescales. Some concrete suggestions were made which would improve matters:

1. Provide a summary of the points that affect particular sectors so that the non-expert can immediately see if they are affected and should read more;
2. Show "tracked changes" in re-drafts;
3. Explain the differences with any other bodies that may be consulting on similar topics e.g. IOSCO;
4. Resolve the language problem - for instance, provide an executive summary or list of key points and a glossary of terms in each language.
5. Include a FIN-USE representative in CESR's Market Participants Consultative Panel.

The issue of working in the global business language is likely to emerge as more serious once the Regulations impact more on users outside international banks and companies. Even just a summary in the EU languages would be sufficient to alert executives to the need to pay attention. Where texts are highly technical, non-specialists with limited language skills are effectively shut out of the process.

(c) Rationalising the consultation process

Cost benefit analysis should be seen as part of the pre-legislative process as it should provide an objective justification for legislative action in the first place. It should also help to improve the quality of any subsequent legislation.

[11] The report is available on the European Commission website: http://www.europa.eu.int/comm/internal_market/finservices-retail/finuse_en.htm

Cost benefit analysis and its role in the consultation process

There is a strong consensus among the regulated community that new legislative proposals need to be constructed around a stronger evidence base, and that this process should involve all stakeholders. One method of providing hard evidence is a real impact assessment and the Commission has recently undertaken to do that more generally (see the Commission Communication on Impact Assessment (5 June 2002; COM(2002) 276 final) and the Action Plan "Simplifying and improving the regulatory environment" (5 June 2002; COM(2002) 278 final). Moreover, the official sector has adopted the same tone – for example, the recent FSC report on financial integration ('Asmussen report') highlighted the "need to prioritise areas for intervention so as to focus on actions which can deliver the largest efficiency and welfare benefits".

The Commission has now made clear that it will act on the basis of "evidence" – but what will be judged sufficient? The Group was informed that a formal cost benefit analysis on each measure may be unnecessary - but what is the standard? Opponents of a proposal on commercial grounds might find it easy to argue that the assessment was insufficiently rigorous. But are there universally accepted and tested methodologies? And who should pay for a larger investigation? Finally, considering all these open questions: could this simply turn into a blocking tactic?

- **The Group's conclusions**

It is widely acknowledged that transparency – via consultation processes and feedback responses – has improved enormously during the life of the Lamfalussy Process and the Group welcomes the knowledge that this has brought. But the Group was informed of concerns: consultation cannot be a substitute for action by the public authorities when necessary; the heavier the consultation procedures, the more difficult it is to respond quickly to changed circumstances in the markets.

The Group shares the objective of broadening the range of stakeholders which are actively involved in consultation processes: papers must be designed to help less sophisticated or linguistically less skilled stakeholders, in particular end-users – for example through making executive summaries and glossaries available in a greater number of languages. At the same time, the Group notes that the complexity of financial market legislation often reflects the complexity of underlying issues and products and that sophistication may, therefore, be unavoidable in some cases.

7. Consistent application of EU securities markets law through Level 3

a) CESR's role at Level 3

- **The issue**

The Lamfalussy report describes the 'essence' of Level 3 as "to greatly improve the consistency of the day-to-day transposition and implementation of Levels 1 and 2 legislation". It goes on to define the role of CESR as to:

- produce consistent guidelines for the administrative regulations to be adopted at the national level;
- issue joint interpretative recommendations and set common standards regarding matters not covered by EU legislation – where necessary, these could be adopted into Community Law through a Level 2 procedure;
- compare and review regulatory practices to ensure effective enforcement throughout the Union and define best practice;
- periodically conduct peer reviews of administrative regulation and regulatory practices in Member States, reporting their results to the Commission and to the ESC.

In its second report, the Group was clear in its view that the overarching objective of Level 3, given the final objective of creating a single market in financial services, should be to secure consistency at the level of, and across, the Member States, in both:

- the transposition and implementation of Community rules into national law – a matter primarily for the national legislatures and executives; and
- the interpretation and application of Community and implementing national rules – a matter primarily for supervisory authorities.

An additional interpretation has been put forward in the Securities Expert Group, which clearly favoured a concept of Level 3 that focuses on co-ordination of daily supervisory practice across regulators and not as a way for further standardisation of securities markets law (See the summary in Annex 2). However, the Group recalls that Level 3 is not exclusively or primarily about the co-ordination of day-to-day supervision. Level 3, at the current stage, is very much concerned with making the implementation and interpretation of EU securities market law consistent across the Member States.

In this context CESR is called to play an important role at Level 3, as described in the Group's recommendations of its second report.

Level 3: The Group's core recommendations

- The European Institutions should pass legislation enabling CESR to concentrate Level 3 activities on the co-ordination of day-to-day regulatory and supervisory practices on a pragmatic basis.
- Consistent implementation of EU law should primarily be sought by means of non-binding guidelines, recommendations and standards, established among CESR and national regulators, as well as through peer pressure within CESR.
- Giving more authority to a Level 3 measure by asking for Commission legal action should only be sought where indispensable. A constructive approach in this respect should be agreed in due course. The role of the Commission as guardian of the Treaty must not be called into question.

Source: IIMG Second Report, December 2003

- **Assessing the issue**

(a) Since the last report of the Group, CESR has issued a consultation document on its own role. To put that document in perspective, it may be useful to recall **CESR's role and position in Community law** as they follow from Commission Decision 2001/527/EC of 6 June 2001 (OJ L 191, 13 July 2001) and from CESR's Charter of 11 September 2001.

Extracts from Commission Decision of 6 June 2001 establishing the Committee of European Securities Regulators (2001/527/EC)

THE COMMISSION OF THE EUROPEAN COMMUNITIES,

Having regard to the Treaty establishing the European Community,

Whereas:

…

(6) In its final report, the Committee of Wise Men called for the establishment of two committees, the European Securities Committee, comprising high-level representatives of Member States, and the Committee of European Securities Regulators, comprising senior representatives from the national public authorities competent in the field of securities in order, inter alia, to advise the Commission.

(7) In its resolution on more effective securities-market regulation in the European Union, the Stockholm European Council welcomed the Commission's intention formally to establish an independent regulators committee, as proposed in the report of the Committee of Wise Men.

(8) The Committee of European Securities Regulators should serve as an independent body for reflection, debate and advice for the Commission in the securities field.

(9) The Committee of European Securities Regulators should also contribute to the consistent and timely implementation of Community legislation in the Member States by securing more effective cooperation between national supervisory authorities, carrying out peer reviews and promoting best practice.

…

(12) The Committee of European Securities Regulators should draw up its own rules of procedure and fully respect the prerogatives of the institutions and the institutional balance established by the Treaty,

HAS DECIDED AS FOLLOWS:

…

Article 2

The role of the Committee shall be to advise the Commission, either at the Commission's request, within a time limit which the Commission may lay down according to the urgency of the matter, or on the Committee's own initiative, in particular for the preparation of draft implementing measures in the field of securities.

…

Extracts from the Charter of the Committee of European Securities Regulators of 11 September 2001

…

Having regard to the importance of greater supervisory and regulatory convergence for the achievement of an integrated internal capital markets in Europe;

Having regard to the need to base all its actions around a common conceptual framework of overarching principles for the regulation of the European securities markets to be established by the European Union;

Having regard to the importance of involving all market participants in the regulatory process;

Considering that the role of the Committee of the European Securities Regulators is to:
(i) improve coordination among European Securities Regulators;
(ii) act as an advisory group to assist the Commission, in particular in its preparation of draft implementing measures in the field of securities;
(iii) work to ensure more consistent and timely, day to day implementation of community legislation in the Members' States;
the members of the Committee resolve to adhere, both in principle and in practice, to this Charter ……

4.3 The Committee will foster and review common and uniform day to day implementation and application of Community legislation. It will issue guidelines, recommendations and standards that the members will introduce in their regulatory practices on a voluntary basis. It will also undertake reviews of regulatory practices within the single market.4.4 The Committee will develop effective operational network mechanisms to enhance day-to-day consistent supervision and enforcement of the Single Market for financial services.

It is beyond the Group's mandate to reflect further on CESR's legal position, and the functions assigned to it. However, given its mandate to identify any possible emerging bottlenecks in the Lamfalussy process, the Group wishes to draw the attention to the limited description of CESR's function in the Commission decision which, in Article 2, solely refers to CESR's advisory function with regard to the preparation of draft Community legislation in the field of securities. By contrast, CESR's role to contribute to the consistent and timely implementation of Community law in the Member States is less well-defined in the Commission decision, given that it is only referred to in the preamble under paragraph (9). This dichotomy is due to the fact that CESR does not have legal personality as such; rather, it functions as an EU network of regulators, each of whom possesses legal competences only at national level. Whilst at Level 2 CESR provides independent technical advice to the Commission, which is accountable to the Council and Parliament for the Level 2 measures that it proposes and adopts, this line of accountability does not extend to Level 3.

In its second report, the Group recommended that "the Institutions adopt Level 1 and Level 2 measures enabling CESR to concentrate Level 3 activities on the co-ordination of day-to-day regulatory and supervisory practices in the Member States on a pragmatic basis" (p. 34). The Group wishes to reiterate this recommendation. In the absence of any Community legislation, there is no legal guarantee of real convergence resulting from the cooperation of national regulators within CESR, which relies instead on cooperation between national authorities to produce uniform implementation through non binding guidelines and standards, backed up by political will within the Member States to ensure that this happens.

(b) As mentioned, the discussion on CESR's role and competences has recently been enriched by the **consultation paper on Level 3** which CESR published in April 2004. As underlined in the Foreword to the paper, "[T]he objective of CESR at Level 3 is to ensure convergent application of EU securities law. [However] [t]he form and content of the cooperation between national securities regulators working together within CESR at Level 3 are not definitively established and are subject to public discussion. In particular, [the Foreword goes on to say], the Inter-Institutional Monitoring Group (…) mentioned in its second Interim Report the fact that 'the differential transposition of EU Directives has become a serious impediment to the functioning of the internal market (…)' which could be prevented by consistent implementation at Level 3."

CESR proposes to pursue this objective through three different avenues: coordinated implementation of EU law in the Member States, regulatory convergence and supervisory convergence.

Extracts from CESR's Consultation Paper of April 2004

"2.2.Coordinated implementation of EU law by CESR members"

"The coordinated implementation of EU law covers the legal transposition process into national law and/or rules and the day-to-day application of the EU legislation." Whilst "the full responsibility to transpose EU Directives lies with the Member States, … the national competent authorities (CESR members) may, where permissible at national level, intervene in the process, being delegated by national legislators …"(p. 6).

"2.3 Regulatory convergence"

"Regulatory convergence is the process of creating common rules. The legitimacy of the role of CESR at Level 3 comes from the fact that CESR members take individual decisions on a daily basis that create jurisprudence. This "bottom up" approach relates to the normative nature of concrete decision making activities of the supervisors. The impact of precedents on decisions is determined by the law and cannot be fully controlled by legislators. In addition, in an integrated European market, the jurisprudence created by supervisors produces effects that cannot be limited to national jurisdictions and therefore must be faced at EU level."… On the basis of this jurisprudence "the members of CESR will introduce … guidance, recommendations and standards in their regulatory practices on a voluntary basis." These "CESR standards can be 'upgraded' at a later stage and form part of Level 1 (or even Level 2) legislation …" (pp. 7-8).

"2.4. Supervisory convergence"

"Supervisory convergence relates to how regulators approach the practical operation of rules and legislation. Convergence of both supervisory objectives and techniques will be achieved by sharing these objectives and techniques to secure a common approach across Europe." (p. 8). "Supervisory convergence can also be found in responses to supervision and enforcement actions. Sharing common experiences in the field of enforcement actions is crucial to ensure that similar cases are treated consistently and in an equivalent manner across Europe." (p. 9).

Source: "Role of CESR at Level 3" *CESR, April 2004*

The Group welcomes CESR's initiative to clarify its role around the basic concepts of coordination and convergence. It welcomes more specifically CESR's approach to **coordinated implementation** and supervisory convergence. As to the former, it is indeed essential that, "where permissible at national level" (p. 6), that is, when the constitutional framework of the Member State concerned permits it, national regulators should be involved in the national legislative process of transposing Level 1 and Level 2 Directives, and applying Level 2 Regulations. Moreover, irrespective of their legal powers, national regulators in all Member States should take an active interest in the transposition process in order to ensure that divergent implementation in the 25 Member States is avoided. The latter concept - **supervisory convergence** - is an idea which the Group fully supports.

Regulatory convergence is a more controversial subject. It refers in substance to *de facto* law making by national regulators through such "soft law" techniques as common approaches recorded in minutes of meetings (as suggested by the Stockholm European Council meeting), and "jurisprudence" emerging from individual supervisory cases leading to common standards which the national regulators would then introduce in their regulatory practices on a voluntary basis. "They are 'binding' decisions on national regulators vis-à-vis each other in order to respect their commitment under the CESR charter on the one hand and to propose mutual confidence and to create 'peer' pressure on the other hand" (p. 8 of the CESR Consultation paper). The Group does not wish to deny the usefulness of the method and only wants to emphasise that "soft law" has its limits. As it is not legally binding, it cannot be relied on by private actors. Nor can it be directly submitted to judicial scrutiny by courts of law at national or Community level. And it may affect the institutional balance between institutions at those levels[12]. From its meeting with CESR representatives, the Group gathered that CESR is not indifferent to these considerations and is willing to take them into account.

- **The Group's conclusions**

The Group welcomes CESR's initiative to clarify its role around the basic concepts of coordination and convergence. It welcomes more specifically CESR's approach to coordinated implementation and supervisory convergence. National regulators in all Member States should indeed take an active interest in the transposition process – including at the legislative level where that is permitted by constitutional rules – in order to avoid divergent implementation in the 25 Member States. Supervisory convergence is an idea which the Group also supports. As regards regulatory convergence, and the use of "soft law" techniques that it implies, the Group takes a more reserved stance: the multiplication of non-binding rules at Level 3 should not lead to a grey area where legal certainty is absent and political accountability is unclear.

b) Facilitating implementation and organising mediation between national regulators

- **The issue**

To facilitate correct implementation of Lamfalussy legislation in the Member States and to make it consistent between the Member States, it is necessary to set up a network of implementation between the Commission and the national regulators as well as, within CESR, a system of mediation between national regulators.

[12] In this respect "jurisprudence" is a misleading term as it refers normally to decision (and rule-) making though precedents from the Judiciary which constitutes, with Parliament and Government, one of the three branches of sovereign power. As such, the concept does not comprise decision (and rule-) making through administrative agencies which do not enjoy the constitutional safeguards of independence which judicial bodies enjoy. Again, it is not the Group's intention to deny the usefulness of "soft law" techniques but to emphasise its limits from a viewpoint of democratic accountability.

- **Assessing the issue**

(a) The Commission already organises **transposition meetings** for individual Directives with the Member States – covering both Level 1 and Level 2 measures. These are technical-level meetings and Member States are free to field representatives from finance ministries, regulators or both. Meetings have so far been held for the Market Abuse and Prospectus Directives. Transposition meetings are complemented by so-called 'package meetings', whereby representatives from the Commission services visit individual Member States to discuss the implementation of a range of Internal Market Directives. The Group welcomes this initiative and regards these meetings as the appropriate instruments that should help to avoid the need for initiation of enforcement actions by the Commission - as is also underlined in the CESR consultation paper (p. 6).

In this regard, the Group further supports the creation within CESR of a **Review Panel** to assist CESR in achieving its objective of convergent implementation. According to the procedure set out in CESR's consultation document (p. 6), CESR members and observers produce a self-assessment of their implementation of a specific set of rules (using correspondence tables). These assessments are then discussed by the Review Panel, which gives its opinion and discusses common approaches for implementation. As pointed out above (in the conclusions to the previous subsection), the Group considers that these assessments should be undertaken as early as possible, thus also at the stage of **drafting national transposition measures**.

(b) CESR's consultation paper recommends **mediation** of an advisory nature **between national regulators** within CESR, in order to avoid disagreement between competent home and host regulators as to how to interpret directive provisions, and therefore *ex post* (p. 9). This is a separate issue from the FESE proposal for an ombudsman, which would mediate in disputes between regulators and private market participants (see section 8 below). At present, Article 16 of the Market Abuse Directive provides for such a mechanism in a particular case of exchange of information and investigations in insider dealings/market manipulation. This article calls for CESR to set up procedures, without prejudice to Article 226 of the EC Treaty, for the rapid and effective solution of competent authorities' non-compliance with obligations relating to the exchange of information and joint investigations contained in the Directive. Further cases are not currently foreseen in any Level 1 Directive.

In their meeting with the Group, CESR representatives said that any mediation process certainly must be reconciled with national administrative procedures, but should not be perceived as a kind of "internal appeal body" open for complaints stemming from market participants. The Commission representatives told the Group that, in their view, a mediation mechanism amongst regulators within CESR could be a promising way forward in terms of strengthening CESR's role of ensuring convergent application of securities laws among national regulators and could be a promising way forward to avoid time-consuming cases before ECJ.

The Group agrees that the mediation proposal would seem to merit further work. The ESC, at its meeting on 22 September[13], appeared to share this view. At this meeting, the Commission chair noted that the mechanism could not substitute for the Commission's enforcement procedures, nor should it be considered as an instance of appeal before a case reaches the ECJ.

- **The Group's conclusions**

The Group considers that implementation meetings and peer reviews, at as early a stage as possible, are very valuable instruments with which to stimulate coherent implementation of Community legislation and to avoid interpretation divergences between the Member States. Mediation between regulators is also very useful and has been applied in the MAD. The Group suggests that the instrument should be worked up more fully and that the principle should be widened beyond the MAD and become of general application.

---

[13] See the summary record of the 22 September meeting of the European Securities Committee: http://europa.eu.int/comm/internal_market/securities/esc/index_en.htm

c) Other issues to be solved

- **The issues**

In light of the foregoing, the Group wishes to address **some controversial issues** which came up in the aftermath of its second report. These issues are:

(i) the usefulness of establishing an endorsement mechanism with regard to Level 3 measures – an issue to which the Group already referred in its last report;

(ii) differences in the legal competences of national regulators across Member States as an impediment to making Level 3 more efficient; and

(iii) the necessity of coordinating Level 3 committees.

- **Assessing the issues**

(i) Endorsement mechanism

> In its second report the Group addressed the issue because of a suggestion made by CESR, and some market participants, of giving more authority to Level 3 standards resulting from cooperation between national regulators (see p. 34-35 of the second report). The Group noted some significant hurdles which granting more authority would encounter, such as affecting the Commission's legislative initiative if endorsement by the Commission were to become an automatism, and increasing regulatory density by adding a new layer of regulation, namely recommendations from the Commission on top of CESR standards. The Group therefore considered:
>
> "that more authority for Level 3 measures should only be sought where indispensable, such as when national regulators do not have regulatory instruments to implement CESR standards in their jurisdictions, or enforceability of certain standards before national courts is expected to become necessary, or peer pressure amongst CESR members, including through a mediator system, proves to be insufficient (…)." (p. 35).

Reactions from market participants to the Group's second report show that scepticism regarding both the principle of, and the need for, official endorsement of CESR standards, remains widespread. Associations continue to prefer non-binding co-ordination within CESR as well as soft law methods to secure compliance with Level 3 standards, such as the right for the private sector to complain, and the use of public annual compliance reviews on agreed standards. As for the Commission, representatives continued to underline that the Commission would see any endorsement mechanism which would result in CESR standards being automatically converted into EU law, or rubber-stamped in Commission recommendations, as a restriction of its right of legislative initiative.

The Group also asked for the views of representatives of the Council and of the European Parliament on this issue, but they considered, however, that it would be premature to express opinions on the need to officially endorse Level 3 standards. For their part, the CESR representatives whom the Group met agreed that the industry's views are fairly mixed. Asked by the Group as to where political accountability for agreed CESR standards would lie, they indicated that, in the absence of endorsement, the accountability issue arises between the individual CESR members and their respective national governments, rather than at the European level.

As mentioned above, CESR points out in its Consultation Paper that, where appropriate, CESR standards could be upgraded to become part of Level 1 or Level 2 legislation, where the Commission decides to exercise its right of initiative and propose such an upgrade.

Criticism, on behalf of the private sector, that this would enhance regulatory density, is not entirely convincing as it stems from the idea that non-binding standards do not have that effect. In fact the contrary is true: non binding rules are also rules, but they are rules which individuals cannot legally rely on, and which they cannot ask courts to enforce. This does not mean that binding rules will or should always require active enforcement: the *threat* of enforcement will often be the best incentive for compliance to occur.

As the Group pointed out in its second report, endorsement should nevertheless be envisaged, however it should be limited to certain instances, as enumerated in the report, that is, when soft law rules risk remaining ineffective, for whatever reason. The Group would like to add one important element - which was also suggested in remarks submitted to the Group by a representative from the public sector - which is that, whenever CESR makes use of its faculty to create common standards, it should comply with, and therefore set up, internal good governance mechanisms, such as those relating to decision-making (e.g. voting requirements and decisional transparency).

(ii) Similar legal powers for regulators

The existence of differences in the legal powers of national securities regulators across the twenty-five Member States constitutes a significant risk for hampering efficient European net-working at Level 3. Market participants drew the Group's attention to this problem in their responses to the Group's second report. In its consultation paper, CESR also raised this concern and called on Member States to look at this issue and to introduce the necessary changes.

All of this highlights the need for an assessment of existing differences between the Member States. The Group would expect that assessment to be undertaken sooner rather than later – presumably by CESR - since it is of crucial importance for the functioning of Level 3. In its meeting with the Group, CESR representatives acknowledged that national constitutions might stand in the way of changing rule-making powers in order to give all CESR members the same regulatory competence. The Commission representatives stressed that, if differences in regulatory structure and powers continued to exist, there would be a need for a "European regulatory system." They regarded the identification of these differences as a priority.

In this context, the Group wishes to emphasise that, according to Article 10 EC Treaty, it is the duty of the Member States to "take all appropriate measures, whether general or particular, to ensure fulfilment of the obligations arising out of this Treaty or resulting from action taken by the institutions of the Community." Article 10 EC does not have direct effect in itself, but it requires the Member States to take action whenever specific Community legislation imposes precise obligations upon the Member States, as is the case of Level 1 and Level 2 legislation under the Lamfalussy Process. In such cases, Article 10 is binding on all the authorities of the Member States, including legislatures, regulators and courts. It is finally for the Commission to ensure the compliance of Member State authorities through actions brought before the ECJ.

Accordingly, whenever the implementation of Community law raises special difficulties, for example difficulties of a constitutional nature, the Member States should submit them to the Commission and work with the Commission in good faith with a view to overcoming these difficulties. Also in this respect, CESR has to play a role in finding solutions, or, if that does not work, signalling to the Commission instances where lack of cooperation on the side of national legislatures or regulators would jeopardize the application of Community law. Moreover, according to case law of the ECJ, national courts must ensure that individual citizens, including legal entities, can enforce rights which they derive from Community law. Thus, for example, by allowing these citizens to bring an action in compensation before a national court against a Member State whose authorities have committed a serious breach of Community law, by action or inaction, through which the citizen has suffered harm.

For a Member State not to provide for competences which enable its regulators to give full effect to Community law measures, or to maintain national legislation jeopardising the full implementation of Community law measures, constitutes a breach of its duty to cooperate with the Community under Article 10 EC. That does not mean that the competences of the national regulators must be the same in every Member State, rather that there should be sufficient similarity that differences do not impede the full effect of Community law across Member States.

(iii) Coordination amongst Level 3 committees

In their responses to the Group's last report, market participants also raised concerns about the co-ordination of work between Level 3 committees to avoid overlaps, such as on accounting issues (CESR on the one side and EFRAG on the other side) as well as on asset management (CESR on the one side for UCITS and CEIOPS on the other side for pension funds). Moreover, consultations on issues which are of concern to market participants in more than one market segment (e.g. recent consultations on outsourcing and credit rating agencies) should be conducted jointly to avoid duplication and unnecessary burdens.

Without suitable co-ordination, this could become something of a bottleneck for the development of the Lamfalussy Process in securities markets – as well as in other financial services sectors once the extension of the Lamfalussy Process to banking, insurance, occupational pensions and UCITS becomes fully operational. Whilst the new Level 3 committees (CEBS and CEIOPS) have only just been established, the Group understands that the three committees are discussing how they can best coordinate their activities and are already actively coordinating where appropriate.

- **The Group's conclusions**

The Group has not found any support for a general endorsement mechanism for CESR decisions. However, in exceptional cases, endorsement may be useful, for example when soft law rules risk remaining ineffective or, as mentioned under (a) above, affecting legal certainty or political accountability.

For a Member State not to provide for competences which enable its regulators to give full effect to Community law measures, or to maintain national legislation jeopardising the full implementation of Community law measures, constitutes a breach of its duty to cooperate with the Community under Article 10 EC. That does not mean that the competences of the national regulators must necessarily be the same in every Member State, rather that there should be sufficient similarity that differences do not impede the full effect of Community law across Member States.

Furthermore, the Group considers that overlaps between Level 3 Committees should be avoided through suitable coordination.

8. Rationale and progress on Level 4 activities

- **The issue**

Level 4 is concerned with **enforcement**: the European Commission checks Member States' compliance with Community law and may take legal action against Member States that are suspected of a breach of Community law. Enforcement action often takes place on the basis of complaints to the Commission.

Reactions from market participants to the last report of the Monitoring Group emphasised that the proper functioning of Level 4 activities is a priority for all the respondents. Some of them referred to unhelpful experiences in the UCITS area and argued that market participants need a swift, flexible and anonymous mechanism whereby they can raise concerns about regulatory decisions by a Member State – typically by the CESR member for that state. As yet, there is no experience of Level 4 in action as none of the Lamfalussy-style Directives have taken full legal effect in the Member States. The concerns for the future are nevertheless clear. Proper attention to head off obvious risks may be an essential part of maintaining confidence in the whole process, thus avoiding a potential bottleneck.

- **Assessing the issue**

The Member States have responded positively to these concerns and the ESC – at its 28 January meeting – minuted an invitation to the Group to consider notably incentives for market participants (such as the idea of a private ombudsman) to launch "promising" complaints (by which the Group understands complaints for which there is sufficient evidence available).

The existing complaints system is set out below. It is mainly concerned with consumer complaints about *business* practices rather than with business or consumer complaints about practices of public authorities in the application of Community law in the Member States. Market participants may be reticent in making public complaints about their regulators if they fear that to do so could damage relations and thus impact negatively on their business.

How the existing Complaints System works

Who may file a complaint, when and how?

Anyone who considers that a Member State's law, regulations or administrative provisions or individual decision are not in compliance with Community law may address a complaint to the European Commission at any time. A complaint should be submitted in writing in one of the official Community languages. The Commission is currently dealing with about 3000 complaints submitted by citizens and companies, more of a quarter of which concern the single market.

How does the Commission deal with a complaint?

1. First steps: a complainant will first receive an official acknowledgement of his/her complaint; this may be followed by a request for further information.

2. Alternative informal routes for addressing cases: the Commission must decide within a maximum of one year if a complaint should be closed or an infringement procedure should be opened. During this period, various mechanisms exist to find rapid solutions:

a) so-called 'package-meetings' between representatives of DG Internal Market and representatives of the relevant national administration, whereby cases are reviewed and possible solutions explored;

b) SOLVIT (Internal Market Problem Solving System) – **For citizens/business *versus* the administration of a Member State.** This is a free-of-charge IT-driven system for solving cross-border problems. The system is operated through SOLVIT centres in national ministries of each Member State (mainly ministries for economic affairs who liaise with the other authorities). A SOLVIT-solution is only possible as long no legal action before a national court has been lodged. The average period for solving a request is 10 weeks.

3. FIN-NET: For **consumer disputes with a cross-border supplier**. It is an **out-of-court complaints network to** resolve disputes **between private actors** rapidly and efficiently by avoiding, where possible, lengthy and expensive legal action. It was launched by the Commission in February 2001 and designed specifically to facilitate the out-of-court resolution of consumer disputes when the service provider is established in an EU Member State other than that where the consumer lives. The network, which brings together more than 35 different national schemes, all of which are independent and impartial, aims to solve problems in the case of cross-border disputes between a consumer and a financial service provider relating to contractual or non contractual issues rather than infringements of Community law by a Member State or its national supervisory authorities.

4. Formal infringement procedure: as the independent 'guardian' of the Treaty, the Commission is free to decide whether and to what extent it intends **to take a Member State** to the European Court of Justice. Before doing so, a pre-litigation procedure of article 226 of the Treaty is formally necessary so that a Member State can defend itself if it so wishes. First, the Commission sends a "letter of formal notice" to the Member State, to which the Member State must react usually within two months. The second stage is the so-called 'reasoned opinion', in which the Commission takes a formal position in that it requests a Member State to repeal or amend the national provisions in question within two months. If the Member State does not do so, the Commission is free to take a Member State to the Court.

Confidentiality

The identity of the complainant and the documents submitted by him/her is protected under Community law. A complainant's identity will only be revealed, following the request of the authorities of a Member State, provided that the complainant's permission has been obtained. Access to correspondence exchanged between the Commission and a Member State in the context of an infringement procedure will, according to Community law, not normally be disclosed without the consent of the Member State's authorities although, once an infringement procedure is closed there is a presumption of accessibility.

Source: Commission services communication to IIMG

The Commission representatives asserted to the Group that the Commission usually gets Member States to bring their actions into line with EU law before ECJ proceedings start and that the Commission wins the great majority of Court cases against Member States, though it is a safe presumption that it will only take winnable cases to the ECJ. Nevertheless, the propensity of market participants to bring infringement cases, directly and individually, to the attention of the Commission has remained weak. Some market participants suggest it is difficult to convince the

Commission to launch infringement procedures. It is possible that the Commission might be hesitant to do so in cases where the relevant Community legislation is open to interpretation and will therefore only act where there is sufficient evidence.

In June 2004 the Federation of European Securities Exchanges (FESE) published a proposal for an alternative approach – to set up a special type of ombudsman for financial services.

The FESE policy proposal: An ombudsman for cross-border financial services' providers in Europe

According to FESE, Europe's financial services industry needs a European ombudsman to oversee cross-border disputes **between businesses and national regulators**. FESE believes that the ombudsman system would provide a speedy and cost-effective mechanism of dealing with problems caused by the uneven enforcement of EU rules and regulations by national regulators. In the medium-term an ombudsman would help create a level playing field for all financial services firms.

In essence, FESE proposes that the EU ombudsman for financial services firms should operate as follows:

The ombudsman would initially examine a firm's grievances, judging them on their cross-border character and importance to the efficient functioning of European capital markets. The ombudsman would then (anonymously) transmit his appraisal of the case to CESR. CESR would be required to respond within 3 months. Subsequently, the ombudsman would discuss CESR's response with the aggrieved party and within three months publicly publish a reasoned response to the case.

CESR and its national regulator bodies must be parties to the ombudsman statute and commit themselves to implement any decisions, unless specifically prohibited by law. The ombudsman should also be accountable to EU institutions – he or she should deliver an annual report to the Commission, the Council and the European Parliament and be prepared to attend relevant European Parliament hearings.

Source: FESE, 11 June 2004

The Group requested the Institutions' views upon the ideas during our hearings. The Member States' views seem to have become more negative than initial indications. According to the summary record of the 22 September ESC meeting, Member State delegations largely share reservations about the proposal outlined by the Commission services concerning:

- uncertainties relating to the nature and role of the ombudsman and lack of added value compared to other proposed mechanisms – with concerns expressed that the ombudsman should not be responsible for interpreting Community law (the role of the ECJ); and that there might be significant overlap with the role of CESR at Level 3;
- lack of independence of the ombudsman vis-à-vis the industry; and
- scope of the ombudsman's mandate – which sectors would it cover?

At the same ESC meeting, the Commission noted that one possible way forward might be "to build a market-participant practical problem solving capacity into Member States emerging supervisory networks – along the lines set by SOLVIT".

Some representatives of market participants also voiced doubts about the usefulness of the proposal, citing lack of clarity on the role of the proposed ombudsman, possible overlap with other mechanisms and lack of political authority as concerns that the proposal would need to address. The concerns relating to lack of political authority should be given some weight: would national authorities accept a solution brokered by an ombudsman funded by the private sector?

CESR thought that the idea risked creating confusion with existing mechanisms and was averse to the idea that CESR itself might become an "appeal court" between a business and a CESR member because the members already trust each other to act consistently with their agreements. Where the issue is really one of differing interpretations of legal texts, the solution may well be for CESR to develop a full mediation mechanism between its members, but that is a different matter (see section 7 above).

Regarding a business complaint against administrative action of a regulator, the Commission took the view that the Ombudsman would simply duplicate much of what the Commission already does. In particular, the key element of confidentiality already exists (see the box on the complaints system above). However, a general scepticism about the confidentiality of the Ombudsman can be discerned. If a market participant has already approached a particular regulator and become engaged in serious debate about a specific topic, then it seems very likely that a subsequent approach to another source, e.g. the Commission or an Ombudsman, on a similar subject will inevitably lead to the officials dealing with the matter realising the source of the complaint. To maintain effective confidentiality would therefore be highly difficult.

An alternative way of tackling the problem of market participants' reticence in coming forward with complaints might be to adopt an approach whereby the Commission appoints one of its staff as hearing officer to whom independence is guaranteed one way or the other. A similar approach has been used by the Commission in EU competition law proceedings to hear objections from enterprises against whom a statement of objections has been filed by the Commission for breaching EU competition rules. This solution would have the following advantages:

(i) the system is already proven in the area of competition;

(ii) the Commission has experience of dealing with complaints from individuals as regards confidentiality, in accordance with ECJ case law; and

(iii) although the hearing officer would have a certain degree of autonomy from the Commission, his/her authority is considerably enhanced (compared to a private-sector-funded ombudsman) by the fact that a formal infringement procedure can be initiated if his/her decision is not complied with.

The Group invited FESE to a Hearing. FESE representatives stressed that their proposal seeks to create an informal mediation mechanism rather than an enforcement method, as that would require a legal basis (which was not being sought). The perceived advantages of such an informal system are that it would be anonymous, speedier and cheaper than the existing options in resolving matters between a business and cross-border regulator. The issues are likely to arise from differing interpretations of measures due to culture, history, different legal systems etc. FESE pointed to several areas where such an Ombudsman would have been helpful. However, the best known cases of problems are in the UCITS sector and the Group was informed that the specifics of those cases were inextricably bound up with different interpretations of regulations by regulators and not with business practices. So these seem rather to be classic cases for CESR mediating amongst its members, rather than for an Ombudsman mediating between a market participant and a national regulator.

- **The Group's conclusions**

Given the long-standing and pervasive concern amongst market participants about uneven enforcement procedures, as well as their hesitancy to bring infringement cases to the attention of the Commission, it is clear that this issue should be tackled decisively and early. Parts of the private sector have even seen fit to put forward their own proposal for an Ombudsman procedure, together with ideas for funding it. After some initial support, the official sector now seems rather doubtful about the concept of a private Ombudsman mediating disputes between a regulator and a private party.

At this stage, the reflection on the Ombudsman idea, and the evidence available to support it, does not seem to the Group sufficiently compelling for the idea to serve as a valid alternative to use of the Commission's powers of enforcement. CESR mediation amongst its members may help to resolve some issues, in particular where these relate to differing interpretations by national regulators. As regards complaints from market participants, an alternative might be establishing a single point of contact within the Commission, that is to say a hearing officer with a large degree of autonomy. Aware of the need to put in place effective methods to underpin Level 4, the Group recommends that all parties involved should reflect further on how to enhance enforcement. Any systematic failure at Level 4 would necessarily become a major bottleneck to the progress of the Lamfalussy Process.

Part III: Evaluating the Lamfalussy Process: past and future

The Lamfalussy Report of 2001 called for a review by the European Institutions by 2004 of the process that it recommended. In its tenth progress report on the FSAP, published on 2 June 2004, the Commission stated that the FSAP "has been delivered in full and on time". This is therefore an appropriate moment to stand back and review the achievements of the Lamfalussy Process in the three years since it began. Indeed, the Financial Services Committee report of May 2004 "re-affirms the need for a thorough evaluation". Two sets of factors underline the importance of undertaking such an evaluation now:

- <u>Events affecting the European Union as a whole, and thus the Lamfalussy Process</u>:
  - May 2004 – accession of ten new Member States, addition of nine further official languages;
  - June 2004 – elections of the European Parliament – more and more diversified MEPs; enlarged competences for the Economic and Monetary Affairs Committee; political priorities of new Commission, EP and successive Council Presidencies;
  - June 2004 – agreement on a new European Constitution, with proposed Article I-36 being of particular importance for the Lamfalussy process;
  - November 2004 – appointment of a new Commission.
- <u>Events primarily affecting the Lamfalussy Process as such</u>:
  - March 2004 – European Parliament agreement on the extension of Lamfalussy;
  - May 2004 – political agreement in the Council on the extension of Lamfalussy;
  - May 2004 – launch of the post-FSAP agenda with the publication of the reports of expert groups.

The theoretical and practical benefits of the Lamfalussy Process have been recognised by the Institutions from the very outset. In line with this consensus, the Council and the European Parliament have reached political agreement on a package of measures to extend the process to banking, insurance and occupational pensions, and asset management (UCITS), though final adoption has had to be delayed until the texts have been translated into all Community languages.

The extension has been undertaken without substantial alteration to the substance of the original Lamfalussy arrangements as adopted for securities markets, indicating that there is overall agreement among political actors concerned with financial markets that the process is a viable instrument through which decision-making can be made more efficient. This view has, in principle, also become widely shared by the majority of market participants and other commentators, as the Group has documented in its reports.

***Extracts from Explanatory Memorandum to Commission Proposal for Directive 2003/0263**: "to establish a new financial services committee organisational structure"*

"…in April 2002 the Council called for a review of how best to make improvements to the financial services committee architecture. On the basis of this review, on 3 December 2002, the **Council**[14] invited the Commission to extend the committee structure applied in the securities sector to the sectors of banking, insurance and UCITS. In particular, the Council invited the Commission to establish "as quickly as possible" new committees in each sector by Decisions of the Commission….

Separately on 21 November 2002, the European Parliament adopted an own-initiative report on prudential supervision in the European Union. In its Resolution A5-0370/2002 on prudential rules in the European Union, it endorsed the emphasis on convergence not only in rules but also in implementation and supervisory practices; welcomed the institutionalisation of a regular dialogue between supervisors at European level through the creation of CESR, and hoped that such an extension would indeed lead to more coherent implementation and enforcement of prudential legislation within the EU.

Nevertheless, in its Resolution B5-0578/2002 on financial regulation, supervision and stability, the European Parliament questioned the urgency of restructuring the committee architecture, and argued that there should be a clear Council commitment to a reform, comprising a revision of Article 202 of the Treaty and Decision No. 1999/468/EEC with a guarantee of the European Parliament being placed on an equal footing with the Council in supervising the Commission's exercise of its implementing powers before it could agree to the proposed extension.

While awaiting the outcome of the revision of the Treaty, the European Commission has proposed such a reform in its 11 December 2002 proposal for a Council Decision amending Decision 1999/468/EEC. In its Resolution A5-0266/2003 adopted on 2 September 2003, the European Parliament endorsed the Commission's approach."

[14] Ecofin (3/12/2002) on the basis of a report from the Economic and Financial Committee on financial regulation, supervision and stability.

1. The Monitoring Group's core recommendations

The Group issued core recommendations in its second report (page 6 of that report). To assess whether its work is useful to the Institutions, the Group enquired whether its recommendations had been taken into account. **The Institutions and CESR confirmed that this has been the case.** Notably, CESR cited concerns expressed in the Group's second report as a stimulus to the work that led to the April consultation paper on its Level 3 role.

The Group notes in particular the following progress against these core recommendations:

- **Level 1:**
  - The ESC[14] noted that "concerns about excessive details in European legislation should be taken into account whatever the choice of the legal instrument might be. Pros (e.g. moving towards a real European rule book) and cons (e.g. attractiveness of European capital markets to third country market participants/investors) should be weighed more carefully";
  - Political agreement was reached on the Transparency Directive, using the fast-track facility, in early May 2004, close to the target date recommended by the European Council for its adoption, though the Directive has been delayed due to the emergence of a translation bottleneck (see section [4] below).
- **Level 2:**
  - The provisional mandate for Level 2 technical advice on the MiFID, issued in January 2004, avoided subjects that remained controversial within the Council and/or Parliament, such as conduct of business rules and pre-trade transparency;

[14] See the summary record of the ESC meeting of 28 January 2004, available at: http://europa.eu.int/comm/internal_market/securities/esc/index_en.htm

- The provisional mandate issued for the MiFID also explains why the provisional mandate is required in terms of defining "priority areas where implementing measures are needed at the time of the entry into force of the Directive in order to ensure its effective application in the Member States" as well as the applicable time constraints, whereby provisional mandates are the only method of allowing CESR sufficient time to prepare and deliver its technical advice;
- So far, two of the five implementing measures adopted under the Lamfalussy process have taken the form of Regulations. The views of Member States on the use of Regulations remains divided and the Commission, when drafting Level 2 implementing measures, decides on a case-by-case basis whether to propose a Directive or Regulation;
- The Commission has requested that CESR should not produce a legal text, but that CESR should "provide the Commission with an "articulated" text in a language which is easily understandable and respects current legal terminology used in the field of financial securities law".

- **Level 3:**
  - The ESC agreed with the Group that Level 3 should be ensured via co-operation and peer pressure among regulators. It did not favour passing legislation in this respect, nor did it support the idea of giving more legal weight to Level 3 measures ("the role of Level 3 committees should not be pushed further, in particular on the basis of any endorsement mechanism").
  - CESR has issued a consultation paper on its role at Level 3 but no firm conclusions have yet been drawn.

- **Level 4:**
  - The ESC has regularly discussed Level 4 in its meetings. Single contact points for implementation have been set up in the Member States and the FESE ombudsman proposal has been discussed along with CESR's proposed mediation mechanism[15];
  - The Commission has sought to engender a more cooperative approach involving, notably, the Member States and regulators. It has held transposition workshops and is encouraging the production of transposition tables by the Member States.

- **Draft EU Constitution:** there is still considerable uncertainty about how the Lamfalussy process will work under the framework of the new Constitutional Treaty. The Group reiterates its recommendation that the Institutions remove this uncertainty as soon as possible. In this respect, the Group notes that the Commission was successful in introducing a Declaration on Article I-36 of the draft Treaty (see Section 4 below).

- **Deadlines:** the European Council called for the Directives on Markets in Financial Instruments and Transparency to be finalised before the end of the then current Parliament. This deadline was substantively met, with the MiFID being adopted at the end of April 2004 and political agreement reached in the Council on the Transparency Directive in May 2004.

- **Resources:** the Group considers that it is difficult to reach a judgement on progress against the objectives on resources at this stage, though it notes that the number of units in the Internal Market DG of the Commission working on securities markets issues has recently expanded from two to three, namely: Financial Markets Infrastructure; Securities Markets; and Asset Management.

- **Consultation:**
  - In the provisional mandate for Level 2 advice on implementing measures for the MiFID, CESR was initially given 12 months, though this was subsequently extended to 15 months;

[15] See the summary record of the ESC meeting of 22 September 2004, available at: http://europa.eu.int/comm/internal_market/securities/esc/index_en.htm

- A 12-month deadline has been provided in the formal mandate to CESR for technical advice on implementing measures on the equivalence between certain third country GAAP and IAS/IFRS;
- CESR allocated three months for its consultation on draft advice for possible measures to implement the MiFID and has also allowed three months for other consultations (for example on CESR Draft Standard No 2 on Financial Information – coordination of enforcement activities, and on its April 2004 consultation on the role of CESR at Level 3 under the Lamfalussy process);
- The ESC supported the Group's "more cautious line on the number of consultation rounds" and invited it to consider further how to involve companies more closely in consultation processes.

- **Transparency:** CESR issued feedback statements following the production of its advice on Level 2 implementing measures for both the Market Abuse and Prospectus Directives. In both cases, the Commission has produced a document explaining the main differences between CESR's advice and the Commission's draft implementing measures.

2. Scope of the Lamfalussy Process: asset management, company law

- **The issue**

The legislative package to extend the Lamfalussy process to banking, insurance and occupational pensions, and to asset management, focuses on the **structural** arrangements within the process. For example, it extends the competences of the ESC and CESR to include UCITS. Separately, questions have been raised about whether the UCITS Directives should be recast as fully-fledged Lamfalussy Directives; and also whether the Lamfalussy process should extend to company law.

- **Assessing the issue**

Now that the remits of the ESC and CESR have been expanded to include UCITS, the case for examining the application of the Lamfalussy process to UCITS is clear. Indeed, the Asset Management Expert Group noted in its report that "the EU [asset management] industry is today still a long way from a genuine single market for asset management" and considered that any modifications to the UCITS Directive should be used to bring it into line with the four-level regulatory approach of the Lamfalussy process. Respondents to our second report were even more enthusiastic in their view that UCITS legislation should be converted to the four-level Lamfalussy process, reflecting in part their view that the way in which consultation, transparency and implementation was operated under the set-up and powers of the former UCITS Contact committee was not wholly optimal.

At the June ESC meeting, it was reported that "CESR welcomed the transfer of competences to the ESC", and also supported the idea of converting the current UCITS Directives into "Lamfalussy type" Directives. CESR requested "clarity in the distribution of roles between the ESC, the Commission and CESR when conducting work in this area" and it also "referred to the need of checking of the legal validity of Level 3 work." At the September ESC meeting, which also considered a draft Level 2 mandate to CESR on eligible assets (under existing UCITS legislation), "CESR pointed to the complexity and the excessive level of technicality of the Directive. A Lamfalussy-type Directive to be proposed by the Commission could be a remedy to those concerns. Furthermore, CESR offered assistance in the form of peer pressure in order to help the Commission to "enforce" recommendations and other forms of soft law in the Member States."

The Asset Management Expert Group report sets out a number of recommendations relating to ways in which the UCITS rules might be improved over the short and medium term. As for the longer term, the Expert Group was undecided as to whether the best way of introducing legislation to enhance the single market in asset management lay in building on the existing legal framework or in creating a "stand-alone pillar for asset management within the EU legislative framework" but in any case based on the Lamfalussy approach.

The Group notes that the Commission's March 2004 proposal to reform the 8th Company Law Directive on statutory audit of annual accounts and consolidated accounts introduces a new audit regulatory committee and provides for the use of Comitology procedures to lay down technical details and for cooperation between public oversight systems in the Member States and between Member States and third countries.

Nonetheless, the Group also observes that the idea of extending the four-level regulatory approach of the Lamfalussy process to company law has been met with much less enthusiasm. The process was designed for adapting the regulatory structure – and company law may not be a subject that lends itself readily to such a process.

- **The Group's conclusions**

The Group welcomes the recent expansion of the competences of the ESC and CESR to encompass UCITS. It supports the view of the CESR, the Asset Management Expert Group and others that the regulation of UCITS at EU level could be improved by full application of the Lamfalussy approach. The review of the operation of the UCITS Directive scheduled for 2005 may be a suitable opportunity to explore this idea more fully. For this report, the Group reserves judgement on the possible application of the Lamfalussy Process to company law.

3. Taking the lead on new EU-initiatives – the example of clearing and settlement

The Commission Communication which consults markets about the idea of a proposal for a Level 1 Directive in the field of clearing and settlement for efficient and safe pan-European clearing and settlement was adopted on 28 April 2004.

The Commission's approach to the acknowledged problem of Clearing and Settlement may be an example of the new spirit of openness in pre-legislative consultation. It has been accepted widely for some years that this final part of a securities transaction would be a critical component of a genuinely single capital market – yet the detail is intensely technical. The Giovannini Group began work on the subject in January 2001 and has now produced two reports on the topic after widespread consultation. Outside the EU, IOSCO has been working on the subject for some time.

The Commission has issued two consultation papers; and much work has been carried out by both the ESCB and CESR on their "Standards for Securities Clearing and Settlement Systems in the European Union". The objectives of these standards are to enhance the safety, soundness and efficiency of securities market post-trading infrastructure. The Commission has followed, as an observer, the ESCB/CESR work on drafting these standards, which are based on the CPSS-IOSCO recommendations. The EP, in its resolution of 15 January 2003, urged the ECB and CESR to "conclude its work as soon as possible", but also recommended that this initiative should not duplicate the work of the Commission in this area.

These standards take into account to some extent the different views of market participants which were furnished to ECB and CESR during the public consultation. However, some of these standards are more likely to become binding in nature than recommendations because the national central banks and regulators will probably use whatever national powers they have to enforce them - even though they will have no explicit Community law status.

The ESCB/CESR standards contain many of the details that might be expected at Level 3 of the Lamfalussy process. Meanwhile, the Commission has announced a general intention to introduce a Directive, but senior officials have made it clear that they are still assembling the evidence that would prove legislation necessary. Major questions relating to the regulatory and governance concepts to be applied and to which parts of which commercial entities – in effect classic Level 1 principles – are yet to be worked out. In this context, the Group notes the recent appeal to CESR/ECB by the EP's Rapporteur to postpone their decision to adopt the standards.

- **The Group's conclusions**

The adoption of standards such as those currently being worked up by the ESCB and CESR will influence the debate surrounding the possible content of any future Level 1 or Level 2 measures. However, such standards cannot institutionally constrain or put into question the legislative responsibilities of the EU Institutions – not just Commission but Council and Parliament as well (see conclusions in relation to CESR's role at Level 3, Part II Section 7 (a) above, on the use of soft law instruments). It would be unfortunate if two sets of standards were to be created that might be inconsistent or contradictory. More generally, the Group does not consider it optimal that quasi-Level 3 standards are being created before impending Level 1 and Level 2 legislation has been passed.

4. Perceived bottlenecks

In earlier reports, the Group had raised the possibility that the June 2004 Parliamentary Elections could have turned out to be a bottleneck. But in reality, the prospect acted as an accelerator to finalise Directives. The Group also pointed out the problems posed by the workload of the jurist-linguists and were informed that these had been resolved.

However, **enlargement** has raised the number of official languages to 20 and that has already caused a significant delay in the formal enactment of the Transparency Directive and the Committee Structure Directive, that will extend the Lamfalussy process to banking, insurance and occupational pensions, and to asset management. The problem may become particularly acute in the near future – for example, when the time comes to adopt Level 2 measures to complete the Financial Markets and Instruments Directive.

The translation bottleneck is certainly not unique to the financial services sector, but it could become a major hold-up. Sufficient resources must be made available within the EU Institutions to ensure that legislative and consultative processes are not jeopardised by translation delays. However, finance is a truly global activity and the vast majority of papers – both official and private – that are addressed to the financial community and not to the public at large, are already produced in English as a matter of practical expediency. Working on the basis of documents in English would leave it to the addressees to have the documents translated at their own expense. But, obviously, this may create difficulties for smaller entities when responding to consultations because of their limited resources. (see Part II Section 6).

The European Central Bank has no official policy on the language to be used for its consultation documents. However, from the outset its working language has been English. As regards documents aimed at professional market participants that are not official communications[16], for the most part the ECB has produced working documents in English and left it to ESCB members to translate what they consider necessary. CESR has no formal policy either, but it is noticeable that all of its publications are in English and the vast majority of consultation responses are in the same language. The onus is on CESR members to provide translations for their own nationals. However, that does not resolve the difficulty at Level 2. Level 2 consists of official legislation that requires translation in all languages to become effective, with the consequence that draft texts for discussion at the ESC will also need to be translated before formal discussion. Given the escalating translation delays and the rising workload of Level 2 legislation, this could turn out to become a major bottleneck.

Implementation lags could also be a bottleneck. In Part II Section 1, the Group concluded that any gains in momentum made under the Lamfalussy process on agreeing legislation could be lost if this momentum is not followed through by Member States in transposing agreed measures. The Group notes that not one Member State had notified transposition of the Market Abuse Directive by the 12 October deadline. It seems unlikely that this Directive and its implementing measures will be fully transposed in all Member States before some time during 2005.

[16] Official communications would, for example, include those on exchange rates.

Delayed transposition may also have repercussions for the private sector. The Group discussed in Part II Section 1 the implications of a legislative timetable (for the MiFID) that left insufficient time for robust testing of technological changes to market-wide infrastructure. The Group understands that the Commission services are currently in contact with market participants and the Member States with a view to exploring possible ways forward.

The inclusion of **excessive detail** – in either or both Level 1 and Level 2 measures – may be one of the underlying factors contributing to delayed implementation. As such, it could risk undermining any gains in speed obtained, for example, through use of fast track facility, thus delaying the start of work at Level 3 and, more generally, running the risk of reducing the overall efficiency and flexibility of the Lamfalussy process.

Implications of the new Constitutional Treaty. The Treaty was adopted by Heads of State or Government in June and signed on 29 October 2004 - it must now be ratified by each Member State[17]. At the time of writing, referendums looked likely or certain in at least eleven Member States (Belgium, Czech Republic, Denmark, France, Ireland, Luxembourg, Netherlands, Poland, Portugal, Spain, UK). Ratification is not a certainty.

If the Treaty is eventually ratified, the Institutions will need to work out how the Lamfalussy Process will operate under the new provisions. A new Inter-Institutional Agreement will probably be needed. A Declaration on Article I-36 has been annexed to the Treaty, which indicates "the Commission's intention to continue to consult experts appointed by the Member States in the preparation of draft delegated European regulations in the financial services area, in accordance with its established practice." It is too early to predict the position that each Institution would adopt in that regard. In order to take away doubts as to the future of the Lamfalussy Process, the Group believes that such operational details need to be clarified formally and as soon as practicable.

The first "sunset clauses" in the existing legislation – the Market Abuse Directive on 12 April 2007 – fall due only a short time after the intended ratification date of Treaty, which is 1 November 2006. Should the Treaty not be ratified by then and/or if there is no inter-institutional clarification on how the Lamfalussy process will be applied in the context of the Treaty, there is a risk that one or more of the sunset clauses would be invoked, that is to say that delegated powers would be revoked. This could, possibly, be avoided by a new Inter-Institutional Agreement anticipating the use of Article I-36 – as if it were in force. If not, the sunset clauses might become a serious bottleneck.

[17] The text of the Constitutional Treaty can be found at: http://ue.eu.int/igcpdf/en/04/cg00/cg00087-re01.en04.pdf

Part IV: Conclusions

In its first Interim Report in May 2003 in order to assess progress achieved the Group applied an analytical approach based around the objectives of the Lamfalussy Process. The Group adopted three criteria for assessing the progress of enactment of new Community law, adding a fourth to review implementation when it became relevant:

1. Has the Lamfalussy Process proved capable of speeding up the legislative process regulating securities markets? Is this Process efficient both in terms of use of resources and in terms of flexibility to keep pace with market developments?
2. Does the Lamfalussy Process make sufficient use of open and consistent consultation processes that are able to produce "reasoned" responses by the Institutions and CESR? Are the consultation processes "representative" , i.e. do they lead to responses covering both the entire spectrum of relevant actors on financial markets, and actors from many Member States of the European Union?
3. Have bottlenecks or blockages appeared, with particular regard to timetables?
4. Has implementation lived up to the expectations raised by the new Process? Has the Lamfalussy Process yielded better results than procedures applied before the Process started?

The Group developed these criteria in its first report to provide a specific framework to fulfil its mandate, namely:

- Assess the progress made on implementing the Lamfalussy process to secure a more effective regulatory system for securities markets; and
- Identify any possible emerging bottlenecks in this process.

Subsequent experience has suggested that these criteria capture the main elements of concern – and there has not been any feedback suggesting that they should be changed. However, the Group recognised from the outset that the delays in setting up the IIMG and the tight timetable for enacting legislation meant that it would not be able to review "implementation" in its two initial reports or assess the results.

Detailed Conclusions

The conclusions section is made of the key sections of this 3rd report. These sections detail **the Group's conclusions** and thus aim to answer the 4 questions set out above on the basis of the Group's analysis of the information gained during this most recent drafting period.

- **How did the process work among institutions?**

The Lamfalussy Process seems to have fostered additional momentum and speed for a series of Level 1 Directives which has, in turn, speeded up agreement on the Level 2 texts from the Commission – despite the expansion of the scope of these laws. This momentum has been built by the setting of deadlines; intensive and early consultation; the Lamfalussy Process itself and the spirit of co-operation that it has engendered between the Institutions. The Group is convinced that, while the institutional structure created by the Lamfalussy process is a necessary condition and instrumental in achieving the objective of speeding up legislation, the key drivers are (a) fostering the mutual understanding, trust and close co-operation between the Institutions and (b) efficiently canvassing outside expertise by means of consultation. It remains to be seen whether the Member States will follow suit through timely transposition of Community Directives into their national laws. If that does not occur, as the non-transposition of the Market Abuse Directive by its deadline would unfortunately suggest, the momentum gained as a result of the Lamfalussy process will be seriously put at risk.

- **On finding the right balance between speed, quality of legislation and responsiveness to market changes:**

Compared to the outset of the Lamfalussy Process in 2001, the Group notes that views of market participants seem to have evolved towards less priority on speed, as issues related to the contents and timing of some Level 2 measures have emerged. It could well be that this change in attitudes could be reversed if more buoyant market conditions stimulated a major round of innovation and/or re-structuring of market infrastructure.

Moreover, as illustrated by the strong and rising concerns expressed, for example, about the aforementioned Level 2 measures for the MiFID, the Group anticipates that all actors – the Institutions, market participants and end-users – will need to invest more time and resources to meet the overall objectives of the Lamfalussy process. In this context, when setting transposition deadlines, lawmakers should pay due attention to the constraints market participants face in terms of time and resources. All stakeholders in the Lamfalussy Process should also be aware that excessive lobbying and amending of legal enactments may affect the quality of the legislative product.

In the more exceptional case of the aforementioned Level 2 measures for the MiFID, the Group welcomes the initiative by the Commission to use any possible flexibility under the implementation stage to provide market participants with a sufficient time to prepare. Extension of transposition deadlines should only be seen as a last resort.

- **On the use of the single reading "fast-track" approach:**

The Group recognises that the use of the fast-track procedure has its merits in terms of speed. As experience with the Transparency Directive shows, however, using fast track is only likely to be operated when there is strong political commitment between the institutions to enact legislation, for example because of an external deadline (such as the end of the European Parliament term) and/or widespread agreement on the content of pending legislation. Moreover, strong reasons of institutional balance preclude the fast track procedure from becoming the general norm.

- **On parallel working between Level 1 and Level 2:**

The Group considers that parallel working has been a necessary proceeding on occasions in the past and has functioned in practice. Despite some reported unwelcome side-effects, "parallel working" has offered the opportunity of leaving more time to CESR for public consultations. Had it not been applied by the Commission and CESR, there would have been very little time for broad consultation by CESR once the Level 1 measure had been adopted. Moreover, parallel drafting makes it possible for the draftsmen to have a better insight into the practical implications of Level 1 principles. Nonetheless, parallel legislative action should be avoided when it threatens to pre-empt the views of Parliament.

- **On degree of detail in Level 1 and 2 legislation:**

Considering the ambitions in terms of speed and flexibility that are expected to be the hallmark of Level 2 in the future – i.e. amending existing Level 2 rules more swiftly than under the co-decision procedure at Level 1 - it may seem paradoxical that market participants cling on to the proven mechanisms of inserting their detailed requirements in the legislative sequence at the first opportunity, that is at Level 1. In so doing, they would appear to hamper future regulatory responses to market needs. The absence of experience so far in Level 2 "second generation" amendments may contribute to this problem – some may also fear that supervisory authorities will have too restrictive an influence on the drafting of Level 2 measures, now or in the future. The Group expects that practical experience of using Level 2 in the future to amend existing legislation *and* of using Level 3 to co-ordinate detailed implementation will foster sufficient confidence that stakeholders would be prepared to accept less detail at Level 1.

Nevertheless, the consensus view that it is useful to restrict Level 1 measures to framework principles does not seem to sit well with the current degree of detail at Level 1. This could jeopardise the Lamfalussy Process. Looking ahead, the proposal for a Directive on clearing and settlement is likely to test market participants' commitment to support restricting Level 1 to principles, as the public policy choices may have profound commercial implications.

- **On too much regulation in general:**

"Over-regulation" and, more specifically, "over-prescription" do not constitute a risk specific to the financial markets sector. Excessive rule-making is characteristic for all sectors and is difficult to remedy in spite of many well-intentioned pleas. However, in the context of the internal market, levelling the playing field is of crucial importance which can only be achieved through a consistent body of uniform or at least harmonised rules. That is particularly the case for financial markets, which are of a global nature. Obviously, that should not prevent public authorities from asking the question, at the occasion of any law-making initiative, whether a particular market activity should be regulated and, if so, with how much detail – e.g. by weighing the case for a self-regulatory or "behavioural" approach versus a more "supervisory" approach based on more active and prescriptive supervisory intervention. There are surely activities where resorting to detailed rules could well appear to be less efficient.

In practice, a case-by-case analysis is likely to remain necessary – whereby the potential risk of over-prescription at Levels 1 and 2, as well as the role of secondary EU legislation in generally supplanting national details, will have to be taken into account.

- **On the form of CESR's advice:**

The Group welcomes the Commission's new practice of requesting "articulated" texts from CESR regarding its advice on Level 2 measures. As to whether CESR's advice may contain several options, the Group believes that there is no single answer for all occasions. When there is a serious divide in opinion, it should be reported in the advice and the different options should be discussed on their own merits and presented to the political level for further consideration. That should not prevent CESR, quite the contrary, from expressing its own preference for one or the other option.

- **On the use of Regulations or Directives at Level 2:**

The Group attaches much weight to the significant threat which Member States' non-compliance with the obligation to transpose Directives on time may have for the whole Lamfalussy Process. Therefore, as of now, the Group sees no reason to change or qualify the recommendation in its previous report: the need for a level playing field (uniformity) is better served by Level 2 Regulations than by Level 2 Directives, which require timely transposition in the laws of the Member States. So far, the experience with the implementation by Member States of Level 2 Directives on Market Abuse does not negate that statement. That may change over time when experience with the implementation of Lamfalussy Directives builds up - the second Directive in the series, the Prospectus Directive, being due to be fully implemented by Member States in July 2005.

- **On consultation practices at Level 1 and 2:**

It is widely acknowledged that transparency – via consultation processes and feedback responses – has improved enormously during the life of the Lamfalussy Process and the Group welcomes the knowledge that this has brought. But the Group was informed of concerns: consultation cannot be a substitute for action by the public authorities when necessary; the heavier the consultation procedures, the more difficult it is to respond quickly to changed circumstances in the markets.

The Group shares the objective of broadening the range of stakeholders which are actively involved in consultation processes: papers must be designed to help less sophisticated or linguistically less skilled stakeholders, in particular end-users – for example through making executive summaries and glossaries available in a greater number of languages. At the same time, the Group notes that the complexity of financial market legislation often reflects the complexity of underlying issues and products and that sophistication may, therefore, be unavoidable in some cases.

- **On CESR's role at Level 3:**

The Group welcomes CESR's initiative to clarify its role around the basic concepts of coordination and convergence. It welcomes more specifically CESR's approach to coordinated implementation and supervisory convergence. National regulators in all Member States should indeed take an active interest in the transposition process – including at the legislative level where that is permitted by constitutional rules – in order to avoid divergent implementation in the 25 Member States. Supervisory convergence is an idea which the Group also supports. As regards regulatory convergence, and the use of "soft law" techniques that it implies, the Group takes a more reserved stance: the multiplication of non-binding rules at Level 3 should not lead to a grey area where legal certainty is absent and political accountability is unclear.

- **On facilitating implementation and organising mediation between national regulators:**

The Group considers that implementation meetings and peer reviews, at as early a stage as possible, are excellent instruments with which to achieve coherent implementation of Community legislation and to avoid interpretation divergences between the Member States. Mediation between regulators is also very useful and has been applied in the MAD. The Group suggests that the instrument should be worked up more fully and that the principle should be widened beyond the MAD and become of general application.

- **On other issues to be solved so as to ensure consistent Level 3 application of securities markets law:**

The Group has not found any support for a general endorsement mechanism for CESR decisions. However, in exceptional cases, endorsement may be useful, for example when soft law rules risk remaining ineffective or, as mentioned above, affecting legal certainty or political accountability.

For a Member State not to provide for competences which enable its regulators to give full effect to Community law measures, or to maintain national legislation jeopardising the full implementation of Community law measures, constitutes a breach of its duty to cooperate with the Community under Article 10 EC. That does not mean that the competences of the national regulators must necessarily be the same in every Member State, rather that there should be sufficient similarity that differences do not impede the full effect of Community law across Member States.

Furthermore, the Group considers that overlaps between Level 3 Committees should be avoided through suitable coordination.

- **On progress at Level 4:**

Given the long-standing and pervasive concern amongst market participants about uneven enforcement procedures, as well as their hesitancy to bring infringement cases to the attention of the Commission, it is clear that this issue should be tackled decisively and early. Parts of the private sector have even seen fit to put forward their own proposal for an Ombudsman procedure, together with ideas for funding it. After some initial support, the official sector now seems rather doubtful about the concept of a private Ombudsman mediating disputes between a regulator and a private party.

At this stage, the reflection on the Ombudsman idea, and the evidence available to support it, does not seem to the Group sufficiently compelling for the idea to serve as a valid alternative to use of the Commission's powers of enforcement. CESR mediation amongst its members may help to resolve some issues, in particular where these relate to differing interpretations by national regulators. As regards complaints from market participants, an alternative might be establishing a single point of contact within the Commission, that is to say a hearing officer with a large degree of autonomy. Aware of the need to put in place effective methods to underpin Level 4, the Group recommends that all parties involved should reflect further on how to enhance enforcement. Any systematic failure at Level 4 would necessarily become a major bottleneck to the progress of the Lamfalussy Process.

- **On the scope of the Lamfalussy Process: asset management and company law:**

The Group welcomes the recent expansion of the competences of the ESC and CESR to encompass UCITS. It supports the view of the CESR, the Asset Management Expert Group and others that the regulation of UCITS at EU level could be improved by full application of the Lamfalussy approach. The review of the operation of the UCITS Directive scheduled for 2005 may be a suitable opportunity to explore this idea more fully. For this report, the Group reserves judgement on the possible application of the Lamfalussy Process to company law.

- **On taking the lead on new EU initiatives:**

The adoption of standards such as those currently being worked up by the ESCB and CESR will influence the debate surrounding the possible content of any future Level 1 or Level 2 measures. However, such standards cannot institutionally constrain or put into question the legislative responsibilities of the EU Institutions – not just Commission but Council and Parliament as well (see above conclusions in relation to CESR's role at Level 3 on the use of soft law instruments). It would be unfortunate if two sets of standards were to be created that might be inconsistent or contradictory. More generally, the Group does not consider it optimal that quasi-Level 3 standards are being created before impending Level 1 and Level 2 legislation has been passed.

- **On perceived bottlenecks:**

The translation bottleneck is certainly not unique to the financial services sector, but it could become a major hold-up. Sufficient resources must be made available within the EU Institutions to ensure that legislative and consultative processes are not jeopardised by translation delays.

Annex 1: The four levels of the Lamfalussy Process

Level 1

Community legislation adopted by the Council and the European Parliament, upon a proposal by the European Commission, under the co-decision procedure: legislation should be based only on **framework principles** and definition of implementing powers for the Commission

Level 2

Community legislation adopted by the **Commission** to lay down the technical details for the principles agreed at Level 1 under the so-called Comitology procedure. Particular features:

- **Technical advice** prepared by the Committee of European Securities Regulators (CESR), following mandates issued by the Commission and based on consultation with market users;
- Favourable **vote of Member States** (qualified majority) as represented in the European Securities Committee (ESC);
- **European Parliament** may adopt resolutions a) within three months on the draft implementing measure; b) within one month after the vote of the ESC if Level 2 measures go beyond implementing powers.

Level 3

Committee of European Securities Regulators (CESR) in which the national supervisory authorities are represented, to facilitate consistent day-to-day implementation of Community law. CESR may issue guidelines and common, but non-binding, standards.

Level 4

Commission checks compliance of Member State laws with EU legislation. If necessary, it takes legal action against Member States before the Court of Justice.

Annex 2: Post-FSAP Expert Group Recommendations

	Levels 1 and 2	Level 3	Level 4
Securities Expert Group	Welcomes the increased transparency brought about by the Lamfalussy process, in particular: • CESR's feedback statements; • Commission explanation as to where and why draft implementing measures differ from CESR's advice (introduced for the Prospectus Directive; • Publication of ESC meeting summary reports. Argues additionally in favour of: • Commission, CESR and national regulators allocating sufficient time to consultation procedures; • Commission, CESR and national regulators preparing Regulatory impact analyses to be prepared following consultation and to accompany all proposals; • The principles set out in the Lamfalussy report forming the explicit basis for regulation and being extended; • Commission, CESR and national regulators making preliminary work programmes accessible; • Commission and national regulators following CESR's example of providing feedback statements; • Council and ESC discussions relating to legislative measures being conducted in public; • Council justifying significant amendments during the legislative process, as the Parliament does.	• Supports aim of strengthened cooperation between regulators at Level 3 but important that Level 3 clearly defined • Role of CESR at Level 3 should primarily be producing supervisory guidelines and recommendations and achieving operational convergence in supervisory practice • CESR should coordinate consultations with market participants and impact analyses to ensure even implementation • Establish implementation group under CESR for each Level 3 activity to coordinate implementation and peer group assessment • Level 3 should provide information about bad or unworkable legislation, as the start of a feedback process to enable upgrading of Level 1/ Level 2 legislation • Level 3 should <u>not</u> be a further push for standardisation of national legislation • National regulators should consult in advance of implementing legislation and should make their rules easily accessible	• Supportive of steps being undertaken by Commission to improve enforcement but makes further recommendations • Commission should allocate sufficient resources to DG MARKT for enforcement • Commission should set up a forum including market participants and CESR members to act as a peer pressure group in reviewing implementation • Market participants need a swift, flexible and anonymous mechanism whereby they can raise concerns • Complaints mechanism to be supported by a European ombudsman for market participants
Asset Management Expert Group		• Strongly welcomes expansion of CESR's remit to include UCITS • Directives must be implemented evenly across the single market • Supervisory convergence and cooperation is the basis for consistent enforcement	

Annex 3: CESR Level 3 framework

CESR consultation: Level 3 Framework in context and new proposals (*in italics*)

Level 1 Framework Directives/Regulations

Level 2 Implementing measures (during this stage CESR prepares advice for the Commission)

Level 3

Co-ordinated Implementation

- Member States' governments and national regulators transposing into national law/rules the EU law;
- Co-ordination efforts promoted by EU Commission as part of its enforcement duties;
- CESR Review Panel ad-hoc decisions and scrutiny of consistent transposition;
- *Keeping alive the network of CESR experts who prepared CESR's Level 2 advice to the European Commission;*
- *Recommending that CESR members all be given similar powers to make rules to implement both EU legislation and CESR standards and guidelines.*

Regulatory Convergence

- Normative effect of individual decision of national regulators: (CESR Members);
- Embed common approaches into Guidelines, Recommendations or Standards by CESR;
- *Alerting the EU Commission on any need to update EU legislation (in the Level 1 and Level 2 texts);*
- *Liaise with the EU Commission, where appropriate, to develop ways to give more authority to CESR guidelines, recommendations and standards.*

Supervisory Convergence

- Mutual recognition of decisions;
- Co-operation between regulators in the performance of their duties (existing work of CESR-Pol and CESR-FIN);
- Establish a role for CESR to:
  - *prepare guidelines and undertake joint investigations of cross-jurisdictional institutions;*
  - *exchange staff and joint training programmes;*
  - *develop additional information databases with precedents of regulatory interpretation and judicial cases;*
  - *develop a 'mediation mechanism' by peers when two competent authorities disagree or where regulators fail to co-operate.*

Level 4

- SOLVIT
- Infringement procedures

Annex 4: Current state of legislation

Directive	Market Abuse	Prospectus	Markets in Financial Instruments	Transparency
Level 1				
Commission proposal	30/05/2001	30/05/2001 (original) 09/08/2002 (amended)	19/11/2002	26/03/2003
1st reading EP	14/03/2002	14/03/2002	25/09/2003	30/03/2004
Council common position	07/05/2002	24/03/2003	07/10/2003	- (political agreement reached 12/05/2004)
2nd reading EP	24/10/2002	02/07/2003	30/03/2004	Not applicable
Date of adoption	28/01/2003[18]	04/11/2003[19]	21/04/2004[20]	-
Date of publication in OJ/ Enters into force	12/04/2003	31/12/2003	30/04/2004	-
Implementation deadline/measure comes into effect	12/10/2004	01/07/2005	30/04/2006	two years after the date of publication in OJ
Level 2				
Mandate to CESR	18/03/2002 (first set of measures, provisional) 20/12/2002 (first set of measures, formal) 31/01/2003 (second set of measures)	18/03/2002 (first set of measures, provisional) 31/01/2003 (second set of measures, provisional) 31/03/2003 (deadline extended for first set) 01/10/2003 (first and second set, formal) 25/06/2004 (third set, formal)	20/01/2004 (provisional) 25/06/2004 (formal)	25/06/2004 (formal)
CESR advice to Commission	31/12/2002 (first set of measures) 31/08/2003 (second set of measures)	31/07/2003 (first set of measures) 30/09/2003 (second set of measures – 1) 31/12/2003 (second set of measures – 2)	Due by 30/04/2005	-
Commission working document	10/03/2003 (first set of measures) 10/11/2003 (second set of measures)	07/11/2003 (first and second sets of measures, excluding second set - 2)	-	-
Formal Commission draft implementing measures	09/07/2003 (first set of measures) 22/12/2003 (second set of measures)	20/01/2004 (first and second sets of measures)	-	-
Agreement in European Securities Committee	29/10/2003 (first set of measures) 19/04/2004 (second set of measures)	30/03/2004 (first and second sets of measures)	-	-
Adoption by Commission	22/12/2003 (first set of measures)[21] 29/04/2004 (second set of measures)[22]	29/04/2004 (first and second sets of measures)[23]		
Publication in OJ/Enters into force	23/12/2003 for the first Regulation and 24/12/03 for the first two Directives 30/04/2004 (second set of measures)	30/04/2004 (first and second sets of measures)	-	-
Implementation deadline/measure comes into effect	12/10/2004	01/07/2005	30/4/2006	-

18 Directive 2003/6/EC of the European Parliament and of the Council of 28 January 2003
19 Directive 2003/71/EC of the European Parliament and of the Council of 4 November 2003
20 Directive 2004/39/EC of the European Parliament and of the Council of 21 April 2004
21 Commission Directive 2003/174/EC, Commission Directive 2003/175/EC and Commission Regulation (EC) 2273/2003 of 22 December 2003
22 Commission Directive 2004/72/EC of 29 April 2004
23 Commission Regulation (EC) 809/2004 of 29 April 2004

Annex 5: Legislative Development: the current stage of MiFID per 11 major trade associations

11 major trade associations[24] approached the Group with the following concerns relating to the timetable for the MiFID and, in particular, the need for industry to re-tool systems.

> "As Level 2 text is yet to be finalised, firms cannot start system development now. Systems cannot be written until the **exact** requirements are known. Furthermore, firms cannot "start to prepare" on the basis of partial knowledge of what they will need to do. It is not possible to prepare a 'contingent system specification'. In addition to Level 2 finalisation, a further unavoidable source of pressure on the timetable for implementation arises from the process of **domestic consultation** which most national regulators will undertake, whether as a result of statutory obligation or otherwise. An *optimistic* timetable for that process appears to be as follows:
>
> **January 2005** – CESR delivers advice on first mandate
>
> **April 2005** – CESR delivers advice on second mandate
>
> **February to July 2005** – Commission drafts Level 2 measures, consults ESC and EP, delivers definitive measures to ESC (assume 6 months) [first mandate].
>
> **May to October 2005** – Commission drafts Level 2 measures, consults ESC and EP, delivers definitive measures to ESC (assume 6 months) [second mandate].
>
> **June to December 2005** – development of national measures under first mandate (assumes Member States are prepared to work on developing domestic legislation and regulations in parallel with the Parliament's and ESC's consideration of the draft measures: 2 months to prepare; 3 months to consult; 2 months to finalise)
>
> **September 2005 to March 2006** – development of national measures under second mandate (assumes Member States are prepared to work on developing domestic legislation and regulations in parallel with the Parliament's and ESC's consideration of the draft measures: 2 months to prepare; 3 months to consult; 2 months to finalise)
>
> (...)
>
> **Therefore firms would be able to start system development at the earliest in January 2006 for the first mandate, and April 2006 for the second mandate**."

[24] The 11 associations are as follows: International Swaps and Derivatives Association, International Securities Market Association, International Primary Market Association, Association of Norwegian Stockbroking Companies, Bankers and Securities Dealers Association of Iceland, Bond Market Association, Danish Securities Dealers Association, Finnish Association of Securities Dealers, Futures and Options Association, London Investment Banking Association, Swedish Securities Dealers Association.