



EUROPEAN CENTRAL BANK

THE GOVERNING COUNCIL

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**REVIEW OF THE APPLICATION OF THE LAMFALUSSY
FRAMEWORK TO EU SECURITIES MARKETS LEGISLATION
CONTRIBUTION TO THE COMMISSION'S PUBLIC CONSULTATION**

1. Introduction

As a contribution to the debate on the review of the Lamfalussy process called for in the Resolution of the Stockholm European Council of 23 March 2001, the European Central Bank (ECB) would like to provide some comments on the preliminary assessment made by the Commission (the "Commission document") published on 15 November 2004 for public consultation¹. These comments represent the views of the Eurosystem, which comprises the ECB and the NCBs of those countries that have adopted the euro.

In line with the scope of the Commission's review, this note focuses on the securities field in which the Lamfalussy approach has been implemented since 2001. It should be noted that on 3 December 2002 the Council invited the Commission to implement arrangements for the remaining financial services sectors based on the final report of the Committee of Wise Men², and thus the application of the Lamfalussy process has been recently extended to the banking and insurance sectors. In particular, Level 3 Committees have been established for banking (the Committee of European Banking Supervisors (CEBS)) and insurance (the Committee of European Insurance and Occupational Pensions Supervisors (CEIOPS)) and have started their activities. Given the relevance of the Lamfalussy process also for the other segments of the financial system, it is important that in the future the review process adopts a broader perspective to cover also the banking and insurance sectors.

To assess the achievements reached with the implementation of the Lamfalussy framework in the securities field it is important first to recall the final objective thereof: the creation of a dynamic and efficient European securities market. To achieve that result, as the Stockholm European Council stated when approving the Lamfalussy procedure for the securities sector, "the regulation of securities markets needs to be sufficiently flexible to be able to respond to market developments and to ensure that the European Union is competitive and can adapt to new market practices and regulatory standards...".

¹ Commission working document, The application of the Lamfalussy process to EU securities markets legislation – A preliminary assessment by the Commission services, 15.11.2004, SEC(2004) 1459.

² See in this respect the proposal for a directive of the European Parliament and of the Council amending Council Directives 73/239/EEC, 85/611/EEC, 91/675/EEC, 93/6/EEC and 94/19/EC and Directives 2000/12/EC, 2002/83/EC and 2002/87/EC of the European Parliament and of the Council, in order to establish a new financial services committee organisational structure (COM(2003) 659 final), which is expected to be published early 2005.(the "Lamfalussy Committee Directive").

Furthermore, the European Council recognised the need for further convergence of supervisory practices and regulatory standards.

It should also be noted that on 16 November 2004 the Council made a positive assessment of the Lamfalussy framework. It highlighted that “The application of the framework has generated additional momentum to, and increased the flexibility of the legislative process in allowing it to respond to technological change and market developments, by adopting implementing rules on a faster and more flexible basis. It has also paved the way for more effective supervisory co-operation and convergence.”³

It is understood that the review of the Lamfalussy process is part of the broader effort to identify a new strategy to foster the integration of the EU financial markets (the so-called “post-FSAP strategy”). This note should therefore be seen as providing some preliminary indications, which will be part of a broader contribution to the Commission’s preparation of the new EU framework for action to foster EU financial integration.

This note is structured as follows: after having highlighted the reasons for the Eurosystem’s interest in the Lamfalussy process and made some general considerations thereon (Section 2), Section 3 provides some views as regards the different levels of the process. Section 4 concludes with some considerations as regards the future of the process.

2. General considerations

2.1 The Eurosystem’s interest

The Eurosystem has a keen interest in any material development concerning the integration of financial system for two main reasons.

First, under the Treaty establishing the European Community (the “Treaty”), a basic task of the Eurosystem is to define and implement the monetary policy of the euro area. In this regard the primary objective of the Eurosystem is to maintain price stability⁴. The achievement of price stability requires that monetary policy impulses be smoothly transmitted throughout the euro area by means of integrated and efficient financial markets. Securities markets, together with the unsecured money market and the banking sector, play a key role in this respect. The existence of some degree of segmentation of financial markets in the monetary area under the jurisdiction of a central bank is not uncommon. However, obstacles to the integration of the financial system in the euro area may slow down or distort the transmission of monetary impulses to the economy. It is in the Eurosystem’s interest that obstacles to the integration of securities markets do not thwart the full benefits of economic and monetary union.

³ It agreed that, in light of the extension of the Lamfalussy framework to all financial sectors, the mandate of the Inter-Institutional Monitoring Group should be extended to cover the new areas of banking, insurance and occupational pensions. New members should therefore be nominated to take account of the new mandate of the group.

⁴ Treaty, Articles 105(1) and (2).

Second, the Eurosystem's interest stems from the relationship between the integration of financial systems and financial stability. The Eurosystem has the institutional task of contributing to financial stability in the euro area and the EU. This entails, inter alia, that the ECB has an interest in ensuring that regulatory and supervisory structures, both at national and Community level, provide all the players with the appropriate incentives to avoid excessive risk exposure.

Furthermore, it has to be noted that under the Treaty the ECB has an advisory role on any proposed Community act (including draft Level 2 legislation) in its fields of competence, including EU legislation that materially influences the stability of financial institutions and markets. In this regard, the ECB has been consulted by the Council and delivered opinions on the Commission's proposals for the four key securities market directives under the Financial Services Action Plan (FSAP): the Market Abuse Directive, the Prospectus Directive, the Markets in Financial Instruments Directive and the Transparency Directive⁵. In the framework of its Opinions on draft FSAP legislation and on the proposed Lamfalussy Committee Directive⁶, the ECB Governing Council has already expressed some views on the procedures for the adoption of Community financial legislation in accordance with the Lamfalussy process.

2.2 General comments

The ECB has from the outset been very supportive of the adoption of the Lamfalussy framework, which it has always considered as a framework with the potential to make substantial improvements to the EU legislative system for the financial markets. After some years of implementation, the ECB confirms its positive stance: on the basis of the satisfactory experience to date, it is clear that the Lamfalussy process will continue to effect a substantial improvement in the regulation of the securities sector. Furthermore, the Lamfalussy process has been conducive to the completion of the ambitious legislative agenda envisaged by the Financial Services Action Plan (FSAP). It is too early for a full assessment of whether this process has been instrumental in allowing the FSAP to achieve its objective of creating highly integrated, efficient and stable securities markets in the EU, as the new regulatory framework has still to be completed. However, it is possible to evaluate how the new legislative procedure allowed a full and efficient interplay among the different institutional players.

All the players in the Lamfalussy process have been active in enhancing the workability of the process. The Commission and the Parliament have both been cooperative and Level 1 legislative proposals have been smoothly adopted, notwithstanding the presence of highly controversial political points (in particular in the case of the Markets in Financial Instruments Directive (MIFID)⁷ and the Takeover Bids Directive⁸).

⁵ Opinion of the European Central Bank CON/2001/36, OJ C 344, 6.12.2001, p.4; Opinion of the European Central Bank (CON/2001/38), OJ C 024, 26.1.2002, p.8; Opinion of the European Central Bank (CON/2003/9), OJ C 144, 20.6.2003, p.6; Opinion of the European Central Bank (CON/2003/21), OJ C 242, 9.10.2003, p.6.

⁶ Opinion of the European Central Bank (CON/2004/7), OJ C 58, 6.3.2004.2003, p.23.

⁷ Directive 2004/39/EC of the European Parliament and of the Council of 21 April 2004 on markets in financial instruments amending Council Directive 85/611/EEC and 93/6/EEC and Directive 2000/12/EC of the European Parliament and of the Council and repealing Council Directive 93/22/EC, OJ L 145, 30.4.2004, p. 1.

⁸ Directive 2004/25/EC of the European Parliament and of the Council of 21 April 2004 on takeover bids, OJ L 142, 30.4.2004, p. 12.

The Commission has fulfilled the commitment to conduct extensive consultation on draft texts and the transparency of the legislative process has been substantially enhanced. Market participants have been able to follow the preparation of legal acts, providing their input through public consultations. In the European Securities Committee, draft Level 2 measures have been discussed openly and no Commission proposal had to face a predominant view against it from Member States which would require its withdrawal⁹. Moreover the Inter-institutional Monitoring Group (IIMG) has provided substantive contributions and through its three reports has helped to identify deficiencies and bottlenecks in the legislative process. In general the commitment of all players has been crucial to reaching the target date of 2005 for the completion of the FSAP.

However, the need for the quick adoption of a number of very important directives did not allow a careful and structured reflection by European institutions and Member States on how to exploit all the possible benefits of the Lamfalussy process. This may provide a “window of opportunity” to benefit from the experience gained so far with a view to further improving the process.

The ECB believes that the priority should be the creation of the right conditions for putting into place a flexible and not excessively burdensome regulatory framework, which would meet the legitimate needs of the market participants and at the same time pursue the policy objectives of the public authorities involved.

In a truly integrated European market, market participants should be subject to the same harmonised regulatory conditions, irrespective of the country where either they are located or are providing financial services. To achieve this end, the Lamfalussy process should be used in such a way as to streamline existing regulatory requirements and develop a common set of harmonised technical rules that would satisfy the needs of both regulators and market participants. This common set of harmonised rules should provide market participants that offer cross-border services a unique source of rights and obligations in the EU harmonised regulatory fields.

3. Specific issues and suggestions for improvements

The ECB shares the Commission’s view that there is a need for “a clearer articulation of what roles and tasks should be performed at each level of the Lamfalussy process”¹⁰. This section gives some suggestions as to how the different levels should function and interact to achieve the objective of creating a common set of technical rules at European level.

3.1 The interrelationship between Level 1 and Level 2

The Commission document, as well as the IIMG’s reports, highlight that the level of detail contained in Level 1 and Level 2 measures is a source of concern. In that respect, there needs to be a clearer articulation of roles and tasks to be performed at each level.

⁹As mandated by the European Council for cases where Level 2 legislation presented by the Commission faces strong opposition from Member States.

¹⁰ See page 9, point 22 of the Commission document.

The ECB agrees with the Commission about the need to have less detail in the legislative framework, nevertheless Level 1 must address the main issues which appeared to be decided by the European Parliament and the Council. As already stated in its opinions on the proposed Lamfalussy Committee Directive¹¹ and on the proposed MIFID¹², the ECB's view is that Level 1 measures should contain all framework principles with a view to addressing technical issues at Level 2. This problem is of particular concern as regards Level 1 legislation, whose modification requires the lengthy co-decision procedure, considering that the objective of the Lamfalussy process is to enhance the flexibility of the regulatory framework. It is therefore crucial to better differentiate between Level 1 framework principles and Level 2 technical implementing measures. The ECB suggests that the scope of rules to be adopted through Level 2 legislation should be extended as far as possible in order to achieve a high degree of both harmonisation and flexibility in the regulatory framework.

This problem can be illustrated by two directives in the securities field: the Transparency Directive¹³ and the MIFID. Both were the subject of intense political debate and include several compromises. The resulting text of these Level 1 measures contains a number of detailed rules, which in a coherent application of the Lamfalussy approach would have been allocated to Level 2. Among many examples, the following may be mentioned: in the Transparency Directive the content of the yearly or half-yearly financial reports, extensively regulated by Articles 4 and 5; and the methods used to calculate the voting rights resulting from ownership of securities with regard to the threshold for notification (Article 9); and in the MIFID the detailed determination of the cases that would justify the withdrawal of investment services authorisation (Article 8).

Secondary measures (Level 2) should develop as a body of rules, to which market players may refer directly, whose purpose should not be limited to simply modifying details of directives. Ideally, there should be a set of Level 1 rules composed of high level principles and a consistent set of Level 2 measures composed of the main technical measures. This would have two beneficial consequences: first, it would limit the need to amend Level 1 rules through the co-decision procedure if a change of technical details is made necessary by market innovation; and, second, a common set of technical rules would be built at Level 2 that could be amended by the regulatory committees. This would help to achieve the key objective of flexibility of the regulatory framework laid down in the Lamfalussy Report.

The Level 1 acts adopted so far combine (i) framework principles; (ii) provisions delegating the definition of their technical content to Level 2; and (iii) technical rules which might be amended or updated through the Lamfalussy procedure. Technical rules are therefore dispersed among those contained in Level 1 legislation and those enacted separately and successively in accordance with comitology procedures. As a result, market participants would have to refer to technical rules scattered through, potentially, many

¹¹ Opinion of the European Central Bank CON/2004/7, paragraph 6.

¹² Opinion of the European Central Bank CON/2003/9, paragraph 6.

¹³ Directive 2004/19/EC of the European Parliament and of the Council of 15 December 2004 on the harmonisation of transparency requirements with regard to information about issuers whose securities are admitted to trading on a regulated market and amending Directive 2001/34/EC, published in the OJ L390/38 of 31.12.2004.

separate legal instruments, raising issues of legal clarity and potentially creating inconsistencies between different legal instruments.

The ECB notes that the Commission has correctly identified the need to avoid technical measures being put at Level 1, but it does not indicate a solution. However, the Commission document indicates its willingness to codify existing securities rules. The ECB agrees with this project, which could be pursued with the more ambitious objective of achieving a better distinction between Level 1 and Level 2 rules. In fact, as indicated by the IIMG, the main reason for having so much detail at Level 1 was the desire of interest groups to have technical compromises clearly reflected in the text under discussion, before the start of the work at Level 2. It could be argued that once Level 2 rules are in place, dropping details from Level 1 to Level 2 would be a very transparent exercise, as the making of the “new” Level 1 and Level 2 acts could be simultaneously undertaken.

3.2 Regulatory impact assessment

According to the Commission document all major Level 1 measures will in the future be subject to a regulatory impact assessment. The ECB agrees on the importance of making such an assessment before any new legislative proposal. The ECB is contributing to this process; it is currently conducting, with the assistance of the Banking Supervision Committee, a risk analysis with reference to the new legislative framework on payment providers – which is being conceived by the Commission – and stands ready to cooperate with the Commission using its technical expertise.

3.3 How should Level 2 be developed?

The ECB believes that, in general, the function to be assigned to Level 2 rules should be more clearly identified. Over-regulation could constitute a real problem where Level 2 measures overlap with or duplicate other sources of law. In cases where Level 2 measures coexisted with national implementing rules, market participants would face an overly prescriptive and sometimes onerous legal framework.

The ECB notes that Level 2 – by reducing the scope of the current national rulebooks – should provide the main set of technical rules to which financial institutions could refer to. In this way, market participant wishing to provide services in other Member States could rely on a large body of common rules in which their rights and obligations vis-à-vis supervisory authorities would be clearly set out.

To have a truly European body of common technical rules, and avoid any overlap of rules, one way forward would be to put, whenever appropriate, Level 2 technical rules in regulations, which do not need implementation at national level. The use of directives implies a long implementation process and entails the risk that inconsistencies in the national implementation of Level 1 acts are exacerbated by further inconsistencies in the transposition of Level 2 rules. In addition, using directives and regulations alternatively (and cumulatively) for Level 2 rules will only further increase the fragmentation of the technical rules and the risk of confusion and inconsistency. One type of legal instrument only should be used consistently for Level 2, at least with regard to the technical rules referring to a single piece of Level 1 legislation. In the ECB’s view, it seems clear that the nature and the purpose assigned to Level 2 rules

would be adequately fulfilled if they were enacted by regulations, directly applicable in all Member States. Therefore regulations are to be preferred to the extent possible, and the Commission should clearly justify in advance those cases in which it proposes directives at level 2 in the light of the need for having more flexibility at national level.

The common set of technical rules embodied in Level 2 legislation would be complemented by the Level 3 work of the supervisory committees.

3.4 Clarification of the boundaries of the Level 3 function

According to the Commission document, Level 3 is still untested and undefined. The main purpose of Level 3 is to coordinate Member States' implementation of EC law; however this role needs to be articulated more clearly. The ECB agrees that it is of particular importance to clarify from the outset the function and boundaries of the Committee of European Securities Regulators' (CESR's) actions at Level 3, as this would also set out the framework for the work of the other two recently-established committees.

It may be recalled that Level 2 rules have two essential and distinctive features. First, they are adopted through a clear and transparent procedure in which all the European institutions and the Member States have a clear role. In particular, Level 3 committees when preparing the technical advice on Level 2 proposals upon the request of the Commission are accountable to the European Parliament. The procedure adopted fully respects the European system of checks and balances and closely resembles, in term of accountability and full interaction between the Commission, the Member States and the European Parliament, the procedure provided for at Level 1. Second, Level 2 rules have a truly binding nature, as they are issued on the basis of the mandates given by Level 1 legislative acts. They are truly Community law and as such are subject to the scrutiny of national and Community courts.

On the contrary, Level 3 deliberations differ from Level 1 and Level 2 legislation since they are not binding and they are not part of Community law. Furthermore, the Level 3 instruments are adopted by the competent committees without neither any formal endorsement by European institutions, nor any accountability to the European Parliament. Instead, as such rules concern the coordination of the work done by supervisors, which are members of the committees, accountability will be at national level¹⁴. Therefore, a common set of EU-wide binding technical rules which individuals have to comply with can be set up at Level 2 only and Level 3 instruments would be a necessary complement thereto. This position seems to be reflected in the Commission document, according to which "CESR standards adopted at Level 3 must be fully compatible with – and cannot substitute for – binding EC legislation at Level 1 and 2", with which the ECB fully agrees¹⁵.

As regards coordinated implementation of EC law, responsibility for the day-to-day implementation is for national regulators, who could play an active role in fostering a common interpretation of rules within

¹⁴ See the IIMG third report, page 31.

¹⁵ Ibid. page 10.

their competence, although the ultimate responsibility for the enforcement of EC law is for the Commission and, ultimately, for the European Court of Justice.

As regards in particular regulatory convergence, the CESR defines it as the “process of creating common approaches”¹⁶, on the basis of the decisions taken in their supervisory activity. They can be transformed into indicative guidance, regulatory recommendations, or standards. The ECB agrees on the importance of this function to be played by the Level 3 committees. Such activity must be seen as complementary to the truly regulatory activity carried out at Level 2. In particular, the ECB sees a great deal of benefit in Level 3 activities in areas not covered by EC law. The European System of Central Banks/CESR standards on clearing and settlement systems, through which the CPSS/IOSCO standards have been adapted to the European context, are a good example. This mechanism could be used for addressing matters on which the basis requirements for EC law (subsidiarity, proportionality) are not yet fulfilled, but there is a need for a common approach among EU regulators. As regards the accountability of the Level 3 committees when acting at level 3, the Economic and Financial Committee suggested that they should develop accountability links with the Financial Services Committee. The ECB notes that this idea should be further discussed and clarified as regards the instruments and the limits of such accountability.

When assessing how the Lamfalussy approach allows achieving the objective of regulatory convergence, it is necessary to look at the overall legislative framework since the achievement of such an objective also depends on the way in which Level 1 and Level 2 measures are structured. If Level 1 or Level 2 legislation leaves Member States some room for uneven implementation, it will be more difficult to achieve regulatory convergence on a pan-European basis. Moreover, it is noted that the functioning of the overall Lamfalussy process and its capacity to achieve the objectives of regulatory and supervisory convergence should be further assessed in those cases in which a minimum harmonisation approach is followed at Level 1 (or Level 2), therefore allowing Member States to adopt more extensive rules. In this context, the Commission could start, together with the CESR, to identify and address matters in which the EC legislative framework allows Member States to regulate differently on harmonised matters and to analyse the resulting diversity. It is noted that this exercise has been conducted by the CEBS as regards the new Capital Adequacy Directive¹⁷, with a successful outcome.

3.5 Level 4

Regarding Level 4, the Commission document highlights that enforcement of implementation by Member States would require a major effort. Indeed the recent case of the Market Abuse Directive¹⁸, which has not been implemented on time by Member States, shows that timely implementation could be a major challenge. The ECB suggests that it is crucial to exploit the assistance of national regulators, as the

¹⁶ CESR, The role of CESR at “Level 3” under the Lamfalussy process. Action plan for 2005, October 2004., p. 9.

¹⁷ Proposal for a directive of the European Parliament and of the Council recasting Council Directive 93/6/EC on the capital adequacy of investment firms and credit institutions COM(2004) 286 final.

¹⁸ Directive 2003/6/EC of the European Parliament and of the Council of 28 January 2003 on insider dealing and market manipulation (market abuse), L 96, 12.4.2003, p. 16.

Commission started to do by establishing a network of single contact points in Member States. Level 3 committees can also play a major role in this area.

4. The future of the Lamfalussy framework

4.1 The new Constitutional Treaty

The Commission document briefly refers to the new Constitutional Treaty and to the declaration concerning Article I-36 referring to 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".

This declaration does not imply that the Lamfalussy approach will not be affected by the Constitutional Treaty. A transparent debate on the future of the Lamfalussy process should be started by the Commission to accommodate the concerns of all institutions involved and consider whether specific measures (such as an Inter-institutional Agreement) would be warranted.

4.2 The monitoring of the Lamfalussy process

The ECB welcomes the extension of the IIMG's mandate to cover banking, insurance and occupational pensions, for which new members will be appointed. It notes that a more integrated monitoring will be needed of all EU institutional arrangements for financial regulation, supervision and stability. Therefore, the IIMG's mandate could be further extended to encompass the assessment of the implementation of the recommendations of the Brouwer reports in the fields of financial stability and crisis management.