

Inter-Institutional Monitoring Group

*First Interim Report Monitoring the New Process for
Regulating Securities Markets in Europe
(The Lamfalussy Process)*

EXECUTIVE SUMMARY

May 2003

First Interim Report
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This Report is the first of the half-yearly reports 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.

Executive Summary

The Inter-Institutional Monitoring Group (the Group) implements the mandate conferred by the European Parliament, the Council of Ministers, and the European Commission, with respect to the Lamfalussy Process, which aims to secure a more effective securities market regulatory system. In order to fulfil this mandate, an analysis of legislative acts following the Lamfalussy Process in all its aspects is required at this stage. Therefore, the Group has chosen four legislative initiatives under the Financial Services Action Plan. These initiatives are also considered by all stakeholders (including financial markets) as those operating under the Process: the Market Abuse Directive, the proposed Prospectus Directive, the proposed Investment Services Directive and the proposed Directive on Transparency Obligations for Issuers. The Group's choice comprises not only monitoring the different stages for enacting legislative initiatives, but also the overall progress to secure their consistent implementation and their enforcement in the medium term.

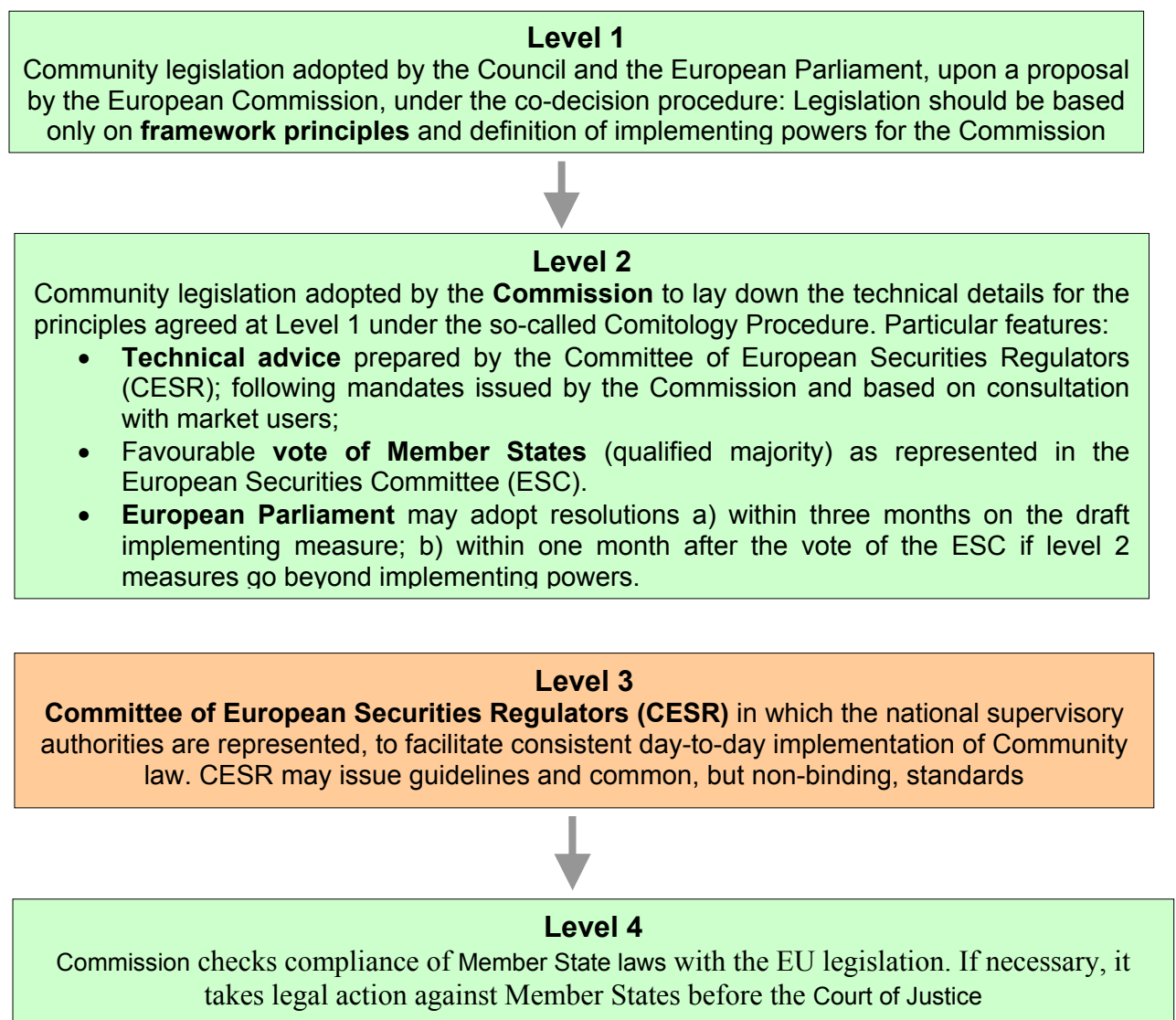
As of today, only one of these four directives has entered into force, and none of them has been developed from the very beginning as well as enacted and implemented under the Lamfalussy Process. Nevertheless, the Group will, for each of these directives, follow step by step the ongoing Process until its final report in 2004. To date, all the evidence given to the Group has been strongly supportive, though all parties recognise that they are in a “learning by doing” phase and that further improvements can still be made. The Group has noted at least five challenges for all stakeholders ahead:

1. **Continued pressures to make swift progress in order to stay ahead of European Parliament elections** and the appointment of a new Commission. In the same vein, Heads of States and Government expressed their expectation in March 2003 that the Prospectus Directive will still be adopted in 2003, as well as the Investment Services and Transparency Directives by April 2004.
2. **Satisfactory solution to the Comitology issues** stemming from Article 202 of the EC Treaty.
3. **Degree of detail in Level 1 legislation**, raising the question whether enough delegation has taken place to allow implementing rules to be adopted at Level 2.
4. **More frequent use of the “fast track facility”** for the adoption of a Level 1 measure (adoption on the basis of a single reading in the European Parliament).
5. **Adequate resources** must be made available to CESR and the Commission to fulfil their respective obligations related to consistent implementation and enforcement of European securities market legislation. In its own interest, the private sector, too, must make available sufficient resources to play its full role.

Understanding the Lamfalussy Process Today

In the light of its future work, the Group felt it important to clarify for all stakeholders, i.e. not only for the European Institutions, but also for the financial markets and the wider public what exactly the Lamfalussy Process means in practice. Merely referring to the recommendations of the Committee of Wise Men is not sufficient. The conditions under which the European Council, the European Parliament and the European Commission agreed to implement these recommendations must also be taken into full account.

In substance, the Process is centred on a four-level approach, as summarised in the diagram below. The essential novelty consists in adding two intermediary levels (Level 2 and 3), each of them to be supported by a new committee – the European Securities Committee (ESC), in which representatives from national ministries are enabled to represent Member States in the formal decision-taking process at European level, and the Committee of European Securities Regulators (CESR) in which the national securities regulators provide technical input to the decision-taking process and enhance co-operation and networking amongst national securities regulators to ensure common implementation standards.



Work programme and assessment criteria

The Group agreed three criteria for assessing the progress in enacting Community legislation, adding a fourth to review implementation when it becomes relevant:

1. Has the Lamfalussy Process proved capable of speeding up the legislative process for regulating securities markets? Is the 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 Lamfalussy Process? Has the Process yielded better results than the procedures applied before the Lamfalussy Process started?

Progress under the Lamfalussy Process

The Group greatly welcomes the firm intention of the European Council to insist on the target dates for completion of the Financial Services Action Plan. In the Presidency’s conclusions of 20/21 March 2003, the European Council “*invited the Council to rapidly complete the Financial Services Action Plan. This will require proper and effective implementation of existing Directives and the adoption by end 2003 of the pensions and prospectuses directives and by April 2004 on the investment services and the transparency directives.*”

Progress has been made on the four Directives which are the focus of this report: (i) The Market Abuse Directive entered into force on 12 April 2003. (ii) The initial proposal for the Prospectus Directive ran into controversy but an amended Commission proposal was issued in August 2002, reaching common position in the Council on 24 March 2003. A Second Reading in the Parliament is now underway. (iii) The Investment Services Directive proposal was made on 19 November 2002. (iv) The proposal for the Transparency Directive was issued on 26 March 2003.

The Group is of the opinion that it will be possible to meet the deadlines set by the European Council in March 2003, provided the current pace of negotiations and the current degree of political willingness are maintained.

Issues

When discussing its work programme and its criteria for assessing the Lamfalussy Process, the Group received comments in writing from outside as well as during meetings with representatives from the Committee of European Securities Regulators (CESR), the European Commission, and also from several European and International Associations, representing a broad spectrum of market participants and end-users of financial markets. In these discussions, the Group noted a number of issues surfacing in the current Process:

1. **Meeting the deadlines set by the European Council** necessarily implies that technical details of associated implementing measures at Level 2 need to be available rapidly. The future Prospectus Directive will even contain a 180-day deadline for the adoption of such implementing measures once the Directive has come into force. Whilst recognising the current political momentum, such deadlines should not result in any sacrifice to the quality of measures agreed under the Lamfalussy Process.
2. **Parallel working, in the technical preparation of Level 2** measures at the level of CESR while the final details of some components of the Level 1 measure are still under debate, appears to be inevitable. There is a need to observe strict timetables; as a consequence, the Commission is required to ask CESR to prepare, and submit, its provisional advice as early as possible (i.e. after the end of the first reading of a Level 1 measure in the European Parliament).
3. **The Fast Track Facility has not been used for the adoption of Level 1 legislation** for any of the four Directives under scrutiny here yet. It would appear that expectations of widespread use of this facility may be unrealistic, save for proposals that are not controversial.
4. **Too much detail in Level 1 legislation would defeat the whole Lamfalussy Process** which aims at responding flexibly to rapidly changing markets. The Group was made aware of the fact that there might still be too much detail. However, so far only one Level 1 measure has been adopted by the European Parliament and the Council, and it is too early to draw final conclusions.
5. **Level 2 legislation should not become an amalgam of already existing detailed rules.** This was a source of concern expressed by some market participants. However, the Group noted that the Commission has not presented any formal draft for Level 2 legislation. Working documents published by the Commission in March 2003 were commendably brief.
6. **The use of regulations or directives at Level 2:** From a practical viewpoint, the use of regulations at Level 2 would speed up and simplify the transposition process, as regulations contain binding rules which are directly applicable in the Member States. In the only example so far, the Commission

intends to consider using a regulation for the implementation of safe harbour rules under the Market Abuse Directive. The Group will follow up this matter in its following reports with respect to further Level 2 initiatives.

7. **CESR's role at Level 3:** CESR as such does not enact binding rules, but simply offers non-binding common standards. This has an impact on the ability of CESR to ensure full compliance with Level 3 standards at the national level. In this context, the Group noted CESR's recently adopted set of standards for enforcing the application of international accounting standards at national level.
8. The Commission reports a “sea change” in their **methods of consultation** – as required by the Final Report of the Committee of Wise Men. All participants acknowledged that they are in a “learning by doing” mode which is still in the process of being developed. As regards CESR, the Group was informed that there were problems in timetabling deadlines and meetings during the consultations; the Group's attention was also drawn to the length of consultation papers concerning the Market Abuse and Prospectus Directives.

Possible Bottlenecks

The Group interprets this part of its mandate in a wide sense. At this stage, two bottlenecks are of relevance: the first relates to a possible need for a change to the Treaty, without which the Lamfalussy Process might be difficult to sustain in the long run. The second relates to the time taken to formally adopt the common position on the Prospectus Directive in the Council. There are also some other points to which the Group wishes to draw the attention of the Institutions as they may become important bottlenecks from the point of view of financial markets and market participants.

1. **Impact of Parliamentary Elections and appointment of a new Commission in 2004:** The European Parliament will complete its final session in April 2004 and the Commission's term will come to an end in November 2004. Concern has been expressed to the Group that uncompleted legislation may be lost, or significantly delayed. Since the Brussels European Council has set April 2004 as a target date for the proposed Investment Services and Transparency Directives, the problem should not arise. In the event of delays, the effect of the parliamentary elections will depend on the stage that has been reached in the co-decision procedure at the moment that the European Parliament is dissolved. This underlines the necessity of speeding up the first reading by European Parliament, and the subsequent discussion of a common position by the Council, on any pending Level 1 legislation.
2. **Article 202 and the Sunset Clause:** The Lamfalussy Process is based on a temporary agreement between the three Institutions as a result of the so-called Sunset Clause – which, it has been agreed, will be inserted into each Level 1

measures. The Sunset Clause provides the Commission with a delegation to enact Level 2 measures, but only for a limited time. The Clause is intended to preserve the European Parliament's request for a change to Article 202 of the EC Treaty. In this way, the Parliament wishes to achieve an equal role as the Council in controlling the Commission in the exercise of Comitology powers. To address this problem adequately, there is an urgent need to find a solution during the ongoing Treaty revision. This is key to the long-run future of the Lamfalussy Process.

3. **Commitment of Resources:** Given the workload on CESR at this stage of generating advice for the Level 2 measures, there might be a particular risk of general overload for all CESR activities under the Lamfalussy Process. In addition, the current state of financial markets means that both associations and market participants are finding it hard to get additional resources. The Commission may also need additional resources to enforce Level 4 implementation effectively.
4. **Capacity of Jurist Linguists:** The European Parliament pointed to the delays that were taking place within the Council, preventing it from moving from the political agreement to the formal adoption of a common position. For example, the formal adoption of a common position on the Prospectus Directive took five months. The delay in Council in this specific case was the result of the requirements which the Copenhagen Summit decisions imposed upon the Jurist Linguists of the Council in connection with the Accession Treaties. These requirements made it impossible for them to respect their normal deadlines. Avoiding such a problem in future will be conducive to the objective of meeting deadlines set by the European Council.
5. **The Aerosol Clause:** That clause commits the Commission “to avoid going against predominant views which might emerge within the Council”. The lack of clarity about what is meant by “predominant,” may hamper the legislative process on some future occasion. That said, the Group is not aware of any intention, on the part of any Member State, to put the clause into operation.

Future Work towards the next interim report of the Group

The Group intends to submit its next interim report in autumn 2003. The Group wishes to continue its work in an open and transparent manner and encourages all interested parties from outside to make comments and observations. A first invitation for more detailed comments is therefore set out below.

Invitation to the public to make comments

The Inter-institutional Monitoring Group welcomes views from the public on the progress made on implementing the Lamfalussy Process, in order to secure a more effective securities markets regulatory system, and on any bottlenecks possibly emerging in this Process. It is particularly interested in receiving feedback and comments on the following questions:

- 1. What are your views on the Group's assessment criteria? Are they sufficiently precise and complete?*
- 2. Are you aware of any obstacles obstructing or hampering the swift and efficient adoption of securities markets legislation at European level?*
- 3. Is the system of parallel working with provisional mandates granted to CESR efficient?*
- 4. Is the scope of delegation of implementing measures at Level 1 sufficient, too limited, or too wide in order to reach the objective of more efficient securities markets legislation at European level?*
- 5. What do you consider to be the best approach as to the choice of directives or regulations as legal instruments used at Level 2 under the Lamfalussy Process?*
- 6. Are the consultation processes sufficient? Are they satisfactory and efficient as regards the number of rounds of consultation and deadlines set? Are consultative documents balanced in terms of depth and size?*
- 7. Is there a further need to provide ex-post transparency, that is to explain to the public why proposals from market participants or others were included in securities markets legislation, or why they were omitted? Do CESR's feedback statements meet the commitments made in its Public Statement of Consultation Practices?*
- 8. What are your views on the Group's preliminary observations on possible bottlenecks?*
- 9. Is the current functioning of the Institutions, committees, market participants, and other parties involved in the Lamfalussy Process conducive to making progress on securing a more effective securities market regulatory system? Are all these actors equipped with sufficient resources?*

The Group invites interested parties to send contributions to the future assessment via a dedicated e-mail address (IIMG-monitoring-group@cec.eu.int) by 7 July 2003 at the latest, for consideration in the next report.