
Inter-Institutional Monitoring Group

Second Interim Report Monitoring the Lamfalussy Process

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This report is the second 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.

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Foreword

Since the Inter-Institutional Monitoring Group's first report of May 2003, acceptance of the Lamfalussy Process has further increased. Today, the Lamfalussy Process is widely appreciated as an appropriate method contributing to a swifter and more efficient system for agreeing legislation and regulating securities markets at EU level. After almost two years of operation, policymakers and market participants alike have gathered important experience on the structures and dynamics of the new regulatory procedures. While some problems identified in the Group's first report have waned, others persist and some new issues have arisen.

The context in which the Group works is changing. On 5 November 2003, the Commission presented a proposal for extending the Lamfalussy Process to banking, insurance, occupational pensions and collective investment schemes (UCITS). The European Parliament and the Council must decide whether this extension is acceptable. Lessons from the Process as it is operated today may therefore prove to be of additional value in as much as they are applicable to all financial market regulation. At the same time, the EU is working towards a new European Constitution. The draft constitutional treaty presented by the European Convention in July 2003 should pave the way towards allowing the Lamfalussy Process to continue in the long run. However, clarity on the final form of the relevant provisions, in particular whether the European Parliament's role as co-legislator will be better taken into account at level 2, is needed as soon as possible.

This second report of the Group is composed of two parts. In the first part, the Group continues its monitoring of the Lamfalussy Process. Evidence from the reporting period covered in this report – May to November 2003 – shows that the Process continues to evolve – in the right direction. In the second part, the Group focuses on two particular aspects of the Lamfalussy Process in greater detail: Public consultation practices at levels 1 and 2, on the one hand, and a review of the rationale of, and first experience with level 3, on the other hand.

The Group wishes to thank all respondents who have provided valuable comments and insights towards the assessment of the Process in the reporting period. This includes the European Commission, CESR and a large number of business associations and market participants and their respective representatives. The Group also thanks the members of its Secretariat, provided by the European Parliament, the Council and the Commission, for their support of its work.

Following the forthcoming assessment period, the third report of the Inter-Institutional Monitoring Group will be presented in early summer 2004.

Michel Prada
(Chairman)

Norbert Walter
(Rapporteur)

Executive Summary

The Inter-Institutional Monitoring Group (the Group) welcomes the recent progress on operating the Lamfalussy Process and on reaching agreement on the measures thus adopted. Evidence from the reporting period, ranging from May to November 2003, strongly suggests that the Lamfalussy Process is proving to be a viable instrument for improving the efficiency and speed of financial market legislation and regulation in the EU.

The Group notes that none of the issues and bottlenecks identified in its First Interim Report has worsened. Nevertheless, shortcomings remain which prevent securities market legislation and regulation adopted under the Lamfalussy Process from unlocking their full productive potential and from becoming as efficient and swift as intended.

The most pressing practical concerns are:

- Keeping legislative detail as low as possible, both at level 1 and at level 2.
- The need to optimise further consultation practices at levels 1 and 2.
- Lack of resources, especially within the relevant Commission services.
- Timely adoption of the new Investment Services Directive (ISD 2) and the Transparency Directive by April 2004.

In addition to concerns pertaining to current activities, the way in which the Lamfalussy Process will be operated in the long term became a matter of discussion after the European Convention presented its Draft Treaty establishing a Constitution for Europe in July 2003. In its Draft Treaty, the Convention proposes new procedures for adopting legislation by the Commission, one for so-called delegated regulations (Article I-35) and one for so-called implementing acts (Article I-36). The potential implications for level 2 of the Lamfalussy Process remain unclear and legal uncertainties need to be resolved in the near future.

With respect to *consultation practices*, the Group notes that progress has been made on making communication between policymakers and market participants at all levels of the Lamfalussy Process more efficient and effective. In general, consultation has reached an appropriate level for all parties so that it is ensured that the views of market participants can be taken into account properly in the legislative and regulatory process. However, communication could still be improved by adjusting the details of consultation practices.

With respect to *experiences of the functioning of level 2*, a full first cycle of decision-making was recently completed when the European Securities Committee (ESC) unanimously voted in favour of three measures implementing the Market Abuse Directive on October 29 2003. In overall terms, the current performance of level 2 suggests that gains over time are substantial in comparison to the method of regulating technical details under a co-decision procedure.

With respect to *CESR level 3 activities*, the Group notes that consistent implementation of Level 1 and Level 2 regulation in the Member States is a key element in achieving a single EU securities market. Consistency should primarily be sought by means of communication and standards established among CESR and national regulatory authorities as well as by means of peer pressure on a pragmatic basis, as originally intended.

Only in cases where it is deemed essential that level 3 measures carry greater authority should an endorsement of such measures by means of more binding legal instruments be sought. A constructive approach to dealing with such cases should be agreed in due course.

In its overall assessment, the Group believes that the Lamfalussy Process is making a positive contribution to the swift and flexible regulation of EU securities markets. However, it can be further improved and the Group therefore recommends stakeholders to take the following measures:

Core recommendations by the Inter-Institutional Monitoring Group

Level 1

- Level 1 measures should lay down framework principles as recommended by the European Council at Stockholm in March 2001.
- The forthcoming Transparency Directive will be a test-case for the fast-track facility because meeting the April 2004 target date which the European Council recommended for its adoption will only be realistic if the Council adopts the directive after a single reading of the European Parliament.

Level 2

- The Commission should issue provisional mandates for level 2 technical advice only on subject matters already acceptable to the EP, the Council and the Commission after the first Parliamentary reading. Provisional mandates should not be granted where issues remain controversial.
- The Commission should carefully explain the reasons why it issues provisional mandates.
- The Commission should keep level 2 measures as lean as possible. At the same time, level 2 measures should contain unambiguous rules in order to ensure consistent implementation in the Member States.
- The Commission should make more frequent use of regulations at level 2 and largely limit the use of directives to cases where fundamental considerations make the use of regulations undesirable, or where the need for national discretion can be demonstrated.
- CESR should formulate technical advice as concretely and as clearly as possible, contributing more directly to the drafting of level 2 measures.

Level 3

- 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.

Level 4

- Effective enforcement requires support from Member States, regulators and the private sector.
- The implementation of level 4 cannot lie solely on the shoulders of the Commission. The Member States should assume more responsibility – in particular after enlargement in 2004.

Draft EU Constitution

- Open questions on Art. I-35 and Art. I-36 should be settled as quickly as possible, ensuring continuity of the Lamfalussy Process. Urgency prevails especially in the light of the extension of the Process to banking and insurance.

Deadlines

- All parties involved should reinforce efforts to meet the given deadlines in the light of the political calendar for 2004.
- For potential future legislative timetables, policymakers should seek an optimal balance between speed and the expected workload for all stakeholders.

Resources

- The Commission should substantially increase resources allocated to financial services and work on securities markets in particular.
- Market participants and national authorities are encouraged, where useful, to allocate additional resources to their work on evaluating and commenting on securities market regulation.

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.

Transparency

- Commission and CESR should ensure extensive ex-post transparency, including convincing feedback statements or other forms of explanation, not least in order to reduce the perceived need for second rounds of consultation.

Invitation to the public to comment

The Inter-institutional Monitoring Group welcomes views from the public on the progress made on implementing the Lamfalussy Process and on any potentially emerging bottlenecks.

With a view to its next report, the Group invites interested parties to send contributions by Monday 16 February 2004 to the following address:

The Inter-institutional Monitoring Group on the Lamfalussy Process

E-Mail: IIMG-monitoring-group@cec.eu.int

Part I. Monitoring the Lamfalussy Process

I.1 General Observations

In its first report, the Group established four criteria for assessing the progress achieved on implementing the Lamfalussy Process:

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 assessment provided in the present report is based on the responses which the Group received from market participants and policymakers following its call for comments on the first report¹ as well as during two hearings the Group held in September 2003².

(i) The Lamfalussy Process at large

In general, the conclusion that the Lamfalussy Process offers a useful instrument for making securities market legislation faster and more efficient has become stronger during the reporting period between May and November 2003. The vast majority of respondents today supports the Process and considers the work achieved as substantial. Progress on legislation is widely regarded as being fast and efficient. Flexibility in reacting to market demands has been acknowledged. On consultation, too, progress has been achieved. None of the bottlenecks identified in the first report have become more severe. New issues such as the application of the Lamfalussy Process to UCITS and to company law, as well as the functioning of level 4, have recently received increased attention, but neither of them can be regarded as vital at this stage. As an interim conclusion, the Lamfalussy Process is proving to be a better device for securities market legislation than the previous practice.

(ii) Level 1

At level 1, legislative work has progressed significantly. Time pressure and consultation practices, however, remain important issues for market participants, who have expressed concern over the workload associated with the remaining legislative items on the agenda.

¹ The Group received a total of 24 written responses in the course of Summer 2003. The respondents are: AFEI, AFEP, AFG, APCIMS, Assogestioni, ASSOSIM, BBA, Barclays, BDB, BDI, COB, CEA, DIHK, ESG, FBF, FEE, FEFSI, IMA, The Law Society, LIBA, MEDEF, UNICE, virt-x as well as a joint reply from FESE, FOA, ISDA, IPMA, ISMA, LIBA, SSSA, FBE. All responses were published on the internet (http://www.europa.eu.int/comm/internal_market/en/finances/mobil/lamfalussy-comments_en.htm). In the following, no explicit reference will be made to individual responses or respondents.

² Following the review of written responses by market participants, the Group held a non-public hearing to which representatives from the following interest associations were invited: AFEI, AFEP, AFG, APCIMS, ASSOSIM, BBA, BDI, CEA, ESG, FBE, FEE, FEFSI, FESE, FOA, IPMA, ISDA, ISMA, LIBA, SSSA, UNICE. The hearing was not attended by BDI, FOA, ISDA, ISMA. Further, the Group held a non-public hearing with representatives from the Commission and from CESR. In the following, no explicit reference will be made to individual responses or respondents.

(iii) Level 2

With regard to level 2, a first full cycle of decision-making has been completed recently, providing a first experience of the level's functioning. Following the production of technical advice by CESR, the Commission proposed a package containing one draft regulation and two draft directives implementing the Market Abuse Directive, on which the Member States voted in favour by unanimity in the European Securities Committee (ESC) on 29 October.

Overall, work at level 2 has progressed in a satisfactory manner. Given that the main benefits in terms of speed and efficiency are set to accrue at the point when existing level 2 rules are found to require adaptations, the current performance of level 2 suggests that gains over time are likely to be substantial.

Background

Experience with working at level 2

The use of the regulatory procedure under the Comitology framework is quite common for various Community policies. In 2002, 280 implementing measures presented to regulatory committees – comparable to the ESC – were submitted to a vote. Only seven thereof (0.25%) did not obtain the required qualified majority by Member States.

In its first report, the Group stated that an overall assessment of the functioning of level 2 in the securities area was premature as the ESC had not at that stage been fully involved in the level 2 process. The situation has clearly changed. On 29 October, the ESC voted a draft Commission Regulation implementing Directive 2003/6/EC (Market Abuse Directive) as regards exemptions for buy-back programmes and stabilisation of financial instruments, as well as two draft Commission Directives implementing Directive 2003/6/EC as regards the fair presentation of investment recommendations and the disclosure of conflicts of interest and as regards the definition and public disclosure of inside information and the definition of market manipulation. It is important to note that the option of a vote by qualified majority was not required on this occasion, and that the draft measures received unanimous agreement, thereby transmitting a clear signal of confidence in the whole Process.

Under the Comitology procedure, the Commission is now required to adopt these measures formally, whilst giving the European Parliament one month from the above date to exercise its right of review as provided for in the Comitology framework. However, the competent committee – the Economic and Monetary Affairs Committee (ECON) – decided on 5 November not to propose any resolution to the plenary session. Therefore, formal adoption is now only a last formality. Further changes can no longer be expected. Thus, the Group is in a position to make an assessment of the experience gained under the level 2 decision-making to date. To do so, it considered various issues. Two further issues (degree of legislative detail and public consultation) are already dealt with at other places. The Group focuses on the following:

1. The overall speed of level 2 decision making

The process taken altogether, starting with the provisional mandates granted to CESR until the vote of the ESC on the draft level 2 measures, took eighteen months. Seven months thereof were reserved for consultations by CESR (one on the mandate and one a consultation document) and for an additional call for technical comments by the Commission on the draft legal measures. A few respondents to the first report claimed that the level 2 procedure would therefore not be faster than a co-decision procedure, if use is made of the fast-track facility. However, such a comparison is not correct. The fast-track facility starts once the Commission presents a formal proposal. The Comitology procedure only starts once the Commission submits a formal draft to the ESC. In the current case, the draft was transmitted (and made public) on 27 June. Since the vote was taken on 29 October, the decision-making process comprises four months – or five months, including the right of oversight which the European Parliament can exercise.

Such a short period would not be a realistic timeframe for any fast track-facility under the co-decision procedure. Two examples already mentioned in the First Report illustrate this: Regulation (EC) 1606/2002 on international accounting standards took seventeen months, calculated from the date of the Commission proposal (February 2001) to adoption by the Council (July 2002); Directive 2003/58/EC amending the First Company Law Directive on disclosure requirements was adopted more swiftly, but it still took eleven months (Commission proposal in June 2002, adoption by the Council in July 2003). As a consequence, the decision-making process under level 2 is much faster than that under level 1.

2. Flexibility in the choice of legal instruments

Level 2 should first of all offer flexibility for adapting legislation. No experience is available; this can only be assessed after 2005, once the FSAP has been completed. However, another type of flexibility should be considered: the flexibility on deciding (a) for which technical details there are strong arguments in favour of the use of regulations, and (b) for which other technical elements it is worthwhile opting for a directive. The decision as to whether a level 1 measure should take the form of a regulation or a directive is a very difficult one. In the area of financial services, the use of directives under the co-decision procedure is widespread, even common practice. In addition, the legal base under the EC Treaty (Art. 44 and Art. 47) already imposes some legal constraints on the use of regulations at level 1. Finally, level 1 directives sometimes do not completely replace but amend existing directives, such as the Prospectus and the Transparency Directives – such amendments are only possible via directives.

Background – *continued next page*

Background – continued

Taking such a decision at level 2 is easier for two reasons: (a) there are no legal constraints on the choice between regulations or directives, and (b) the issues to be dealt with should in principle be technical details. The Commission can therefore better respond to this question, depending on the details concerned. The first set of level 2 measures provides evidence of this flexibility: whilst a uniform safe-harbour rule for buy-back and stabilisation programmes is achieved through a regulation, Member States would keep discretion for imposing administrative sanctions for failing to ensure disclosure of inside information.

3. European Parliament

The novelty under the Lamfalussy Process is that the European Parliament not only receives draft level 2 measures which have been voted by the ESC, as under the Comitology framework, but also initial drafts which the Commission submits to the ESC. Under the arrangements agreed with the Commission, the European Parliament may consider this draft for at most three months. The ECON receives and reviews the documents on the elaboration of the level 2 measures at the same time as they are sent to the ESC. The initial draft implementing measures were sent to the Committee on 27 June, i.e. four months before a vote in the ESC took place.

It has been agreed by ECON co-ordinators that the rapporteur for the level 1 directive is responsible for the follow-up of the level 2 measures. The rapporteur for the Market Abuse Directive, MEP Goebbels, therefore drafted a working document on the basis of the first formal draft measures and made a number of recommendations concerning the content of the proposed measures, in particular as regards rating agencies. He noted during the Committee debate that almost all his concerns had been addressed in the Commission revised drafts. Following the vote in the ESC on 29 October, ECON held a further exchange of views on the proposed measures and, on the basis of a recommendation by the rapporteur, decided that the measures were in conformity with the mandate given in the level 1 legislation, and thus as such did not give rise to any further observations from the Parliament. A letter to that effect has been addressed by President Cox to President Prodi.

4. CESR

As regards the involvement of CESR, the appropriateness cannot be measured according to the proportion of technical advice which has finally been taken on board in the voted level 2 measures. Around 90% of CESR's technical advice is reflected in the set of measures voted on 29 October. This shows on the one hand that there has been a strong consensus, but also that all the other stakeholders (Commission, ESC) take political responsibility for the final implementing measures. If changes take place in the course of discussions, such as on credit rating agencies before the vote on 29 October, this is the result of the usual decision-making process. It is more important to look at the overall time given to CESR for preparing its technical advice. CESR indeed prepared its technical advice within ten months, respecting the deadlines set.

(iv) Level 3

CESR has commenced activities laying the ground for consistent implementation of EU securities market rules in the Member States. Given that the bulk of implementation and transposition will only take place in 2004 and thereafter, the steps taken so far have been appropriate.

(v) Level 4

Enforcement of EU securities market legislation has been identified as one area of priority action. Such action is now commencing in order to prepare for monitoring regulatory practices once implementation and transposition in the Member States starts, too. It includes discussions between the Commission and the ESC on future proceedings.

Across all four levels, therefore, there has been good progress on making the Lamfalussy Process work. In detail, a number of procedures can still be improved, however. The following sections examine the relevant issues and discuss measures the Group consider would be useful.

I.2 Salient issues and potential bottlenecks following up on the First Interim Report**I.2.1 Meeting the deadlines set by the European Council****(a) *Developments in the reporting period***

Since May 2003, the European Institutions and CESR have made remarkable progress on negotiating and adopting the remaining parts of the securities market agenda of the FSAP. At level 1, the Prospectus Directive (Directive 2003/71/EC) was adopted on 15 July 2003. Deliberations on the Commission proposal for a new directive on financial instruments markets (ISD 2 hereafter) have, notwithstanding serious political disputes, reached the stage of a political agreement on a common position of the Council on 7 October. Deliberations on the Commission proposal for a new directive harmonising transparency requirements for issuers (the Transparency Directive hereafter) are now underway. Pending discussions in the European Parliament, the Council reached a general approach on the Transparency Directive on 25 November.

At level 2, the first three implementing measures on the Market Abuse Directive (Directive 2003/6/EC) were unanimously voted by the European Securities Committee (ESC) on 29 October and are set to be adopted by the Commission before the end of 2003. Public discussions will start to focus on draft measures for implementing the Prospectus Directive at level 2 where Commission services called for comments on a draft regulation on 7 November.

The initial FSAP deadline of completing level 1 work on securities market measures by the end of 2003 is no longer tenable, however. This is only acceptable as long as the Institutions succeed in completing the remaining work before April 2004, as demanded in subsequent European Council conclusions, so that the FSAP can be implemented by the end of 2005. The remaining critical elements are the timely adoption of the ISD 2 and of the Transparency Directive, which will need to be adopted before the end of the EP's current mandate.

(b) The issue and the public debate

In general, the Commission, CESR and the majority of market participants consider that the Lamfalussy Process has contributed to the efficient execution of the ambitious work programme of securities market legislation. Compared to the deliberations on, for example, the first ISD between 1988 and 1993, current legislation at levels 1 and 2 has been more efficient and speedy.

Time pressure under the FSAP is generally regarded as a serious problem by market participants and end-users. Most importantly, it is feared that speeding up securities market regulation in order to meet the deadlines imposed by the FSAP may come at the cost of losses in the quality of regulation. Lack of sufficient time is cited as limiting the scope for high-quality drafting of legal texts, for deliberations in the context of the legislative process and for consultation with market participants and end-users. Many of the latter, in turn, have reported serious difficulties in coping with the amount of consultative papers and hearings, running in parallel for each single measure, and in parallel across different measures. Recent concerns in that regard are mainly associated with the consultations on the ISD 2 and the Transparency Directive and on technical advice for the Market Abuse and the Prospectus Directive. Adoption of the ISD 2 and the Transparency Directive prior to the forthcoming EP election is regarded a potential problem.

The majority of respondents is firmly opposed to a general relaxation of deadlines and agrees with the objective of completing the FSAP agenda in time. They also made clear that the current time pressure is temporary and not a permanent challenge under the Lamfalussy Process. Hope has been expressed that legislative activities will slow down once the FSAP has been completed.

In individual cases, here especially with respect to the ISD 2, an extension of deadlines and a continuation of the deliberations on certain politically sensitive issues has been suggested, pointing to the argument that quality should take precedence over speed of legislation.

(c) Assessment

- The Lamfalussy Process is making a substantial contribution to the production of faster and more efficient EU securities market legislation. This already applies to the progress made in the starting phase when the relevant processes had not been tested. Given increasing experience, legislative efficiency can plausibly be expected to increase even further.
- The fact that the initial FSAP deadline of completing level 1 work on securities market measures by the end of 2003 is no longer tenable is only acceptable if the Institutions succeed in completing the remaining work before April 2004, as demanded in subsequent European Council conclusions.
- The Group re-iterates that the time pressure related to the forthcoming election of the EP as well as EU enlargement and the appointment of the new Commission is not a problem specific to the Lamfalussy Process. Yet, naturally, the electoral deadline will have an impact on securities market legislation.
- The Group recommends reinforcing efforts with the aim of meeting the given deadlines, to keep up the speed of work on level 2 activities and to take care that this is not impeded by potential bottlenecks originating from EP elections or Commission appointment in the course of 2004.
- As to potential future legislative timetables, the Group recommends to policy makers to seek an optimal balance between the desired speed of achieving certain regulatory objectives and the expected workload for all stakeholders.

I.2.2 Parallel working

(a) Developments in the reporting period

Problems associated with parallel working and going beyond those referred to in the Group's first report have not been registered during the reporting period.

However, respondents voiced concerns over potential forthcoming instances of parallel working in the case of the first provisional mandates for drafting technical level 2 advice on certain issues related to the ISD 2. The Commission is expected to issue such mandates before the end of 2003.

(b) The issue and the public debate

The majority of market participants have re-confirmed their view that parallel working tends to create inefficiencies in the regulatory process. They consider parallel working at levels 1 and 2 as a necessary evil, a sacrifice to be made on the way to meeting the FSAP deadlines. Concerns have been expressed that the commencement of work on level 2 technical advice may be premature in cases where the underlying level 1 rules have not yet been adopted. This may be particularly counterproductive if provisional mandates are issued on rules on which no firm political agreement has been reached at level 1 at the time that the mandate is given.

Some respondents refer to the potential benefits of parallel working that might arise as a consequence of synergy effects from discussing framework principles, and the technical measure necessary for their implementation, simultaneously. Positive spill-over effects from parallel deliberations may, in fact, help improve the overall quality of regulation.

A limited number of respondents consider parallel working inappropriate and hold that level 2 work should only commence after the relevant legislative measure has been adopted at level 1.

Clear empirical evidence has not been brought forward to support either of these arguments.

(c) *Assessment*

- The Group reiterates its view that parallel working on 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, is inevitable.
- The Group calls on the Commission to issue provisional mandates for level 2 technical advice only on those items on which a political settlement has been reached which is considered to be sufficiently stable so as to reduce the risk of premature or obsolete work at level 2.
- The Group recommends that provisional mandates for level 2 technical advice should be limited to subject matters already acceptable to the European Parliament, the Council and the Commission after the first Parliamentary reading. Provisional mandates should not be granted where issues remain still controversial.
- The Group recommends that the Commission carefully explains the reasons why it has issued provisional mandates.

I.2.3 Fast-track facility

(a) *Developments in the reporting period*

The fast-track facility has not been applied in the reporting period. An adoption after a single reading in the EP is currently being discussed in the context of the Transparency Directive. Pending the discussions in the EP, the Council reached a general approach on the Transparency Directive on 25 November.

(b) *Assessment*

- The forthcoming Transparency Directive will be a test-case for the fast-track facility because meeting the April 2004 target date which the European Council recommended for its adoption will only be realistic if the Council adopts the directive after a single reading of the European Parliament.

I.2.4 Degree of detail in level 1 and level 2 legislation

(a) *Developments in the reporting period*

On the question of whether the overall level of detail in recent securities market legislation is appropriate, the majority of market participants report to the Group that regulatory detail risks reaching worrying heights at levels 1 and 2 in a number of instances.

On the other hand, it was pointed out that, had the decomposition of legislation into levels 1 and 2 not been implemented as in the Lamfalussy Process, level 2 details as now drafted would probably have been included at level 1 in some way. Without the Lamfalussy Procedure, the Market Abuse Directive, the Prospectus Directive and the future ISD 2, in particular, may very well have been far more detailed, with negotiations expected to have lasted decisively longer than encountered in recent months. So far, the argument concludes, the Lamfalussy Process has to be considered an important means of achieving more efficient and systematic legislation, as well as a swifter legislative procedure.

Fears that level 2 legislation could become an amalgam of already existing detailed rules at national level have, following the Commission's first three level 2 proposals, not been reiterated. Still, level 2 measures have been reported to be too detailed in parts. A more recent positive example is CESR's advice on level 2 measures implementing the Prospectus Directive, which has been reasonably short.

As for the distribution of legislative detail across levels 1 and 2, responses have not produced a clear picture of the views of market participants and end-users.

Some respondents consider the level of regulatory details at levels 1 and 2 as appropriate. Others consider it too early to make a judgement.

A third group of respondents considers that there is too much detail in level 1 legislation, in particular in the Prospectus Directive as well as in the ISD 2 proposal, given that level 1 legislation was intended to be of a framework-type.

A fourth group of respondents, in contrast, argues that more rules should be laid down at level 1, rather than delegating them to level 2. These respondents refer to the requirements on companies and auditors in the Prospectus Directive as a case in point.

(b) Assessment

- The Group recommends that the Institutions lay down level 1 framework principles as recommended by the European Council at Stockholm in March 2001.
- The Group recommends that the Commission keep level 2 measures as lean as possible. At the same time, level 2 measures should provide for unambiguous rules in order to ensure consistent implementation in the Member States.

I.2.5 Use of regulations or directives at level 2

(a) Developments in the reporting period

One of the first three level 2 implementing measures voted by the European Securities Committee (ESC) on 29 October, 2003 will be a regulation, whereas the two others take the form of directives and therefore require transposition at national level:

Commission Regulation implementing Directive 2003/6/EC as regards exemptions for buy-back programmes and stabilisation of financial instruments (Working Document ESC/24/2003) aims at providing the necessary details for implementing the Market Abuse Directive with respect to safe harbours. Here, uniform application of EU law in the Member States is desirable and feasible. In brief, the Commission, supported by market participants, opted for a solution ensuring that there will be a "single safe harbour" for market participants in the European Union and not 15 (or after 1 May 2004 even 25).

Commission Directives implementing Directive 2003/6/EC as regards the fair presentation of investment recommendations and the disclosure of conflicts of interest (Working Document 23/2003) and as regards the definition and public disclosure of inside information and the definition of market manipulation (Working Document ESC 22/2003), in contrast, seek consistent implementation of information disclosure requirements and administrative sanction in case of non-compliance. As the imposition of such administrative sanctions is a prerogative of the Member States and rules and practices in this regard differ across the EU, the use of regulations as legal instrument was excluded.

The debate on regulations will however continue since the Commission called for comments of market participants on a working document containing a draft regulation implementing the Prospectus Directive on 7 November.

(b) The issue and the public debate

Applying regulations as legal instruments bears the advantage of ensuring uniform application of the desired provision in the Member States. At the same time, there may be plausible reasons for seeking some form of flexibility in applying EU law at the national level, e.g. the preservation of national regulatory practices which are deemed indispensable, such as administrative sanctions, which under the legal system of the EU is a prerogative of the Member States.

According to these general considerations, market participants and end-users are split over the question of whether directives or regulations should be the legal instrument of choice at level 2. One group of respondents favours the uniform application of EU law in the Member States and advocates the use of regulations as a general rule. A second group stresses that the legal instrument should be chosen on a case-by-case basis. A third group considers flexibility an important aspect of implementing level 1 legislation, not least to avoid contradictions with existing national law, and therefore supports the use of directives as a general rule.

(c) *Assessment*

- The Group recommends that the Commission make more frequent use of regulations at level 2 and largely limit the use of directives to cases where fundamental considerations make the use of regulations undesirable, or where the need for national discretion in implementing EU law can be demonstrated.
- The Group also encourages considering the benefits of regulations at level 2, which would in particular overcome differences in competencies of CESR members and would thus facilitate further level 3 work.

I.2.6 Art. 202 of the EC Treaty and the Sunset Clause

(a) *Developments in the reporting period*

In the Draft Treaty establishing a Constitution for Europe, which the European Convention presented to the European Council in July 2003, an overhaul of the EU's Comitology infrastructure is envisaged. With Art. I-35 and Art. I-36 of the Draft Treaty, replacing Art. 202 of the EC Treaty which is currently the legal basis for Comitology, two different ways of adopting level 2 measures have been proposed.

According to the proposals, one way (Art. I-35) of devising implementing measures would be by means of so-called delegated regulations, providing for the adoption of such measures by the Commission, subject to two safeguards for the co-legislators, the European Parliament and the Council of Ministers: when providing a delegation to the Commission, they have to decide whether they wish to be in a position to block the adoption of an individual delegated regulation or even to withdraw the entire delegation passed to the Commission. However, Art. I-35 is not exhaustive in its scope. In this way, the Council and the EP would be put on an equal footing in controlling the Commission – in contrast to Art. 202 of the EC Treaty.

An alternative way (Art. I-36) would be to issue so-called implementing acts by means of which the Commission could ensure uniform rule-making in the Member States, with no explicit role for the EP or Council, unless the Council itself were exceptionally mandated with adopting implementing acts. Art. I-36 is based on the principle that the Member States have the prerogative, and the obligation, of implementing European law in line with Articles 10 and 202 of the EC Treaty. Furthermore, there is no role for the European Parliament to block the adoption of implementing measures by the Commission.

The provisions are currently being discussed in the context of the Intergovernmental conference.

(b) *The issue and the public debate*

The two provisions (Art. I-35 and I-36) have given rise to the question, under which of the two the existing Lamfalussy Process would be operated, in particular to what extent the existing level 2 committee structure could be maintained. The Economic and Monetary Affairs Committee (ECON) of the European Parliament has already made unequivocally clear that both the EP's decision on continuing the Lamfalussy Process as such under a European Constitution and the decision on the extension of this Process to other financial services sectors will depend on whether the European Parliament obtains sufficient call-back powers,

as currently provided in Art. I-35 of the draft Constitutional Treaty. Representatives of the Commission expressed concerns that the lack of clarity, on which provision of the new Treaty the Lamfalussy Process might fall under, bears the risk that it might implode. In addition, the Monitoring Group noted that the issue has been debated at the level of the European Securities Committee (ESC). EU finance ministers recently gave support to the use of Art. I-35 as regards the exercise of delegated powers.

Among respondents to the Group's call for reactions, no clear positions can be identified. The majority of respondents, however, pointed out that the EP's demand for an explicit call-back clause on Level 2 legislation, as supported by the Commission, CESR and the majority of market participants, would not be satisfied under the proposed Art. I-36, and may therefore be unrealistic.

(c) *Assessment*

- On the basis of the current draft Treaty by the European Convention and pending a resolution of a number of fundamental questions in the context of the treatment of the Lamfalussy Procedure under Art. I-35 or Art. I-36, the Group observes that Art. I-35 is the only provision granting call-back powers with respect to level 2 measures to the EP, which is considered a precondition for political agreement on the continuation of the Lamfalussy Process by the EP.
- The Group recommends that open questions in this regard should be settled as quickly as possible, ensuring continuity of the Process. Urgency prevails especially in the light of the extension of the Lamfalussy Process to banking and insurance.

I.2.7 Commitment of Resources

(a) *Developments in the reporting period*

Regarding the Commission, no new developments have been observed in the reporting period.

As for CESR, the budget of the committee has been increased by 33%, starting from fiscal year 2002.

(b) *The issue and the public debate*

Resources within the Commission are still considered deficient. A lack of sufficient staffing has been reported in the area of financial market legislation. The Commission services are considered to be burdened considerably. In addition, the workload of the Commission is set to become even more demanding. First, the amount of activities directly associated with the Lamfalussy Process is expected to increase, e.g. with respect to the drafting of further level 2 measures on the Market Abuse Directive, the Prospectus Directive, the Transparency Directive and in particular the ISD 2. Further, efforts will need to be tightened with respect to enforcement in the Member States (level 4). Second, activities in the wider context of the FSAP are expected to grow as well, e.g. in the context of the Capital Adequacy Directive, drafting the post-FSAP agenda, and EU enlargement. Concerns have been voiced that potential lack of resources, especially specialist personnel resources, at the Commission, may limit its potential of producing high-quality draft legal text on time.

CESR itself has expressed confidence that, following the rise in its annual budget by 33%, resources should suffice to fulfil its tasks, also with respect to the increase in the workload which can be expected to result from future level 2 work, especially the ISD 2, as well as from the forthcoming work on level 3. The interplay of the CESR Secretariat and the national regulatory authorities is considered to work efficiently. Some market respondents have expressed concerns that certain national regulatory and supervisory authorities, including national ministries, may not yet dispose of sufficient resources to fulfil their obligations

stemming from the transposition and application of EU securities market law in the Member States. The same reactions were reported by Member States in the ESC.

As for market participants and end-users, some respondents have reiterated that, given their level of involvement with respect to securities market legislation, work in the context of market consultation has been difficult to keep up with, especially against the background of peaks during short consultation periods or in advance of hearings.

As for the Council, the Services have stated that, meanwhile, sufficient resources have been built up to cope with the increasing workload after enlargement in April 2004. This also applies with respect to the delays previously observed at the stage of jurist-linguist services.

(c) Assessment

- The Group recommends that the Commission substantially increases resources, especially specialist staff, allocated to financial services and the work on securities markets in particular.
- The Group encourages market participants and national authorities, where useful, to allocate additional resources to their work on securities market regulation. The Institutions and CESR would be ill-advised to slow down work on securities market legislation in order to accommodate resource constraints which some market participants encounter in responding swiftly and efficiently to calls for consultations.

I.2.8 Aerosol Clause

The aerosol clause has not been invoked in the reporting period. The Group is not aware of any intention, on the part of any Member State, to put the clause into operation.

I.2.9 Possible bottlenecks in the Lamfalussy Process

In its first report, the Group drew the attention of the Institutions to a range of possible bottlenecks. Having reviewed the Lamfalussy Process so far, the Group does not see any reasons for changing its opinion on the risks related to the sunset clause and the continuity of the Lamfalussy Process; and the inevitable impact of the elections to the new European Parliament on the ongoing discussions of level 1 legislation. However, the Group has been informed that the capacity of Jurists Linguists preparing the formal adoption of a common position no longer represents a problem. Also, the aerosol clause does not seem to represent an obstacle to efficient securities market legislation for the time being. In addition, there is no evidence that lack of resources within CESR would hamper the functioning of the Lamfalussy Process.

I.3 Issues not covered by the First Interim Report

I.3.1 Scope of the Lamfalussy Process with respect to UCITS and EU company law

(a) Developments in the reporting period

So far, the Lamfalussy Process has been primarily concerned with four directives: the Market Abuse Directive, the Prospectus Directive, the ISD 2 and the Transparency Directive. To some extent, the European Institutions also chose the Lamfalussy Process for the endorsement of International Accounting Standards under the IAS Regulation, although the relevant level 2 committee is different and the endorsement mechanism within the framework of the Comitology Procedure is not subject to any sunset clause.

In other terms, the European Union limited the scope of the Lamfalussy Process when implementing it. The Group recalls that the Final Report of the Committee of Wise Men – as well as the Resolution of the European Council of March 2001 – were not so limited. The

Final Report also comprised issues related to collective investment schemes (UCITS), accounting standards, and company law issues, in particular the Takeover-Directive.

This differentiation may be recalled given that, in the meantime, two issues have arisen that are relevant to the scope of the Lamfalussy Process. First, the Council has, in principle, endorsed the idea of bringing the area of collective investment schemes (UCITS) into the realm of the securities markets committees – the ESC and CESR – in December 2002. On 5 November, 2003 the Commission decided to present a formal proposal for a directive extending the competencies of the ESC to cover UCITS and to adapt its decision on CESR of June 2001 to include UCITS into the competencies of CESR. These decisions still require the assent of Council and the European Parliament. As observed above, CESR is currently preparing for new mandates.

Second, the question arises as to how the concept of securities market legislation should be defined under the existing structure of the Lamfalussy Process and whether some areas of company law should be encompassed. This question is still open to debate. Most importantly, forthcoming regulation of company law, especially with regard to the Commission's Action Plan on Corporate Governance, can be considered as part of securities market law in as far as companies are listed on regulated markets.

On UCITS, implementation, application and enforcement of the UCITS Directives is expected to be brought under the scope of levels 3 and 4 of the existing Lamfalussy Process. CESR is currently preparing for its new mandate in this regard. A transition of responsibilities shifting from the existing UCITS Contact Committee to CESR is expected.

On company law, no measures related to the Lamfalussy Process have been initiated so far.

(b) The issue and the public debate

On UCITS, market participants and end-users have responded positively to the prospect of an extension of the Lamfalussy mandate.

On company law, some market participants have expressed concerns over the prospect of Lamfalussy-type regulation in this area, mainly referring to problems associated with the starting phase of the process, as well as to worries that issuers may not be sufficiently represented in consultations, hearings, and other debates.

(c) Assessment

- The Group considers that the Lamfalussy Process is a valuable instrument for adopting, implementing and enforcing financial market legislation in a faster and more efficient manner. In principle, the Process therefore recommends itself as the basis for any type of legislation relevant for financial market activities.
- The Group welcomes the intention to bring the implementation, application and enforcement of the UCITS Directives under the scope of levels 2, 3 and 4 of the existing Lamfalussy Process.
- The Group considers that it may be worthwhile investigating to what extent forthcoming legislation and regulation in the areas of company law and corporate governance can benefit from the processes established under the Lamfalussy Procedure. In order to do so, the Group encourages the Institutions to maintain a close dialogue with market participants and end-users affected by forthcoming measures in these fields so as to ensure public acceptance of the approach taken.

I.3.2 Rationale of and progress on level 4 activities

(a) Developments in the reporting period

The Committee of Wise Men identified lack of strict enforcement of EU securities market legislation in the Member States as one possible barrier to achieving a single and efficient financial market. Enforcement refers to the process of ensuring that the law established at EU level is transposed into national law correctly and on time, and that the law is actually applied and enforced in the Member States. In case of infringement by a Member State, the Commission, or another Member State, may take such a Member State to the European Court of Justice.

In practice, enforcement has been found to suffer from two major deficiencies. First, the Commission lacks the resources to monitor and investigate whether all pieces of EU law are transposed correctly and on time and whether the law is applied in practice. The Commission disposes of efficient mechanisms to deal with cases of infringement once an infringement has been reported, but it does not have the capacity to fully observe compliance with the entirety of EU law in Member States at all times. This problem is set to become aggravated with the forthcoming enlargement of the EU.

Second, significant disincentives are understood to exist when it comes to public or private entities reporting cases of infringement to the Commission. Thus, financial market participants may not be inclined to report to the Commission non-compliance with a certain EU directive by the Member State in which they are domiciled for fear of adverse consequences of such reporting. Options such as anonymous reporting or communication via interest associations may not in all cases be regarded as suitable remedies.

The issue was discussed at the ESC meeting of 29 October 2003.

(b) The issue and the public debate

The Commission has emphasised on several occasions that it relies to a considerable extent on the Member States, regulators and the private sector for improving enforcement of EU securities market law. It needs complaints, information, and strong, well-researched cases. Yet, too often, the private sector is reluctant to come forward for fear of damaging its market opportunities.

Market participants have, in turn, emphasised on many occasions that disincentives discouraging reporting of infringements are real, and that it is the obligation of the Commission to ensure strict and consistent enforcement.

(c) Assessment

- The Group recommends that support from Member States, regulators and the private sector is highly important for improving enforcement of EU securities market law.
- The Group believes that the implementation of level 4 cannot lie solely on the shoulders of the Commission.
- The Group encourages CESR to continue setting up an internal reporting system to review compliance of CESR standards by CESR members.

Part II. Issues in detail

II.1 Consultation practices at levels 1 and 2

Open, transparent and systematic consultation with market participants and end-users is one of the central objectives of the Lamfalussy Process and is regarded by the majority of policymakers as a vital prerequisite for efficient policy outcomes. Whether, and to what extent, consultation with market participants and end-users of the financial markets has been sufficiently conducted in the context of the Lamfalussy Process has been subject to considerable debate over the past months. This chapter, therefore, analyses the need for changing consultation practices in the Process. It does so by reviewing the initial recommendations of the Wise Men Group with respect to consultation. Second, it investigates current consultation practices and the positions expressed by policymakers as well as market participants. The chapter is concluded by a list of pragmatic policy recommendations which the Group deems useful for further improving consultation practices in the context of the Lamfalussy Process.

Background

Conceptual thoughts on public consultation

Public consultation is one widely appreciated channel of communication between interest groups in society and public policy makers. It essentially serves the purpose of transferring information from those *de facto* or potentially affected by public policy measures, i.e. in most cases the private sector, on the one hand, to public policymakers, on the other hand. This transfer of information can yield benefits for both sides:

- From the perspective of policymakers, obtaining information from individuals or groups affected by their measures about the expected impact of certain policy measures can help them improve the design of these policy measures and, thereby, their effectiveness. In addition, and in as far as the preferences of those affected are taken into consideration, a policy measure may enjoy greater legitimacy in the eyes of the private sector. If this raises the propensity of the private sector to comply with the relevant measures, again a higher degree of effectiveness of public policy can, *ceteris paribus*, be achieved.
- From the perspective of the private sector, informing policymakers about the expected impact of and their preferences with respect to a certain policy measure can be beneficial in as far as they may thereby succeed in preventing policy outcomes running against their interests, i.e. mainly rules that incur a regulatory burden that private-sector individuals may regard as inappropriate. That may be the case if a draft policy measure is considered to be detrimental to the market in general, mainly resulting from insufficient or asymmetric information on the part of the policymaker. The more complex the object of regulation, the greater such information asymmetries tend to be, and, *ceteris paribus*, the greater the benefits of communication between policymakers and market participants. Alternatively, a draft of a policy measure may be regarded as inappropriate by a market participant because it runs counter to its individual interests. In the case of competing interests, communication between policymakers and market participants can help making the differential impact of a measure and the distribution and intensity of preferences in society more transparent.

Against the background of these benefits, market consultation is widely regarded among academics, policymakers and the private sector as a highly useful tool for making public decision-making processes more efficient and for improving the overall quality of legislative and regulatory output of the political process. Considering that financial securities business is a highly complex, expertise-driven market activity, the potential benefits of close communication between policymakers and market participants on the objectives and contents of market legislation and regulation in the context of the Lamfalussy Process can safely be concluded to be high.

However, market consultation also incurs costs, namely in two forms. First, consultation takes time which becomes a particular burden when legislation needs to be adopted under severe time pressure. Second, a systematic consultation process also binds personnel and material resources on the part of the policymaker, as well as on the part of market participants.

Similar to the potential benefits of consultation, its potential costs, too, bear specific relevance in the context of the Lamfalussy Process. As observed, the Process is characterised by severe time pressure, originating from the EU's objective of achieving the single market in financial services as quickly as possible as well as from established deadlines. In addition, bottlenecks with respect to personnel and material resources on the part of the actors involved in the Process have been reported.

Bringing the benefits and the costs of market consultation together suggests that market consultation is a highly useful tool but that an optimal amount of consultation needs to be found by policymakers so as to balance the associated costs and benefits. Where competing interests exist among market participants, policymakers and market participants can achieve better policy outcomes by working towards a reasonable compromise. However, conflicts of interest among market participants cannot be "consulted away".

II.1.1 Recommendations of the Committee of Wise Men

The potential benefits of consulting with market participants and end-users were identified by the Committee of Wise Men as vital for, on the one hand, achieving a faster and more efficient process of securities market legislation and regulation and, on the other hand, higher quality in legislative and regulatory output.

Accordingly, the Committee – referring to level 1 of the Lamfalussy Process – called on the Commission to take the following steps:

- Consult, beforehand, in an open, transparent and systematic way with market participants and end-users, including clear deadlines and open hearings.
- Consult Member States and their regulators on an informal basis as early as possible on any impending level 1 proposals.
- Inform the EP on an informal basis of forthcoming proposals and seek understandings on points of discussion.

Further, the Committee, referring to level 2, recommended that CESR must consult market participants, consumers and end-users according to a fixed, preferably mandatory set of procedural rules.

The Committee's recommendations clearly emphasise the importance of consultation with market participants, particularly at the earliest stage of the decision-making process, namely the drafting done by the Commission for level 1 measures; by CESR for level 2 technical advice; and, again, by the Commission when it comes to drafting the legal texts of level 2 measures. Further, the Committee recognised the importance of consultation processes – both at levels 1 and 2 – being well-structured, open, accessible and transparent. Finally, the recommendations explicitly take into account that consultation should be conducted so as to minimise strain on the time schedule and the resources available to the bodies involved.

II.1.2 Public consultation under the Lamfalussy Process in practice

(i) Public consultation at level 1

The European Parliament, the Council and the Commission have confirmed their commitment to ample and transparent communication with market participants. The Commission, in addition to its general principles and minimum standards for consultation of interested parties, endorsed the Committee's recommendations. The EP and the Council, too, reinforced their commitment to market consultation in response to the Committee's recommendations. In general terms, the underlying co-decision procedure today allows interested parties to communicate their information and preferences during the legislative process at three stages and via a multitude of formal and informal channels:

(a) *Pre-legislative stage – Commission*

Prior to presenting a formal legislative proposal, the Commission consults³ with interested parties via formal Commission communications (including Green Papers) and working documents issued by Commission services, or via public hearings, and expert or other working groups. In certain cases, the Commission decides to hold more than one round of consultation on a given legal proposal.

(b) *Legislative stage – European Parliament*

Formally, the EP can decide to hold public hearings on Commission proposals for Level 1 legislation. All documents throughout the legislative process in the EP, such as draft reports, reports of the rapporteur, amendments thereto as well as final texts adopted, are available in the Public Register accessible through the EP's Internet sites.

³ See also Commission Communication COM(2002)704 of 11.12.2002 "Towards a reinforced culture of consultation and dialogue – General principles and minimum standards for consultation of interested parties by the Commission"

(c) Legislative stage – Council

Council consultation does not take place at Community level. Instead, consultations are organised in individual Member States at any time of the EU legislative process as an input into defining the Member State's position on that measure inside the Council. Meeting documents of working parties are available on the Council's Internet sites.

Controversy over the appropriateness of consultation practices at level 1 has essentially focused on the pre-legislative stage. As a consequence, the Group concentrates in this report on that stage. At level 1, questions as to the appropriateness of consultation have – to varying degrees – been raised with respect to the four recent securities market directives, namely the Market Abuse Directive, the Prospectus Directive, the ISD 2 and the Transparency Directive. The process of market consultation in these four cases can be summarised as follows:

Background	
Market Abuse Directive	Prospectus Directive
<p><u>Commission</u></p> <ul style="list-style-type: none"> - Forum group composed of market participants and regulators, meeting three times between November 1999 and February 2000. - No further formal public consultation prior to Commission proposal in May 2001. <p><u>EP</u></p> <ul style="list-style-type: none"> - ECON public hearing on 15 October, 2001 with academic experts on stock market legislation and experts with considerable regulatory experience invited. 	<p><u>Commission</u></p> <ul style="list-style-type: none"> - No formal consultation prior to Commission proposal presented in May 2001. <p><u>EP</u></p> <ul style="list-style-type: none"> - ECON held two public hearings in autumn 2002 with representatives reflecting issuers, marketplaces, institutional investors, small investors and the legal profession invited.

Background	
Investment Services Directive (ISD 2)	Transparency Directive
<p><u>Commission</u></p> <ul style="list-style-type: none"> - Publication of Green Paper in November 2000. Deadline for replies: 31 March, 2001. Publication of summary of replies in July 2001, reflecting responses from investment firms, credit institutions, trade and post-trade infrastructure, supervisors, regulators, monetary authorities. - Consultation document published in July 2001. Deadline for responses, end-October 2001. 77 submissions received from covering financial institutions, public authorities, regulated markets and others. - First consultation discussed in an open hearing, attended by 150 interested parties, in Brussels in September 2001. - Substantially revised set of orientations for ISD revision on 31 March, 2002. More than 110 responses in the second consultation round. - Second consultation document subjected to scrutiny in public hearing (April 2002) attended by more than 200 participants. <p><u>EP</u></p> <ul style="list-style-type: none"> - ECON public hearing on 18 February 2003. Representatives reflecting wide range of interests, from small retail investors to banks and regulated markets invited. 	<p><u>Commission</u></p> <ul style="list-style-type: none"> - First consultative paper published in July 2001. Deadline for comments: end-September 2001. Summary of the replies received published in December 2001, reflecting views of national regulators, auditors, accountants, exchanges, consumers, underwriters, investors, industry, issuers and others. - Final consultation launched in May 2002. Deadline for comments: July 2002. 93 responses received. <p><u>EP</u></p> <ul style="list-style-type: none"> - No hearing planned.

General assessment of consultation procedures at level 1 – the Commission

On the basis of early evidence on the four securities market directives, the Group observes that the Commission conducts its consultation at level 1 largely in line with the recommendations made by the Committee of Wise Men and sticks closely to the consultation principles it has given itself:

- **Frequency of consultation**

The progression of the four measures suggests that consultation activities on the part of the Commission have become substantially more extensive and systematic following the establishment of the Process. The itineraries for both the ISD 2 and the Transparency Directive suggest that, with three and two rounds of public consultation, respectively, and prolonged consultation periods, communication with market participants and end-users at the pre-legislative stage has become significantly more intensive.

- **Duration of consultation periods**

Interested parties were given two months to respond to Commission calls for comments on working documents with respect to the ISD 2 and the Transparency Directive.

- **Transparency**

The Commission publishes working documents reflecting its preliminary views on its Internet site before making a formal proposal. Commission services publish a summary of replies received after a first round of consultation. The reactions received in a final round of consultation are set out in the explanatory memorandum of the official Commission proposals.

General assessment of consultation procedures at level 1 – the EP

On the basis of first evidence on the four securities market directives, the Group observes that the **EP** conducts its consultation at level 1 largely in line with the recommendations made by the Committee of Wise Men:

- **Frequency of consultation**

Reports by the Economic and Monetary Affairs Committee (ECON) during a first reading were principally preceded by at least one public hearing. The only case where no hearing has so far been currently organised is the Transparency Directive.

- **Transparency**

The ECON and the EP publish their proposed amendments to draft legal texts, including extensive explanations for each proposed amendment.

- **Other observations**

The ECON has established an Advisory Panel of Financial Services Experts (APFSE). The panel is expected to advise the ECON on the measures set out in the FSAP. It also provides evaluations of Commission proposals for implementing measures submitted to the ESC, as well as consultation documents issued by CESR. The panel is composed of four experts drawn from universities and six market practitioners. The panel met for the first time on 17 May 2002 and presented its first reports in September 2002. The experts' reports are only made available to the ECON.

(ii) Public consultation at level 2

The Commission drafts its level 2 proposal after receiving technical advice from CESR. It subsequently adopts the draft measures provided that the Member States have voted in favour in the ESC. Further, the interests of the European Parliament are safeguarded by allowing it a one-month observation period, during which it can assess the final draft and, in case of dissent, issue a resolution.

With respect to level 2 activities, consultation with market participants and end-users is essentially undertaken by CESR. CESR has responded to the proposal of the Committee of Wise Men by issuing its Public Statement on Consultation Practices. By issuing extensive feedback statements, CESR actually goes well beyond what was proposed in this regard, i.e. only providing summaries of the replies it receives. This open approach is explicitly welcomed by the Group.

Level 2 decision-making today allows interested parties to communicate their information and preferences at two stages and via a multitude of formal and informal channels:

(a) *Technical advice – Committee of European Securities Regulators (CESR)*

Before drafting its technical advice for the Commission, CESR is committed to consult with all interested parties, e.g. formally by means of working consultative groups of experts, public hearings or roundtables, written and Internet consultations. Further, information and preferences can be communicated at any time directly to CESR. In addition, CESR has set up a Market Practitioners Consultative Panel (MPCP) which meets regularly and serves as a sounding board.

(b) *Preparatory stage – Commission*

After receiving technical advice from CESR, the Commission drafts the proposed legal text for the level 2 implementing measure. Following earlier suggestions made by market participants, the Commission carries out a call for comments on the draft legal text before it formally launches the Comitology procedure in the ESC. At this stage too, information and interests can be communicated to the Commission.

In contrast to level 1 decision-making on the first four Lamfalussy Directives, work on level 2 measures is still at an early stage. The first three level 2 measures, based on the Market Abuse Directive, were voted in the ESC on 29 October 2003. On the remaining parts of that directive, CESR delivered its advice and the Commission draft legal texts were published on November 10. On the Prospectus Directive, CESR presented the main parts of its technical advice on 31 July and 30 September 2003. The Commission services called for comments by the public on the draft legal text on 7 November. The process of market consultation on those level 2 measures which have been mandated so far can be summarised as follows:

Background	
Market Abuse Directive	Prospectus Directive
<u>CESR</u>	<u>CESR</u>
- Call for evidence of 27 March 2002 with a deadline for responses by 17 May 2002. Five submissions received.	- Call for evidence on first provisional mandate on 27 March 2002 for 17 May.
- CESR Consultative Working Group established to advise its Expert Group during the drafting.	- First consultative paper of 16 Oct 2002, open meeting on 26 Nov 2002 with more than 50 participants. More than 90 written responses
- Consultation process, including in particular representatives of issuers, intermediaries as well as institutional and individual investors.	- Addendum to first consultation paper of 19 Dec 2002 for responses by 6 Feb 2003. Open hearing on 24 Jan with 50 attendees and 60 responses.
- Detailed consultative paper 16 Oct 2002. Deadline for response: 31 Dec. Open meeting on 26 Nov.	- Extension of initial Commission deadline for the technical advice until 31 July 2003.
- Addendum to the Consultation Paper of 16 Dec 16 2002. Deadline for responses: 6 Feb 2003.	- Second consultation round and further hearing on 27 May with about 40 participants and about 30 written contributions.
- Open hearings held on 26 Jan and 12 May 2003.	- Technical advice + feedback statement published on 31 July 2003 and on 30 Sep.
	- Call for evidence on second provisional mandate on 7 Feb 2003 with 20 responses received
	- First consultation paper published on 12 June 2003 with deadline for responses by 12 August; open hearing 9 July 2003. Second paper published on 30 July with deadline until 30 Oct 2003; a public hearing on 9 Oct.

General assessment of consultation procedures at level 2 - CESR

On the basis of first evidence on the Market Abuse and Prospectus Directives, the Group observes that CESR conducts its consultation largely in line with the recommendations made by the Committee of Wise Men and sticks closely to the consultation principles it has given itself at the beginning of its operations:

- **Frequency of consultation**

Drafting of each CESR's technical level 2 advice has been preceded by at least one round of written consultations. In addition, public hearings were held on several occasions. Consultative Working Groups have been established.

- **Duration of consultation periods**

Periods of written consultations last on average slightly less than three months.

- **Transparency**

CESR publishes consultative documents, final technical advice and feedback statements on each of its pieces of technical advice on its Internet homepage.

- **Other observations**

CESR has established a Market Practitioners Consultative Panel (MPCP), which aims to act as a sounding board for CESR and which is expected, in particular, to express views on the work programme of CESR, provide comments on the way in which CESR is exercising its role (in particular, implementing its Public Statement of Consultation Practices), assist CESR in the definition of priorities, alert CESR on regulatory inconsistencies in the Single Market and suggest areas for level 3 work, and inform CESR on major financial market evolutions. The MPCP has met four times since its establishment. The MPCP's members reflect a wide range of interests within securities markets. Adjustment of membership with reference to (a) EU enlargement and (b) the increasing range of topics covered by CESR are currently under discussion. The MPCP plays no immediate role with respect to specific level 2 policy measures.

General assessment of transparency-enhancing measures at level 2 – the Commission

The Group notes that the Commission does not launch a further consultation round once it has received CESR's technical advice. Instead, it allows the public to send comments on a draft legal text before making formal proposals to the European Securities Committee. Based on preliminary evidence, the Group observes that the Commission conducts its consultation largely in line with the recommendations made by the Committee of Wise Men:

- **Frequency of consultation**

Each draft level 2 measure is, prior to being presented to the ESC, published by the Commission as a working document containing a draft legal text for comments by the public.

- **Duration of consultation periods**

On the first set of implementing measures, respondents were given two months to react to the Commission's working document.

- **Transparency**

The Commission publishes working documents on each proposal for level 2 measures on its Internet homepage.

II.1.3 Consultation practices and the public debate

As the preceding section shows, a general assessment of the functioning of consultation practices at levels 1 and 2 of the Lamfalussy Process leads to the conclusion that the overall performance can be regarded as satisfactory and in line with the recommendations of the

Committee of Wise Men as well as other general principles. However, the Group observes that many market participants – while appreciating the progress that has been made on public consultation practices in general – have criticised certain aspects of the way EU legislative and regulatory bodies communicate with market participants and end-users.

In order to assess the extent to which potential changes in the details and the day-to-day practice of market consultation on the part of the Commission and CESR can help improve the consultation regime further, the following section reviews the responses which the Group received from market participants and policymakers following its call for comments on the first report as well as during two hearings the Group held in September 2003.

(i) General observations

The Group notes that almost all respondents reported a substantial improvement in consultation practices. A large majority of market participants regards the regime as it stands today as by-and-large sufficient and appropriate. However, certain respondents consider the overall consultation framework as still insufficient. This criticism reflects the overall agreement among respondents that, despite recent progress, consultation under the Lamfalussy Procedure can be further improved both at level 1 and level 2. Requests for changes to the current framework can be summarised to refer (a) to the time allowed for market participants to respond to calls for comment, (b) to the number of stages in the legislative process at which the public is given the opportunity to comment on legislative measures, (c) to the appropriateness of consultation documents, (d) to transparency at certain stages of the process, and (e) to the adequacy of representation during consultation exercises.

(ii) Timing and deadlines for public consultation

There is widespread agreement among market participants that they are given too little time to respond. Instances where the time available for reaction on the part of market participants has been criticised for being too short include:

- Level 2, Market Abuse Directive implementing measures, first mandate, CESR consultation prior to drafting technical advice, especially second round of consultation,
- Level 2, Prospectus Directive implementing measures, first mandate, CESR consultation prior to drafting technical advice, especially second round of consultation.

Market participants have commented critically on the fact that in some instances they were not given three months to respond. This has been perceived as inappropriate, considering the substantial size of consultation documents and the complexity of the issues covered.

The problem was, as reported by numerous respondents, aggravated in some cases by the fact that CESR public hearings were scheduled during periods of consultation, increasing the amount of work on a given issue during the period of consultation.

Respondents recognise the overall time pressure under the FSAP as the major source of this problem.

The Group also recognises that consultation with market participants and end-users represents an important element for securing a more efficient legislative process as well as for ensuring better quality in financial market legislation. Market consultation should therefore be allocated an appropriate amount of time.

- The Group recommends that CESR allocates three months to market consultation for each given mandate for technical advice where possible.
- In addition, the Group recommends considering that CESR be given twelve months for completing pieces of technical advice, as a general rule.
- Finally, the Group recommends that market participants make sufficient resources available to meet the demands placed on all parties involved for completing the FSAP.

(iii) Number of consultation rounds

A number of respondents propose that at the drafting stage of both levels 1 and 2 two rounds of consultation should be held by policymakers, as a general rule, i.e. one preceding the drafting of regulation and one following the first draft. It has been argued that additional rounds of consultation may increase the quality of legislative output by allowing further reflection on issues which had not been deemed relevant during the first consultation.

Respondents cite the Market Abuse Directive and the Prospectus Directive at level 1 as well as the first level 2 mandates of those directives as negative examples of lack of second-round consultation. The ISD 2, Transparency Directive as well as the second sets of level 2 mandates are mentioned as examples of a successful application of second rounds of consultation.

The Group reiterates that additional rounds of consultation may incur costs in terms of time as well as resources, which policymakers need to balance with the expected gains in terms of confidence and quality of a draft measure at levels 1 or 2.

- The Group recommends that the Commission and CESR consult intensively with market participants and end-users, especially in order to ensure input on the overall need for market regulation, the specific rules which should come to bear, as well as the expected costs and benefits of legislative and regulatory action.
- The Group recommends that the Commission and CESR might hold more than one round of consultation, but only if there are clear indications that a legislative or technical advice draft can significantly benefit from additional input.
- The Group considers that appropriate ex-post explanation of legislative drafts by the Commission and CESR may reduce the perceived need for second rounds of consultation.
- The Group recommends that market participants and end-users make available all information they deem relevant during each first round of consultation so as to minimise the need for additional subsequent rounds of consultation. Duplication or re-iteration of information and positions already known to the Institutions and CESR may be counter-productive.
- The Group welcomes the Commission decision to create further room for comments on draft level 2 implementing measures. The Group notes that such calls for comments are not meant to open a new round of consultation. Any duplication with CESR's consultation should be avoided.

(iv) Appropriateness of consultation documents

In their responses to the Group's call for comments, market participants have voiced concerns over the quality of consultation documents on the basis of which public consultations were conducted by the Commission and CESR. Again, attention has largely focused on level 2 and the nature of consultation documents published by CESR.

In particular, the consultation documents published in the context of the first mandate on Market Abuse Directive implementing measures were criticised for being excessively detailed and lengthy. They were perceived as assortments of best practices in each Member State rather than drafts for genuine technical advice.

This impression on the part of market participants has given rise to two distinct concerns. First, form and contents of the consultation documents were perceived to as discourage responses, especially against the background of the time constraints, as discussed above.

Second, questions have been raised as to what the potential impact of market consultation in these circumstances might be, when the Commission subsequently translates CESR advice into formal legal texts. In that respect, it has been argued, that the less CESR advice resembled a formal legal text, the less clear its recommendations are, and the more unlikely it would be for the advice to appear in the Commission's draft legal text. Some respondents therefore argue that CESR consultation documents and advice should take the form of legal texts from the very outset in order to improve the precision of their position.

Respondents agree in general that the quality of CESR consultation documents has improved substantially over time, suggesting therefore that the first question has already been resolved in part and, given further improvement, can be expected to lose in significance over time.

As regards the second question, it relates to the Commission's Treaty-based right of initiative – both at level 1 and at level 2 – and concerns a prerogative which other bodies, or authorities, may not, and should not be allowed to, exercise. However, so far, CESR has taken a circumspect approach, which should permit it, in order to make the level 2 process as efficient as possible, to draft its technical advice as concretely and clearly as possible so as to maximise input into the final wording of the legal text.

- The Group therefore encourages the Commission and CESR to present consultation documents which are as clear and purpose-oriented as possible so as to promote an efficient consultation process.
- The Group recommends that CESR formulates technical advice as concretely and clearly as possible – thus contributing to the drafting of level-2 implementing measures.

(v) Transparency

Ex-post transparency

Reactions from market participants suggest that ex-post transparency is a well-appreciated element of decision-making processes which a great majority would like to see upgraded.

CESR feedback statements are regarded by most respondents as a very useful and adequate instrument for explaining why CESR chose to incorporate certain proposals made by market participants in the course of consultations and why they left out others, for each specific level 2 technical advice drafted. One respondent considered CESR feedback statements to be in "raw form" rather than part of a considered analysis.

The Commission, in contrast, has been criticised by several respondents for not publishing separate, systematic ex-post explanations for the formulations in its draft level 1 proposals. In particular, it was noted that e.g. the last-minute insertion of Art. 25 into ISD 2 had not been adequately explained to the public.

In general, ex-post transparency by means of feedback statements can indeed be an important instrument for making pre-legislative decisions on the part of the drafting authority more transparent and thereby potentially increasing public acceptance of a legislative proposal. As argued above, good explanation of a legislative draft may in certain cases even help avoid further time and resource-consuming rounds of consultation. At the same time, however, it needs to be recalled that providing extensive ex-post transparency at the drafting stage, too, is likely to consume significant resources in terms of time, personnel and material.

- The Group recommends that the Commission and CESR ensure ex-post transparency, including convincing feedback statements, not least in order to reduce the perceived need for second rounds of consultation.
- In particular, the Group recommends that the Commission issue convincing feedback explanations upon publishing its Level 2 implementing proposals so as to make transparent the way in which it has deviated from CESR's technical advice.

Transparency of the legislative and consultation schedules

Several respondents have expressed concerns that the legislative and consultation schedules still lack transparency and that especially the latter is perceived as unsystematic and unpredictable. Critics state that the availability of consultation, working documents and other papers, and the overview of deadlines of consultation periods, dates of hearings, as well as of the overall course of legislation could be improved or made more systematic.

As observed above, the Institutions, as well as CESR individually, disclose and publish the documents relevant for the legislative process, in general, and public consultation, in particular, on their respective internet homepages. Deadlines and dates are also published, mainly as part of the relevant consultation documentation.

(vi) Adequate representation

Some respondents to the first Group's report are concerned that deficiencies may exist in the Lamfalussy Process which restricts open access to the consultative process with respect to certain interest groups.

More precisely, one interest group demands that the interests of asset managers be given proper representation and due respect, anticipating the planned extension of the range of regulatory issues to be discussed under the Lamfalussy Procedure to investment-fund and asset-management regulation (UCITS).

Two respondents made the criticism that the high speed of securities market legislation placed a particular burden on publicly-quoted companies (issuers) who might not be as familiar with the issues discussed at levels 1 and 2 as securities market experts. Also, the respondents regretted that issuers were not properly represented on the MPCP.

One interest group considered that the insurance industry was not adequately represented, in particular on the MPCP.

The Group also noted a considerable problem related to the representation of retail investors and consumers, from whom it did not receive any reaction to its first report. However, it has been suggested that national regulators have already taken on particular responsibility for these interests.

- The Group encourages the practice of ensuring that consultation processes are as open as possible to all market participants and end-users.
- The Group calls on all individuals and groups with an interest in the Lamfalussy Process or the legislation adopted in its course to make use of the various channels that already exist for the communication with the Institutions and CESR, especially calls for written consultation and open public hearings as well as the option of addressing the Institutions and CESR individually.

II.2 Level 3 – consistent application of EU securities-market law in the member states

Level 3 is concerned with the implementation of level 1 and level 2 legislation once adopted. Implementation was identified by the Committee of Wise Men as an area where action needed to be taken urgently. Level 3 was therefore devised so as to improve the consistency of the day-to-day transposition and implementation of level 1 and 2 legislation.

CESR has started working on level 3, and first measures with respect to consistent implementation of securities market rules are now on the way. At the same time, the purpose of level 3, as well as the instruments by means of which consistent implementation shall be reached, remain subjects of public discussion. The Group will therefore provide a brief review of the objectives and instruments originally envisaged by the Committee of Wise Men for level 3 work, of the nature of level 3 activities, and comments on major questions that have arisen recently.

II.2.1 Rationale of consistent implementation at level 3

In the EU's securities markets, differential transposition of EU directives has become a serious impediment to the functioning of the internal market and incurs costs on market participants and end-users which discourage them from pursuing cross-border business in financial securities. The most serious example of this malfunctioning is the Investment Services Directive currently in force (ISD 1).

Background

Origins of differential implementation

The problems associated with consistent transposition of EU law in the Member States is directly related to the use of directives as one of the EU's legal instruments. In contrast to regulations, which are directly applicable to market participants in all Member States, directives are binding only upon each Member State to which they are addressed, as to the result to be achieved, but leave to the national authorities the choice of form and methods. In order to become applicable in the Member States, a directive therefore needs to be transposed into, or implemented in, national law. This is the case for directives adopted in the course of the co-decision procedure (Level 1) as well as for Level 2 legislation adopted by the Commission alone. Depending on the material contents and formulations chosen in individual directives at EU level, Member States enjoy a greater or lesser degree of discretion as to the form and methods applied in implementing EU rules. Higher discretion, in general, allows Member States greater leeway in accommodating existing rules and procedures in the home country when implementing a new EU rule. The higher the degree of discretion and the greater the heterogeneity of forms and methods of application of EU law in the Member States, however, the lower the degree of harmonisation likely to be achieved among the Member States. Differential transposition thus becomes an obstacle for the cross-border provision of financial services as market participants have to adjust to different rules in the national jurisdictions.

In its final report, the Committee of Wise Men made concrete suggestions for alleviating the problems associated with inconsistent implementation of EU directives on securities market activity. For one thing, the Committee proposed that more use should be made of regulations rather than directives. Of the three level 2 measures on which the Commission has made formal proposals so far, one takes the form of a regulation while the remaining two measures have been drafted as directives.

Second, and relevant in the present context, the Committee also called for a framework of strengthened co-operation and networking between national regulators with a view to ensuring consistent implementation. This framework is referred to as level 3 of the Lamfalussy Process and should follow a set of rules as defined by the Committee:

Objective

- Greatly improve the common and uniform implementation of Community rules.

Responsibility

- National regulators, acting in a co-operative network.

Acting body

- CESR. Commission should attend as observer.

Instruments

- Consistent guidelines for the adoption of administrative regulations at national level.
- Joint interpretative recommendations and common standards regarding matters not covered by EU legislation. Where necessary, these could be adopted into Community law through a level 2 procedure.
- Comparison and review of regulatory practices to ensure effective enforcement throughout the Union and define best practice.
- Regular peer reviews of administrative regulation and regulatory practices in Member States, the results of which are reported to the Commission and to the ESC.

Legal force

- Outcome of CESR work is non-binding although clearly it carries considerable authority.

While not explicitly included in CESR's legal basis, level 3 tasks are defined along the lines of the recommendations of the Committee of Wise Men in CESR's Charter.

It is worthwhile emphasising that the scope of Level 3 activities extends across the entire range of securities market law, regulation and rules with a European dimension, i.e. it includes all secondary EU legislation and implementing measures relevant for securities markets as well as other relevant rules established at EU or international level (e.g. by the CPSS, IOSCO, IASB and others). It should also be recalled that level 3 does not only apply to measures adopted under the Lamfalussy Procedure, but that it also extends to the entire body of existing EU law on securities markets.

II.2.2 Review of current and potential future CESR level 3 activities

CESR has commenced working on improving the consistency of the implementation of EU securities market law in the Member States. Recent activities can be summarised as follows:

Background	
Review Panel and implementation of CESR Standards	
<i>Objectives</i>	<i>Activities</i>
<ul style="list-style-type: none"> - Assisting CESR in its task of ensuring more consistent and timely implementation of Community legislation in Member States. - Panel is the middle step in the implementation process. It intervenes after the self-assessment conducted by members and before the final assessment and publication by CESR. 	<ul style="list-style-type: none"> - Monitoring the implementation process of CESR Standards on Investor Protection (CESR/01-014d and CESR/02-098b) and ATS (CESR/02-086b)
UCITS and asset management activities	
<ul style="list-style-type: none"> - Publication of consultation paper in which CESR proposes how it intends to develop its new role in the regulation of UCITS and asset management activities. 	<ul style="list-style-type: none"> - Proposal of general principles underpinning its activities and of areas of possible intervention.
CESR-ESCB Working Group on Clearing and Settlement	
<i>Objectives</i>	<i>Activities</i>
<ul style="list-style-type: none"> - Enhance the safety and efficiency of securities settlement systems. - Promote the competitiveness of European markets by fostering efficient structures and market-led responses to developments. 	<ul style="list-style-type: none"> - Working Group finalised the consultation paper, aimed to strengthen and improve CPSS/IOSCO recommendations and to upgrade these into standards. - Observance of other simultaneous international initiatives (e.g. European Commission, Giovannini Group and G-30).

Following the commencement of level 3 work in 2003, the agenda of activities with respect to consistent implementation is set to expand rapidly in the near future. In the coming months, therefore, level 3 work is expected to extend to clearing and settlement, the Market Abuse and Prospectus Directives, UCITS, IAS, CESR MoUs as well as the continuation of monitoring the transposition of CESR standards.

The list of current and future activities highlights two important points. First, it demonstrates the wide range of issues CESR has to tackle when it comes to consistent implementation, including measures directly related to Lamfalussy-based legal texts as well as other regulatory frameworks.

Second, it becomes evident that the work on consistent implementation of EU law is only getting started. The Group will therefore refrain from an assessment. Nevertheless, a number of conceptual issues are of key importance for how level 3 work will evolve in the months to come. In the following section, the Group reviews two major issues currently debated and puts forward suggestions for further proceedings.

II.2.3 Level 3 measures and the public debate

Two broad questions are being discussed among policymakers and market participants. First, the question has been asked by some whether level 3 work should be geared towards uniform transposition of EU law in the Member States or whether consideration should also be given to the need for flexibility in applying EU rules, given the existence of very different legal systems and traditions in the Member States. Second, the question is being discussed whether CESR level 3 measures enjoy a sufficiently high level of authority across Member States. Both questions will be discussed here at a conceptual level, as practical experience with level 3 measures is not yet available.

(i) Consistent implementation vs. discretion for national regulators

Should level 3 work serve to promote the uniform application of rules and give incentives to regulators to adopt joint practices? Or should it serve to promote discretion among national regulators so as to accommodate existing national rules and practices and allow for discretionary regulation where policymakers at levels 1 and 2 have failed to reach a common, binding solution?

The debate was sparked off as a result of CESR's work carried out on level 2 measures related to the Market Abuse Directive, asking which issues must be treated at level 2 and which issues can be relegated to level 3. In essence, two opposing, stylised ways of proceeding can be discerned:

Background	
Underlying concept: Consistent application	Underlying concept: Flexibility in applying EU rules
<ul style="list-style-type: none"> - Political decisions on regulating securities markets are taken at levels 1 and 2. The result is a body of comprehensive level 1 and level 2 rules which leave a minimum amount of discretion as well as open questions to national regulators. - Level 3 work is thus limited to reaching joint ad-hoc practices at a rather technical level. 	<ul style="list-style-type: none"> - Not all political decisions can be settled at levels 1 and 2. The result of level 1 and level 2 work leaves wide discretion to national regulators in applying the body of EU rules. - Level 3 work becomes one of either (a) settling controversial issues left open at levels 1 and 2, or (b) presiding over application of EU law in the interest of flexibility, or a combination of both (a) and (b).

The arguments in favour of consistent application or in favour of more flexibility have to be carefully balanced. Decisions should be taken on a case-by-case basis.

The majority of market participants and end-users who have expressed views on this problem has declared that consistent implementation of level 1 and level 2 measures is a highly important part of making the single EU securities market work. Most are strictly opposed to a procedure in which all issues on which political agreement is impossible to reach at level 1 or 2 are automatically relegated to level 3.

Background			
Underlying concept: Consistent application		Underlying concept: Flexibility in applying EU rules	
Potential advantages	Potential disadvantages	Potential advantages	Potential disadvantages
- Maximum consistency in implementing EU rules at national level	- Requires far-reaching political agreement at levels 1 and 2	- Political controversies can be by-passed	- Minimum consistency in implementing EU rules at national level
- Minimum legal ambiguities left to level 3	- Relatively higher regulatory density at levels 1 and 2	- Relatively lower regulatory density at levels 1 and 2	- Maximum legal ambiguities left to level 3
- Consistent with principle of harmonised legal market	- More far-reaching need for adjustment of national rules and practices	- Less far-reaching need for adjustment of national rules and practices	- Inconsistent with principle of harmonised legal market
- Fully consistent with level 3 concept of Committee of Wise Men	- Minimum of discretion for accommodating existing national rules and practices	- Maximum of discretion for accommodating existing national rules and practices	- Inconsistent with level 3 concept of Committee of Wise Men

At the same time, numerous respondents also consider that, notwithstanding the aim of consistent application, differences in legal and cultural environments prevail in the EU's national securities markets, that in many instances there is a genuine need for flexibility, and that, as a consequence, it would be undesirable to eliminate such differences by all means. It has also been noted that a strategy of fully regulating all eventualities at levels 1 and 2 could imply flooding securities markets with a high density of rules. Finally, it has been argued that if political agreement on a certain issue is impossible to reach at levels 1 and 2, leaving the solution to level 3 might still be preferable to blocking of political decision-making or excluding that issue from the agenda of deliberations altogether.

Some respondents have suggested establishing a set of clear criteria for answering the question as to whether an issue should be dealt with at level 2 or be discussed by national regulators at level 3. Some respondents have suggested consulting market participants and end-users on the question of allocating decisions to levels 2 and 3 as well as on the activities pursued under level 3.

The Group considers that consistent implementation of EU law is a vital prerequisite for reaching a single EU market in financial securities and that level 3 is an essential element of the Lamfalussy Process. The long-term commitment to eliminating cross-border obstacles should take precedence over the short-term desire of maintaining regulatory rules and practices at national level, at each level of decision making.

Level 3 is an inappropriate locus for substantial economic, regulatory or social choices, but must be restricted to co-ordinating the practical administrative work and regulatory practices among regulators and supervisors in a narrow sense and of immediate concerns for their day-to-day work. This co-ordination should be done in a practical, co-operative manner.

If policymakers deem flexibility in implementing EU law at national level necessary or desirable, they should provide explicitly for the necessary flexibility in the legal text adopted at levels 1 and 2. Similarly, if certain provisions made at levels 1 or 2 are considered

unsatisfactory, it would be counterproductive in the long run to seek to dilute level 3 activities only for the sake of softening the impact of the relevant level 1 or level 2 measure.

- The Group recommends 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, in order to ensure consistent implementation and application of EU securities market legislation and other relevant rules.
- The Group encourages CESR and the national regulatory authorities to intensify and speed up their work at level 3, especially with regard to the implementation of newly-adopted EU securities market legislation at levels 1 and 2.
- The Group calls on CESR and the national regulatory authorities involved in level 3 work to reduce the degree of flexibility in applying EU law in the Member States to the minimum required for accommodating regulatory differences in the member states.
- The Group encourages market participants and end-users to communicate information and views on measures undertaken in the context of level 3 to the relevant decision-makers, i.e. CESR or the national regulatory authorities.
- The Group encourages CESR and the national regulatory authorities to make their activities in the context of level 3 public and pursue a transparent approach.
- A convergence of regulatory practices may, in the long run, also be sought by means of exchange of staff between national regulators, as well as a closer involvement of research institutions and universities in CESR work.

(ii) Greater authority for CESR level 3 measures

In order to fulfil its tasks under level 3, CESR issues guidelines, recommendations and standards. It also undertakes peer reviews of regulatory practices within the single market. CESR members, i.e. the competent national regulatory authorities, introduce these instruments in their regulatory practices on a voluntary basis. As the Committee of Wise Men observed, level 3 measures will not be binding upon the Member States and their regulators – although they should clearly carry considerable authority.

This concept has given rise to concerns that

- Level 3 measures might not be adhered to in a Member State in cases where they are opposed by the relevant national decision makers, and that
- national courts may not sufficiently take into account in their jurisdiction what CESR has agreed at Level 3.

As a consequence, it has been suggested by CESR and some market participants that CESR level 3 measures might be given more authority. The option for doing so that has been brought forward is to give Level 3 measures more authority if the Commission agrees to adopt recommendations in this respect.

Any move to provide more authority to level 3 measures would nevertheless encounter significant hurdles:

First, policy initiation is the sole prerogative of the Commission under the Treaty. This principle may be violated in the event of any form of automatism flowing from the adoption of a CESR level 3 measure to an endorsement by means of Commission legal action were sought.

Second, recommendations bear the danger of leading to an ever-increasing density of lasting regulation at a point where pragmatic co-operation had been intended. At the end of such a

process, the body of rules around a certain legal measure might be composed not only of the underlying level 1 directive and a range of level 2 measures based thereon, but also of level 3 guidelines, recommendations and standards and, in addition to that, Commission measures designed to give the latter greater authority through the form of recommendations. The use of additional recommendations outside level 1 and level 2 might, therefore, render the EU's regulatory framework increasingly fragmented and opaque.

- The Group recommends that consistent implementation of EU law should primarily be sought by means of non-binding guidelines, recommendations and standards, established among CESR and national regulatory authorities, as well as by peer pressure within CESR.
- The Group encourages CESR and the relevant national regulatory authorities to follow a pragmatic approach on level 3 activity.
- The Group considers 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 to ensure compliance with CESR standards.
- The Group recommends finding a constructive approach in due course on how to proceed in such cases. The role of the Commission as the guardian of the Treaties would in no case be called into question.
- The Group also encourages CESR to set up an internal mediator system under its Charter in order to resolve conflicts between national regulators. Such a mediation mechanism should not pre-empt or call into question the general European system for monitoring and interpreting EU law.