

EPFSF Briefing

Assessing the Lamfalussy Process

The four-level Lamfalussy approach for the regulation of financial services in the EU has, except for the inter-institutional agreement, been in place for over 5 years in the field of securities, and for about 2 years in banking and insurance. A summary of the Lamfalussy approach is set out in the Annex.

Review of the Lamfalussy process:

The Lamfalussy report itself made clear that the process should be reviewed at 5 years (i.e. now) to see how it was working and what improvements should be made. A number of reviews of the process have been published, including from the Level 3 Committees themselves. These reports have debated whether the Lamfalussy arrangements are successful in terms of their own objectives and more broadly as a key feature in consolidating regulation of the pan-European financial services market. With an eye on this requirement to produce an official report, the Council, European Parliament, and European Commission have awarded mandates to the Inter-Institutional Monitoring Group (IIMG), composed of six independent experts from industry and academia. The IIMG has over time been asked to report on all aspects of Lamfalussy, assessing in particular progress made in implementation at the different levels in order to identify possible bottlenecks.

Hence over the past few months, a range of bodies have commented on the Lamfalussy review, including the Commission, the IIMG, European Parliament, Level 3 Committees, and some Member States. Among the issues that these have raised are:

- (a) Whether the Level 3 Committees need a different legal basis,
- (b) Whether there is a need to change decision-making processes in the Level 3 Committees,
- (c) Whether Level 3 Committees should be directed by and accountable to the European Institutions, or whether they should continue to operate as networks of nationally accountable regulators,
- (d) Whether national regulators' mandates should specifically encourage cooperation at EU level,
- (e) How to improve cooperation between home and host regulators in case of large groups operating cross-border (e.g. strengthening the powers of the lead supervisor).

The ECOFIN-Council on 4 December 2007 adopted a series of conclusions, and a road-map, which set out a work programme on these Level 3 issues, and also on other points relating to the rest of the Lamfalussy process.

Challenges and Assessment of the Lamfalussy process:

The Lamfalussy process has proved to be important in fostering supervisory convergence across the EU and valuable as a means of enhancing the flexibility and pace of the legislative process.

A broad consensus exists on the benefits that the Lamfalussy process brought to EU financial rule-making (levels 1 and 2). There is also broad consensus that the Level 3 Committees have brought about closer supervisory cooperation and have sowed the seeds of a common supervisory philosophy in the EU. Most commentators also agree that they have achieved the tasks they were asked to undertake. Some critics have suggested that they could and should have gone beyond their mandates and done more, but it is important to bear in mind how far they have had to focus their resources on legislative advice and follow-up on MIFID, CRD, and Solvency 2. There is less agreement on the issue of a revision of the Level 3 structures.

Assessing levels 1 and 2

The Lamfalussy structure has been in existence for about 5 years, but only the securities sector has been operating the Lamfalussy arrangements for that period of time, most of which has been spent on Level 1 and 2 work. The banking and insurance sectors, which have been running under

Lamfalussy for about three years, have more limited experience. No experience of amending level 2 legislation in response to market changes has so far been possible due to the current state of play on banking and insurance legislation (see below for more detail).

Two sets of criticism are voiced frequently as regards Levels 1 and 2.

First, that there has been a tendency to incorporate excessive detail in Level 1 legislation. There are various reasons for this: partly a lack of trust that, without detail, national priorities will not be protected; partly the fact that Level 1 is intended to be principles-based, which is a new legislative environment for many participants in the process; and partly the fact that for some countries and for the EP and Council certain technical details are politically important. There are different ways of dealing with this issue. Some have argued that, in order to correct this tendency more robust definitions of the boundaries and requirements at each Level should be added to the Lamfalussy guidelines and agreed by the EU Institutions. Others consider that the fundamental issue of trust and cooperation between institutions and regulators, both cross-border and cross-function, is at the heart of the problem: these take years to develop and have had insufficient time to mature within the Lamfalussy framework.

Second, concerns have been expressed about shortcomings in the consultation procedure, notably that timetables (typically imposed by the Commission) are too tight, risk lowering the quality of consultation, and potentially exclude some market participants by disproportionately burdening their resources. There are also legitimate concerns that much of the work has been done without proper regulatory impact assessments. It is arguable that these problems have been caused by the pace of and quantity of legislation under the Financial Services Action Plan (FSAP), which has broadly coincided with the early years of Lamfalussy. If so, as the FSAP is now completed there may be legitimate expectations for more reasonable consultation flows and deadlines in future, and the Level 3 Committees have now adopted common guidelines to perform impact assessments on their Advice and Guidelines. In general, there is agreement that consultation can be improved slightly, for example by providing consultees with regular meaningful feedback on their input and by extending consultation periods to a minimum period of three months. Information to the market is important as part of consultation and, partly to assist in helping to avoid duplication in the course of consultation processes, there are those who would welcome more transparency from the Level 1 and 2 authorities about some of the selections made, such as in the acceptance or rejection of Level 3 advice. CRD has the characteristics of Lamfalussy Level 1 and 2 measures, but because it is not a full Lamfalussy directive, the Commission is not obliged to ask CEBS for technical advice, a situation which may be remedied as part of the CRD revision in 2008.

Assessing Level 3

Supervisory cooperation and convergence has undoubtedly improved since the creation of the Level 3 Committees. Much has been achieved in a short time-period. These Committees have deployed various instruments to ensure greater consistency in the application of EU financial regulation. The use of Level 3 guidelines, passed by consensus, has probably been the most important of these. Because Level 3 committees cannot issue official guidelines on Level 3 outcomes before legislation at higher levels has been concluded, the wish has been voiced that market participants be provided with informal guidance on Level 3 implementation issues ahead of time, in order to smooth and facilitate practical implementation steps by firms.

The following are important issues in the continuing work arising from the review of the Lamfalussy process:

1. The fact that supervisory cooperation does not always keep pace with the needs of cross-border firms for practical cross-border supervisory arrangements.
2. The fact that Level 3 Committees operate by consensus. While this procedure has advantages, such as enhancing trust among national supervisors and acceptability of the guidelines, it has also drawbacks, for instance the risk for an agreement to be the lowest common denominator and to be achieved slowly. There are challenges in this area for example, the desire of cross-border groups to streamline their reporting and other systems as

much as possible. ECOFIN has concluded that the Level 3 Committees should be allowed to adopt Qualified Majority Voting (QMV) for certain purposes, even though the results would not be legally binding.

3. The absence of a mechanism to guarantee consistent implementation at national level by the relevant competent authorities of Level 3 agreements.
4. The fact that individual members of the Level 3 Committees have different powers, tools and responsibilities. There is a need to examine the full effect of these divergences, perhaps in the context of mapping and comparing the different national legal structures under which the regulatory authorities operate in the member states. The Level 3 Committees could undoubtedly assist in this exercise.
5. The fact that while all Level 3 Committee members have a national mandate to safeguard the interest of their respective member state, they at the same time are expected to cooperate and converge supervisory practices at EU level. This issue forms part of the discussions on how to develop a culture of European supervisory cooperation and convergence within a context of national accountability of regulators.
6. Differences in the willingness of Level 3 Committee members to engage in close collaboration with authorities in other EU countries vary markedly across member states. The different intensity of cooperation is also reflected in the fact that practices for supervisory colleges changes considerably. An agreement on best practice standards for supervisory colleges could prove helpful here. In addition, a systematic programme for staff exchanges between supervisory authorities may represent a way of achieving a spirit of cooperation and mutual trust, a pre-condition for the Lamfalussy Process.
7. The question about how "soft law" techniques can interact most effectively with legislation, or "hard law", to develop enhanced supervisory cooperation and convergence.

Assessing Level 4

Level 4 is a crucial, often overlooked part of the Lamfalussy process, but remains largely untested in practice. Full application of Level 4 requires the allocation of sufficient Commission staff to monitoring. But monitoring can work most effectively if the concerns it raises can be applied during the implementing phase of the directives when comments can easily be taken up by participants in the national legislative processes. The Commission's scorecards on the state of play of the implementation of EU financial regulation in Member States are an important instrument to create transparency on implementation deficits as well as to create peer pressure. It remains to be seen whether a "name and shame" approach will prove sufficient or whether there will be a need for additional, new instruments to complement the ultimate weapon of infringement proceedings.

Briefing notes are prepared by the Financial Industry Committee to the European Parliamentary Financial Services Forum. For further information on the subjects raised in the briefs please contact the Chairman, Members or Secretariat of the Financial Industry Committee.

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Annex: Summary of the Lamfalussy process

Comitology is governed by Council Decision 2006/512/EC. The Lamfalussy process has given a strong role to comitology to complete the essential elements ruled at Level 1. The expert group chaired by Alexandre Lamfalussy considered in its final report of 15 February 2001 that the legislative and regulatory processes in the securities sector were too rigid, too slow and not well adapted to the needs of fast changing securities markets. The proposed remedy was to break the system into four levels. The first two tiers (Levels 1 and 2) of these should be the preserve of the European Parliament, Council, and Commission, and be concerned primarily with European level legislation and implementing measures (legislation or regulation). It was anticipated that these levels would operate on the basis of key principles and eschew prescriptive detail. Levels 3 on the other hand would be in the remit of the national regulatory authorities. In order to bring these authorities together in an appropriate format, consensus-based Committees composed of the relevant EU member state national regulators or competent authorities should be formed in the securities, banking and insurance/pensions sectors with the objective of agreeing on implementation and enforcement at national level of the legally binding Levels 1 and 2 documents. The Committees would not have the power to make rules, and therefore their collective decisions would not be legally binding, but they would seek consistency on how each national regulator should give effect to the European law and regulation that had been passed. All levels of the process should involve market participants and end-users through extensive consultation.

Level 1: Framework Directive or Regulation adopted after full co-decision procedure.

Level 2: Commission adopts implementing measures (directives or regulations) prepared on the basis of consultation with the "Level 2 Committees" (i.e. committees focusing on regulation and comprising Member States' governments' representatives: ESC, EBC, EIOPC) and advice from the "Level 3 Committees" bringing together national supervisors in the fields of banking, securities and insurance (CESR, CEBS and CEIOPS). These measures fill some technical details of the more principle oriented "Level 1 measures" (framework legislation).

Level 3: Level 3 Committees ensure consistent implementation and application of EU legislation in all member states through information exchange, cooperation, and supervisory convergence (e.g. day-to-day administrative guidelines and joint interpretation guidelines).

Level 4: Commission monitors national implementation and enforcement, and checks on the timely transposition of Community law, taking legal and other action in case of breaches of this.

New 2006 Comitology Decision

On 17 July 2006 a new comitology decision (Council Decision 2006/512/EC) has been adopted by the Council with a greater involvement of the European Parliament. This Decision, aimed at introducing a new comitology procedure: "the regulatory procedure with scrutiny". This places the EP and Council on an equal footing regarding the supervision and control of the delegated legislation of the Commission thereby giving also to the EP a right of control over the substance of any implementing measure under Level 2.