FESCO revamped: the new CESR

Once upon a time there was FESCO: a useful forum where European securities regulators would meet in an attempt to establish some form of cooperation. It produced a multilateral MOU, signed by all its members; it established a permanent committee to enhance cooperation in enforcing; it produced a number of relevant papers expressing common views on regulatory matters that were discussed with market participants and sent to the Commission as voluntary contributions. It was the germ of an institution, but it was not an institution insofar as its tasks were not clearly defined; it had an arm’s length relationship with the Commission; it had few relations, if any, with the other European institutions.

Then came the Lamfalussy report, endorsed first by Ecofin and then by the Stockholm Council resolution of March 2001, with its four-level proposal to make financial services legislation more timely and more flexible: a simple and very obvious proposal, if you wish, but one that was articulated and came at the right time to receive political endorsement in the hope to speed up the FSAP and to translate into facts all the good intentions expressed by successive Council resolutions. In the Lamfalussy approach a European securities regulator committee acquired institutional dignity: the Commission was mandated to institute it formally - which it promptly did in June 2001 - and it was assigned precise institutional tasks: an advisory role to the Commission in the drafting of the proposals for implementing measures at level 2; an autonomous role of cooperation and coordination in the transposition of EU legislation at level 3. The lengthy turf war between the three European institutions (Commission, Council and Parliament) following the Stockholm resolution (on which I shall not comment) did not so much concern CESR as such as the apparently arcane but politically very substantial matter of the acceptability for Parliament of level-2 delegated technical legislation.

Without waiting for the outcome of this war (an honourable though not altogether efficient compromise), on the basis of the Commission decision FESCO was transformed into CESR, an acronym that lent itself to a slightly megalomaniac pronunciation. Thus CESR is the institutional metamorphosis of FESCO: a cosy club of European regulators acquired institutional dignity in the European decision making process.

The roles of CESR

Level 2

At level 2 CESR is assigned an advisory role to the Commission. Following the indications of the Lamfalussy report, the Stockholm Resolution stated that “[The Regulators Committee] will act as an advisory group to assist the Commission in particular in its preparation of draft implementing measures (level 2)”. The Commission decision establishing CESR thus defined the latter’s role: “to advise the Commission, either at the Commission’s request..., or on the Committee’s own initiative, in particular for the preparation of draft implementing measures in the field of securities”. This clause is reproduced in article 4.1 of the CESR Chart.

Level 3

According to the Lamfalussy report:, the level 3 tasks of CESR should be: to produce consistent guidelines for the administrative regulations to be adopted at the national level; to issue joint interpretative recommendations and set common standards for matters not covered by EU legislation; to compare and review regulatory practices to ensure effective enforcement throughout the Union and define best practice; to periodically conduct peer reviews of administrative regulation and regulatory practices in Member States, reporting their results to the Commission and the ESC.

Accordingly, the Stockholm Council resolution asked CESR to “play an important role in the transposition process (level 3), by securing more effective cooperation between supervisory authorities, carrying out peer
reviews and promoting best practices, so as to ensure more consistent and timely implementation of Community legislation in Member States''

According to its Chart (paras. 4.2 and 4.3), CESR ''will foster and review common day to day implementation and application of Community legislation. It will issue guidelines, recommendations and standards that the members will introduce in their regulatory practices on a voluntary basis. It will also undertake reviews of regulatory practices...[It] will develop effective operational network mechanisms to enhance consistent supervision and enforcement...''

**The work of CESR**

The major outcome of the metamorphosis of FESCO into CESR is to be found so far in its enhanced advisory role to the Commission.

Level-2 work in response to European Commission mandates includes advice on the directive on market abuse, to be delivered by end December 2002, concerning the definition of inside information and market manipulation, the obligations of issuers, the requirements for research, the safe harbours (buy-backs and stabilisation); and advice on the prospectus directive, to be delivered by end of March 2003, concerning disclosure requirements for various types of securities, documents that can be incorporated by reference, availability of the prospectuses.

CESR is also working in view of ongoing Commission initiatives with an expert group on transparency and efficiency (interim report June 2002) and responding to the Commission's consultation on ISD.

CESR, as FESCO before, has also been active in issuing standards, of which the following were issued this year: standards for investor protection, with conduct of business rules for retail investors (April 2002) and for professional and counterparty regimes (July 2002); primary market practices - stabilisation and allotment (April 2002); standards for alternative trading systems (July 2002).

There is further a permanent group on accounting (CESR-Fin), for the implementation of international accounting standards and for setting the principles of enforcement and one for cooperation and coordination of surveillance and enforcement activities (CESR-Pol)

**Issues**

So much for description of the tasks of CESR in the framework of the Lamfalussy procedure and for a summary of ongoing work. The fact that the community of EU regulators has found a proper institutional role and that much work is being done should not be a reason for complacency: major problems still lie ahead and major obstacles still have to be overcome. Good intentions and a suitable institutional design are necessary but not sufficient conditions to yield good results. If, as the saying goes, the proof of the cake is in the eating, the cake produced so far is still very much in the process of baking. Let me therefore touch upon some relevant issues.

One regards the setting of the implementing measures at level 2. Another one, more important for the effectiveness of CESR concerns the still unchartered territory of the level 3 tasks. There are then two problematic issues that span across the first two: consultation and the extent to which harmonization should be pursued.

1 - **Will level 2 work?**

The level 2 setting of implementing measures predicated by the Lamfalussy approach has not been tested yet: the market abuse directive will be the first case. We can only note at the moment that the EU Parliament has tended to narrow the room for the delegated adoption of implementing measures and has introduced a severe sunset clause to the possibility of updating and adapting those measures.

The Securities Committee exists on paper but is not yet operational; nor is it clear that its membership will follow the indications of the Lamfalussy report (Governments represented at a high level, with official empowered to deliver a decision).

The Commission and CESR have moved speedily. As reported above, both are working on draft proposals for implementing measures on two directives even before they are approved: Thus, in the case of market abuse, the Commission will be ready with its proposals as soon as the directive is finally approved. The problem is whether the (untested) Securities Committee will work fast, and especially whether it will avoid the same squabbles that have often paralysed Council decisions. Remember that if the SC votes against the draft implementing measures or is unable to deliver an opinion, the draft measures are submitted to the Council, that votes within three months. It may well happen (indeed it has happened even before the Lamfalussy
method) that the consensus reached at the level of national securities commission is not reached at the level of national (political) representatives.

2 - How should the level-3 tasks of CESR be performed?

Potentially, this may become the most important area of CESR work, because uncoordinated and variegated implementation of the directives in national legislation and regulation is an obstacle to the development of a single market for financial services: only potentially, however, because at the moment there is little to report.

There are, as we have seen, two major tasks for CESR at level 3: to set common standards and issue recommendations for matters not covered by European legislation; and to play a role in the transposition process in order to ensure consistent and timely implementation of Community legislation in Member States. In both cases there arise problems of assessment and, in a very broad sense, of enforcement.

Recommendations can only be accepted and standard introduced on a voluntary basis, as they are not legally binding. But there should be a regular assessment of the degree of compliance. Then, the appropriate sanction for a member failing to comply ought to be of a reputational nature: even without name-shaming, that member should be requested to explain and justify his behaviour. For this to be possible, CESR should have the means, and above all the strength, to conduct regular reviews of its members’ compliance.

This is all the more true for the other major task. The same piece of legislation, even to the level of implementing measures, can be applied in several different and sometime inconsistent ways and these differences can create obstacles to the free movement of services; worse, its adoption can be delayed for a long time without providing any convincing justification (it took several years for one Member State to adopt the ISD directive). Again, insuring that EU legislation is implemented in a consistent and satisfactory manner in national regulation and in the regulators’ practice requires that CESR performs a new and delicate role: new and delicate because it implies intruding in its members regulatory activities and practices. This may hurt national susceptibilities and find resistances to submitting to his peers' assessment: it is perhaps telling that the requirement of "peer reviews", present in the Stockholm Council resolution has disappeared in the CESR chart.

No procedure to face these problems has yet been set in place. A method of self-assessment has obvious limits. International organizations, such as the IMF or the OECD, conduct independent assessments in various areas. In the case of CESR the technical structure is still weak, so that the review for each jurisdiction should be conducted by a review panel composed of other members. But will CESR members accept to be examined by their peers? Without suggesting here specific solutions, I only wish to stress that working at implementing measures and issuing standards is not enough. CESR must face the choice: unless it is able to develop its level 3 role, it will only play an auxiliary task to the Commission - and when an input for level 2 is required - and will do little to contribute to the convergence of regulation and regulatory practices. Failing an independent effort on the part of CESR, because of the reluctance of its members to submit to collective constraints, I should be happy if the market provided the necessary stimulus. Market participants would perform a very useful role if they signalled to CESR the difference between of documents' words and its members' deeds.

3 - Consultation

Reference to market participants leads me to the industry's involvement in the drafting of measures. Consultation is nowadays the name of the game. The Lamfalussy report, the European Parliament and the Council all recommend extensive consultation at all levels and "with all interested parties".

CESR has created a permanent 11-members consultative panel of market participants and submits all its papers, and in particular those dealing with level 2 technical implementing measures, to wide outside consultation. All this activity should not conceal the problems inherent in the consulting procedure.

First the procedure in its present form is highly time consuming: lengthy papers are sent round and the replies to them have to be sifted and organized. The task would be easier if the views of trade associations, to which consultation paper are regularly addressed, were actually representative of some average or median opinion of their members. This is often not the case, as the big players have repeatedly made clear that they wish to answer on their own, irrespective of the views of the associations to which they belong. Not even European associations appear to be able to express a consensus view accepted by their national members associations - as exemplified by the debate on internalisation in the revision of the ISD.

Second, and more important, consultations should in principle concern technical matters: more, in the economists' jargon, X-efficiency - i.e. the efficiency and the cost/benefit assessment of a regulatory solution - than the underlying political choices, which ought to be decided at the political level. More often than not, instead, consultation provides an opportunity use efficiency arguments in order to defend specific and often opposing interests - of sectors, trades, individual firms, and of particular countries, depending on the
concentration of sectors, trades and firms. This is not particularly helpful. The weight to be assigned to different interests ought to be properly dealt with at the political level, i.e. by the Council and by the European Parliament. (I do not seem to recollect that the Sarbanes-Oxley bill was the object of extensive consultation).

Thirdly, and related to the point I just mentioned, consumers' and end users' association, the consultation of which was recommended by the Lamfalussy report, by Council and by Parliament, are conspicuously absent in the actual consultation process. I would not in principle complain for this omission. It is not clear that consumers' association provide a satisfactory solution to the classic collective action problem besetting small investors (as acting individually is too costly, nobody takes the initiative, even though everybody would benefit if somebody else did). The representative legitimacy of the various consumers' association is unclear and so is their accountability to an undefined constituency. Actually, the legitimate bodies which are in charge of protecting consumers' interests - this being their task mandated by law - are the regulatory authorities. The presumption should be that, when regulators are in charge of drafting the rules, there is not much need of consultation with the end users.

This would be perfectly straightforward if consultation with the end users' counterparties - i.e. with the financial industry - were restricted to the efficiency and the cost/benefit assessment of the measures to be enacted. But if, and to the extent to which, this is not the case and other considerations interfere regarding the industry's convenience and profitability, then ways (probably clumsy and unsatisfactory ways) must be found to give adequate voice also to the constituency of the end users of investment services.

4 - Harmonization: flexible subsidiarity or imperative rules?

This leads me to another vexed issue, well summarized by Howard Davies in his recent Mansion House speech. There he detected "increasing anxiety about...the maximum harmonisation approach" and said that directives which, instead of setting minimum standards, require that you can do no more and no less than what they say impose "a one-size fits all approach,...which simply does not reflect the reality of the difference from one member state to another". These misgivings about directives could of course be extended to implementing measures and, no less, to the level-3 tasks of CESR.

There are good arguments for this view: the different degree of evolution of markets in different Member States, their different legal regimes, the different role played by self-regulatory organizations are all obstacles to an attempt to establish a one-size fits all regulation. There are also arguments, on the other hand, for a more flexible and perhaps less radical view. It has often been the case that very minimum standards of harmonisation have provided Member States with the opportunity to introduce demanding additional requirements that have served the purpose to erect protectionist barriers and insulate the domestic market from competition. Community laws, moreover, must be implemented and administrative regulations and regulatory practices must respect CESR standards and be consistent, in order to remove the existing obstacles to a single market for financial services. It is perhaps useful to remember that in the United States securities laws, unlike the company law, soon acquired a federal status; and that even in the case of company law there has been federal intervention with Sarbanes-Oxley.

I am inclined to take a middle-of-the-road view on this issue, based on the following lines. First, we must accept that the process towards a single European financial market requires gradually raising the level of harmonisation, even without specifying to the millimetre the size that should fit all. Second, this process can only be gradual. Third, the more uniform model to which it will lead will not necessarily be that prevailing in one jurisdiction to which all others should conform. Fourth, and as a result, everybody should be ready to contribute to a workable solution, even at some cost for short-term national and sectoral interests: a more level playing field will provide in the end a better opportunity for the fittest to survive.