The Lamfalussy method: An interim assessment

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1. The Lamfalussy method has become the name of the game in European circles. A detached observer however may be justified in concluding that there is little, if anything, of substance behind the appearance. But, if that of observer were more of an insider, he may realise that acceptance by European institutions of that method is yielding some results. I briefly wish to take stock of progress - or lack thereof - of European legislation and regulation in the first year of the Lamfalussy era.

First, let me to remind you how the whole thing started and how it developed.

2. European legislation on the financial sector and the suggestions of the Lamfalussy Committee

2.1 We all know the deficiencies of the European legislation in the financial sector.

It is incomplete, because there are many relevant gaps; it is inconsistent, because of ambiguities and because it sets only minimal requirements; it is subject to rapid obsolescence, as it is unable to keep pace with financial and market innovation. On top, regulatory practices, supervision techniques and enforcement powers differ widely between jurisdictions.

In considering this situation one must acknowledge at least two objective difficulties. First, financial markets find no place in the Treaty, either because they were forgotten or on the mistaken assumption that internal market provisions would solve the problems. Second, effective harmonization in the rules and supervision in the securities markets are far more difficult to achieve than in the banking sector: the object is far more variegated; there does not exist the equivalent of universally accepted Basle rules; the home country principle is more readily applicable in banking; in the case of securities markets, there does not exist an institution like the ECB and, if needed, an institutional peg (art.105.6 of the Treaty)

2.2 Well aware of the situation, the Commission has taken over time a number of initiatives, all invariably and duly endorsed by the Council


Growing political awareness of lack of progress and possibly other more substantial motivations (the then impending merger between Deutsche Börse and the London Stock Exchange) prompted the Ecofin Council, on 17 July 2000, to set up a committee of independent person, to be assisted by the Commission, to discuss the practical arrangements for the implementation of the FSAP and to propose various approaches to adjusting the practice of regulation and cooperation between regulators.

2.3 It soon became clear to the committee that there was little need of another shopping list, adding to that of the FSAP as the major shortcomings of EU legislation in the financial sector, institutionally if not politically, were due to the intrinsic characteristics of the European legislative process. As stated in the report, “the problem is the system itself”. It was apparent that the present legislative system is too slow, owing to the blockages occurring in the process of co-decision, especially at the Council level; it is inefficient, as the attempt to adapt the Community framework to existing national legislation leads either to minimal harmonization, or to unnecessary complexity, or to deliberate ambiguity; it fails to distinguish between core framework principles and technical implementing rules; it is much too rigid, as it cannot be adapted to the fast pace of changes of financial markets without going through the cumbersome co-decision process.
In suggesting an alternative, the committee was careful to steer away from two polar myths: regulatory competition and the Single European Regulator. It decided instead to set itself a seemingly modest task: finding a way to deliver speedy reforms in the decision process within the bounds of the present Treaty. This task was perhaps modest but not obvious: Keynes' somewhat extreme remark, that "it is only by a rare and lucky coincidence that what is administratively sensible is also lawful", appears to apply with particular force to European matters, so that we were often reminded of the British civil service plea, to have "lawyers on tap, not lawyers on top".

2.4 As is well known the committee suggested as four level approach to speed up, implement and make more flexible European legislation on the financial sector.

In essence the proposal, which rests on the legal basis of article 202 of the Treaty and an of an earlier decision on "comitology", introduces a mechanism of delegated legislation/regulation, not subject to co-decision, for the implementation of measures of a technical nature, while leaving the setting of framework principles to primary legislation. The two major objectives are: speed in the legislative process and flexibility in the adaptation of the implementing measures to the innovations of products and markets.

At level 1, primary EU legislation (directives or regulations), to be enacted with the normal co-decision procedures, should set broad framework regulatory principles. Each legislative act specifies, on a case-by-case basis, the nature and extent of technical implementing measures to be adopted at Level 2.

At level 2, the Commission, advised by a Regulators Committee, submits draft proposals of the implementing measures to the vote, within a fixed time frame, of a Securities Committee, the members of which are nominated by member States). The Securities Committee acts as a regulatory committee. If approved, the Commission's proposals become immediately binding; if not, they are submitted to the Council. The updating of existing implementing measures would follow the same procedure.

At Level 3 the Regulators Committee which comprises the representatives of all the member States securities commissions, provides consistent guidelines for the adoption of regulations at the national level, ensures consistent and equivalent transposition of legislation, coordinates regulatory practices.

At Level 4: the Commission enforces the national transposition of Community rules.

3. The political and institutional follow-up

3.1 After the approval of the final report by the Ecofin Council, the Stockholm Council of March 2002 endorsed the proposal of a four-level approach. As a result it accepted that a Securities Committee should act in a regulatory capacity under 'comitology' rules and mandated the Commission to set up a Securities Committee and a European Regulators Committee.

Two Commission decisions of 6 June 2001 established the European Securities Committee and the Committee of European Securities regulators. CESR. The former FESCO (Forum of European Securities Commission) thus received official recognition and an institutional role at the Community level.

The Commission put quickly in practice the Lamfalussy procedure (i.e. the regulatory procedure laid down in the 'comitology' decision) by introducing delegation for implementing measures in the two newly proposed directives on prospectuses and on market abuse.

3.2 This quick and apparently impressive progress - never before had happened that an experts' committee recommendations were implemented so quickly - was slowed down by a turf war between the European institutions.

At a very early stage the European Parliament, and especially its Economic and Monetary Affairs Committee, expressed suspicions and misgivings on the envisaged four level approach, as it felt that the delegation of implementing powers to a regulatory committee would narrow the Parliaments' prerogatives. In an exchange of letters with Commissioner Bolkenstein, the chair of EMAC, requested that Parliament be given a call-back right for the implementing measures. The Commissioner replied that such provision would not be compatible with the Treaty as it stands, while on the other hand the rules set for the Lamfalussy procedure were sufficient to keep Parliament fully informed and allow it to exercise full control that the implementing measures would not exceed the mandate.
This turf war ended with a compromise. The European Parliament obtained the introduction of a sunset clause, whereby the right to adapt and update level 2 rules only lasts four years after the adoption of each directive and must then be renewed at the legislative level.

This is a compromise and not a stable and satisfactory solution, for two reasons. In the first place, the sunset clause, seriously limits the possibility of promptly adapting the rules to changes in the securities markets without having to go through the whole legislative process. Secondly, and more importantly, the European Parliament, in the c-decision at level 1, will tend to narrow as much as possible the scope of level 2 rulemaking: this has already occurred in the parliamentary examination of the directives on prospectuses and market abuse.

Having said this, it must be recognized that the EP had, and still has, two very strong points supporting its misgivings.

First the perfectly sensible arguments of the Commission on the legal foundations of the Lamfalussy procedure would carry more weight if the Commission had not been forced to forget about existing texts in order to accept the Council’s whims in Stockholm. There, the Commission “committed itself … for those cases of implementing measures … acknowledged to be particularly sensitive to avoid going against predominant views which might emerge in the Council …” . The “predominant views” instead of the qualified majority, do not belong to any legal Community text, including that on comitology decisions. If the Council prevaricated on the Commission in Stockholm, it is not surprising that Parliament should attempt to do the same.

Second, and more relevant, Parliament, and the chair of EMAC, are largely right when the say that the tantalizingly slow pace of European legislation is due not so much to the co-decision process and to the whims of European Parliament, as to the political difficulties that prevent Governments to reach an acceptable compromises in the Council under the constraints of national interests and existing national legislation. This being the case, the misgivings expressed by Ms. Randzio-Plath that the same obstacles may arise in the working and deliberations of the Securities Committee, in its exercise of binding regulatory powers, may have some justification.

4. Half empty or half full?

4.1 It is perhaps too early to judge on the effectiveness of the new procedure, because in spite of all the noise and fuss, nothing has happened yet, and nothing will happen for some time at Lamfalussy level 2.

The prospectus directive is in deep waters. After the amendments introduced by Parliament in the first reading (some of which I consider questionable) the Council and the Commission are still far from reaching an agreement on a new proposals: a good example of the difficulties that are met at the Council level. If all goes well, a common positions will only be reached under the Greek Presidency.

The market abuse directive is in a somewhat better shape. Again, if all goes well, it may be finalized by the end of the year - at which stage the Securities Committee would, for the first time, exercise its level 2 powers (more limited than in the case of the prospectus directive).

Thus, on the face of it, there is not much to write home about, also considering that the working rules of the Securities Committee have not yet been approved.

Still, I think it would be wrong to stop here and adopt a purely negative view of what is happening in the field of European legislation in the financial sector.

4.2 First, even forgetting Lamfalussy, if one looks at the rate of production of European legislation in recent times, one gets a better impression, because there has certainly been an acceleration: whether this is a side effect of the Lamfalussy report or whether the acceptance of the Lamfalussy method was another symptom of a new sense of urgency is not very relevant.

We now have the directive on financial conglomerates; the all important regulation on accounting standards; the directive on collateral; the political agreement on pension funds; the consultative document on clearing and settlement following the report of the Giovannini group.

There are, on the other hand, areas where no progress has been made, or even where we have moved backwards from the progress that had already been made: the take over directive, where the Winter report failed to offer a ground of compromise, is a case in point. Furthermore the main course of the bill-of-fare of European legislation is still to come. The earlier Commission drafts of the orientations for a revised ISD have
been discussed with national authorities and submitted to open hearings and written opinions from interested parties, which are now being examined by the Commission services. The major bones of contention here are not technical solutions to technical problems. There are - typically on the issue of internalization - mighty opposing interests of stake, with surprisingly little analysis, on every side, of the economic consequences and implications of alternative solutions. If each government blindly follows its own national industry's interests (though national in some cases refers to naturalized immigrants), I am afraid that it will take a very long time before this central piece of legislation comes to light.

4.3 But there are developments that, though important do not meet the eye. While there may be doubts on the top-down level 1-level 2 approach, where regulators play an advisory role to the Commission upon the Commission's request, an important bottom-up change is taking place. The former FESCO, now CESR, having acquired with official recognition institutional dignity, is working hard at an enhanced level 3 while getting ready for its level 2 tasks. While the Securities Committee is still an ectoplasm, CESR meets and works actively, independently of, but in strict cooperation with, the Commission, and also with the European Parliament.

Work is under way on market abuse and prospectuses even before a formal advisory mandate has been received. Perhaps more importantly agreement has been reached on a number of matters that anticipate the revision of ISD: conduct of business rules; primary market practices; standards for ATS's. Work in progress regards market transparency and efficiency, and clearing and settlement.

Two permanent groups, CESRpol and CESRfin ensure cooperation for the application of the multilateral MOU and for the endorsement and enforcing of financial reporting requirements.

The status of CESR prescriptions for its members is uncertain. For sure they are not legally binding as long as they do not find their place in level 2 measures. I sense however that not only they may provide an input for level 2, but that they may be growing into becoming reputationally binding, if you pass me the term. More and more, a member of CESR will be compelled to do some explaining if his national regulations are out of line with the standards set by consensus at CESR.

It may be argued that CESR is doing the same thing as the old FESCO. This argument however misses an important point. FESCO was more of a cosy club for regulators. CESR is part of an institutional structure in closer contact with the Commission. Some of my fellow regulators feared that this may restrict their independence: these fears were misplaced. That very independence required that they should not be entrusted with the adoption of binding implementing measures, for which political accountability is necessary. On the other hand, it is owing to its institutional role that CESR carries now more weight than FESCO.

5. Conclusion

To conclude, the road towards the achievement of a truly integrated European capital market is still long and beset with obstacles. Recently however we have witnessed an acceleration of progress, of which the acceptance of the Lamfalussy method was an effect, and to some extent a factor.

The Lamfalussy procedure will be useful if, and in so far as, it speeds up the working of the codecision process and, especially, if it introduces a degree of much needed flexibility to European legislation, though within the limits of the sunset clause. It has already proved useful in revamping the CESR and fostering the cooperation between regulators.

The Lamfalussy method is not however a magic wand. It cannot, by itself, provide the political agreement that is required to reach a decision on relevant issues at the Council level. Disagreements there are responsible for the slow motion of the legislative process. Disagreements, in turn, reflect the different vested interests that are inherent in different market structures and in the geographical distribution of the financial industry.

Rome was not built in a day. But it will never be built, in this case, unless the political will is found by all to look beyond short-term calculations of costs and benefits: if not, this will be the major cause of the persistent fragility of the European institutional construction.