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Summary

In this paper we started from the theoretical perspective developed in our Deliverable 07/D3 (agency and trust theories) in order to interpret the Lamfalussy reform in the securities sector. We reformulated our three working hypotheses on the policy effectiveness of the Lamfalussy scheme and tested them empirically. Our conclusion is that:

(i) Evidence based on the four main directives adopted according to the new procedure seems to validate our hypothesis H2, namely that the Lamfalussy process has reduced the average time taken in order to negotiate and adopt the first framework directives at level 1 compared to the normal co-decision procedure, and that it has facilitated the removal of bottlenecks in the process through parallel working at the Levels 1 and 2. In this sense, we may conclude that delegation has indeed enhanced the policy effectiveness in the securities sector.

(ii) It is far more difficult to assess the validity of the trustee hypothesis (H3), i.e. whether the Commission and CESR, in fact, act not as agent and sub-agent of the Council and the Parliament, but as trustees of the member states and market actors at Level 3. The problem here is that the process is completely new and that for the time being no one knows how CESR will evolve into a European regulator in the securities markets.

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I. Introduction

This inter-disciplinary research project combines a political science and legal perspective on an economic issue that is at the core of the EU single market project: the creation of a single EU securities market.

A thorough and detailed investigation of the Lamfalussy scheme, which is the new regulatory structures in the EU securities sector since February 2002, is a highly relevant research objective since the Lamfalussy reform of the EU securities market might indeed be considered as one facet of a general trend or a pilot for changes, which are in line with the Commission's own proposals on governance¹ and, which are likely to follow in other fields of European public policy.

Quite new is the role assigned to a new consultative body called the Committee of European Securities Regulators (CESR) whose primary function is to express the views of the market practitioners during the consultation phase and to coordinate their action at the implementation phase.

This research project is aimed at assessing the policy effectiveness as well as the democratic legitimacy of this new approach of governance. It analyses further the wider implications for European governance of this system of delegated powers to the Commission and comitology.

II. Emergence of the Lamfalussy reform

The creation of a single EU securities market has been an important step in harmonising the financial markets of the EU Member States. In this regard, the European Council decided in Lisbon in March 2000 to set up an independent Committee of Wise Men in order to reduce the backlog in the EU securities market regulation. The Committee, named after his chairman A. Lamfalussy, former president of the European Monetary Institute, proposed that the EU regulatory process and the institutional framework be reformed and adapted to enable the speedy adoption of the required and often very technical legislative proposals in the securities sector.

This case illustrates both the difficulties for the European institutions to agree on a system for the adoption of legal acts in the securities market, and the general conflicts of interest between the European institutions concerning comitology. According to the Treaty, the financial market should have been harmonised by 31 December 1992². Some directives were passed during the nineties to fulfil this objective, but they were not far-reaching enough³. Two major reforms, amendments of Council directive 93/6/EEC on the capital adequacy of investment firms and credit institutions and Council directive 93/22/EEC on investment services⁴, were blocked because of the co-decision procedure in force since 1993: the Council and the Parliament could not agree on the legislative acts in question.

For the time being the Council kept the implementing power concerning the application of the directive on investments services and all legislation had to be passed through the time-consuming co-decision procedure. This was not acceptable since it meant that the legislation

¹ See the Commission's White Paper on Governance, 25 July 2001, COM (2001)428.

² See article 14 of the EC Treaty.

³ For example, see directive 85/611, 73/183, 92/96 and 92/49.

⁴ Council directive 93/6/EEC of the 15 March 1993 on capital adequacy of investment firms and credit institutions Official Journal L 141/93 p 1-26 and Council directive 93/22/EEC of the 10 May 1993 on investment services in the securities field Official Journal L 141/93 p 27-46.

could not be adapted rapidly enough to new developments on the securities market. On 8 February 2000, the Financial services policy group⁵ met to discuss the securities market. The group stated that it was necessary to improve the financial market, and on 17 July 2000 the EcoFin Council⁶ decided to set up the Lamfalussy Committee⁷. The problems to be addressed by the Committee were mainly procedural: how to get out of the institutional deadlock?

At the same time, though, the Commission itself dealt with the more substantive matters of the financial market in the so called Financial Services Action Plan (FSAP) that was presented by the Commission on 11 May 1999⁸.

In its report on 5 February 2001⁹, the Lamfalussy Committee proposed as a remedy to introduce a four-level system for adoption, implementation, transposition, and monitoring of the legislation. The four-level system is based on an extensive use of comitology and consultation with market practitioners and end-users.

The regulatory framework presented by the Committee and endorsed by the Council and the Parliament functions as follows. At level one, the initiation phase, the Commission adopts a proposal for a directive or a regulation after a full consultation process. The proposal is thereafter sent to the European Parliament and the Council who together adopt the legislative act and reach agreement on framework principles and definitions of implementing powers according to the co-decision procedure. At level two, the implementing phase, the Commission adopts the implementing measures decided at level one in cooperation with two committees, the European Securities Committee, ESC, and the Committee of European Securities Regulators, CESR. The Commission first consults ESC and after that requests advice from CESR on the implementing measures. CESR prepares the advice in consultation with market practitioners, end-users and consumers and submits its advice to the Commission. On the basis of the advice from CESR the Commission then makes a proposal to ESC. The Commission adopts the implementing measures after an approving vote from ESC. At level three, the transposition phase, CESR works to ensure consistent implementation and application of EU legislation in all member states, for example by adopting guidelines and common standards. Finally, at level four, the monitoring phase, the Commission fulfils its function as guardian of the treaty by checking compliance with EU legislation in member states and, if necessary, by legal action if a breach is suspected¹⁰.

The European Securities Committee, ESC, was established by a Commission decision in June 2001¹¹. The decision established ESC in its advisory capacity. According to Article 2 of the

⁵ The members of the policy group are representing the ministries of finance of the Member States. The group meets regularly in order to discuss the reform of the FSAP.

See http://www.europa.eu.int/comm/internal_market/en/finances/general/pogroup.htm.

⁶ See http://www.europa.eu.int/comm/internal_market/en/finances/general, 2002-08-15, Financial services policy group discusses securities markets.

⁷ 10328/00 (Presse 263), ECOFIN, Brussels on 17 July 2000, mandate to the Wise Men Committee.

⁸ COM (1999) 232, 11.05.99, Financial Services: implementing the framework for financial markets: Action Plan Communication from the Commission. See also the Commission General Report on the Activities of the European Union, 1998 p 25.

⁹ Final Report of the Committee of Wise Men on the Regulation of European Securities Market, Brussels, 15 February 2001

¹⁰ See Final Report of the Committee of Wise Men 2001, p. 6.

¹¹ See Commission Decision 2001/528/EC of 6 June 2001 establishing the European Securities Committee (OJ 2001 L 191/45). In November 2003 Article 2 of the Decision was amended by Commission Decision 2004/8/EC of 5 November 2003 amending Decision 2001/528/EC establishing the European Securities

decision “The role of the Committee shall be to advise the Commission on policy issues as well as on draft legislative proposals the Commission might adopt in the field of securities”. This means that the Committee advises the Commission in level one initiatives, during the initiation phase. In level two, the implementing phase, the Committee functions as a regulatory comitology committee. ESC is composed of representatives of the member states and chaired by a representative of the Commission^{12, 13}.

The Committee of European Securities Regulators, CESR, was also established by a Commission decision in June 2001¹⁴. CESR is an independent advisory group and its two main tasks are to advise the Commission on level two measures and co-ordinate national transposition and implementation on level three. CESR is composed “...of high-level representatives from the national public authorities competent in the field of securities”¹⁵. The Committee meets at least four times a year and a member of the Commission is entitled to participate in all meetings. It consults extensively at an early stage with market actors, consumers and end-users before giving its advice to the Commission. CESR produces guidelines, recommendations and standards in order to improve consistent implementation of EU legislation. The work is prepared by expert groups established on a non-permanent basis¹⁶. CESR has also to submit an annual report to the Commission.

The proposed four-level system of the Lamfalussy committee was, thus, implemented and approved by the institutions on 5 February 2002, almost one year after the presentation of the Report of the Wise Men. It was formally extended to banking, insurance, occupational pensions and UCITS in 2005¹⁷, but it is important to keep in mind that the process is not applied in the same way across the sectors. In the securities sector four so-called “Lamfalussy Directives” have passed through the new decision making process: transparency¹⁸, prospectus¹⁹, market abuse²⁰ and MIFID²¹. In the banking sector the activity of CEBS (at level 3) is concentrated on the implementation of the Capital Requirements Directive, and in the insurance sector, the first Lamfalussy Directive is still under preparation.²²

The last piece of the Lamfalussy structure, the Inter-institutional Monitoring Group (IIMG), was established in 2001. The Group consists of six independent experts appointed by the

Committee (OJ 2004 L 3/33) extending the role of the Committee to advise the Commission not only in the field of securities but also on undertakings for collective investment in transferable securities (UCITS).

¹² See Article 3 of Decision 2001/528/EC.

¹³ Summary records of all meetings are made available on the ESC website:

http://ec.europa.eu/internal_market/securities/esc/index_en.htm

¹⁴ See Commission Decision 2001/527/EC of 6 June 2001 establishing the Committee of European Securities Regulators (OJ 2001 L 191/43).

¹⁵ See Article 3 of Commission Decision 2001/527/EC.

¹⁶ See Articles 5 and 6 of Commission Decision 2001/527/EC; and CESR’s website <http://www.cesr-eu.org>.

¹⁷ Directive 2005/1/EC of the European Parliament and of the Council of 9 March 2005 amending Council Directives 73/239/EEC, 85/611/EEC, 91/675/EEC, 92/49/EEC and 93/6/EEC and Directives 94/19/EC, 98/78/EC, 2000/12/EC, 2001/34/EC, 2002/83/EC and 2002/87/EC in order to establish a new organisational structure for financial services committees.

¹⁸ http://europa.eu.int/comm/internal_market/securities/transparency/index_en.htm.

¹⁹ http://europa.eu.int/comm/internal_market/securities/prospectus/index_en.htm.

²⁰ http://europa.eu.int/comm/internal_market/securities/abuse/index_en.htm.

²¹ http://europa.eu.int/comm/internal_market/securities/isd/index_en.htm.

²² Inter-institutional Monitoring Group, *First Interim Report Monitoring the Lamfalussy Process*, Brussels, 33 March 2006, pp. 6-7.

Council, the Parliament and the Commission (two representatives each). The Monitoring Group held its first meeting on 7 October 2001. Its task was to follow the development in the field and identify possible bottlenecks in order to ensure a more effective legislation. The IIMG produced three reports between 2001 and 2004. Following the extension of the Lamfalussy process to other financial services sectors (banking, insurance, occupational pensions and UCITS), it has been re-established under an extended mandate to consider developments in the three sub-sectors (banking, insurance, securities)²³.

Under the Lamfalussy scheme, both public (national securities regulators) and, to a lesser extent, private actors (market practitioners) are entitled to participate to policy-making in a functionally clearly delimited policy area, the financial services policy. Furthermore, the establishment of CESR as an official body entrusted with coordinated implementation and policy convergence could be interpreted as an example of “*regulated self-regulation*” (Héritier & Lehmkuhl, 2006). Although this dual reform falls within the scope of the 2001 Commission White Paper on European Governance²⁴, the European Parliament has been reluctant to go along with it since it wants to be treated on equal footing with the Council.

Therefore, some safeguards have been built into the Lamfalussy process at level 2 in order to secure the influence of the European Parliament and the Council, as democratically legitimated actors, on the regulation of the securities market:

1. The European Parliament has to be fully informed of all legislative and regulatory proposals at an early stage and it benefits from a three-month period in order to react to draft implementing measures put forward by the Commission. In addition, it can pass a resolution when it considers that the measures adopted by the Commission exceeds its implementing powers (“*call back*” procedure).
2. All framework directives contain a “*sunset clause*”, meaning that the mandate given to the Commission has to be renewed by the Council and the Parliament after a period of time (generally four years). The Parliament decides – with the Council – on the scope of the delegated powers and it can even refuse to renew the mandate assigned to the Commission.
3. In the Prodi Declaration (2002), the Commission commits itself not to go against a “*pre-dominant view*” of the Council when passing secondary legislation (“*aerosol clause*”).

These control mechanisms are not part of the original Lamfalussy model itself, but they are the result of the European Parliament incessant complain regarding the extensive delegation to the Commission and CESR in the securities field.

At stake is also the political and democratic accountability of CESR towards the European institutions. This problem has gradually emerged since CESR, as a network of national regulators, has developed the capacity to act as a sort of European regulator. Its common guidelines are non-binding, but they produce effects in the day to day supervision of the markets and this creates accountability expectations. However, the political control on its activities remains to a large extent at national level since the recommendations or guidelines have legal power only at that level. In addition, most national governments do not want to recognise CESR as a supranational and unitary actor at the European level. The Parliament expressed its concerns about this lack of transparency on CESR’s “*discretionary*” powers at level 3 and

²³ European Commission, Press release, IP-05-1002 EN, 25.07.2005.

²⁴ http://eur-lex.europa.eu/LexUriServ/site/en/com/2001/com2001_0428en01.pdf.

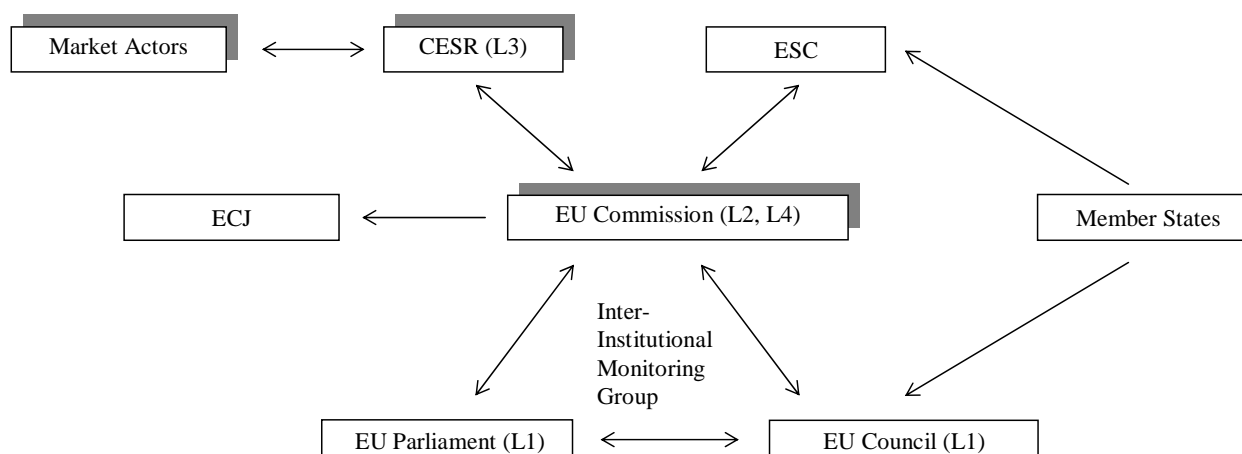
claimed to have an oversight on its activities²⁵. Since 2005 both the Commission and CESR have accepted to inform the Committee on Economic and Monetary Affairs of the Parliament (ECON) regularly on their activities and progress achieved on supervisory convergence at level 3.

In sum, the emergence of the Lamfalussy reform seems to confirm two hypotheses of the NEWGOV consortium. Firstly, it is plausible that “central intervention failed to reach its set policy objectives (i.e. a single European securities market) and led to the development of the new modes of governance, e.g. delegation (i.e. delegation to the Commission and to CESR)”. Secondly, the Lamfalussy case tends to confirm that “in highly contested issue areas, new modes are chosen in order to save political transaction costs.” (i.e. between the European Parliament, the Council and the Commission).

III. Execution of the Lamfalussy reform

In order to analyse the concrete operation of the Lamfalussy scheme, it is useful to identify whether the relationships between the actors involved in the regulation of the securities sector after the Lamfalussy reform occur within an agency or trust model. (see graph 1 below).

Graph 1: Relationships between policy actors in the Lamfalussy reform



In brackets: formal decision-makers at the levels 1 to 4 of the Lamfalussy scheme.

The reason for choosing this approach is that the Lamfalussy reform develops the practice of delegating tasks. The aim of the Committee of Wise Men was, on the one hand, to have an efficient regulation of the European securities market, which takes into account new market developments and adapts outdated regulations (on pension funds, international accounting standards,..). This led to the consultation of market practitioners, end-users and consumers. On the other hand, the aim was to ensure "consistent and equivalent transposition"²⁶ of Level 1 and Level 2 measures, some Community acts being interpreted and applied differently from

²⁵ European Parliament, *Press Release*, 13.09.2005

²⁶ Committee of Wise Men on the Regulation of European Securities Markets. 2000. *Initial Report*, Brussels: Commission of the European Communities, http://ec.europa.eu/internal_market/securities/docs/lamfalussy/wisemen/initial-report-wise-men_en.pdf, November 9, p. 25.

Member State to Member State. This was achieved through the creation of a Level 3 committee, the CESR.

The main reason the reform developed delegation mechanisms is thus a matter of expertise. Expert knowledge is one of the main reasons for delegating responsibilities in the case of technical policy areas (Pollack 1997; Kassim, H., and Menon, A., 2003: 123), which the financial markets are part of²⁷. To compensate for its missing expertise in the field, the Commission created, as proposed by the Committee of Wise Men, two committees: the ESC and the CESR.

There are two basic modes of delegation, agency and trust, which are complementary approaches to the study of European Union governance: “*while agency theory can be legitimately used to analyse the comitology system – i.e. the system of control by committees of national representatives – in areas where the Commission has been delegated implementing powers (Franchino 2000), the same theory cannot satisfactorily explain the treaty-based independence of the Commission in initiating legislation and in monitoring compliance with European law by the member states. The real purpose of delegating such autonomous powers, it should be noted, is to enhance the credibility of the member states’ commitment to the integration process.*” (Majone, G., 2001: 104). The Lamfalussy is a relevant case to discuss further the explanatory power of these two approaches of delegation.

The **agency theory** comes from the law of contracts. Under the American Second Restatement of the Law of Agency²⁸, an agency is defined as “the fiduciary relation which results from the manifestation of consent by one person to another that the other shall act on his behalf and subject to his control, and consent by the other so to act” (§ 1(1))²⁹. “The one for whom action is to be taken” is the *principal* (§ 1(2)), and “the one who is to act” is the *agent* (§ 1(3)). The fact that agency is a fiduciary relation implies that the interest of the principal prevails over that of the agent³⁰.

The concept of agency was applied in economics and political science in the 1970s³¹. Several political situations can be characterized as *principal-agent* relationship. For example, the ideal-type of parliamentary democracy is illustrated by a *chain of delegation and accountability* between principals and agents (Strøm 2000).

Agency theorists usually discuss two main types of *agency loss*. Because of hidden information, principals may select agents who have preferences that are bound to conflict with theirs

²⁷ Another reason may be credibility given by the independence of the one to whom it is delegated.

²⁸ A third version of the restatement is in progress since 1995 (DeMott, D. A., 1998: 1035, asterisk); the last version as of August 2006 is DeMott, Deborah A., Reporter. 2005. *Restatement (Third) of Agency*, Tentative Draft, No. 6 (<http://www.law.duke.edu/fac/demott/bibliography.html>).

²⁹ The term “person” refers both to natural and legal persons (Gregory, W. A., 2001: 23-24).

³⁰ A fiduciary relationship is a relationship in which “one party (the “fiduciary”) acts *on behalf of* another party (the “beneficiary”) while exercising *discretion* with respect to a *critical resource* belonging to the beneficiary” (Smith, D. G., 2002: 1402). The “on behalf” characteristic distinguishes fiduciary relationship from other delegation relationships. For instance, the landlord-tenant relationship contains the two other characteristics: *discretion* of the tenant over a *critical resource* of the landlord, the rental property. However, the tenant does not manage the property primarily for the benefit of the landlord (*Ib.*: 1402-1043).

³¹ It was first applied in economics by Stephen Ross (Stephen A. Ross. 1973. “The Economic Theory of Agency: The Principal’s Problem”, *American Economic Review Papers and Proceedings* 63 (2): 134-139) and in political science by Barry Mitnick (Barry M. Mitnick. 1973. “Fiduciary Rationality and Public Policy: The Theory of Agency and Some Consequences”, paper presented at the Annual Meeting of the American Political Science Association, Washington, DC) (Mitnick, R. M., 1982: 444).

(problem of *adverse selection*). Because their action may also be hidden whilst in office, they may even not be sanctioned for acting to the detriment of the principal's welfare (problem of *moral hazard*). Thus, the asymmetry of information between the principal and the agent allow the latter to engage in a non-fiduciary behavior (*shirking*) that is costly and harmful to the principal while, at the same time, difficult to detect (Kassim, H., and Menon, A., 2003: 122).

However, a key assumption of the principal-agent approach is that political actors should be able to design *specific institutional rules and arrangements* guiding delegation and accountability in response to these agency problems. These devices include both *ex ante* contract design, screening and selection on the one hand and, *ex post* monitoring, reporting and institutional checks on the other hand (*Ib.*: 124).

The general framework of the principal-agent theory seems at first glance appropriate to describe the content of Lamfalussy reform, and to assess the evolution of the delegation of regulatory powers to the Commission as well as the accountability of the Commission towards the European Parliament and the Council of Ministers. In a general way, one could argue that the European Parliament and the Council of Ministers delegate as principals regulatory powers to the Commission, their agent. Structurally, this represents a case of dual agency, that is, an agency relationship where the agent has two principals (Gregory, W. A., 2001: 14, 142). Furthermore, the Commission as a principal also delegates powers to the ESC and to CESR, which are in charge of defining the technical implementing measures. That level of delegation constitutes a sub-agency³², insofar as the ESC and the CESR are the agents of an intermediate agent, the Commission, and the sub-agents of ultimate principals, the Council of Ministers and the European Parliament, to which they are accountable³³.

When looking more closely at the relationship between the actors involved in the new Lamfalussy scheme, it must nevertheless admitted that the classic agency model does not succeed in explaining the relationship between the Commission, the ESC and the CESR on the one hand and the Commission and the Council on the other hand. Whereas the ESC can indeed be considered both as an agent of the Council – i.e. as a sort of “watchdog” of the Member States – and of the Commission to which it gives technical expertise (Bouwen, P., 2002), the role of the CESR does not fit completely into this agency model of delegation. It is conceived of as being more independent, in comparison with the ESC, from the Commission and the Council. The same rationale applies to the Commission in its relation with the Council. In both cases, one has to go beyond agency theory to understand the new role assigned to these institutions in the Lamfalussy process.

The **trust** is a legal concept from equity (Hayton, D. J., 2004: 9); it is applied in common law regimes and some variations may be found in civil law³⁴. It can be defined as "the legal relationships created – *inter vivos* or on death – by a person, the settlor, when assets have been placed under the control of a trustee for the benefit of a beneficiary or for a specified purpose"³⁵. The structure of the trust is therefore different from the agency's structure by the fact

³² A sub-agent is "a person appointed by an agent (...) empowered to do so, to perform functions undertaken by the agent (...) for the principal (...) but for whose conduct the agent (...) agrees with the principal (...) to be primarily responsible" (Restatement (Second) of Agency, § 5, quoted in GREGORY, W. A., 2001: 6 and 6, note 14 of § 2 for the reference).

³³ "The sub-agent differs from other agents only in that he acts for and has duties of loyalty to two principals [intermediate agent and ultimate principal] who do not employ him jointly" (Gregory, W. A., 2001: 109).

³⁴ For instance, the *Treuhand* in German law and the *Bewind* in Dutch law (Witz, C., 1991: 11-14).

³⁵ Convention on the Law Applicable to Trusts and on their Recognition, article 2. This convention was concluded on July 1, 1985 and entered into force on January 1, 1992.

that the trustee, who is the equivalent of the agent, acts for the benefit of a beneficiary, not of the settlor as such, that is to say unless the settlor is also the beneficiary. However, both delegation models are equivalent regarding the fact the person delegating (the settlor or the principal respectively) is the one who exercises control over the person to whom it is delegated. If a trustee agrees to be subject to the control of the beneficiary, he/she then also becomes an agent of the beneficiary (Gregory, W. A., 2001: 8).

According to E. Majone (2001), "*since agency may possess the element of trust and confidence of a fiduciary relation, both agents and trustees can be classed together as fiduciaries for many purposes, but the two concepts are distinct*" (Majone, E., 2001: 113). Applying the concept of trust to European governance, he argues that political property rights (policy-making rights), which include elements of national sovereignty, are transferred from the member states to the Community institutions for the benefit of the former. This is the case for example with the European Central Bank, of which the role consists in preserving the property rights of the member states in the area of monetary policy. Similarly, some provisions of the Treaty establishing the European Community provides the Commission with property rights in order to safeguard the *acquis communautaire*, such as the right of initiative. E. Majone adds that the main difference between the situation of the agent and of the trustee is the level of independence with regard to the principal or settlor respectively³⁶. Contrary to the agency relationship where the agent's preferences must be in line with those of the principal in order to avoid or minimise agency losses, in the case of a trustee relationship, these preferences have to be relatively different from those of the settlor to ensure the credibility of the policy proposals put forward by the trustee.

One has to look empirically at the real motives of delegation to identify which mode of delegation is concretely at stake. We focus here our analysis on the Commission on the one hand, because it is at the center of the new framework, and on the CESR on the other hand, which is a new European actor involved in the Lamfalussy process.

There is in fact a double logic of delegation in the relationship of the Commission with the Council and the Member States. The Commission can be considered as an agent when it exercises implementing powers delegated to it by the Council at Level 2. The Lamfalussy reform provide for the Commission to lay down the technical details for the principles agreed at level 1, after consultation of the market regulators (CESR) and approval by the Member States (ESC). However, the Commission can also be considered as a trustee when it exercises its right of initiative at Level 1 and acts as guardian of Community law when checking compliance of Member States law with Community legislation at Level 4. The two modes of delegation are present in the Lamfalussy process.

Consequently, a single agency approach might lead to understate the Commission's role at levels 1 and 4, while at the same time overstating the capacity of the Member States to keep it in control at Level 2. E. Grossman stresses in this respect the Commission's opportunism which creates forums to compensate for missing expertise and to give greater weight to its proposals on the one hand and, once the green light is given by the Council, does not hesitate to reinforce its own competences and further European integration in general on the other hand (Grossman, E., 2004:).

³⁶ In that sense, D. J. Hayton describes the borderline between trust and agency as "when the settlor's influence or control is so excessive that the trustees must in substance be treated merely as agents administering and distributing his property as he wants" (Hayton, D. J., 2003: 136).

The same questions could be raised about the CESR's position and power in the new policy process. At first sight, the CESR seems to be a sub-agent which gives technical advice to the Commission (Level 2); but there are some arguments in support of the trust model as well. Firstly, the CESR is rather independent, from a statutory point of view, from the Commission. It has its own rules of procedure and own operational arrangements, elects its chairperson among its members – it is thus not an official of the Commission, in contrast to the chairperson of the ESC who is an official of the Internal Market Directorate-General (DG) – and, more importantly, is funded by the national supervisory authorities³⁷. Secondly, the CESR operates at two levels, 2 and 3. Although it still remains an open question how its role at level 3 will evolve, it might be assumed that its coordinating role at Level 3, where it issues guidelines and common standards, might reinforce its influence not only on the national market regulators, but even vis-à-vis the Commission at Level 2. This potential rise in influence and power of the CESR was taken into consideration by the Internal Market DG, which mentions in a working document on the application of the Lamfalussy process that "Level 3 must evolve in a carefully modulated, open and transparent environment that fully respects Institutional boundaries and the importance of democratic accountability. CESR standards adopted at Level 3 must be fully compatible with – and cannot substitute for – binding EU legislation at Levels 1 and 2. They should not prejudice the political process, nor the Institutional prerogatives of the Parliament, the Council or the Commission"³⁸.

In sum, most of the original hypotheses of the NEWGOV consortium are largely validated by the theoretical analysis of the relationships between the actors involved in the Lamfalussy scheme: Firstly, "If a new mode (delegation to Commission and CESR) is linked to hierarchy (sunset clause, call-back right and aerosol clause), agency loss is less likely." Secondly, "If a new mode and its organization (Commission at level 2 and CESR at level 3) is embedded in a regulatory space with several principals (e.g. European Parliament, Council, Member States and market operators), it is less likely that its operation can become self-serving and biased in favour of particular interests." Thirdly, "the harder it is to substitute an actor's resources (CESR expertise), the more power the actor in question has to shape the application of the new mode of governance (at levels 2 and 3)." Finally, "the actors in the application of the new mode may engage in a process of deliberation and joint learning and come to convergent views (e.g. institutional control mechanisms of the Parliament and Council) on how to solve the problem.

IV. Evaluation of the Lamfalussy reform: impacts on policy results and on institutional structures

It becomes clear from the preceding theoretical discussion that one has to take several hypotheses into consideration when evaluating the potential benefits of the Lamfalussy reform. Our research has brought us to investigate further these hypotheses regarding the benefits of the Lamfalussy reform and to test them through an empirical analysis. By benefits we mean the reform's potential contribution to the policy effectiveness in the securities field as well as their consequences on the balance of power between the EU institutions.

³⁷ See Commission Decision 2001/527/EC of 6 June 2001 establishing the Committee of European Securities Regulators (OJ 2001 L 191/43).

³⁸ Commission of the European Communities. 2004. *The Application of the Lamfalussy Process to EU Securities Markets Legislation: A Preliminary Assessment by the Commission Services (Commission Staff Working Document)*, Ref.: SEC(2004) 1459, Brussels: European Commission, November 15, SEC(2004)1459, http://ec.europa.eu/internal_market/securities/docs/lamfalussy/sec-2004-1459_en.pdf, page 10, point 31.

This first hypothesis could be labelled as the *status quo* option: Some observers (as Grossman, 2004; Hertig & Lee, 2003, e.g.) are sceptical about the alleged benefits of the new framework. In their opinion, the Council and the member states on the one hand, and the Parliament on the other hand, will continue to disagree on the principles and the scope of delegation to the Commission since financial regulation remains a very sensitive issue in many national contexts. As a consequence, the comitology system will not function more rapidly or smoothly. On the contrary, with the “*aerosol clause*” a greater veto power is even given to member states in order to hold up the Commission’s proposals. Overall, the new process will not succeed in improving the policy effectiveness – namely reducing excessive delays in the implementation of Community law - and the balance of power between the three main institutions will not change significantly since each of them will stick to its prerogatives.

The following arguments support this hypothesis. First, it follows from the main objective of the new system in terms of speed and flexibility that excessive details should be avoided at Level 1. The legislators (EP and Council) should adopt general principles at level 1, leaving it to the Commission and CSR/ ESC to decide on the technical details. However, despite the fact that market actors have a larger access to information through the consultation process organised by CESR at level 2, representatives of national ministries or interest groups will probably continue to lobby at level 1 in order to have all technical details already regulated at level 1. Second, although the overall reaction to the new Lamfalussy process has been positive, it remains an open question how far the member states are really enthusiastic about it and are ready to open up the consultation process. Grossman (2004) has his doubts about it; evidence from the Market Abuse Directive has demonstrated that an agreement among member states was already reached before the consultation process with market actors was closed. In this case, the interest groups complained essentially because the new regulation is considered to be too severe. The IIMG also reports that market participants “(...) *want more transparency with regard to the Council and the European Securities Committee; two rounds of consultation; and more extensive and convincing feedback statements so that consultation is demonstrably a genuine dialogue.*”³⁹

A second hypothesis - labelled as the *Lamfalussy hypothesis* because it was the one the Group of Wise men had mind - consists in interpreting the Lamfalussy scheme purely and simply as a method of delegation in line with “classical” agency theory. The Council and the Parliament (as principals) delegate implementing powers to the Commission (as agent) in order to achieve some political objectives in terms of speed, efficiency and quality of policy outcome. Similarly the Commission (as principal) delegates some power to ESC and CESR (as sub-agents) with the intention of opening up the consultation process to national regulators and market actors at level 2, and of pursuing a consistent implementation of EU financial legislation in all countries at level 3. The new four-level approach is expected to enhance the overall policy effectiveness in the securities sector, provided that the risk of agency loss is well under control.

The Committee of Wise Men’s argument is summed up as follows:

- (i) The legislative process would speed up – because the key Level 1 political co-decision negotiations between the Commission, the Council of Ministers and the European Parliament would focus solely on the essential issues and not on the technical implementing details. (...)
- (ii) The process would be democratic and flexible – with the range and scope of implementing

³⁹ Ibid., p. 23.

powers being defined by the Council of Ministers and the European Parliament by co-decision on a case by case basis for each Level 1 proposal.

(iii) The EU institutions would be able to benefit from the technical and regulatory expertise of European regulators, with the European Commission fully retaining its right of initiative.⁴⁰

As regard to the balance of power, the new process is likely to strengthen the position of the Parliament to some extent. As mentioned earlier, some safeguards have been built into the process (at level 2) in order to secure the Parliament's control on the implementing measures. The Parliament is fully informed of all legislative and regulatory proposals at an early stage and it benefits from a three-month period in order to react to draft implementing measures. Furthermore, it can pass a resolution when it considers that the Commission exceeds its implementing powers ("*call-back clause*"). Also, all framework directives contain a "*sunset clause*", meaning that the mandate given to the Commission has to be renewed by the Council and the Parliament after a period of time (generally four years). This means that the Parliament decides – with the Council – on the scope of the delegated powers and that it can even refuse to renew the mandate assigned to the Commission.

A final argument in favour of the Parliament states that while the Community has expanded its competencies since the Treaty of Rome, the balance of power between the Commission and the other institutions has shifted gradually too. In this respect Majone (2002) points to the fact that the progressive politicisation of EU policy-making processes – i.e. the intrusion of more politically sensitive political issues on the European agenda - has brought about a reinforcement of the Parliament's power that is in contrast to the (relatively) decreasing political force of the European Commission. This phenomenon has even been reinforced by some political scandals and the resignation of the Santer Commission in 1999.

A third hypothesis would take for granted that the Commission and CESR together act as trustees of the member states and of market operators. More precisely, it assumes that the Commission and CESR, by increasing their autonomy, in the long run will move from their initial position of agent of the Council and the Parliament, to that of a trustee of the member states. Two basic arguments are advanced as to why they gain in autonomy.

One could reasonably expect that in highly technical matters, as it is the case in the securities markets, the experts of the Commission (DG Internal Market) will progressively form an "epistemic community" with the national regulators and the market actors (Wilks, 2005), which will play on equal footing with the member states and Parliament. Contrary to a widespread belief, it appears that comitology committees don't behave as if they were guardians of national interest, but that they take their decisions in a spirit of consensus in the search for the common good (Dehousse, 2003). The Lamfalussy process does even reinforce this "deliberative autonomy" since the Commission and CESR control the chain of command in the tasks of initiating, implementing and monitoring legislation at the Levels 2, 3 and 4. More generally, for Wilks and Pollack (1997) the Commission as guardian of market principles and Treaty powers has gained considerable power so that it has become less vulnerable than before to the sanctions of its principals. Revising the agent's mandate could then be very costly for the principals.

⁴⁰ *Final Report of the Committee of Wise Men on the Regulation of European Securities Markets*, Brussels, 15 February 2001, pp. 24-25.

But one could take this approach a step further by putting forward that the Commission and CESR, in fact, act not as agents but as trustees of the member states. In other words it can be argued that some political property rights have already been transferred from the member states to the Commission and to CESR. There are indeed the exclusive powers assigned by the Treaty to the Commission – the right of initiative at Level 1, the control of compliance with European legislation at Level 4. We may also infer from the Lamfalussy structure that CESR has inherited some political property rights from the member states at the implementation level since CESR is supposed to play a significant role at Level 3 instead of the national regulatory authorities.

In terms of policy effectiveness, a trustee relationship would probably produce effects similar to the second hypothesis (more transparency through extensive consultation, higher speed of decision-making process, etc.). But the balance of power, in this case, will probably be in favour of the Commission.

As a synthesis of this theoretical discussion, table 1 below summarizes the impacts of the Lamfalussy reform that could be expected from alternative theoretical approaches.

Table 1: Hypotheses on the implications of the Lamfalussy reform

| | Policy Effectiveness | Balance of power between EU institutions |
|--------------------------------------------------------|-----------------------------|-------------------------------------------------|
| Hypothesis 1 (Status quo): Members states predominance | Unchanged | Unchanged |
| Hypothesis 2 (Agency): Commission and CESR as agents | Increase | In favour of the European Parliament |
| Hypothesis 3 (Trust): Commission and CESR as trustees | Increase | In favour of European Commission |

In order to test empirically the plausibility of the three research hypotheses presented above, about fifteen interviews were conducted with representatives of the European Council, the Parliament, the Inter-Institutional Monitoring Group, the Commission (DG Internal Market), ESC and CESR, and with members of the permanent representation of four countries. The topics discussed with these actors focused mainly on the actual relationships among the European institutions, ESC and CESR (as broadly identified in graph 2) and on the first tangible impacts of the Lamfalussy reform on the regulation of the financial market (e.g. assessment of the decision-making process and outputs of the directives adopted after the Lamfalussy reform). In addition, a workshop took place in Brussels with some of these representatives in order to confront their points of view. Evidence from the official reports of the IIMG is also compared to our own empirical findings.

Contrary to the expectations of the intergovernmental school of thought which predicted a failure in the implementation of the process (Hertig & Lee, 2003), there is now widespread agreement among the interested parties to consider that the Lamfalussy approach has fulfilled its general purpose, namely that of providing an appropriate process for passing primary and secondary legislation in the securities field. The Lamfalussy process has created a sort of “political momentum” that has speeded up the adoption of the Financial Services Action Plan (FSAP), even if there are still a lot of unresolved questions or critiques around the new procedure. Similarly, no one would reasonably assert that the ongoing process has strengthened

member states' ascendancy. For these reasons, **H1** – the *status quo* hypothesis – should be ruled out.

At this point of the discussion, we suggest making a distinction between the policy outcome at the Levels 1 and 2 on the one hand, and on Level 3 on the other hand.

Evidence based on the four main directives⁴¹ adopted according to the new procedure seems to validate **H2**, namely that thanks to extensive and frequent consultation of experts, the Lamfalussy process has reduced the average time taken in order to negotiate and adopt the first framework directives at level 1 compared to the normal co-decision procedure, and that it has facilitated the removal of bottlenecks in the process through parallel working at the Levels 1 and 2⁴². In this sense, we may conclude that delegation has indeed enhanced the policy effectiveness in the securities sector.

According to Council and Commission officials, the adoption of the Market Abuse, Prospectus and MIFID directives at Level 1 went relatively quickly and swiftly, although the negotiation process lasted up to the last minute. The positive aspect of the Lamfalussy reform is thus deep, technical, enlarged consultation that belongs to the structure of the decision process itself. If consultations make the decision-making process more transparent (practically anybody can send his/her opinion when consultations are carried out), their negative side is that there is interference to be filtered. Another problematic issue is how to distinguish between framework or “principle” legislation and implementing measures⁴³.

Things went equally smoothly at Level 2, even in the case of the MIFID if we might consider that projects of such a magnitude usually either take 10 years to be adopted or are never approved. It is worth noting that the Commission does not always follow CESR's draft text. For the MIFID for instance, the Commission decided to change substantially the draft because the advice was too long and too detailed to be incorporated in the directive.

Contrary to expectation, the Lamfalussy reform has not changed the balance of power at the Levels 1 and 2 dramatically, even if the European Parliament has increased its control on the comitology committees (right of information, call back mechanism if the Commission exceeds its implementing powers, sunset clause). Recently, the Council and the Parliament settled their dispute on comitology⁴⁴. The Parliament is now treated on equal footing with the Council, but it failed in being directly involved in the working of the committees. And it is quite difficult for the MEP's to scrutinize all the technical details of financial legislation. Most interviewees confess that it is in fact the Commission that has gained a great deal of power. At Level 1, it has the right of initiative; at Level 2, it has a preponderant role because it drafts the proposals, controls the consultation process and chairs the meetings of the L2 committees. Its officials have regular contacts and negotiate bilaterally with member states representatives in order to prepare the draft proposals to submit at the plenary meetings.

⁴¹ Market Abuse Directive, Prospectus Directive, Markets in Financial Instruments Directive and Transparency Directive (see footnotes 18-21)

⁴² In the same way, see: Inter-Institutional Monitoring Group, III Report, p. 12-13 ; Commission Staff Working Document, p. 6.

⁴³ Inter-institutional Monitoring Group, *First Interim Report Monitoring the Lamfalussy Process*, Brussels, 33 March 2006, p. 9.

⁴⁴ Decision of the European Parliament on the conclusion of an inter-institutional agreement taking the form of a joint statement concerning the draft for a Council Decision amending Decision 1999/468/EC laying down the procedures for the exercise of implementing powers conferred on the Commission (6 July 2006).

It is far more difficult to assess the validity of the trustee hypothesis (**H3**), i.e. whether the Commission and CESR, in fact, act not as agent and sub-agent of the Council and the Parliament, but as trustees of the member states and market actors. There can be no doubt that the argument is not tenable when one considers the situation at Level 2: Even if the Commission has increased its power, it remains accountable to a large extent to its principals, namely the Council and the Parliament. The main issue under discussion refers then to the relationship between the Commission, CESR and the member states and market actors at Level 3. The problem here is that the process is completely new and that for the time being no one knows how CESR will evolve into a European regulator in the securities markets. During the first four years of its existence, CESR devoted most of its activity to consultations at the levels 1 and 2 on request of the Commission. Since 2004 it has also developed its supervisory role in three directions:

- setting standards in the framework of supervisory convergence⁴⁵ at Level 3, where it can establish common guidelines to ensure correct and equivalent transposition⁴⁶;
- setting mediation mechanism between the national supervisors at Level 3⁴⁷ in the framework of supervisory cooperation⁴⁸;
- promoting voluntary delegation of tasks, nay responsibilities, between supervisors at Level 3, regarding supervisory cooperation as well⁴⁹.

But there are a lot of uncertainties with regard to its autonomy vis-à-vis the member states. Even if the common approaches defined by CESR members produce already effect in the day-to-day supervision, their effects are still not binding. In addition, if CESR wants to develop its capacity to take decisions at the European level, it should depart from the unanimity rule that it has followed until now. The modification of the legal profile of CESR would require a new legal text⁵⁰. It is doubtful whether member states are inclined to grant additional powers to CESR and to see it evolving into a European regulatory agency. The priority for the time being would be either to work within the current Lamfalussy framework.⁵¹

In sum, by introducing a new mode of governance, the EU institutions have succeeded in reducing to a large extent the backlog in the securities market regulation. Cooperation with

⁴⁵ FSC. 2006. *Report on Financial Supervision*, Ref.: FSC 4159/06, Brussels: Secretariat of the Council of Ministers, <http://www.minfin.nl/binaries/minfin/assets/pdf/dossiers/financi-le-markten/fsc-report-on-financial-supervision--februari-2006-.pdf>, February 23, p. 4, note 6.

⁴⁶ Committee of Wise Men on the Regulation of European Securities Markets. 2000. *Initial Report*, Brussels: European Commission, http://ec.europa.eu/internal_market/securities/docs/lamfalussy/wisemen/initial-report-wise-men_en.pdf, November 9, p. 25.

⁴⁷ Finalized on August 2, 2006 for the Committee of European Securities Regulators (CESR): CESR. 2006. *Protocol on Mediation Mechanism of the Committee of European Securities Regulators*, Ref.: CESR/06-286b, Paris: CESR, <http://www.cesr-eu.org/index.php?page=groups&mac=0&id=50>, August. The process on the setting-up of such a mechanism started on April 8, 2005 (CESR. 2005. "CESR Starts Level 3 Work on the Establishment of a Mediation Mechanism amongst Supervisors" (press release), Ref.: CESR/05-252, Paris: CESR, <http://www.cesr-eu.org/index.php?page=groups&mac=0&id=50>, April 8) and was encouraged for all three Level 3 committees by the Financial Services Committee (FSC) (FSC. 2006. *Report on Financial Supervision*, *op. cit.*, p. 8)

⁴⁸ FSC. 2006. *Report on Financial Supervision*, *op. cit.*, p. 4, note 6

⁴⁹ *Ib.*, pp. 8-10.

⁵⁰ See: CESR, *Preliminary Progress Report: Which supervisory Tools for the EU Securities Markets ? An Analytical Paper by CESR.*, Paris, October 2004, pp. 10 and 17.

⁵¹ See: European Union – Financial Services Committee, *FSC Report on Financial Supervision*, doc. 4159/06.

market practitioners and national supervisors has increased the overall policy effectiveness. Our empirical study suggest that the speed of the process has increased overall and that there are less bottlenecks than before in the different steps leading to the adoption of legislation. There is also more consistency in the proposals submitted by the Commission to the Parliament and the Council, thanks to extensive consultation. In sum, the Lamfalussy process has brought about more transparency and more expertise in the policy process and has also contributed to the emergence of a common culture of supervision in the securities sector.

V. Evolution of the Lamfalussy reform

As already mentioned above, the Lamfalussy scheme proposes a new process and is a very recent reform. Thus, it is yet impossible to answer seriously the fourth question of the NEWGOV consortium: “Once new modes of governance have been introduced, how do they evolved over a longer period of time?”. This could be done only after the full completion of the process (at levels 3 and 4) within the securities sector and by comparing the first impacts of the Lamfalussy reform in several sectors (i.e. securities, banking and insurance).

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