

Governance of the EU Securities Sector: Impacts of the Lamfalussy Reform

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The creation of a single EU securities market has been an important step in harmonising the financial markets of the EU Member States. 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 Baron A. Lamfalussy, the respected 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.

1. The Lamfalussy scheme

The proposed remedy to improve policy performance in securities market regulation was 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 main difference between the proposals of the Lamfalussy report and "traditional comitology" was to extend the cooperation between the Commission and the market practitioners of the securities market through the establishment of the Committee of European Securities Regulators (CESR).

The regulatory framework presented by the Lamfalussy Committee functions as follows:

1. At level 1, 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 which together adopt the legislative act

and reach agreement on *framework principles* and definitions of *implementing powers* according to the co-decision procedure.

2. At level 2, the implementing phase, the Commission adopts the implementing measures decided at level one in cooperation with two committees, the European Securities Committee (ESC) and CESR. The Commission first consults ESC and after that requests advice from CESR on the implementing measures. CESR prepares its advice in consultation with market practitioners, end-users and consumers and submits it 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.
3. At level 3, 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 (but non-binding) standards*.
4. Finally, at level 4, the monitoring phase, the Commission fulfils its function as a guardian of the treaty by checking compliance with EU legislation in Member States and, if necessary, by *legal action* against them before the Court of Justice if a breach is suspected.

Under the Lamfalussy scheme, policy- and rule-making are partially delegated to private actors of the securities market, extensively consulted by CESR. However, the *shadow of hierarchy* is also present in the Lamfalussy scheme that has strengthened - to some extent - the position of the European Parliament. Some safeguards have been

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

1. The *European 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.
2. Furthermore, it can pass a *resolution* when it considers that the Commission exceeds its implementing powers.
3. Last but not least, 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. The inclusion of sunset clauses in the basic legislation is *not* part of the original Lamfalussy model itself; it is a result of the European Parliament concerns regarding the extensive delegation to the Commission and CESR in the securities field.

Our research project seeks to evaluate the implications of this system of delegated powers on the inter-institutional balance of power and on policy effectiveness. It focuses mainly on the relationships between the Commission and the comitology committees, drawing on theoretical work regarding delegation: the agency model and the fiduciary model.

2. CESR acting as a “trustee”

If one looks closely at the relationship between the actors involved in the new Lamfalussy scheme, one must admit that the ordinary agency model (a principal delegating some regulatory powers to an agent and controlling him *ex post*) falls short in explaining the complex relation between the Commission, ESC and CESR on the one hand and between the Commission and the Council on the other hand.

Whereas ESC can be considered both as an agent of the Council – i.e. as a sort of “watchdog” of national governments – and of the Commission to whom it provides

technical expertise (Bouwen, 2002), CESR’s role does not fit completely into this model of delegation. It is conceived of as being more independent (in comparison with ESC) from the Commission and the Council. The same applies to the Commission in its relation to the Council. In both cases, one has to go beyond agency theory to understand fully the new role assigned to these institutions in the framework of the Lamfalussy process.

According to Majone (2001), the idea of fiduciary relationship is derived from the trusteeship relation in Anglo-American law. A trust is a situation where the owner of some property (the settler) transfers it to a trustee with the stipulation that the trustee should not treat it as his own but manage it for the benefit of the beneficiary, who could be the settler himself. Thus, a trustee is an agent and something more. The trustee’s fiduciary duty is not simply a personal obligation but is attached to a piece of property (e.g. policy-making rights).

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With regard to European governance, policy-making rights – i.e. some elements of national sovereignty – are transferred from national governments to the European institutions for the benefit of these governments. This is the case for example with the European Central Bank, whose role consists of preserving the “property rights” of the Member States in the area of monetary policy. In the same vein, some provisions of the treaty give the Commission real property rights in order to safeguard the *acquis communautaire*, to begin with the right of initiative.

In a trustee relationship, the preferences of the settler and the trustee have to be different to some extent from those of the principal, in order to safeguard the *credibility* of the policy proposals put forward by the trustee.

At first sight, CESR seems to be a simple agent, which provides technical advice to the Commission at level 2. But there are some arguments in support of the fiduciary model also.

1. First, 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 (not an official of the EU Commission, in sharp contrast to the chairperson of the ESC who is an official of DG Internal Market) and, more importantly, is funded by the national supervisory authorities.
2. Second, CESR operates at levels 2 and 3. Although it still remains an open question how it will concretely conceive of its role at level 3, one might reasonably think that its coordinating role at that level by issuing 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 CESR has not been understated by the Commission services themselves.

As a matter of fact, CESR really acts as a trustee of all other partners (and not only of the Commission) within the Lamfalussy scheme. It behaves as if it is in a fiduciary relationship with governmental actors, national authorities as well as European institutions.

Further reading

This policy brief is based on research carried out within the NEWGOV project no. 7 on “Governance and the EU Securities Sector”. It is the objective of this research project to assess to what extent a specific new form of governance might contribute to the EU's overall capacity to govern effectively and democratically. To that effect, the project has developed a comparative intra- and inter-sectoral research design that allows investigating the Lamfalussy approach to governance in the EU securities sector in terms of the above-mentioned requirements.

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Further information can be found on the NEWGOV Website in the [special section](#) of Project No. 7.

3. Policy effectiveness

Regarding the policy performance of the Lamfalussy reform, our empirical study – as well as the Interinstitutional Monitoring Group reports – suggest that the speed of the process has increased overall and that there are fewer 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. Secondly, the Lamfalussy process has created a sort of political momentum that has speeded up the adoption of the Financial Services Action Plan (FSAP). Thirdly, there is also a spirit of cooperation that has been rising among the national supervisors. But observers disagree on the improvement in quality of the legislation that has passed through the new process. This rather depends from the substance of the policy that has been reviewed.

The input legitimacy has increased too. Extensive consultations of national supervisors, interest groups and, to some extent, of end-users have taken place at levels 2 and 3.

Innovative ways of governance, for example through the organisation of hearings or consultation processes on websites, have been launched. 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.

The major drawback of this new mode of functional governance is that it is not always obvious to separate the general principles included in the primary legislation (level 1) from the detailed technical rules (level 2). Moreover, the practical implementation of this new scheme has raised an important controversial issue concerning the famous “call-back” powers claimed by the European Parliament. In short, the Parliament considered that the proposed delegation of powers could go against its legitimate position in the whole legislative process. After the “Prodi Declaration” of 2002, which granted some guarantees to it (right of information, sunset clause, call back mechanism,...), the European Parliament gained steadily more power and accepted to go along with the new Lamfalussy scheme to adopt legislation. And the new EU Constitution confirmed the correction of this imbalance of power in favour of the Parliament. However, the rejection of the new Constitutional Treaty puts the question again on the agenda. The long-term success of the Lamfalussy-model is dependent on a robust solution on comitology

arrangements that would satisfy both the Parliament and the Council.

4. Conclusion

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. Both the input and the output legitimacies tend to increase thanks to extensive cooperation with market practitioners and national supervisors. But contrary to the expectations of the Lamfalussy Committee of Wise Men, CESR tends to act more as a trustee of all EU institutions than as a simple agent of the Commission. In addition, the flexibility claimed by the Commission for approving detailed legislation has been contested by the European Parliament who wants to be treated on equal footing with the Council.

Bibliography

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