

# ISDA

International Swaps and Derivatives Association, Inc.  
One New Change  
London, EC4M 9QQ  
Telephone: 44 (20) 7330 3550  
Facsimile: 44 (20) 7330 3555  
email: [isda@isda-eur.org](mailto:isda@isda-eur.org)  
website: [www.isda.org](http://www.isda.org)

European Commission  
Internal Market Directorate General  
Financial Conglomerate and Cross-Sector Issues Unit C/3  
Avenue de Cortenbergh 107  
B-1000 Brussels

18 November 2002

Dear Sirs

The International Swaps and Derivatives Association is an international organisation with over 600 members, including the world's largest commercial, universal and investment banks as well as other companies and institutions with extensive activities in the area of swaps and other individually negotiated derivatives transactions. Additional information on ISDA can be found at our website ([www.isda.org](http://www.isda.org)).

ISDA welcomes the opportunity to respond to the request for comment on the Economic and Financial Committee's report on Financial Regulation, Supervision and Stability of 9 October 2002. ISDA is particularly encouraged that a matter of such importance to the future of the European financial markets is being subjected to an open process of consultation.

ISDA participated actively in the consultation process surrounding the work of the Lamfalussy Committee which resulted in reform to the process applicable to legislation in the field of securities. We were supportive of the Lamfalussy proposals and generally welcomed both the four level legislative process and the stress on the importance of consultation and transparency.

The Lamfalussy reforms have been in place for a short time only. It is therefore too soon to draw any definitive conclusions as to their success or as to weaknesses in the operation of the new processes. Nevertheless, a number of comments can already be made which will have a bearing on the proposals contained in the EFC report.

LONDON-2/1298665/02

---

NEW YORK • LONDON • SINGAPORE • TOKYO

Incorporated as a Non-For-Profit Corporation with limited liability in the State of New York, United States of America

### **Legislative and Regulatory Structure**

The EFC report essentially proposes to replicate in the fields of banking, insurance and financial conglomerates the legislative structure and process now operating in the securities field. We support this. It seems to us that there are a number of important benefits to be gained from doing so and that these benefits will become more evident as the EU grows to 25 member states.

The first benefit is clearly the potential flexibility that such a process will build into the legislation itself. This is particularly a result of the splitting of legislation between Level 1, Level 2 and Level 3 measures, allowing Level 1 measures to be essentially framework in nature, subject to implementing measures at the two subsidiary levels. This is a highly desirable objective, although the experience so far with directives in the securities field to which this process has been applied is that there is little evidence that Level 1 directives are significantly more "framework" in substance. On the contrary, the inexorable drive towards more detailed regulation has led to more detail at each legislative level. While some of this may be inevitable, we believe that detail should be pushed down to Levels 2 and 3.

The second important benefit of the new process is the formalisation of the role and input of the relevant regulators. They clearly have a valuable and expert contribution to which due weight is given in the Lamfalussy process. We see significant advantages in taking the same approach in the other three areas.

Extending the Lamfalussy framework to all financial sectors will also enable cross-sectoral measures to be dealt with in a coherent and consistent way. An example of this is the importance of ensuring that the implementation of the Basel capital adequacy framework through amendments to the EU capital adequacy directives is achieved through a Lamfalussy style process. This is particularly important given the need to ensure that the Level 1 directive is of a framework nature, leaving the details to Level 2 and Level 3. We believe that it is essential to use the Lamfalussy process for implementation in the EU of the Basel proposals so as to ensure that EU credit institutions are not disadvantaged in comparison with non-EU institutions by delays in introducing appropriate and flexible capital rules due to the current cumbersome nature of the EU legislative process.

Although not debated in the EFC report, it has been suggested by some that progress should be made as fast as possible towards a single EU regulator for the financial services industry. We foresee a large number of practical and policy problems with such an approach, at least at this stage in the development of the EU markets. We believe that the right approach is to build on the Lamfalussy structures and, in particular, to encourage greater co-ordination between the regulatory authorities of each of the EU states. In our view, regulation should be administered and conducted as closely as possible to the markets and market participants themselves.

### **The need for a clear understanding of regulatory objectives**

Experience of the operation of the legislative process both before and after Lamfalussy demonstrates that one of the obstacles to effective legislation and regulation is a lack of common agreement as to the objectives of regulation in this area. This problem will be exacerbated by the enlargement of the EU. We would urge that the opportunity be taken to adopt a formal set of regulatory objectives for the EU, which would bring greater focus to the regulatory effort and would act as a constraint on protectionist or anti-competitive regulation. As far as we are aware, this has only been attempted in the UK but we believe that the objectives set out in the UK legislation have already shown their worth and are supported by regulator and regulated alike.

### **Transparency and Consultation**

An equally significant element of the Lamfalussy reforms has been the introduction of a more transparent legislative process with a greater degree of consultation of interested parties. We continue to believe that this is a vital part of the reforms and that it should be extended to other financial sectors. We do not, however, believe that the reforms in the securities field have gone far enough.

We welcome the consultative approach adopted by the European Commission to the reform of the Investment Services Directive. We believe that this will produce a significantly better piece of legislation than either the Prospectus Directive or the Market Abuse Directive, neither of which were treated to early and open consultation. We have no doubt that the Commission will adopt this approach in future. Likewise, the Committee of European Securities Regulators (CESR) has been admirably open in its consultation of interested parties on measures proposed by it.

Our principal concern, which we believe to be generally shared by the financial services industry, lies in the relative lack of transparency and consultation surrounding the work of the Council, whether at ECOFIN or at EFC level. Given the central role played by these bodies in the legislative process, this leaves a significant gap in the structure of transparency and consultation. We are also very concerned that there may not be sufficient consultation built into the Level 2 process. We would urge, for example, that all proposed Level 2 implementing measures to be proposed by the Commission should be subject to full consultation in addition to any preceding related advice given to the Commission by CESR or its functional equivalent. The purpose would be to enable the Commission and ESC to receive expert input to ensure that the proposed legal text accurately reflects the policy objective and does not have unforeseen adverse consequences.

The EFC report does indeed contain a number of commitments to transparency and consultation. Those relating to the work of Level 3 committees contained in Appendix 2 are encouraging in their explicitness. We remain concerned, however, that the discussion in Appendix 1 relating to the work of Level 2 committees does not appear to give equivalent weight to transparency and consultation, containing as it does only a brief reference to them in the list of accountability mechanisms. We urge very strongly that transparency and consultation should be entrenched at Level 2 at least to the same extent as at Level 3.

It is sometimes suggested that strengthening the process of consultation simply results in unnecessary or unacceptable lengthening of the legislative process. Even if this were the case, the benefit in terms of better legislation far outweighs the risk of potential delays. Furthermore, better legislation leads to speedier and more effective implementing legislation.

We would also comment in passing that transparency and consultation at national level is just as important. While some countries have already taken significant steps in this direction, the general level of consultation and transparency across EU Member States remains woefully inadequate. We would encourage the EU institutions to recommend strongly to Member States that they follow standards of transparency and consultation which are at least equivalent to those adopted at EU level.

### **The need to avoid hasty legislation**

One of the avowed objectives of the Lamfalussy recommendations was to speed up the EU legislative process. It has clearly achieved this. We are, however, deeply concerned that measures are now being devised, proposed and pushed through the legislative process at such a speed that adequate time is not

being allowed for proper analysis, consultation and discussion. There is, in our view, a significant danger that this is resulting in poor Level 1 legislation which lacks the requisite clarity. A good example of this is the Market Abuse Directive, which suffers from many defects and will no doubt give rise to difficult implementation issues. Many of the legislative measures in the financial services sector, such as the Market Abuse Directive, deal with very complex legal, market and business issues. If the EU is to avoid, on the one hand, damaging the EU financial markets by adopting inappropriately restrictive legislation and, on the other hand, allowing EU financial markets to be subject to abuses due to inappropriately lax legislation, it is vital that sufficient time is allowed in the legislative process to obtain the input from those with the relevant expertise.

It is also essential that, before proposing any measure at Level 1, the Commission undertakes a thorough factual review of the relevant aspects of the EU financial market so as to determine the necessity for the measure and so as to formulate it in a proportionate and focused way. This is likely to involve input from national regulatory authorities and market practitioners. Although this may add to the length of the process, the benefits in terms of improved legislation would in our view clearly merit the exercise.

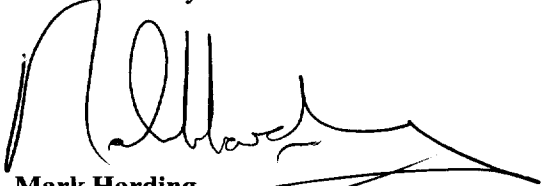
### **Role of FSPG**

The remodeled Financial Services Policy Group will clearly play a significant role in the new structure. We welcome the proposal that the FSPG concentrate on policy issues and not on technical matters. It is clearly essential that some appropriate body, such as the FSPG, is charged with ensuring that consistent policies are adopted and implemented across the financial services sectors. We are encouraged by the suggestion that the FSPG might hold hearings with third parties: we believe that this would significantly enhance its ability to obtain informed contributions on policy matters. We note that it is proposed that the FSPG be chaired by a Member State representative. We are unclear whether the chair would then rotate every six months in the same way as the presidency of the Union. We do not believe that a rotating chair would be conducive to consistency of approach by the FSPG.

ISDA reiterates its welcome both for the opportunity to comment on these important issues and, broadly, for the proposed extension of the Lamfalussy process to other financial services sectors. It is essential that the implementation of the Lamfalussy proposals, which is still in its early days, is monitored closely. To that end, we support the creation of the Lamfalussy Monitoring Group. We note that it has not yet met and would encourage it to be used actively to ensure that the Lamfalussy objectives are achieved.

We trust that our comments will be helpful and look forward to continuing to participate in this debate.

Yours faithfully



**Mark Harding**  
Chairman, European Regulatory Committee