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Federation of European Securities Exchanges (FESE)
Futures & Options Association (FOA)
International Swaps & Derivatives Association (ISDA)
International Primary Market Association (IPMA)
International Securities Market Association (ISMA)
London Investment Banking Association (LIBA)
Swedish Securities Dealers Association (SSDA)
European Banking Federation (FBE)

JOINT RESPONSE TO THE INTER-INSTITUTIONAL MONITORING GROUP FIRST INTERIM REPORT

The above associations greatly appreciate the opportunity to respond to the Inter-Institutional Monitoring Group (IIMG) Interim Report. Given their common views on many aspects of the Lamfalussy process, they are submitting this joint response.

The associations would like to stress that they very much support the objectives of the Lamfalussy. Any criticisms relate to the way it has been implemented to date, rather than the principles of the process itself.

Answers to the IIMG's Questions:

1. What are your views on the Group's assessment criteria? Are they sufficiently precise and complete?

We believe that the criteria included are good, but it would be useful to add a specific criterion on the ***quality of legislation*** which the process yields ('better results' in Criterion 4 is not specific enough). Quality, as measured by the effectiveness of the implemented legislation in achieving its objectives, is more important than speed (Criterion 1). We have a strong feeling that the excessive focus on speed has so far undermined the quality of the legislation. This will be discussed in more detail in response to questions 2, 3, 4, 6 and 8.

2. Are you aware of any obstacles obstructing or hampering the swift and efficient adoption of securities markets legislation at European level?

So far, the process has yielded far too much detail at both Level 1 and Level 2, which is incompatible with diversity of European markets and legal systems and indeed with the outcome as envisioned by the Lamfalussy Committee. Excessive detail allocates decisions to politicians on matters that require detailed technical

knowledge and leads to political deadlock as framework public policy principles are overrun by incompatible technical detail. Given that one of the main reasons pre-Lamfalussy directives failed was excessive detail (and not sufficiently clear principles), this problem will definitely have to be addressed.

Core political and systemic principles should be the contents of Level 1 legislation and we should not accept great levels of detail. We should not forget, especially with the enlargement of the European Union around the corner, that Level 1 legislation will be with us, if not for perpetuity, for at least 10-20 years.

We would like efforts to be focussed on truly functioning passports for the market participants.

We also believe that earlier discussions on ideas, rather than discussions right away on legislative texts, would be an advantage for the ultimate product. Alternatives to creating new legislation also ought to be considered; every legislative step must be preceded by an accurate analysis as to whether legislation at European level is needed and appropriate, and one must adhere to the conclusion of this analysis. The process that the Commission is currently applying in clearing and settlement infrastructure is perhaps an example in this vein.

At Level 1, cost effectiveness, the effects on the ground and impact analysis are aspects of the process that are too easily forgotten.

The line of division between the various levels is clearly a very important one, whether it applies to Level 1/Level 2 or Level 2/Level 3. Where it is demonstrably clear that a provision must be binding on all Member States, it should go into Level 1 or 2, depending on whether it represents an enduring principle or is likely to be subject to change as markets develop, respectively.

With this principle in mind, we also believe that there is not a sufficient use or even recognition of the swifter and more adaptable Level 3 process as a means of understanding and accommodating diversity in the context of pan-European standards/principles.

Overall, the industry is aware that the FSAP deadline is imposing constraints that impede efficient adoption of legislation, leading to a type of discussion and decision-making that is motivated too much by political priorities and not enough by the needs of investors and market users and business efficiency.

3. Is the system of parallel working with provisional mandates granted to CESR efficient?

Unlike the IIMG, we would not say that parallel working is inevitable. Once the current pressure due to the FSAP is over, in the medium-term, one can certainly envisage a process that does not involve parallel working.

Overall, our assessment is that parallel working as it is practised right now, driven as it is by timetable pressures, is not entirely efficient. The first problem recognized by the IIMG is the risk of wasting resources and de-motivating CESR staff and market participants if the provisional mandate under which CESR carries out work is radically changed so as to make the work irrelevant or inappropriate. Another problem that is not adequately addressed in the Report is

that of creating bias: As CESR takes on work based on one regulatory approach set out in a provisional mandate, there is a concrete risk of limiting options based on an alternative approach. This limitation could clearly influence the decision-making at Level 1, which is not the intention of the Lamfalussy process.

On the other hand, we have observed certain potential benefits to parallel working other than the most obvious, i.e., allowing market participants more time for consultation. In fact, CESR consideration of the issues (in enquiry mode) at early stages of the legislative process can also be useful to provide warnings of inadequacies or impracticalities at Level 1. Of course, this feature can only be constructive if it does not prejudge later consultations and decision-making at Level 2 in the light of the final Level 1 text.

The experience with the Market Abuse Directive consultation could be informative for the future: Industry had a different view from CESR on several points as to whether these should be considered as Level 1 or Level 2 items. These problems were not included in the eventual CESR advice to the Commission. This raises the question as to whether it may be useful to consider a process or dialogue whereby such issues are addressed or at least pointed out as potential problems in CESR's advice to the Commission.

An issue linked to parallel working is the staggered schedules employed by CESR to complete its advice on different parts of the same mandate or mandates. While it can be an efficient use of CESR´s time and resources, it does not allow the industry to see the technical advice in its entirety. This can be crucial for inter-linked subjects. If there are aspects of CESR´s advice for the Prospectus Directive that will be finished in September that alter the industry's view of the part finished in July, would CESR agree to modify its earlier advice or would there need to be an additional mandate? Would the Commission wait for the subsequent, but inter-linked, parts of the technical advice before submitting the earlier draft implementing measure to the ESC?

Where the issues are closely related, it seems reasonable to allow market participants to provide input on the full package up to the end of the consultation on the last mandate.

4. Is the scope of delegation of implementing measures at Level 1 sufficient, too limited, or too wide in order to reach the objective of more efficient securities markets legislation at European level?

The industry finds that there is generally too much detail at both Level 1 and Level 2. Consequently, the scope of delegation from each level is too limited, though, paradoxically, the scope of what is proposed at both Level 1 and Level 2 is too wide. Too much of what is at Level 1 is detail that should be left to Level 2, Level 3, or national implementation; and overall too much provision for comitology on matters which are better approached at Level 3. Too much detail also makes the legislation too complex to interpret which itself will slow down the implementation process.

Generally speaking, the Level 2 advice for the Prospectus Directive currently under preparation is too detailed and prescriptive. This also raises the difficulty of an efficient update of these measures, which will have to be kept up-to-date with market innovation and changes.

5. What do you consider to be the best approach as to the choice of directives or regulations as legal instruments to use at Level 2 under the Lamfalussy process?

We believe that it is difficult to establish a general preference on this point. Each case should be considered on its merits. The Regulation route is likely to be most appropriate where there is no scope or need for flexible interpretation. The Directive route is likely to be preferable in the majority of circumstances where flexibility in implementation and update - between Member States, between markets, and over time – is essential.

One potential complication that must be kept in mind occurs when one mixes different instrument at Level 1 and Level 2 (a Regulation for one and a Directive for the other). There is some concern that the use of different legislative instruments at Level 1 and Level 2, as in the Market Abuse Directive, could lead to increased complexity and may result in problems of implementation in the national jurisdictions. The sequence of the deadlines for implementation of each level of legislation could help prevent undue complexities.

6. Are the consultation processes sufficient? Are they satisfactory and efficient as regards the number of rounds of consultation and deadlines set? Are consultative documents balanced in terms of depth and size?

Though much improved by comparison with the situation before the Lamfalussy reforms, consultation processes are still not sufficient, satisfactory, or efficient.

At Level 2, although CESR's paper on its consultation practices is admirable in its principles, the actual practice is sometimes rushed. There is a lack of clarity as to which of the Commission, CESR, or Member States should be responsible for allowing more time.

Particular problems include inadequate time sometimes given for responses (partly a function of FSAP deadlines, partly of over-ambitious implementation timetables); inadequate feedback analysis and explanation of reasons why particular policy approaches have been adopted or rejected (this criticism applies, for example, to the Commission's lack of explanation of its rejection or amendment of CESR's advice in its Market Abuse Directive draft implementing measures, CESR's consultation on that advice, as well as certain aspects of the consultation on the Transparency Obligations Directive); excessively long and detailed consultation documents and texts (a feature of Lamfalussy implementation at all levels, with no control over politically-inspired detail); and lack of transparency when decisions deviate from results of consultation.

At Level 1, for example, the majority of members consider that the last minute change that occurred at the stage of finalising the ISD, which led to provisions in Article 25, had not been subject to consultation and should have been avoided. Further, the Commission has not accounted for the rationale of either this change in procedure or of the change itself to the market participants which exacerbated the problem surrounding the proposals.

Time limits have prevented satisfactory second rounds of consultation (e.g. Market Abuse implementing measures). Consultation documents are far too detailed and long to enable sensible scrutiny of the proposals in the time

available; see also comments in 4 above on the excessive level of detail, in particular at Level 2. Timetable pressure on CESR tends to lead consultation documents to become 'shopping lists' aggregating Member States' particular needs, rather than a considered abstraction of the detailed measures needed to flesh out Level 1.

In the previous dialogue leading up to the First Interim Report, many have brought to your attention specific problems with respect to the timetable of the CESR consultations on the Market Abuse and Prospectus Directives, which we do not want to repeat here. We understand that CESR is aware of these concerns. We would only wish to stress that the quality of the result of a consultation depends directly on sufficient time being available for reviewing the proposals, whether these are revised proposals or new. Timetables should also take into account EU-wide traditional holiday periods.

CESR recently told the Parliament that it needs at least 9 to 12 months for any implementing measure if it is to do a proper consultation. The Parliament and the Council need to bear in mind that deadlines should provide a structure for the work CESR has to do, but not become a straitjacket. The current deadlines are preventing CESR from carrying out a thorough consultation. The urgency of the consultations forces market participants either to provide poor quality commentary or not to respond at all. To make a positive contribution, consultation should allow time for a genuine dialogue.

On a more positive note, it is commendable that in March 2003 the Commission set up a process to allow market participants to review the first three draft legal implementing measures for the Market Abuse Directive before it submits the formal proposals to the ESC. We expressly welcome this as a precedent. It is essential for the industry to have the opportunity to comment directly to the Commission on the legal text because:

- Translation into legal text can lead to problems of interpretation due to the various legal traditions. Consultation involving practitioners and legal experts should ensure consistency of interpretation;
- Consultation with CESR only provides market participants with an indirect opportunity to comment on the proposed technical advice. It can then be amended by the Commission;
- Preparation of the legal implementing measures may go beyond the scope of the technical advice provided by CESR (as it does in this case), making input on these items useful.

These reasons make it clear that such a pre-consultation does not undermine the role of CESR, as might have been feared, since the scope and focus of the consultation is entirely different from that carried out by CESR. The industry believes that these consultations will be useful in ensuring the consistency and coherence of the formal legal measures.

Finally, among all the institutions involved, the ESC has perhaps the farthest progress to make to become sufficiently transparent. This stands in stark contrast with CESR, which has adopted a charter with principles for consultation and uses both open public consultation and expert groups to consult on its work.

7. Is there a further need to provide ex-post transparency, that is to explain to the public why proposals from market participants or others were included in securities markets legislation, or why they were omitted? Do CESR's feedback statements meet the commitments made in its Public Statement of Consultation Practices?

The inadequacy of CESR's and the absence of the Commission's feedback statements are one of the most important continuing defects of Lamfalussy implementation to date. We continue to miss reasoned responses by CESR to the points made in the consultation process. Once again, timetable and resource pressures have led to CESR's publication of responses in raw form, rather than as part of the considered analysis of pros, cons, and decisions that is needed. This makes it difficult or impossible to follow the rationale for decisions made, thereby undermining the democratic legitimacy of the outcome and the scope for correction of inadvertent technical errors. There is also insufficient transparency regarding how CESR actually weights the input from consultees (for example in terms of geographic or sectoral representativeness).

We would also suggest that it may be useful to consider the role for a practitioner review of the responses. Such a tool would not deprive the regulators of their final authority in the decision-making process, but rather help in achieving a more balanced assessment.

8. What are your views on the Group's preliminary observations on possible bottlenecks?

Due to extremely tight deadlines the usual trade-off between quality and speed has become increasingly tangible as CESR has been pushed to deliver its technical advice while also attempting to carry out a proper consultation. Over the last year, the deadlines originally set by the Commission at the outset of the legislative process were overtaken by events and turned out to pose an undue constraint on CESR's consultation with market participants and, therefore, on the quality of the technical advice being prepared.

If the objective is to ensure that the FSAP achieves its goals, the April 2004 bottleneck must not be used as an excuse to hurry through bad legislation. The Lamfalussy process is primarily about making better, not faster, legislation.

We understand that the continuing support of the Parliament for the Lamfalussy process is dependent on its receiving democratic safeguards to ensure an equal role of control over comitology as the Council. These safeguards will only be fully achieved through amendment of Article 202 of the EC Treaty, and industry has expressed its support for such an amendment to the Convention on the Future of Europe.

We agree strongly with the Interim Report's comments about the mismatch between the resources available in the Commission, CESR, associations and market participants, and the demand on those resources in developing and enforcing legislation and regulation. We believe that an easy way to reduce the strain and release existing resources, and to improve the effectiveness of EU legislation, is to reduce the amount and level of detail at Levels 1 and 2 (see answers to questions 2, 4 and 6 above) and give greater weight to the less

politically-driven Level 3 – this shift would be consistent with the more streamlined use of resources that the Lamfalussy Committee intended.

9. Is the current functioning of the institutions, committees, market participants, and other parties involved in the Lamfalussy process conducive to making progress on securing a more effective securities market regulatory system? Are all these actors equipped with sufficient resources?

Despite significant improvements, further significant progress is needed to secure a more effective securities market regulatory system, as described in answer to questions 1 to 8. Improvements to date are too subject to reversal in the interests of speed or expediency. As noted in response to question 8 above, increasing resources is not necessarily the only or best way of solving these problems. The problems are themselves a manifestation of aspects of the implementation of the Lamfalussy process which work against the gains in quality and efficiency of legislative development that the Lamfalussy approach intended.

Political priorities should not take precedence over the key practical objectives of the FSAP, such as the objectives of market flexibility, business efficiency, investor choice, and the underlying purpose of enhancing the competitiveness of EU markets and institutions.