

CESR CONSULTATION

The role of CESR at "Level 3" under the Lamfalussy process

**Response of the French Association of Investment Firms
(AFEI)**

1. The French Association of Investment Firms (*Association Française des Entreprises d'Investissement* – AFEI) comprises nearly 130 investment service providers, mainly investment firms, but also credit institutions authorised to provide investment services. The majority of AFEI members operate in the fields of equities and derivatives. Approximately one-third are subsidiaries or branches of foreign institutions.

AFEI has closely followed the work carried out at European level on the Lamfalussy process, which is of direct interest to its members. It is particularly concerned to ensure that the consultation procedure is open and transparent and that market participants are involved at every level, in accordance with the recommendations of the Committee of Wise Men¹.

2. Accordingly, AFEI has carefully examined the document published in April by the Committee of European Securities Regulators (CESR) for the purpose of gauging industry opinion on the functioning of the Committee at Level 3. We wish to submit the following response.

I. – GENERAL COMMENTS

➤ A welcome initiative, given the importance of Level 3 implementing measures

3. The drafting of Level 3 measures is a critical phase in the European standard-setting process. These measures seek to transpose Level 1 and Level 2 legislation in an efficient and equivalent manner and to improve the way the laws are applied across the European Union (EU). Achieving a level playing field between market participants, whatever their home state, will hinge on the detailed content of the Level 3 measures drafted by CESR.

AFEI therefore welcomes the initiative taken by CESR with this consultation. A precise definition of the Committee's field of action as well as its powers and prerogatives is vital to achieving a truly integrated European financial market.

Moreover, the consultation is a valuable accompaniment to the first two reports of the Inter-Institutional Monitoring Group (IIMG) for securities markets, published in May 2003² and December 2003³.

¹ "Final Report of the Committee of Wise Men on the Regulation of European Securities Markets", 15 February 2001

² "First Interim Report Monitoring the New Process for Regulating Securities Markets in Europe (The Lamfalussy Process)", Inter-Institutional Monitoring Group, May 2003.

➤ ***A need for clarification about the involvement of industry professionals at Level 3***

4. While most of the proposals are consistent with the line taken by AFEI, the consultation paper fails to specify how industry professionals are to be involved in preparing Level 3. Given the overarching importance of this issue, the absence of detail is worrying.

AFEI urges CESR to present the procedures it intends to follow in this respect in the near future. One of our particular concerns is to ensure that the Committee provides for realistic timeframes so that the comments and remarks made during consultation rounds can be taken into account.

II. – DETAILED COMMENTS

A. - Coordinated implementation of EU law by CESR members

Question 1

Do you agree with the described role of CESR with respect to the coordinated transposition and application of EU law?

5. The role described in the consultation paper is indeed the role that CESR should play. AFEI wishes to stress CESR's importance in the process of drafting Level 3 measures, as well as its particular responsibility for the efficient, consistent and equivalent transposition of Community legislation throughout the EU. "The essence of Level 3 [...] is to greatly improve the consistency of the day to day transposition and implementation of [...] legislation⁴". Accordingly, CESR's missions and prerogatives, as set out this paper, must enable it to reach that goal.

6. Moreover, the Committee usefully recalls the position of the European Commission and CESR members within this framework. It also insists on the need for coordination between standard-setting bodies and on the fact that each participant should respect the role played by the others.

³ "Second Interim Report Monitoring the Lamfalussy Process", Inter-Institutional Monitoring Group, 10 December 2003

⁴ "Final Report of the Committee of Wise Men on the Regulation of European Securities Markets", 15 February 2001, p. 37

Question 2

Do you see an "additional role" for CESR under level 3 where CESR could contribute to the co-ordinated implementation of EU law? If so, please explain what CESR should do to establish the role proposed?

7. The powers given to CESR for implementing and transposing Level 1 and Level 2 measures are exhaustively and precisely described. At this stage, and on the basis of this detailed description, AFEI does not see any additional roles for the Committee.

8. Moreover, AFEI endorses the two proposals put forward by the Committee regarding the coordinated implementation of EU law.

AFEI obviously agrees with the proposal to preserve the network of experts charged with advising CESR on the implementation of EU standards. Expert input and advice is bound to improve the quality of CESR's work.

AFEI also agrees with the proposal that each CESR member-authority should have the same powers in terms of transposition. This proposal is fully in line with the conclusions of the Committee of Wise Men. Without actually recommending harmonisation *per se*, it stresses in its report⁵ that Level 3 depends above all on closer cooperation between member states, regulators and the European Commission. It is true that this cooperation will be much more productive once regulators have identical resources for transposing and enforcing Level 1 and 2 measures. The report laid particular emphasis on "the importance of supervisory and regulatory convergence", stressing that "fundamental convergence is necessary among European regulatory structures in a number of areas. The main ones are to converge "horizontal" structures; the degree of autonomy of regulators; and not least the involvement of market participants in the regulatory process. The Committee urges governments to coordinate their efforts in this regard given the various initiatives underway⁶".

B. - Regulatory convergence

Question 3

Do you see any other aspect of regulatory convergence where CESR could play a role?

9. In its current form, CESR's proposal to give more authority to Level 3 measures in certain cases is not acceptable.

AFEI recognises that leaving member states too much leeway to interpret and assess the scope of measures could be risky. It could result in competitive distortions between market participants, thereby hindering progress towards a truly level playing field. Accordingly, it is necessary for CESR to have the possibility of being actively involved in the process of ensuring mutual discipline and harmonising interpretations.

However, AFEI stresses that "possibility" is the operative word, and that CESR should use this prerogative judiciously. Level 3 measures address the need for flexibility arising from legal and cultural differences, so excessive harmonisation could be harmful to markets. Furthermore, in view of CESR's composition and its place in Europe's institutional architecture, there is no question of its establishing

⁵ "Final Report of the Committee of Wise Men on the Regulation of European Securities Markets", 15 February 2001, p. 9.

⁶ "Final Report of the Committee of Wise Men on the Regulation of European Securities Markets", 15 February 2001, p. 38

binding standards in the true sense of the term. The Committee is made up of national regulators, and its role is to ensure that everything operates smoothly at that level, relying on its unparalleled knowledge of the practicalities of market supervision. It is only normal that CESR should have the power to alert a national regulator to the questionability of implementing a particular point, or that it should be able to interpret certain rules, particularly in case of disagreement between regulators or between regulators and market participants. However, it is not normal that the Committee should also have coercive powers.

Therefore, should the need arise for a normative and binding rule, the responsibility would naturally lie with the competent authorities at Levels 1 or 2 of the Lamfalussy process.

10. AFEI endorses CESR's proposal that it should be permitted, through a precisely defined and carefully supervised procedure, to alert the Commission if it identifies the need to update Level 2 measures (and possibly those at Level 1).

This proposal is entirely consistent with the goals of harmonisation and adaptability set in the Lamfalussy process. As stated in the report of the Committee of Wise Men, the aim of that process is to enable EU legislation to adapt to fast-breaking developments in financial markets. In view firstly of the workload of the Commission and secondly the role assigned to CESR under the Lamfalussy process, it would be useful to introduce an early-warning procedure whereby CESR could draw the Commission's attention to the need for statutory or regulatory amendments in order to keep pace with such developments. This is all the more relevant since CESR is ideally equipped to play that role.

Question 4

Do you think that CESR could play a role in providing coordinated opinion on new services or products with pan-European scope?

11. It should first be noted that, when defining CESR's tasks at Level 3, the report of the Committee of Wise Men explicitly refers to the formulation of joint interpretative recommendations as well as common standards in fields not covered by EU legislation, with the possibility of subsuming such standards into Community law.

This task creates no problems and is welcome, provided it fits into the framework described above (see §9). Proposals for standards can certainly make a valuable contribution, but they cannot in themselves be normative. Where appropriate, they must be incorporated into legislation at Level 1 or 2.

12. Furthermore, when CESR sets common standards on its own, it must do so in a way that avoids wasted energies. For example, it is particularly important that the Committee should not initiate work on areas that are already being addressed by the Commission.

In AFEI's view, the joint project between CESR and the European System of Central Banks (ESCB) on clearing and settlement in the EU⁷, which CESR refers to in the consultation paper, epitomises the type of overlap that must be avoided at all costs. It is regrettable that CESR and the ESCB are setting standards in this area, just as the European Commission is launching a consultation on the need for a directive defining the role and oversight of post-trade infrastructures. At best, the Commission's deliberations have been pre-empted. At worst, subsequent EU legislation will call these standards into question – and, if a national authority has put them into practice, market participants will bear the cost of adapting once again to new rules and regulations.

⁷ "Standards for Securities Clearing and Settlement Systems in the European Union", August 2003, and "The Committee of European Securities Regulators (CESR) and the European System of Central Banks (ESCB) Joint Consultation on Standards for Securities Clearing & Settlement Systems in the European Union", September 2003.

It is therefore necessary to introduce a procedure that will allow CESR to check whether an issue it plans to address is already being dealt with by the Commission.

13. AFEI also believes it is important to make clear exactly how professionals will be involved in deciding the areas in which CESR intends to act. Here again, the work on the CESR-ESCB standards is a perfect example of what not to do: although market participants have unanimously challenged the timeliness of these standards, it now seems certain they will be adopted.

Question 5

Would you consider endorsement by the Commission of the common guidance established by CESR as a helpful tool to ensure consistent application of EU directives/regulations?

14. To give actual legal effect to its standards, which in principle are non-binding, CESR proposes to involve the Commission. As provided by the Committee of Wise Men⁸, CESR envisages a procedure whereby the Commission would be responsible for incorporating its standards into the body of EU law.

In principle, AFEI agrees with this proposal on the grounds that it is sometimes necessary to give binding effect to measures that exceed the scope of Level 3 (see §9 *et seq*).

15. It should be noted, however, that this solution should be used only in exceptional circumstances. Reliance on Level 3 rather than Level 2 is predicated on the need for leeway at national level in order to allow for differences in legal and cultural environments. Accordingly, the decision to give binding effect to standards in certain cases depends necessarily on the observation that national leeway is either pointless or no longer useful. This implies that reliance on Level 3 from the outset was inappropriate, unless, of course, some standards are allowed to remain in place until these environmental differences had been eradicated.

AFEI stresses its constant concern that, in cases where European harmonisation based on binding standards is necessary, it should be achieved by measures at Levels 1 and 2, leaving the necessary leeway at Level 3 (on condition that Level 1 and 2 measures are consistently applied).

16. However, before the Commission sets out to incorporate CESR standards, it must consult with market participants, who are the first to be affected by any laws that might be adopted.

It must be remembered that there is no mandatory consultation process for Level 3 measures. AFEI deeply regrets this state of affairs and recalls that the quality and suitability of future legislation depends on consultation with the industry and, more generally, with all those that will be affected by the new laws. As already mentioned in our response to the IIMG consultation in December 2003⁹, we once again stress the need to closely involve market participants at every stage of the procedure, as recommended by the Committee of Wise Men.

⁸ The report provides that the joint interpretative recommendations and common standards drawn up by CESR can, if necessary, be incorporated into EU law via a Level 2 procedure. "Final Report of the Committee of Wise Men on the Regulation of European Securities Markets", 15 February 2001, p. 48.

⁹ AFEI memo of 6 February 2004 (*AFEI/04-04*): Implementing measures for the Financial Markets Instruments Directive - CESR call for evidence – Response of AFEI.

C. - Supervisory convergence

Question 6

Do you see any other aspect of supervisory convergence where CESR could play a role? If so, how and why?

17. AFEI endorses the description given in the consultation paper. The text highlights the fact that, in accordance with the Committee of Wise Men, "national regulators [...] have the prime responsibility for this work – acting in a cooperative network.¹⁰". CESR discusses in a positive light the resources needed to set up such a network in order to achieve convergence. The description fleshes out the elements discussed by the Committee of Wise Men¹¹: "Level 3 should encompass a '*...framework of enhanced and strengthened cooperation and networking between (national) regulators with a view to ensuring consistent and equivalent transposition of Level 1 and Level 2 legislation...*'. National regulators [are] also encouraged to agree joint protocols for improving implementation and a peer review process to ensure consistent enforcement practice in the ESRC".

18. AFEI wishes to place particular emphasis on the importance of exchanges of information between authorities. This bedrock principle is vital to the orderly operation of the supervisory mechanism. In this respect, CESR members – and Lamfalussy stakeholders in general – must be encouraged to provide the Committee and the standard-setters with all the information they consider relevant in an effort to enhance and improve the normative process. Exchanging information is key to achieving convergence.

Question 7

What kind of mediation role do you consider would be appropriate for CESR?

19. CESR, like the IIMG in its second interim report, proposes the creation of a mediation mechanism within the Committee, with a view to solving any disputes that may arise between national regulators in connection with the implementation of Level 3 measures. The principle of this mechanism echoes the proposal made by AFEI when the IIMG published its first report in May 2003¹².

AFEI believes it necessary to foster a system of mutual discipline between national authorities. CESR would be the linchpin of such a system, ensuring overall compliance with the guidelines set out in Level 3 measures. Naturally, the respective roles of each level must be respected, as described in §9.

20. The arrangements for the mediation procedure meet the need to regulate Level 3 measures and to ensure they are applied effectively and consistently by member states, without calling into question the existing legal procedure at EU level. AFEI believes that, at a minimum, the following points should be provided for:

- Each CESR member-authority must submit an annual report on its national Level 3 practices.
- CESR member-authorities should have the right to inform the Committee if the practices of a sister authority contravene CESR's standards and guidelines. They should also be allowed to complain to CESR in cases where national decisions create obvious competitive distortions, without actually infringing those standards and guidelines.

¹⁰ "Final Report of the Committee of Wise Men on the Regulation of European Securities Markets", 15 February 2001, p. 37

¹¹ "Final Report of the Committee of Wise Men on the Regulation of European Securities Markets", 15 February 2001, p. 37

¹² See AFEI/ 04-04

- Market participants subject to CESR-dependent regulation, as well as the professional associations representing them, must have the right to complain to CESR if the practices of a member state clearly distort competition, having regard to CESR's standards and guidelines.

Question 8

Do you have any comments on the catalogue of all mutual recognition and cooperation obligations under the Directives where CESR is active (see *Annex 4*)?

21. AFEI agrees with the amendments set out in Annex 4 of the consultation paper. They tend to incorporate the text of CESR's proposals, most of which AFEI endorses.

22. That said, when examining the annex, we concentrated mainly on the sections relating to the Market Abuse and Financial Instruments Markets Directives, which are issues of particular importance for us.

