

MEMO# 13199

February 23, 2001

EUROPEAN COMMITTEE OF WISE MEN PUBLISHES FINAL REPORT

[13199] February 23, 2001 TO: INTERNATIONAL COMMITTEE No. 14-01 RE: EUROPEAN COMMITTEE OF WISE MEN PUBLISHES FINAL REPORT On February 15, 2001, the Committee of Wise Men, chaired by Alexandre Lamfalussy, issued its final report on the Regulation of European Securities Markets.¹ The Committee's report, a copy of which is attached, describes the reasons for proposing changes to the current regulatory structure and its recommendations for regulatory reform. The Council of Economic and Finance Ministers (ECOFIN) and the European Commission will report on the Committee's final recommendations to the Stockholm European Council in March. We briefly summarize below the highlights of the report.

Reasons for Recommending Changes The Committee's report concludes that regulatory reforms are necessary to produce an integrated securities market, which would yield significant economic benefits to Europe. The Committee believes that the shortcomings of European regulation are one of the contributing factors to the current lack of an integrated financial market. To this end, the Committee specifically identifies outdated investment rules for UCITS and pension funds as one of the most important gaps in European regulation, as noted previously by the Institute in its comments to the Committee.² The report also takes the view that the current regulatory system is unable to react quickly to changing market conditions, produces too much ambiguity, and fails to distinguish between essential principles and practical implementing rules.

Regulatory Reform As in its initial report, the Committee recommends a four-level approach to securities regulation. The Committee's final report provides details regarding the Committee's proposals for this approach and emphasizes the importance of transparency and open consultation with market participants in the legislative process. ¹ See Memorandum to International Committee No. 41-00 (Nov. 16, 2000) (Committee's initial report). ² See Memorandum to International Committee No. 33-00 (Sept. 29, 2000) (Institute comments to Committee's online consultation).

Level 1 – Framework Principles. The Committee recommends that at Level 1 new types of directives or regulations be developed to regulate securities. These directives and regulations would contain framework principles and would delegate the power to adopt implementing rules to Level 2.³ In practice, the European Parliament and the Council of Ministers would need to agree to core political principles or "essential elements" of a directive or regulation based on a proposal made by the European Commission. The Level 1 principles also would specify the nature and extent of the technical implementing measures that would be adopted at Level 2 and the limits within which those implementing provisions can be adapted and updated without a change of the framework legislation. Under this proposed system, the Council of Ministers and the European Parliament specifically would have to agree to the powers to be delegated to Level 2. The Committee also recommends that, although the European Commission would continue to have the authority to initiate proposals, the Commission

conduct prior consultations with market participants and other interested parties in an open, transparent, and systematic way. The Committee suggests that the Commission continue to consult with member states and their regulators on an informal basis as early as possible on any impending Level 1 proposals. The Committee recommends that the Commission notify informally the European Parliament of the forthcoming proposals and seek early non-binding understanding on the scope of any implementing powers that might be delegated to Level 2.

Level 2 – Implementation of Principles. The Committee recommends that Level 2 -- which would be composed of a network of national securities regulators, the European Commission, and a new European securities committee -- define, propose, and determine the implementing measures of the framework principles as specified by the Level 1 legislation. There would be two new formal committees in Level 2 -- an EU Securities Committee (ESC) and an EU Securities Regulators Committee (ESRC). In Level 2, after consultation with the ESC, the Commission would ask the ESRC to begin work on the implementing measures for the directive or regulation and would decide on a timeframe for the process. After an open consultation period, the ESRC would provide its technical advice to the Commission.⁴ Taking into consideration the work of the ESRC, the Commission would forward a proposal to the ESC. The ESC then would vote on the 3 The Committee's report also recommends that regulations (along with fast track procedures), rather than directives, be used because regulations can speed up the implementation process by applying directly in the member states without adoption of national legislation by the member states. 4 Under the Committee's approach, the ESRC would follow four basic procedures for an open consultation. These procedures would include: (1) issuing a "concept release" that would outline the problems and request public input on a regulatory approach; (2) releasing a draft proposal for consultation with markets and end users once a regulatory approach has been decided; (3) using the Internet and, where necessary, hearings or roundtables during the consultation process; and (4) attaching a summary of the public comments to each of the ESRC's final recommendations. The maximum consultation period for the concept release and draft proposal would be three months, respectively. 3 Commission's proposal within three months.5 If the ESC agrees to the Commission's proposal, the Commission could decide to enact the legislation.6 In proposing the details of its approach, especially with respect to the adoption of Level 2 legislation, the Committee was mindful of the need to maintain balance among the various EU institutions and to preserve the European Parliament's role in the legislative process. As a result, the Committee would require that the European Parliament be fully informed of the ESC's work and of the Commission proposals and the European Parliament would be able to request that the ESRC report to it periodically.7 The Commission and the committees also would be required to provide the European Parliament with all the relevant documents. Finally, the Parliament would have the authority to consider the draft proposals submitted by the Commission and determine within a month whether the implementing powers provided by the Level 1 legislation have been exceeded. If the Parliament determines that the Commission's proposal is not consistent with the delegated powers, it can pass a resolution that would require the Commission to reexamine the proposal and take account of the European Parliament's position.

Level 3 – Strengthening Cooperation Among Regulators. The Committee's final report confirms that Level 3 would involve a network of national regulators, which would ensure consistent and equivalent implementation of Level 1 and Level 2 legislation. In Level 3, the ESRC would (1) produce consistent guidelines for the administrative regulations to be adopted at the national level; (2) issue joint interpretative recommendations and set common standards regarding matters not covered by EU legislation; (3) compare and review regulatory practices to ensure effective enforcement throughout the Union and define best practices; and (4) periodically conduct peer reviews of administrative regulations and regulatory practices in member states, reporting the

results to the Commission and to the ESC. Level 4 – Enforcement. The Committee recommends in Level 4 the strengthening of enforcement of Community rules. The Committee places this responsibility on the European Commission but notes the necessity of assistance from member states, regulators, and the private sector for improving enforcement. * * * The Committee believes that this four-level approach is the only practical alternative to achieving an integrated European securities market at this time. To report on the functioning of this approach, the Committee recommends that a monitoring group be established to produce semi-annual reports. A full review would be conducted in 2004 unless the progress reports 5 The ESC, made up of high-level member state nominees, would have several roles under the Committee's proposed approach. The main function of the ESC would be to act as a Regulatory Committee and to vote on the Commission's proposal, which would be enacted by the Commission if the ESC agreed to the proposal by a qualified majority. In its advisory role, the ESC would counsel the Commission on Level 1 legislation and Level 2 mandates for the ESRC. 6 If the ESC votes against the proposal or provides no opinion, the proposal is submitted to the Council of Ministers as the Commission's proposal. 7 The ESRC would be required to produce an annual report of its work for all of the EU institutions. 4 indicate a need for an earlier review. If the full review demonstrates that the approach has not produced sufficient progress, the Committee would consider at that time the need for a Treaty change, including the creation of a single EU regulatory authority for financial services. If you have any questions or comments on the Committee's final report, please forward them to me by phone at (202) 326-5810, by fax at (202) 326-5841, or by e-mail at jchoi@ici.org. Jennifer S. Choi Assistant Counsel Attachment Attachment (in .pdf format)