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25

The Committee of European Securities Regulators and level 3 of the Lamfalussy Process

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Professor Wymeersch's long and distinguished career, and his remarkable influence on EU securities regulation, is well-reflected in his Chairmanship of the Committee of European Securities Regulators (CESR). CESR can now be argued to be one of the (if not the) dominant influences on the recent and explosive development of EU securities regulation. This chapter seeks to assess the nature of CESR's activities at level 3 of the Lamfalussy process and, in particular, whether the burgeoning reach of its influence poses accountability and legitimacy risks or whether CESR has the potential to construct a discrete accountability model which supports its rapidly developing range of activities.

I. Introduction

It is a truisim to state that the Financial Services Action Plan (FSAP) period has wrought massive regulatory, institutional and supervisory change on EC securities markets. One of the main drivers for change has been the Lamfalussy process for delegated law-making.[1] As is well known, under the Lamfalussy process, the Commission adopts 'level 2' rules, which are frequently, although not always, detailed and technical, based on mandates in the related 'level 1' measure (either a directive or a regulation) which is adopted under the Treaty-based inter-institutional procedures. The Commission is advised by the Committee of European Securities Regulators (CESR, composed of national regulators) and supervised by the European Securities Committee (ESC, composed of Member State representatives). Level 3 of the Lamfalussy process concerns convergence and consistency in the application of level 1 and 2 rules. Level 4 concerns enforcement. The Lamfalussy process

[1] Final Report of the Committee of Wise Men on the Regulation of European Securities Markets (2001).

has supported an exponential increase in the content of EC securities regulation over the FSAP period – whether the quality of the regulatory regime has increased equally dramatically is less clear.[2] But it is clear that the Lamfalussy process has brought an actor of central importance to the policy stage in the shape of CESR. This chapter addresses CESR and its burgeoning influence on EU securities regulation which raises significant accountability and legitimacy questions.

CESR's activities at level 2 have, temporarily, come to a close. The FSAP stage of the level 2 process is now complete with CESR noting its move from level 2 advisory activities to level 3 supervisory convergence in its June 2006 annual report.[3] A vast range of level 2 rules have been adopted under all of the key measures including the Markets in Financial Instruments Directive (MiFID),[4] the Market Abuse Directive,[5] the Transparency Directive,[6] the Prospectus Directive[7] and the pre-FSAP 1985 UCITS Directive.[8] The evidence which has recently emerged on the CESR/Commission/ESC dynamic during the adoption of the first generation of level 2 rules (during the FSAP period) suggests that CESR's advice is heavily influential on the shape of the rules ultimately adopted by the Commission. But the constitutional controls on level 2 in terms of Commission, ESC and Parliament oversight of CESR's advice and the location of rule-making power in the Commission, appear reasonably robust. [9] The evidence also suggests that CESR is acutely aware of the

[2] For a critique of the effectiveness of the capital-raising rules see E.V. Ferran, *Building an EU Securities Market* (Cambridge University Press, 2004).

[3] CESR, *Annual Report* (2005), 5. All CESR references are available on www.cesr-eu.org.

[4] Commission Directive 2006/73/EC [2006] OJ L241/26 and Commission Regulation (EC) No 1287/2006 [2006] OJ L241/1.

[5] Commission Definitions and Disclosure Obligations Directive 2003/124/EC [2003] OJ L339/70, Commission Investment Recommendations Directive 2003/125/EC [2003] OJ L339/73, and Commission Regulation (EC) No 2273/2003 on Buybacks and Stabilisation [2003] OJ L336/33.

[6] Commission Directive 2007/14/EC [2007] OJ L69/27.

[7] 2004 Prospectus Regulation (EC) No 809/2004 [2004] OJ L149/1. It sets out the detailed information which must be included in public offer prospectuses. It has been amended to reflect the decision to postpone the equivalence determination with respect to third country accounting systems (Commission Regulation (EC) No 1787/2006 [2006] OJ L337/17). A second revision addresses disclosure by issuers with complex financial histories (Commission Regulation (EC) No 211/2007 [2007] OJ L61/24).

[8] In 2007 the Commission adopted level 2 rules concerning the definition of the 'eligible assets' in which a UCITS fund can invest under the UCITS III regime for UCITS investment. Commission Directive 2007/16/EC [2007] OJ L79/11.

[9] For discussion see N. Moloney, *EC Securities Regulation*, 2nd edn (Oxford University Press, 2008), Ch. XIII. The Commission has, e.g., reinforced the importance

constitutional limitations of its position as an advisory body at level 2 and is not prepared to act outside the level 1 mandates, even where there is strong market support for level 2 action on a particular issue.[10]

But the level 2 controls do not apply at level 3 where, in the troublesome sphere of supervisory convergence, CESR is increasingly exercising direct influence over the financial markets. Level 3, which is strongly associated with supervisory convergence, is designed to support convergence and consistency in the implementation and application of level 1 and level 2 rules. It was initially envisaged by the Lamfalussy Report as producing guidelines on implementation, developing recommendations and standards on issues not covered by EU law (a controversial element which has not been pursued by CESR), and defining best practice. It was characterized by CESR in its 2004 Level 3 Report as having three strands: coordinated implementation of EU law; regulatory convergence; and supervisory convergence.[11] As the FSAP shifts from regulation to operation, level 3 is now commanding attention at the highest political and institutional levels as the Community's response to the challenges raised by supervision of the post-FSAP marketplace and it was at the centre of the recently concluded 2007 Lamfalussy review.

The recent dramatic evolution of the level 3/supervisory convergence aspect of CESR's activities is perhaps best described as organic. Through its level 3 activities, CESR has acquired a degree of influence over the financial markets which is remarkable given its establishment in 2001 and given the resource commitment the level 2 advice process

of the level 1 delegation on occasion. This was the case with its rejection of CESR's advice that the MiFID level 2 regime address the content of the investment firm/investor contract on the grounds that, in addition to the national sensitivities and risk of disruption to national contract-systems, the level 1 delegation did not support such measures. It also rejected CESR's advice in relation to the level 2 market-abuse regime that investment recommendations by journalists be subject to a specific regime given the need to respect the difficult level 1 compromise achieved on this issue with the European Parliament. The market-abuse regime also saw the Commission reject CESR's advice that credit-rating agencies become subject to the investment research rules of the market abuse regime.

[10] A notable example relates to the MiFID level 2 consultation on the suitability regime and CESR's refusal to treat derivatives as 'non-complex' products and as within the 'suitability-free' execution-only regime, given the exclusion of derivatives at level 1, in the face of strong market demands for their inclusion. Similarly, CESR refused to give advice on expansion of the Market Abuse Directive Art 8 stabilization and buy-back regime beyond its level 1 limits.

[11] CESR, *The Role of CESR at 'Level 3' Under the Lamfalussy* Process (2004), CESR/04–104b.

demanded. This has occurred through a range of quasi-regulatory\ supervisory mechanisms, discussed in the following sections, none of which are specified in CESR's founding Decision.[12]

Issuer disclosure provides a good example of CESR's burgeoning influence. CESR's role has developed from providing level 2 advice on the Prospectus and Transparency Directives, to establishing own-initiative level 3 guidance on the prospectus regime,[13] to developing an innovative Q and A device to support supervisory convergence, [14] to quasi-enforcement activity with respect to supporting the implementation of IFRS and consistency in the enforcement of IFRS by national authorities,[15] to liaising with the SEC on US GAAP/IFRS reconciliation,[16] to driving operational innovation and supporting market initiatives with respect to the electronic network of Officially Appointed Mechanisms (with respect

[12] Commission Decision 2001/527/EC OJ [2001] L191/43.

[13] CESR/05–054b.

[14] CESR/07–852. The Q and A is regularly updated (three times over the course of 2007). It is designed to 'provide market participants with responses in a quick and efficient manner to 'everyday' questions which are commonly posed to the CESR secretariat or CESR members', CESR/05–054b.,1.

[15] See e.g., CESR's recommendations on the adoption of Alternative Performance Measures (CESR/05–178b) and its exhortation that issuers provide clear disclosure on their use of options in the reporting regime (CESR/05–758). CESR also produced a road map for the IFRS transition (CESR/03–323e) and has continued to exhort supervisory authorities to remain vigilant in ensuring compliance with the new regime (CESR/07–121b). Through CESR-Fin, which promotes convergence in the application of IAS/IFRS and has a strongly operational orientation, CESR produces non-binding standards for the enforcement of IAS/IFRS at national level and supports coordinated enforcement by providing a forum within which dialogue and cooperation can occur. In 2003, for example, it recommended basic principles for the robust and consistent enforcement of IAS/IFRS by the Member States (Enforcement Standards on Financial Information in Europe). This was followed in 2004 by a standard on coordination of national approaches to enforcement (Co-ordination of Enforcement Activities) which led to a framework for coordinating enforcement mechanisms and, in particular, to the European Enforcers Co-ordination Sessions. The Sessions, which support discussion of enforcement decisions and emerging issues, are designed to support the development of a high level of convergence on enforcement practices. In a key enforcement initiative, CESR has also established a database which includes national enforcement decisions on IAS/IFRS application in order to support supervisory convergence on the application and enforcement of the standards and consistency in the use of the standards on the marketplace.

[16] CESR/06–434. The work programme was established to promote the development of high-quality accounting standards, the high quality and consistent application of IFRS worldwide, consideration of international counterparts' positions regarding application and enforcement, and the avoidance of conflicting regulatory decisions on the application of IFRS and US GAAP. Consistent application of IFRS is a central concern of the work programme which includes discussion by the SEC and CESR of issuer-specific matters in an attempt to avoid diverging interpretations.

to issuer disclosure)[17] and, potentially, providing a supervisory capacity with respect to the electronic network.[18] All of this occurred without any substantive change to CESR's founding Decision and Charter.[19] It might appear to be but one step from here to prospectus-approval capacity – a role which CESR had earlier identified in the Himalaya Report.[20] But it is also clear that CESR is acutely sensitive to the accountability and legitimacy risks and is developing a multi-faceted response (discussed later in this chapter) which, the 2007 Lamfalussy Review suggests, enjoys institutional and political support.

II. Range of activities at level 3

A. Agenda-setting and quasi-regulatory activity

CESR's range of activities at level 3 is becoming formidable and its rhetoric, of considerable symbolic importance,[21] is increasingly that of an established regulator/supervisor. Its 2005 Annual Report noted that 2006 would 'witness CESR's metamorphosis from being primarily a regulatory advisory body to becoming a body which is well on its way to becoming an operational network of supervisors.'[22] The 2006 Annual Report adopted a similar tone and asserted that CESR 'was entering a new phase'.[23] Its 2007 Work Programme was similarly ambitious and

[17] The Commission described CESR as pivotal to the development of the network during ESC discussions on the Recommendation which governs the electronic network (Commission Recommendation 2007/657/EC on the electronic network of officially appointed mechanisms for the central storage of information referred to in the Transparency Directive [2007] OJ L267/16): ESC Minutes 13 September 2007. CESR's generally pragmatic and market-facing advice on the design of the network (CESR/06–292), which followed an earlier orientations document (CESR/05–150b), was reflected in the Recommendation.

[18] The Commission suggested in the Recommendation that the network could be supervised by a college of supervisors (either CESR or a specially constituted body) but rejected this solution as being outside the scope of the level 2 powers granted to the Commission under the Transparency Directive with respect to the storage of regulated information.

[19] CESR 06/289c.

[20] CESR, *Preliminary Progress Report, Which Supervisory Tools for the EU Securities Market? An Analytical Paper by CESR* (2004), CESR 04–333f.

[21] This point has been well made by Professor Langevoort in connection with the US SEC. See e.g., D. Langevoort, 'Structuring Securities Regulation in the European Union: Lessons from the US Experience' in G. Ferrarini and E. Wymeersch (eds.), *Investor Protection in Europe. Corporate Law Making, the MiFID and Beyond* (Oxford University Press, 2006), 485.

[22] CESR, *Annual Report* (2005), Foreword by the Chairman, 5

[23] CESR, *Annual Report* (2006), Foreword by the Chairman, 3.

was sharply directed towards level 3 activities, with CESR noting the 'marked shift in focus' towards operational activities.[24]

The range of guidelines adopted at level 3 (adopted without a formal mandate) stands out as a striking example of the reach of CESR's influence. They now cover the UCITS regime with respect to eligible assets[25] and the transition to the UCITS III regime[26], the prospectus regime[27], and, in some detail, the market abuse regime.[28] The MiFID regime is strongly characterized by amplification at level 3 and includes guidelines on the MiFID passport[29], on inducements[30], on best execution[31], and on the MiFID record-keeping regime.[32] CESR has also produced guidance on MiFID's transaction-reporting regime.[33] Standards have been adopted in conjunction with the European System of Central Banks with respect to clearing and settlement,[34] although these have proved particularly troublesome, generated considerable tensions with the Parliament, and have yet to be formally adopted. Standards have also been adopted with respect to financial reporting,[35] in support of the enforcement of the IFRS reporting regime.[36]

These guidelines have in common their considerable level of detail, extensive consultation, market support (for the most part), as well as a (generally) practical, market-facing, and operational orientation which points to CESR's ability to build consensus and develop pragmatic solutions to problems generated by the regulatory regime.[37] But, and aside from concerns as to their effectiveness (given their tendency to increase the opacity of the regime and their non-binding status), the guidelines also share considerable accountability and legitimacy risks, not least given CESR's tendency to use level 3 to achieve solutions which were subsequently either rejected, or regarded as not appropriate for level 2.[38] While guidance is formally

[24] CESR, *2007 Work Programme for the Committee of European Securities Regulators* (2006), CESR 06–627, 2.

[25] CESR/07–44. [26] CESR/04–434b. [27] CESR/05–054b.

[28] CESR/04–505b and CESR/06–562b.

[29] CESR/07–337 and CESR/07/337b.

[30] CESR/07–228b. [31] CESR/07–320. [32] CESR/06–552c.

[33] CESR/07–301. [34] CESR/04–561.

[35] CESR/03–073 and CESR/03–317B.

[36] See note 15, above.

[37] As was the case, e.g. with respect to its resolution of double reporting by branches under MiFID's transaction reporting regime under CESR's Branch Protocol (CESR/07/672).

[38] There are elements of this in CESR's level 3 guidance on the UCITS III eligible assets regime e.g., and in its 2007 level 3 guidance on the determination of inside information under the market abuse regime. In the latter, CESR included guidance on the definition of inside information in the form of examples of how inside information might arise;

non-binding, regulatory guidance has traditionally been regarded by the market as tantamount to regulatory fiat. CESR has also recently become more confident in its assertions as to the potential effects of level 3 and in seizing the initiative as to the appropriate characterization of level 3, which remains elusive.[39] It has suggested, in the context of the MiFID Q and A project, that while level 3 is not legally binding its 'legal effects' could include: being used by courts and tribunals in interpreting level 1 and 2 measures; being 'of relevance' in enforcement action taken by a competent authority; and 'creating relevant considerations and legitimate expectations', particularly with respect to the predictability of actions taken by competent authorities.[40] Given that the MiFID level 3 matrix includes best execution Q and A guidance by CESR to the effect that connection by an investment firm to one execution venue might meet the best execution obligation, which seems, optically at least – firms remain subject to competitive pressures – to subvert the concentration-abolition principle on which MiFID is based, this is not an assertion to be taken lightly. Similarly, it has suggested that its level 3 guidance on the transparency regime might provide a safe-harbour for market participants.[41] While the ambitious reach of CESR's characterization of its guidance may represent a degree of wishful thinking by CESR, it is also unlikely that CESR's pronouncements, as authoritative statements from Europe's regulators, will be ignored in judicial and enforcement proceedings.

But the guidance is generally rooted in the level 1 and 2 regime (although this was not the case with the ill-fated clearing and settlement initiative), is typically stated not to conflict with or subvert level 1 and 2 rules, and level 2 discussions have seen the Commission and ESC negotiations move particular standards to level 3, as was the case with the UCITS III regime. CESR's efforts to bolster the legitimacy of the guidelines are also clear, as discussed later in this chapter. A more tentative approach to the adoption of guidance also appears to be emerging. CESR's July 2007 Call for Evidence on the Transparency Directive level 3 regime suggested some reluctance to engage in an extensive

these are closely based on the additional guidance provided by CESR in its earlier level 2 advice and which was not adopted at level 2.

[39] See e.g., City of London Group, *Level 3 of the Lamfalussy Process. Submission to the Inter-Institutional Monitoring Group By a Group in the City of London* (2007), www.cityoflondon.gov.uk.

[40] CESR/07–704c, 3.

[41] CESR/07–043.

programme,[42] while its post-consultation Feedback Statement (February 2008) was similarly restrained, reflecting some market support for no action at level 3 given the premature state of the regime.[43]

Perhaps in a reflection of the accountability risks of its guidance, as well as CESR's growing sophistication in developing level 3 tools, it has also embraced softer forms of intervention. The prospectus regime, for example, has seen the adoption of a regularly updated and well-received Q and A document which allows CESR to respond rapidly to market and supervisory concerns.[44] It does not require a consensus CESR position and identifies dissenting opinions – although, in a reflection of CESR's potential to build supervisory convergence, these are reducing. A FAQ document has also been used to explain the Accepted Market Practice regime which is of central importance with respect to the determination of market manipulation under the market abuse regime.[45] The development of a MiFID Q and A is a priority for CESR's MiFID level 3 agenda.[46] But while FAQ initiatives carry considerable benefits in terms of speed and practicality, they also, in common with level 3 guidance more generally, have the potential to complicate further the already dense regulatory environment and obscure the distinction between binding and non-binding measures, increasing legitimacy and accountability risks.

CESR's influence over regulatory policy extends beyond level 3 guidance and level 2 advice. It has been closely involved in the preparation of the reviews and reports required of the Commission with respect to controversial MiFID provisions under MiFID Article 65 and which will frame future revisions to MiFID. In particular, it has been a significant actor in the sensitive discussions on whether MiFID's transparency regime should be extended to the debt markets. Although CESR has adopted a measured approach,[47] in principle the risks attached to CESR's legitimacy are added to the momentum risks which already attach to Article 65.

Although the Commission has shown some signs of avoiding over-reliance on CESR, perhaps in an attempt to limit its influence, it has also turned to CESR to develop new policy solutions, notably with respect to the reforms to the UCITS summary prospectus in which CESR is playing a key role in developing and, importantly, market testing disclosure formats. Most notably, perhaps, the turmoil in world credit markets in

[42] CESR/07/487. [43] CESR/08–066. [44] CESR/07–852. [45] CESR/05–365.
[46] CESR/07–704c, 2. [47] CESR/07–284b.

2007 saw the Commission turn to CESR for policy advice, particularly with respect to the rating by credit rating agencies of structured products.[48] While this development augurs well for the quality of new policy design post-FSAP, it also deepens CESR's influence and the legitimacy risks it poses.

B. Agenda-setting and policy activities

In the level 3 policy sphere, CESR is, notwithstanding the lack of a specific mandate, fast-developing a distinct policy towards the retail investor, including outreach activities to encourage investor involvement in law-making and investor education.[49] This development sees CESR acting independently as quasi-policy-maker and supporting the nascent retail investor interest. It also points to its ambitions in the policy sphere and its ability to take ownership over a high-profile policy area which carries considerable potential for institutional and political influence.

CESR has also been quick to exploit the blurred boundaries between securities market regulation and corporate governance, perhaps in a reflection of the current political high profile of corporate governance reform. It has drawn cross-border takeovers, which carry considerable potential for political sensitivity, into its ambit through its, thus far, relatively benign discussions on the practical operation of the takeover regime.[50] Auditors have also come within its ambit, with CESR's own-initiative activities including a survey of its members with respect to the relationship between the auditor and the public which asked, provocatively, whether direct communications between auditors and the public should be enhanced.[51]

Less controversially, CESR has also developed a monitoring role with respect to EC financial markets more generally. Its 2006 Report contains

[48] Commissioner McCreevy requested that CESR examine the rating of structured-finance products as a 'matter of urgency': letter from Commissioner McCreevy to CESR (11 September 2007), attached to CESR's 12 September 2007 Press Release on the Commission's Additional Request to Review the Role of Credit Rating Agencies, CESR/07–608.

[49] CESR's 2007 Work Programme, e.g., highlighted 'engaging retail investors more effectively' and 'investor information' as specific priorities: CESR/06–627. Notable initiatives include CESR's MiFID guide for retail investors: CESR, *A Consumer's Guide to MiFID. Investing in Financial Products* (2008).

[50] CESR, *2007 Interim Report on the Activities of CESR* (2008), CESR/07–671, 27.

[51] CESR, *2007 Interim Report on the Activities of CESR* (2008), CESR/07–671,14.

an extensive discussion of overall market trends and risks.[52] While this might appear to be among the less glamorous and contentious of its level 3 activities, it nonetheless cements CESR's position as an authoritative voice on financial market policy.

Chief among its general policy initiatives, however, are those in support of supervisory convergence and, in particular, the development of a European 'supervisory culture'. CESR has been charged with reporting on progress on supervisory convergence to the Council's Financial Services Committee, which places it at the heart of the efforts to support convergence. More mundane practical CESR initiatives, but which should reap considerable convergence benefits, include the development of staff exchange-programmes between CESR members and the development of a joint-training programme, which the 3L3 committees are developing under their Joint Steering Committee on Training.[53]

C. Monitoring and quasi-enforcement

CESR's monitoring activities are directed towards its members, in support of supervisory convergence, but they are also, and more controversially, market-facing.

In one of its most notable institutional contributions to supervisory convergence, CESR's Peer Review Panel, established in 2003 but recommended by the Lamfalussy Report, reviews the implementation by CESR members of CESR guidelines and standards and, where requested by the Commission, of Community rules. The Panel, which represents an innovative, self-disciplining technique for monitoring CESR members, has the potential to drive strong convergence, although only as long as peer pressure and reputational dynamics are effective.

But there is also a more troublesome market-facing dimension to CESR's quasi-enforcement activities. Notably, it reviews compliance by credit rating agencies with the 2004 IOSCO Code of Conduct for Rating Agencies. This innovative joint venture between CESR and the industry, based on a voluntary agreement, gives CESR the colour of a European regulatory and supervisory agency. Its first report in January 2007 included, for example, a warning to the industry concerning the lack of progress in the separation of rating business from other business lines in order to manage conflicts of interests.[54] CESR also carries out a more

[52] CESR, *Annual Report* (2006), 10–19.
[53] CESR, *Annual Report* (2006), 26.
[54] CESR/06–545.

indirect and lighter monitoring role, in conjunction with other actors, with respect to the Code of Conduct on Clearing and Settlement through the Code's Monitoring Group.

D. Supporting supervision, enforcement action, and institutional innovation

CESR's supervisory-convergence activities are supported by its rapidly developing operational structures which support supervision and the coordination of national enforcement strategies. The MiFID regime, for example, is notable for the practical initiatives adopted by CESR to support passport notifications and the supervision of branches.

With respect to enforcement, the market abuse regime is notable for the operational structures which have been developed by CESR-Pol, a permanent operational group within CESR which addresses the surveillance of securities markets and cooperation concerning enforcement and information exchange. Key operational developments include the establishment of the Urgent Issues Group and the Surveillance and Intelligence Group and the construction of an enforcement database. Operational innovation is also evident in the financial reporting sphere where CESR-FIN, a permanent operational group which coordinates enforcement of IFRS by CESR members, has established the European Enforcers' Co-ordination Sessions as well as a database on enforcement decisions. In a significant move towards the promotion of stronger supervisory convergence, CESR has also developed a mediation mechanism to support supervisory convergence and resolve supervisory disputes between national authorities.[55] Particular care appears to have been taken here to respect institutional sensitivities. A concern not to subvert institutional competences, particularly with respect to the interpretation of rules, can be seen in the development of the mechanism.[56]

E. Operational initiatives: supporting trading transparency and issuer disclosure

One of the most striking features of post-FSAP securities regulation has been the extent to which EC securities regulation has begun, slowly, to encompass operational measures in support of regulatory objectives. While the operational regime is, as yet, embryonic, CESR has

[55] CESR/06–286b.

[56] CESR, *Annual Report* (2005), 48–9 and CESR, *Annual Report* (2006), 53–4.

considerable potential to provide an operational capacity which supports the post-FSAP regulatory regime and to provide a focal point for the articulation of industry and regulatory interests.

In particular, CESR has emerged as a key player in the development of the electronic network of Officially Appointed Mechanisms, which is designed to consolidate the distribution of ongoing issuer disclosure. CESR has also supported the development of a pan-EC dissemination system for trading transparency disclosures (under MiFID) by adopting level 3 guidelines which govern dissemination channels and, significantly, are designed to support the consolidation of information flows. Both initiatives are characterized by their hybrid nature: high-level principles are designed to support market-led innovation. While the success of this approach remains to be seen, it represents an important sea-change in the regulatory orientation of EC securities regulation.

MiFID's transparency and transaction reporting regime has also seen considerable operational innovation led by CESR-Tech. Notably, the TREM (the Transaction Reporting Exchange Mechanism) project, although problematic, has seen the construction of a system which allows CESR members to exchange reports and adopts particular format and coding standards for reports.[57] CESR also maintains a series of databases which support MiFID obligations, chief among them the Database on Shares Admitted to Trading on a Regulated Market,[58] which includes the important list of 'liquid shares' which are key to the application of MiFID's transparency regime.

F. A distinct supervisory capacity?

CESR's level 3 activities thus far have been confined to supporting supervisory convergence within the network of home and host supervisors which police EC securities regulation. The scale of these activities alone gives some pause. But, and leaving on one side the debate as to the appropriateness of a Euro-SEC, there have been some straws in the wind which, given CESR's tendency to acquire influence organically, and its broadly

[57] CESR/07–739 and CESR/07–627b. TREM is used to exchange reports between CESR members but the project also acts as a platform for trialling technical issues concerning national transaction reporting, particularly with respect to the technical codes used by firms. For a discussion see CESR, *Annual Report* (2006), 46.

[58] CESR/07–718. CESR has also published a guide on how the database can be used (CESR/07–370b).

positive relationship with the market, might, if only tentatively, point to a more formal, limited supervisory capacity were political conditions to change.

The development of the issuer-disclosure dissemination regime, for example, saw some suggestions that CESR might act as the supervisor of the new electronic network, although the Commission ultimately resiled from this approach in favour of a 'workable solution' based on network supervision. CESR initially harboured far-reaching ambitions in this regard. Although the Himalaya Report rejected the central supervisor model, it initially floated whether CESR should acquire a capacity for 'EC decision making', including with respect to pre-clearance of innovative products and approval of, for example, standardized UCITS and the supervision of trans-European infrastructures.[59] More recently, however, a sharper awareness of the legitimacy risks to its position, and perhaps, a realization of the possibilities afforded through level 3, appears to have reduced its enthusiasm for the political maelstrom any such transfer of power would generate.[60]

G. Institutional and market links

CESR's influence and capacity to drive supervisory convergence is only likely to increase as cross-sector links strengthen, new advisory bodies are developed post-FSAP, and as the institutional structure which supports financial market policy development fragments, thereby increasing CESR's influence as the actor with policy links across all the major actors. It has, for example, observer status on the European Securities Markets Expert Group which advises the Commission on financial market policy. It has close links with the European Central Bank, as is clear from its clearing and settlement activities. It sits on the Monitoring Group which oversees market implementation of the novel Code of Conduct on clearing and settlement. The level 2 process has seen it develop close links with the Commission and the Parliament. Formal links have been made with its parallel 3L3 committees in the banking and insurance/pensions area through the 3L3 Joint Work Programme on issues of common concern, such as credit rating agencies, financial

[59] Himalaya Report 2004, 17.

[60] In its 2007 Securities Supervision Report CESR stated clearly that it was 'not advocating for the creation of an EU single regulator embedded within the Treaty': CESR, *A Proposed Evolution of Securities Supervision Beyond 2007* (2007), CESR/07–783, 6.

conglomerates and regulatory arbitrage in product regulation.[61] CESR is also developing considerable political influence and contacts. It increasingly acts as a high-level adviser to the Council by reporting to its Financial Services Committee on supervisory convergence and to the Financial Stability Table of the Council's Economic and Financial Committee on issues related to the overall stability of the EU financial system.[62]

Through its extensive consultation procedures, CESR has driven largely national, if vocal and well-resourced, market interests to adopt more sophisticated and networked pan-EC lobbying models.[63] It now has strong links to the markets which are only likely to intensify. This is all the more the case as it seems to be in the very early stages of developing a quasi-lobbying role for market interests under the level 3 prospectus regime, where CESR has suggested that market reaction to the Q and A could act as a driver for supervisory convergence.[64] Support from the market could also act as a bulwark against accountability charges,[65] although there are some indications of nervousness in some quarters as to the extent of CESR's reach, particularly with respect to its market abuse initiatives.[66] Tellingly, CESR engaged in an extensive consultation over 2007 on the industry's and stakeholders' assessment of CESR's activities from 2001–7.[67]

[61] See, e.g., CESE, CEBS, CEIOPS, *3L3 Medium Term Work Programme. Consultation Paper* (2007) (CESR/07–775).

[62] CESR's FST reports have covered market conditions as well as cross-sector reviews (with CEBS and CEIOPS) of the bond markets, financial conglomerates, regulatory arbitrage, and offshore financial centres (CESR, *Annual Report* (2006), 65, 74).

[63] See e.g. the London Investment Banking Association's (LIBA) construction of networks with other European trade associations in order to engage more effectively with CESR's MiFID consultations. LIBA, *Annual Report* (2005), Chairman's Statement.

[64] This is clear from the dissenting views of competent authorities on particular questions which were identified in the 2006 Q and A (along with the Commission's position in some cases). The 2007 Q and A, by contrast, did not contain any dissenting opinions in the new material included, suggesting that CESR's view that publication of the dissenting views would 'foster a wider debate among market participants which the CESR members with diverging views might find useful in considering their previous positions' was well-founded: CESR, *CESR's Report on the Supervisory Functioning of the Prospectus Directive and Regulation* (2007), CESR/07–225, 9.

[65] See e.g. market support for further CESR convergence activities under the prospectus regime: Supervisory Functioning of the Prospectus Report 2007, 3.

[66] See e.g. the response by APCIMS to CESR's 2006 consultation on what would become the 2007 level 3 guidance in which it expressed a wish that no further guidance be adopted and noted a general view to that effect. Available on www.cesr-eu.org.

[67] CESR/07–499.

Although the consumer interest remains lamentably and dangerously under-represented in financial market consultations, CESR is also building links to the nascent retail investor lobbying community through initiatives such as its MiFID Consumer Day, its commitment to preparing consumer-friendly versions of consultation papers, and its recent initiatives to develop investor governance and education.

CESR's growing stature and influence also reflects deepening transatlantic links. Although high level and increasingly successful political contacts between the Commission and the SEC occur through the US–EU Financial Markets Regulatory Dialogue,[68] CESR is emerging as the main point of contact for regular, operational SEC negotiations and has entered into an agreement with the SEC on cooperation and collaboration on market risks and regulatory policy.[69] It has also entered into a formal agreement with the SEC on the enforcement of IFRS application, which placed it close to the highly sensitive but ultimately successful EU/US negotiations on IFRS/US GAAP reconciliation. Its links with IOSCO are also deepening, as its January 2007 report on credit rating agencies makes clear. CESR's ambitions in this sphere are considerable. It regards itself as increasingly the 'advocate of common interests' of CESR members internationally and has called for a more direct role in international negotiations, in order to limit supervisory competition with respect to third country market access in particular. Notably, it has called for a role in the developing negotiations with the SEC on the mutual recognition of supervisory regimes – one of the most significant recent developments in international securities regulation – and suggested that it play a more direct role in the US–EU Financial Markets Regulatory Dialogue.[70]

CESR therefore sits at the centre of an increasingly complex institutional web and is developing strong links to market and consumer interests. It looks set to have a unique institutional and market perspective and influence on policy formation.

[68] For a review of its current activities see Commission, *Single Market in Financial Services Progress Report 2006,* SEC (2007) 263, 7–9. The resolution in early 2007 of the dispute concerning the de-listing of EU issuers from US exchanges in the wake of Sarbanes-Oxley, as well as the November 2007 decision by the SEC to lift the US GAAP reconciliation requirement for accounts prepared in accordance with IFRS, count as major successes of the Dialogue.

[69] CESR, *Annual Report* (2006), 70.

[70] CESR, *Securities Supervision Report* (2007), 6.

III. Accountability and legitimacy risks

All this has developed organically from the original 2001 Commission Decision which established CESR as part of the Lamfalussy process and as an independent advisory group on securities, to advise the Commission, either on the Commission's initiative or on its own initiative, in particular with respect to level 2 measures (Article 2). The Decision does not refer directly to supervisory convergence activities, although they are covered in CESR's Charter.[71] The Lamfalussy Report simply recommended that level 3 produce guidelines on implementation, develop recommendations and standards on issues not covered by EU law, and define best practice. CESR has deepened and widened this initial characterization of level 3 through its 2004 Level 3 Report and the Himalaya Report and, more tellingly, by its recent practice. Although both 2004 Level 3 reports were, for the most part, accepted by the institutions,[72] recent practice suggests that CESR's influence now has an organic and dynamic character. But there is no formal legal basis for CESR's activities.

CESR's formal accountability is minimal.[73] It is not formally accountable to the Member States or the EU institutions and sits somewhat adrift in the institutional structure. It declares itself as independent[74] and the foundation Decision establishing CESR simply required CESR to present an annual report to the Commission (Article 6) and to maintain close operational links with the Commission and the ESC (Article 4).

[71] Art. 4 provides that CESR is to 'foster and review' common and uniform day-to-day implementation and application of Community legislation, issuing guidelines, recommendations and standards to be adopted by CESR members in their regulatory practices on a voluntary basis (Art. 4.3). It also provides for the establishment of the Review Panel. Level 3 is also reflected in Art. 4.4 which provides that CESR is to develop effective operational network mechanisms to enhance day-to-day consistent supervision and enforcement of the single market for financial services.

[72] See e.g.: Commission, *The Application of the Lamfalussy Process to EU Securities Market Legislation* (2004), 10; European Parliament, *Van den Burg Resolution on the Current State of Integration of EU Financial Markets* (2005), T6–0153/2005 (based on the Economic and Monetary Affairs Committee, *Van den Burg Report* (2005) (A6–0087/2005)), B.12; and ESC Minutes 15 December 2004, albeit that all, presciently, expressed reservations as to accountability.

[73] For a recent exploration of accountability in the context of the comitology process (which CESR engages in at an early stage through its level 2 advice to the Commission) see D. Curtin, 'Holding (Quasi-) Autonomous EU Administrative Actors to Public Account', *European Law Journal,* 13 (2007), 523.

[74] CESR's Annual Report for 2004 describes CESR as 'an independent Committee of European Securities Regulators': CESR, *Annual Report* (2004), 66.

Very little is known as to the dynamics of CESR decision-making at level 2. This difficulty persists at level 3 (and with respect to the adoption of CESR guidance in particular) where consensus (unanimity minus one or two)[75] dominates. This opacity as to its regulatory philosophy and decision-making dynamics therefore obscures the interests and traditions which inform the quasi-regulatory and supervisory choices it makes for the integrated financial market. The stakes are high as the constitutional controls exerted by the level 2 process and Commission/ESC/Parliament oversight are removed and given the rate at which CESR has acquired influence over the markets.

The institutions have, however, become more alert to the growing influence of CESR,[76] with concern that CESR may operate in a 'grey zone where political accountability is unclear'.[77] The European Parliament was the most vocal in the initial calls for greater CESR accountability. In the 2005 Van den Burg Resolution, and in order 'to guarantee democratic accountability', it called for CESR (and CEBS and CEIOPS) to report semi-annually to the Parliament.[78] Somewhat more aggressively, Parliament attached the utmost importance to 'guaranteeing the political accountability of the supervisory system' and noted 'gaps in parliamentary scrutiny and democratic control particularly with respect to work undertaken at level 3'. It urged all 3L3 committees 'to pay the utmost attention to providing a sound legal basis for their actions, avoiding dealing with political questions and preventing prejudice to upcoming Community law'.[79] Given the relatively limited reach of level 3 in 2005, Parliament's hostile reaction can be linked to its severe criticism in 2005 of the CESR-ESCB Standards on Clearing and Settlement which launched an inter-institutional fracas, given the attempt to embue the Standards, which do not derive from a level 1 or level 2 measure, with a quasi-binding quality, and which saw the Parliament deliver a stinging rebuke to CESR as to the need for its actions to have a legal base and for stronger accountability. [80]

[75] CESR, *Securities Supervision Report* (2007), 4.

[76] Prior to the explosion in level 3 activities, the reaction was more sanguine. The Council's Economic and Financial Committee reported in 2002 that accountability mechanisms employed by CESR (in the form of reporting obligations and consultation procedures) were adequate: EFC, *Report on Financial Regulation Supervision, and Stability* (2002), 19

[77] As described by certain (unidentified) ESC delegations: ESC Minutes 15 December 2004.

[78] Van den Burg Resolution 2005, B.14. [79] Van den Burg Resolution 2005, B.19.

[80] *European Parliament, Resolution on Clearing and Settlement in the EU* (2005), P6_TA(2005)0301, paras 18–22.

The Commission also, albeit less vocally, has raised accountability concerns, as has the European Central Bank.[81] In its 2004 Report on the Lamfalussy Process, for example, the Commission expressly addressed level 3 accountability risks and called for a clearer articulation of the role of level 3, particularly with respect to protecting the institutional prerogatives of the Council, Parliament and Commission.[82]

IV. Constructing an accountability model

A. Institutional links

But CESR's political antennae appear to be sensitive. It clearly feels the need to develop a model for its accountability and legitimacy, perhaps in order to avoid the imposition of an unattractive model. Recent Annual Reports, for example, contain repeated references to CESR's efforts to develop accountability structures.[83]

CESR initially responded by 'establish[ing] clearer accountability links with Council Committees and with the European Parliament' over 2005. A new accountability framework with the Parliament was formalized in September 2005 which is, in essence, based on frequent reporting by CESR to the Parliament. Parliamentary relations are a recurring theme of CESR's annual and interim reports.[84] Annual and half-yearly reports are addressed to the Commission, as required in CESR's founding Decision, but also to the Parliament and the Council. CESR has also developed close links with Council's Financial Services Committee through its supervisory convergence reports. CESR regards these reports as strengthening its accountability,[85] although they might be

[81] European Central Bank, *Review of the Application of the Lamfalussy Framework to EU Securities Market Legislation* (2005), 7–8.

[82] Commission Lamfalussy Process Report 2004, 4. Writing in 2005 Internal Market Director General Schaub warned that level 3 could not prejudice the political process: A. Schaub, 'The Lamfalussy Process Four Years On', *Journal of Financial Regulation and Compliance,* 13 (2005), 110–16.

[83] The 2005 Annual Report contains a section on accountability and reporting to the EU institutions (CESR, *Annual Report* (2005), 72–3, while accountability is prominent in the Chairman's statement (at 5). The 2006 Report contains extensive discussion of CESR's reports to the European Parliament: CESR, *Annual Report* (2006), 75.

[84] The 2007 Interim Report e.g. notes the concern of CESR's Chairman to build on the good relationship established with the European Parliament: CESR, *Interim Report* (2007), 30.

[85] See e.g. CESR, *First Progress Report on Supervisory Convergence in the Field of Securities Markets for the Financial Services Committee* (2005), CESR/05–202, 2.

better regarded as opportunities for CESR to extend its political influence: CESR has publicly characterized the 2006 ECOFIN conclusions on supervisory convergence[86] as 'explicit support for the work of CESR'.[87]

As discussed below with respect to MiFID, it also now appears to be anxious to engage the Commission more fully in its decision making and to capture, albeit informally, the legitimacy which may flow from the Commission's tacit approval, if not endorsement, of its activities. This approach may be wise. Recent evidence from the Commission's approach to the development of policy in new and sensitive areas such as bond market transparency, hedge funds and private equity, sees the Commission drawing on a wide range of market and institutional opinion and reducing the risks of over-reliance on CESR. The Commission's somewhat benign public statements on CESR's problematic accountability model (certainly by comparison with the Parliament's trenchant views) appear to have been counter-balanced by an institutional determination in practice not to yield too much power to CESR. In its initial strategy report on the highly-sensitive extension of MiFID's transparency regime beyond the equity markets,[88] the Commission's consultation strategy included advice from CESR but also from ESME, FIN-USE (on retail interests) and other expert groups. Although CESR has since become the first port of call for large-scale regulatory design questions (such as the UCITS disclosure review) and live policy challenges (with respect to the 'credit crunch'), the Commission now has a variety of expert groups as its disposal.

B. The MiFID example

Attempts to build an accountability model can also be traced in CESR's recent level 3 activities which represent a more careful attempt to address the legitimacy of its actions than earlier pronouncements.[89] Although

[86] 2726th ECOFIN Meeting, 5 May 2006, Press Release 8500/06.

[87] CESR, *Interim Report* (2006), 24.

[88] Commission, *Call for Evidence, Pre- and post-trade transparency provisions of MiFID in relation to transactions in classes of financial instruments other than shares* (2006).

[89] CESR initially related the legitimacy of its level 3 role, rather tenuously, to the 'fact that CESR members take decisions on a daily basis that create jurisprudence. This bottom-up approach relates to the normative nature of concrete decision-making activities of the supervisors. The impact of precedents on decisions is determined by the law and cannot be fully controlled by legislators. In addition, in an integrated European market, the jurisprudence created by supervisors produces effects that cannot be limited to national jurisdictions and therefore must be considered at EU level: A.-D. Van Leeuwen, (first CESR Chairman) and F. Demarigny, (CESR Secretary General), 'Europe's

CESR is clearly anxious to protect its level 3 agenda (it has stated in uncompromising terms that it is 'master of its own agenda' at level 3)[90] it appears acutely aware of the accountability risks of its level 3 guidance and seems to be developing a response. The MiFID level 3 regime is particularly instructive in this regard.

In October 2006 CESR presented its first MiFID level 3 agenda,[91] following an earlier consultation which revealed considerable market unease as to its scale.[92] The MiFID level 3 process has emerged as largely driven by the Commission and by 'cascades' from level 1 and level 2, rather than by CESR-driven initiatives. A substantial proportion of the initial level 3 agenda concerned the extensive reporting and review obligations required of the Commission under MiFID Article 65. Cross-sector convergence was also a dominant theme; the initial agenda included a number of initiatives of common concern to the banking, pension, insurance and securities sectors.

The more troublesome quasi-regulatory standards or guidance also formed a central part of the initial MiFID level 3 agenda. But it yields intriguing evidence as to CESR's approach to legitimacy risks. The inducements regime, in particular, saw CESR harnessing the Commission to its cause and thereby cloaking its quasi-regulatory activities with the mantle of the Commission's authority. The Guidance notes that the Commission participated in CESR's development of the recommendations on inducements as an observer, that CESR discussed the interpretation of relevant MiFID legal obligations with the Commission, and that the Commission agreed with CESR's interpretations and considered that the recommendations did 'not go beyond the MiFID regime but flow[ed] from a normal, natural reading of MiFID and the Level 2 Directive'.[93] This might be tentatively described as a quasi-endorsement process had CESR not already vehemently rejected any institutional endorsement of its level 3 standards under the market abuse regime.[94] It might be better

securities regulators working together under the new EU regulatory framework', *Journal of Financial Regulation and Compliance*, 12 (2004), 206 (at 4 of the online version).

[90] CESR, *2006 Report on Supervisory Convergence in the field of Securities Markets* (2006), CESR/06–259b, Summary (in the context of the market abuse regime).

[91] CESR/550b.

[92] See the joint response of a group of leading financial market trade associations to CESR's consultation (12 September 2006). It expressed concern that the work programme was 'more extensive and ambitious than necessary'.

[93] CESR/07–228b, 3.

[94] One respondent to CESR's initial consultation on the market abuse level 3 guidance suggested that the AMP list being drawn up by CESR members in accordance with CESR's

described as an aspect of the multi-level, evolutionary, and pragmatic accountability model which CESR is beginning to develop. It also reflects CESR's concern to bolster the validity of its guidance in the face of fierce market hostility, particularly where questions arise as to the legal base of its activities. The inducements regime generated severe market hostility as to its scope and its relationship with the MiFID regime (in particular its basis in the Article 19(1) 'best interests' obligation rather than in the narrower MiFID conflict-of-interest regime) and appears to have led CESR to rely on the Commission to buttress its authority.

CESR's October 2007 Protocol on the Supervision of Branches, adopted just prior to the application of MiFID in November 2007, is also revealing.[95] In an example of a developing dynamic between CESR and the Commission which supports accountability, and under which the Commission provides additional guidance on the scope of legal obligations and CESR develops operational responses (the best execution regime, discussed below, provides another example), CESR asked the Commission for an interpretation as to the meaning of Article 32(7), and the division of responsibilities between home and branch Member States, on which it could build a practical mechanism for the supervision of branches.[96] This followed in the Commission's June 2007 advice on Article 32(7).[97] But CESR's heightened sensitivity to accountability risks, and its concern to maintain its independence, are both apparent in its subsequent Protocol. It took some care to distance itself from the Commission's advice and to place the Protocol in the context of its previous level 3 guidance on the passport. CESR noted that the Commission's advice was a 'helpful contribution' that set out various scenarios and which it used as background in developing the Protocol, but that the advice did not form part of any CESR arrangements. A concern to avoid a perception of over-reaching its competences at level 3 seems implicit in the robust statement that it was not for CESR to address the legal interpretation of Article 32(7) and that it neither endorsed nor challenged the Commission's advice.[98] The Protocol does not therefore address the difficult questions as to which competent authority is responsible for branch

level 3 procedures be approved by the European legislature. CESR trenchantly responded that there was no legal or other justification for this: CESR/05–274, 9.

[95] CESR/07/672.

[96] CESR/07–337, 7.

[97] Commission, *Supervision of Branches under MiFID* (2007), MARKT/G3/MV D (2007).

[98] CESR/07–337, 2.

activity in specific cases, but establishes a cooperation framework which supports close coordination between competent authorities.

Although the Branch Protocol might suggest some distance between CESR and the Commission, evidence has emerged from the best-execution guidance of workman-like dialogue between the Commission and CESR in the construction of level 3 standards, which supports accountability. CESR made clear in its early position paper on best execution in February 2007 that its objective was 'supervisory convergence and not the making of new rules'.[99] Following deadlock in CESR as to the treatment of dealer markets, it also sought and received clarification from the Commission on the scope of the MiFID best-execution regime to anchor its work.[100] In addition, rather than adopt additional formal guidance in a highly controversial area which is already heavily regulated at level 1 and 2, CESR proceeded through a 'process-driven'[101] Q and A format which is designed to 'present [CESR's] views in a user-friendly way that facilitates compliance by firms and convergence among competent authorities…it presents CESR's answers to practical questions raised by firms and competent authorities'.[102] This is a practical and, in principle, 'light touch' response to the best execution issue and is designed not to impose additional obligations but to 'explain CESR's views on how firms can comply with the [MiFID regime] in the particular circumstances and situations that stakeholders have raised'.[103] In practice, however, market participants are likely to treat this guidance as a binding rule to reduce regulatory risk.

A restrained approach continued in CESR's 2007–8 MiFID work programme.[104] Notably, CESR's approach to the sensitive 'thematic' workstream which covers level 3 guidance and standards was economical and reflective of market concerns. Noting that the market and supervisors required time to adjust to the recent regulatory changes, it de-emphasized the guidance strand, focusing only on those areas highlighted by stakeholders as requiring guidance, including conflicts of interest, best execution, and soft commissions and unbundling. CESR has also

[99] CESR/07–050b, 4.

[100] CESR/07–050b, 4. The Commission responded at length. Letter from David Wright, Commission to CESR Chairman (19 March 2007), http://ec.europa.eu/internal_market/securities/isd/mifid_en.htm.

[101] CESR, *Interim Report* (2007), 18.

[102] CESR/07–320, 3.

[103] CESR/07–320, 3.

[104] CESR/07–704c. An earlier consultation took place (CESR/07–704).

frequently cautioned against moving measures from level 2 to level 3, even though level 3 gives more freedom to CESR. It was particularly concerned during the MiFID level 2 discussions that level 3 not be used to escape from political decisions at levels 1 and 2 and, in a clear concern to avoid legitimacy risks, that any transfer from level 2 to level 3 be made explicit in the level 2 measure 'in order to have the political backing of the EU institutions'.[105]

C. Consultation

Accountability is also enhanced through CESR's increasingly sophisticated consultation procedures. More indirectly, CESR has prompted market interests to adopt more sophisticated and networked lobbying models which should ensure that genuine European market expertise and legitimate concerns are reflected in its initiatives – as long as CESR remains uncaptured by the market interests which dominate consultations. The recent strengthening of its resources and capacity for cost–benefit analysis through the establishment of ECONET in summer 2006[106] should act as a counter-balance. CESR is also actively promoting the development of a retail lobby through its governance and education initiatives. The striking move by CESR into retail policy may, indeed, give considerable political weight to CESR's activities in the long term as well as dilute the risk that the well-organized market lobby could engender a market-facing bias in CESR's activities.

D. Tests for level 3 intervention

CESR has also voluntarily adopted a suitability test for deciding which activities it will undertake at level 3. It will only undertake work which meets three 'rigorous criteria': (i) a risk threshold (in that the issue addressed at level 3 represents a significant market failure or a repeated or major regulatory or supervisory failure); (ii) an EU threshold (in that the issue is likely to have an EU-wide impact on market participants or end-users and on the smooth functioning of single market); and (iii) an effectiveness threshold (in that CESR can contribute positively by

[105] ESC Minutes, 23 February 2005.

[106] ECONET was established in August 2006 as part of the wider reforms to CESR's operation. It is to evaluate, develop and maintain CESR's approach to impact analysis, in line with CESR's commitment to more extensive use of economic analysis and evidence-based methodologies.

creating change or through 'collective direct action' by CESR members).[107] Internal limits have therefore been imposed on the reach of level 3.

E. Charter reform

July 2006 saw CESR make the first changes to its Charter since its inception and a major change to CESR's decision-making structure.[108] The most important reforms concern CESR decision making. Article 5 of the CESR Charter[109] now provides for qualified majority voting with respect to level 2 advice. But the Charter also now provides that level 3 work which is expressly requested by Community legislation, or is directly related to Community legislation, must be subject to a unanimous vote where one or more members so requests. Where unanimity cannot be reached, the Commission must be informed.[110] Although this reform suggests the possibility of formal vetoes in limited circumstances, consensus is likely to remain the primary method for addressing level 3.

V. The 2007 Lamfalussy Review

The accountability and legitimacy of the level 3 process emerged again in the important 2007 Lamfalussy Review which saw input from the market,[111] think tanks[112] and the institutions.[113] Although radical institutional changes to the supervision structure were not suggested,[114] important reforms designed to strengthen accountability were proposed.

[107] CESR, *Supervisory Convergence Report* (2006), 2–3.

[108] CESR, Press Release 2 August 2006, CESR/06–303.

[109] CESR, *Charter of the Committee of European Securities Regulators* (2006), CESR/06–289c. Further reforms followed in 2008 after this book went to press.

[110] Charter, Art 5(7).

[111] See e.g. City of London Group 2007 and Deutsche Bank, *Towards a New Structure for EU Financial Supervision*, EU Monitor 48 (2007), 3.

[112] See e.g. E. Ferran, and D. Green, *Are the Lamfalussy Networks Working Successfully?* (A Report by the European Financial Forum) (2007) and the opinions issued by EUROFI for its December 2007 conference on Achieving the Integration of Financial Markets in a Global Context.

[113] The major reports and reviews included: Parliament Van den Burg Resolution 2007 (P6_TA (2007) 0338); the Commission, *Review of the Lamfalussy Process. Strengthening Supervisory Convergence* (2007); Inter Institutional Monitoring Group, *Final Report Monitoring the Lamfalussy Process* (2007) (which was based on consultation with the institutions and other key stakeholders, including market interests); and CESR, *Securities Supervision Report* (2007).

[114] The Commission e.g. argued that more ambitious institutional changes, such as the granting of independent rule-making power to the level 3 committees were not

But the essential legitimacy of the level 3 process and of CESR's activities was supported.

Reinforcement of the status of the level 3 committees, including CESR, was a recurring theme of the review which saw discussion of a possible strengthening of the level 3 committees through the regulatory framework[115] and through voting reforms – in particular greater use of qualified majority voting – although positions varied.[116] Related accountability concerns were also prevalent. Proposed reforms included the adoption by the institutions of general mandates for the 3L3 committees,[117] institutional endorsement of 3L3 work programmes by the EU institutions, and the submission of progress reports and reasons for failure to meet objectives.[118] The accountability discussion was also, and for the first time, framed in terms of national supervisors, with support for national supervisory mandates to refer to supervisory convergence obligations.[119]

CESR's approach to the Review warrants some attention given its earlier attention to developing its own accountability model. Despite its care to address accountability sensitivities, it has recently become more assertive in pointing to the limits of its non-binding level 3 guidance and the related threat to its credibility, particularly on the marketplace.[120] But it has opted for an approach which builds on peer

feasible given lack of agreement among Member States and stakeholders: Commission Lamfalussy Report (2007), 3.

[115] Inter Institutional Monitoring Group (2007), 14; Commission Lamfalussy Report (2007), 8; Van den Burg Resolution 2007, 55.

[116] The Inter Institutional Monitoring Group supported consensus as the default voting method, but suggested that the 3L3 committees operate under QMV in respect of specific delegations under level 1 and 2: Inter Institutional Monitoring Group (2007), 18. The Commission was more radical, concerned as to the difficulties posed by consensus decision making, and suggested that QMV be used for any measure aimed at fostering convergence: Commission Lamfalussy Report (2007), 9. The Parliament also supported QMV decision-making: Van den Burg Resolution 2007, para. 55.

[117] Commission Lamfalussy Report (2007), 7; Van den Burg Resolution 2007, para. 55.

[118] Inter Institutional Monitoring Group (2007), 17; Commission Lamfalussy Report (2007), 7; and Financial Services Authority and HM Treasury, *Strengthening the EU regulatory and supervisory framework: A Practical Approach* (2007), 7.

[119] Inter Institutional Monitoring Group (2007), 18; and Commission Lamfalussy Report (2007), 8.

[120] CESR argued that 'there is a gap between an informal (de facto) EU mandate given to CESR creating the expectation that rules will be applied in the same manner in the market, and the legal national accountability obligations of each CESR member that governs their daily activities. Uniform supervisory behaviour should not be expected by market participants within the current framework as CESR members may have no

pressure dynamics, and which reflects its generally nuanced approach to accountability risks, rather than calling for binding status to be, somehow, afforded to its guidance. It has maintained its commitment to consensus-led decisionmaking for level 3 initiatives.[121] But in addition to supporting the comply-or-explain technique with respect to findings of non-compliance by the Review Panel, it has also suggested that it adopt enforcement instruments, 'fundamentally reputational' in design.[122] Any 'enforcement-style' decisions would be subject to a qualified majority vote. This represents a significant hardening of CESR's peer pressure mechanisms. CESR has also called in aid from the enforcement powers of the Commission, suggesting that the Commission indicate that it would not ignore the existence of level 3 when exercising its enforcement powers. Building on its earlier attempts to establish a tailored accountability model, CESR also called for national supervisory mandates to include compliance with supervisory convergence – a shrewd move which allows CESR to strengthen compliance with its level 3 initiatives without opening the Pandora's Box which embuing level 3 guidance with binding force would involve.

The review process culminated with the important December 2007 ECOFIN Conclusions[123] which broadly reflect these themes and CESR's proposed reforms. The Conclusions did not support major institutional change, but represented a strong statement of political support for supervisory convergence/level 3 and for the work of the 3L3 committees. The key accountability recommendations included ECOFIN's call for the Commission to clarify the role of the 3L3 committees and to consider 'all options' to strengthen them – but with the caveat that the institutional structure must not be unbalanced.[124] Accountability was further addressed by the traditional reporting model developed by CESR, with ECOFIN inviting the 3L3 committees to submit a draft work programme to the Council, Commission and Parliament and to report annually on the achievement of the objectives set.[125] The non-binding effect of level 3 guidance, the voluntary nature of convergence, and the extent to which national supervisors could be bound against their will were also

alternative but to respect legitimate national discretions': CESR Securities Supervision Report 2007, 2.

121 CESR, *Securities Supervision Report* (2007), 4.

122 CESR, *Securities Supervision Report* (2007), 5.

123 2836th ECOFIN Meeting, 4 December 2007, Press Release 15698/07.

124 December 2007 ECOFIN Conclusions, 17.

125 December 2007 ECOFIN Conclusions, 17.

major themes of the Conclusions. ECOFIN took a compromise position and requested the 3L3 committees in order to enhance the efficiency and effectiveness of their decision-making procedures, to introduce the possibility of qualified majority voting. But it also acknowledged that decisions would remain non-binding and suggested that, as proposed by CESR, the comply-or-explain model be used to drive compliance.[126] ECOFIN also supported the adoption of supervisory-convergence mandates in national supervisory mandates, although it was not prescriptive and simply recommended that Member States consider including in the mandates of national supervisors the task of cooperating within the EU and working towards supervisory convergence.[127]

CESR's careful attempts to address accountability risks appear therefore to have reaped dividends as, overall, CESR has emerged strengthened from the 2007 Review (not least given the ECOFIN commitment to strengthening its funding model and addressing the severe resource strain under which CESR now operates). The Commission's strong support for supervisory convergence, and its enthusiasm for CESR's decisions to be afforded akin-to-binding authority (through its support of qualified majority voting in particular) during the Review, suggests that it had reached an accommodation with CESR's burgeoning powers, while the European Parliament also appears more sanguine as to accountability and legitimacy risks.[128] The 2007 Review also saw strong political support for CESR's activities which suggests that CESR members should not face too many domestic political conflicts. The risk of a change in the political climate cannot, however, be ruled out. Although some tensions persist, notably with respect to CESR's voting mechanisms and its role in international relations, the scale of CESR's activities at level 3 now appears to have institutional backing.

The range of CESR's activities, and its key role as the driver of supervisory convergence, raises complex accountability and legitimacy issues which reflect the wider complexities of the dynamic process whereby the disciplines of the financial markets are established by a range of actors. CESR's accountability model looks set to develop as a hybrid, based for the most part on indirect, reporting and consultation accountability

[126] December 2007 ECOFIN Conclusions, 17.

[127] The FSC and EFC were mandated to consider this issue.

[128] The 2007 Van den Burg Resolution 'welcomed' the work of the 3L3 committees at level 2 and their progressing of the convergence agenda 'without overstepping their remit' or attempting to replace the legislators, and argued that their work must be encouraged: Van den Burg Resolution 2007, para. 53.

links, but also placed cleverly within national supervisory and accountability structures. The current dynamic period may well see the emergence of an optimal model which reflects the particular functions CESR exercises and the particular accountability risks it poses. The indications also continue to suggest that CESR will remain careful to tread lightly in expanding the boundaries of level 3. Notably, CESR members appear to be uncertain as to the wisdom in seeking binding status for level 3,[129] reflecting a grasp of political realities which augurs well for its future stability.

[129] CESR, *Securities Supervision Report* (2007), 7.