



COMMISSION OF THE EUROPEAN COMMUNITIES

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**COMMUNICATION FROM THE COMMISSION**

**Review of the Lamfalussy process  
Strengthening supervisory convergence**

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#### 1. INTRODUCTION

A dynamic and healthy financial sector is crucial for the proper functioning of the European economy and for global competitiveness. Financial services are extremely important for European consumers and companies, large and small, who want a wide range of financing options and to rely on high-quality and secure products and institutions that are well managed and supervised. This requires a solid European framework for the regulation and supervision of the financial sector.

The launch of the Lamfalussy process in 2001 aimed at putting in place an efficient mechanism to begin converging European financial supervisory practice and enable Community financial services legislation to respond rapidly and flexibly to developments in financial markets. Under this new approach financial regulation is passed in two levels.

At "**Level 1**", framework legislation setting out the core principles and defining implementing powers is adopted by co-decision after a full and inclusive consultation process in line with the better regulation disciplines.

The technical details are formally adopted by the Commission as implementing measures at "**Level 2**", after a vote of the competent regulatory Committee (the European Securities Committee, the European Banking Committee and the European Insurance and Occupational Pensions Committee). In the Level 2 process the Commission takes careful account of the European Parliament's position. For the technical preparation of the implementing measures, the Commission is advised by Committees, made up of representatives of national supervisory bodies, referred to as the "**Level 3**" **Committees** – the Committee of European Banking Supervisors – CEBS, the Committee of European Insurance and Occupational Pensions Supervisors – CEIOPS and the Committee of European Securities Regulators – CESR. These Committees set up by Commission Decisions<sup>1</sup> also have an important role to contribute to consistent and convergent implementation of EU directives by securing more effective cooperation between national supervisors and the convergence of supervisory practices. This is "**Level 3**" of the process. "**Level 4**" is where the Commission enforces the timely and correct transposition of EU legislation into national law.

This four-level, comitology-based regulatory approach for financial services has been in place for more than five years in the securities sector and for more than two years in banking and insurance. Directive 2005/1/EC which established the new organisational structure for financial services committees requires the Commission to carry out a review of the Lamfalussy process by the end of 2007. This is an appropriate time for review. EU financial markets have undergone important changes over the last years. European financial market integration is accelerating. Financial institutions are increasingly conducting their business outside their home market. Financial products are increasingly dealt with on a pan-European basis. Market concentration is increasing, as is product innovation and complexity. Mergers and acquisitions are increasingly on a cross-border and cross-sectoral basis.

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<sup>1</sup> Commission Decisions 2001/527/EC, 2004/5/EC and 2004/6/EC establishing CESR, CEBS and CEIOPS, respectively.

The recent market turbulence has shown how interconnected markets are becoming – and injecting an added degree of urgency to evolve the EU supervisory framework in line with these new market realities.

In spite of these achievements, there is a growing consensus that some future evidence-based, practical improvements are needed in the operation of the current EU supervisory framework. In October 2007, the ECOFIN Council agreed to take further steps to develop the arrangements for cross-border financial stability within the EU. The enhancement of the Lamfalussy framework is a necessary complement to these steps. In October, the Inter-institutional Monitoring Group (IIMG) published its final report which examined the functioning of the Level 3 Committees. The Financial Services Committee should also come forward with a report on long-term supervisory issues and convergence. All of these reports will trigger a debate at political level, with a view to formulating concrete recommendations in 2008.

This review presents some practical, necessary and achievable improvements to the Lamfalussy process. These will encourage deeper cooperation between national supervisory authorities and ensure greater consistency and convergence in national implementation and enforcement. The Commission considers that at this stage more ambitious institutional changes such as granting of independent rule making powers in Level 3 is not feasible given, inter alia, the lack of agreement among Member States and other stakeholders. This is in particular due to the complexity of the issues at stake in the financial sector (where there are different supervisory arrangements for banking, insurance and securities as well as different organisational models for supervision in the Member States). In that context the changes proposed in this Communication represent those the Commission considers essential to strengthen further the current EU supervisory framework.

## 2. GENERAL ASSESSMENT

The overall experience to date with the Lamfalussy process has been positive - a view broadly shared by Member States, the European Parliament<sup>2</sup>, market participants and regulators. *Ceteris paribus*, the Lamfalussy process has significantly contributed to the development of a more flexible European regulatory system and begun to pave the way for greater supervisory convergence and cooperation. The overall decision making process is more efficient and inclusive and has speeded up. The time needed to adopt the first four Lamfalussy directives amounted to 20 months on average, which compares favourably to the time taken to negotiate previous directives (e.g. 4 years for the Investment Services Directive in 1989-93).

The Lamfalussy process has developed at a different pace across sectors. In the securities sector, four Level 1 directives and twelve implementing Level 2 measures have been adopted, all of them unanimously, with strong support of the European Parliament. This would not have been possible without CESR's technical advice. In the banking sector, the Capital Requirement Directive (CRD, 2006/48/EC) allows for technical details reflecting regulatory agreement at G10 level to be amended via comitology decisions. Twelve Level 3 guidelines have been adopted by CEBS to deliver a converged application of the Capital Requirements Directive. In the insurance sector, CEIOPS work has been dominated by providing technical advice to the Commission on the proposal on Solvency II [COM(2007) 361] and its implementing measures. CEIOPS has also helped the Commission with testing the impact of Solvency II by carrying out a series of Quantitative Impact Studies.

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<sup>2</sup> EP's Report on Better Regulation in the EU (A6-0273/2007), paragraphs 18 and 19.

Implementation of the Lamfalussy process has coincided with a significant improvement of the global competitiveness of Europe's financial services and markets. The quality of the EU regulatory method has played an important role in creating a dynamic framework for EU capital markets to develop and innovate. In addition, the principles-based EU approach regulation is shaping international convergence in accountancy, investment services, UCITS, banking (CRD), and in other areas offering opportunities for global standard setting leadership.

Another fundamental objective of the regulatory architecture is to achieve optimal supervision at the lowest possible regulatory cost for financial firms. Today no overall reliable estimate of the costs and other burdens of cross-border, cross-sectoral regulations for the industry are available. The Commission has therefore launched a study which will examine in more detail the costs of compliance for firms of a limited number of EU directives. The result of this study will be available by 2009. Based on the results of this study the Commission, in cooperation with the Level 3 Committees, will assess whether and where other improvements may be needed.

### **3. IMPROVEMENTS IN LEGISLATIVE PROCESS AND ENFORCEMENT**

#### **3.1. Assessment of current situation**

Progress has been made in focusing the Level 1 Directives on general rules and principles – although there are a few critics who claim there is still too much detail in the Level 1 texts. The Level 2 measures have been carefully calibrated by the Commission, anchored on technical advice of the Level 3 Committees and consultation with stakeholders, to avoid over-prescription. Moreover, the European Parliament's concerns about safeguarding an appropriate institutional balance at Level 2 have been addressed by an agreement in July 2006 of a new regulatory procedure with scrutiny. Once the technical scope is agreed, the European Parliament will be empowered to scrutinise and even block the adoption of “quasi-legislative” (comitology) measures. The three EU institutions have also agreed that the implementing powers should be conferred on the Commission without time-limit, which means that the existing “sunset clauses” included in financial services directives must be abolished<sup>3</sup>. It is now of utmost importance to fulfil this commitment before the end of 2007 to remove institutional uncertainty.

#### **3.2. Sequencing of Level 1 and Level 2 measures**

The sequencing of the negotiations and adoption of framework co-decision legislation (Level 1) with implementing measures (Level 2) has resulted in some bottlenecks and unrealistic timetables.

In practice, a significant portion of the transposition period set in Level 1 legislation is taken up with the preparation of implementing measures, without which Member States cannot effectively proceed with their transposition. It is, however, hazardous to estimate the duration of the negotiation process at Level 2 at the time of adoption of the framework legislation. This has resulted in difficulties in setting reasonable deadlines both for transposition by Member States and for application by industry. This led to the extension of the transposition and application deadlines of the Market in Financial Instruments Directive (MiFID).

The Commission considers it essential to better align the timetables for the adoption and transposition of legislative and implementing measures. This could be achieved by linking the

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<sup>3</sup> OJ C 255, 21.10.2006, p. 1, point 3.

transposition deadline for the whole legislative package to the adoption of the last implementing measures identified in the Level 1 legislation.

Similarly, work on the Level 1 and Level 2 measures should be carried out as much as possible in parallel to improve legal coherence and understanding. Considering the Level 2 measures at an early stage in the process will facilitate the negotiations of the basic act and provide the co-legislators with clarity about the basic content of future implementing measures.

### **3.3. Better regulation**

The Lamfalussy process has been a pioneer in introducing and strictly applying sound regulatory principles: a bottom-up approach, open consultation, impact analysis, early and thorough participation of market professionals and consumer bodies plus national regulators. The openness and transparency of this process has minimised regulatory arbitrage, improved quality and enhanced the transparency and predictability of EU policy making. In order not to undermine these achievements, it is highly important that Member States refrain as much as possible from adding national rules to the ones agreed at European level (the so-called "gold-plating"). Drastically reducing gold-plating and more frequent use of regulations (as the Lamfalussy report suggested) will improve regulatory outcomes for the market. The Commission will propose regulations whenever appropriate and to the greatest extent possible for implementing measures. On gold-plating, the Commission will continue to follow a robust policy as initiated with the Article 4 of the MiFID implementing Directive (2006/73/EC). Member States should justify rigorously any regulatory additions or add-ons to the Commission in cases where such latitude is possible.

#### *Consultation*

Systematic and transparent consultation has been strongly welcomed by stakeholders. However, in certain cases, particularly in securities, market participants have claimed that consultation periods were too short. The Commission will consider how to ensure the right balance between the time allocated for consultation and the technical complexity of the issue.

Transparent policy making also requires full transparency about the results of consultations. Except for cases where confidentiality is requested, the systematic publication of responses should become normal practice. The Commission will publish summary reports of hearings organised as part of consultations on the internet and invites Level 3 Committees to follow the same practice. The Commission welcomes commentary from whatever source on its draft proposals but where alternatives are proposed they should be accompanied by sufficient and persuasive economic evidence, which is not the case today.

#### *Impact assessment*

Impact assessment is essential, both to evaluate the need for regulation and to ensure quality. All Level 1 legislation is now subject to an impact assessment by the Commission. But better regulation is a holistic concept – all parties must work for the overall result to be optimal. The Commission welcomes the European Parliament's reaffirmed commitment "*to conducting impact assessments when making substantive changes to legislative proposals*"<sup>4</sup>. It will also invite the Council, when tabling substantive amendments, and the Level 3 Committees when they give advice to the Commission, similarly to accompany their proposals with comprehensive impact assessments.

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<sup>4</sup> Resolution on financial services policy (2007)0338.

The Commission considers that since implementing measures may have significant impacts on various stakeholders, serious consideration must be given to carrying out impact assessment for any significant measure proposed at Level 2. The Commission will therefore progressively endeavour to extend its current impact assessment practice to implementing measures taken in the framework of these committees.

### **3.4. Enforcement at Level 4 – Enhancing transparency about transposition**

The introduction of the Lamfalussy process has not significantly improved Member States' performance with regard to timely transposition of Level 1 and Level 2 legislation. The Commission remains concerned about delayed transposition of European directives, which has negative impacts for both Member States and markets. A small cluster of Member States is repeatedly in the slow lane.

Several disclosure mechanisms have been put in place to increase transparency. For example, article 144 of the CRD includes the requirement for supervisors to disclose information regarding the implementation of the CRD in national law and the use made of a range of national options and discretions in this Directive. To facilitate its consistent implementation, CEBS has developed a web-based framework for supervisory disclosure<sup>5</sup>. However, as the CRD only fully applies on 1 January 2008, its implementation is still in its early phase.

Twice a month, the Commission has been publishing scoreboards showing the rate of transposition of the Financial Services Action Plan (FSAP) Directives<sup>6</sup> and both Level 1 and Level 2 Lamfalussy directives<sup>7</sup> on the Commission website. Similarly, the Commission publishes the state of play of MiFID transposition, based on questionnaires addressed by the Commission to Member States.

During the transposition periods, the Commission has worked intensively with national administrations, including through transposition workshops, bilateral and multilateral meetings plus providing guidance through other means, such as non-binding interpretative guidance and web-based Q&A modules. These practices will continue. The Commission in addition will immediately launch infringement proceedings under Article 226 of the EC Treaty for any Member State that is late in implementation. The Commission also expects Member States to provide transposition tables to facilitate checking. In addition, it will systematically include an obligation for a correlation table to be communicated in each new proposal for a directive.

## **4. SUPERVISORY COOPERATION AND CONVERGENCE**

### **4.1. Assessment of current situation**

A key objective of the Lamfalussy process is to foster supervisory convergence and cooperation. This is one of the most innovative elements of the Lamfalussy architecture.

The convergence of supervisory practices across Member States should result in consistent regulatory and supervisory solutions and consistent application on the ground. To achieve this may require EU supervisors in Level 3 to agree and apply common non-binding guidelines and recommendations.

There are several tools to strengthen supervisory convergence and cooperation. For example, mediation, delegation of tasks, streamlined reporting requirements and information and data-

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<sup>5</sup> The Commission introduced a similar provision in the proposal for Solvency II, Article 30.

<sup>6</sup> [http://ec.europa.eu/internal\\_market/finances/actionplan/index\\_en.htm#transposition](http://ec.europa.eu/internal_market/finances/actionplan/index_en.htm#transposition)

<sup>7</sup> [http://ec.europa.eu/internal\\_market/securities/transposition/index\\_en.htm](http://ec.europa.eu/internal_market/securities/transposition/index_en.htm)

sharing arrangements. Training programmes and staff exchanges between supervisors can also play an important role in the development of a common supervisory culture.

Despite the Level 3 Committees' efforts to put in place the tools necessary to achieve this objective, the results have not always met expectations. Some unnecessary blockages on important supervisory issues have occurred.

*CEBS has had a difficult job to establish a common transaction reporting format under MiFID and experienced some delays with regards to the establishment of the Transaction Reporting Exchange Mechanism. In the banking sector, the common reporting framework requested by finance ministers has given rise to a complex outcome, rather than the streamlined, simplified, homogenous one demanded by the market. CEBS encountered difficulties in convergence in prudential treatment of hybrids and would prefer that the Commission to move directly towards new legislation. Also, the introduction of mediation procedures has not borne fruit so far, since no use has been made of them.*

At times, the Level 3 Committees do not seem to be fully equipped to deliver what has been expected of them. A stronger political impetus is needed. On the other hand, since supervisors first responsibility is a national one, they might not have either adequate powers or incentives to converge at the European level.

The Commission has identified a few policy areas to enhance greater supervisory convergence. The Commission expects these changes to be put in place, to the greatest possible extent, in the course of 2008.

## **4.2. "Strengthening Level 3"**

### *4.2.1. Enhancing political accountability of Level 3 Committees*

The Level 3 Committees are accountable to the Commission to the extent specified in their founding Decisions. Their members are accountable to their own governments and/or Parliaments at national level. Many national supervisors do not have the capacity to perform their tasks at Level 3. If supervisors' obligations under their national law conflict with non-binding measures pursuant to Level 3, supervisors will let national obligations prevail.

Due to the importance of the Level 3 Committees' mission for supervisory convergence at EU level, but without prejudicing supervisory independence, the European institutions should express their political expectations as regards the main results to be delivered by the Committees over a standard period ahead (e.g. 2 years). They should also be given the faculty to assess regularly the performance of the Level 3 Committees.

This could be achieved through a two-step procedure.

**Firstly**, on a basis of a Commission text – and after prior consultation with the Level 3 Committees - the European Parliament and the ECOFIN Council could adopt together a short political statement indicating the main achievements expected from the Level 3 Committees for the period ahead.

**Secondly**, during that period and at the end, the Level 3 Committees would report to the Commission, the European Parliament and the Council on their achievements or, as the case may be, the reasons which prevented them from meeting the objectives set. In the latter case they would be expected to provide detailed explanations, including the identification of any recalcitrant supervisors. If no progress on a particular initiative identified in the mandate is possible at Level 3, as a practical measure, three possibilities remain: i) the status quo, with no further development; ii) escalating the measure to a Commission comitology measure,

assuming that it falls under the scope of delegated powers; iii) if the conditions are not met for (ii) and if the matter is sufficiently important, consideration of a Level 1 amendment.

This overall approach would increase political pressure on the Level 3 Committees to deliver results and strengthen Level 3 Committee Chairs. This would significantly enhance the efficiency of the Lamfalussy process and strengthen peer pressure among Committee members. The Member State whose regulator or supervisor is in a minority could be asked for additional explanation.

At the national level, this should be supplemented by the inclusion in the constitutive charters of national supervisory authorities the requirement to cooperate with other supervisors to enhance European supervisory convergence. The Commission agrees with the recommendation of the IIMG that "*a clear task to support the European convergence process should be added to the mission statement of the relevant supervisory authorities*". This has already been endorsed by the ECOFIN Council in October which invited Member States to decide whether to include an EU-dimension in the national mandates of supervisory authorities and to take into account the financial stability concerns in all Member State before the end of 2007.

#### 4.2.2. *Reinforcing the legal status of Level 3 Committees*

The Commission decisions setting up the Level 3 Committees do not sufficiently reflect their importance in an increasingly integrated European financial market. The missions of each Committee vary slightly from one decision to the other, reflecting concerns and political agreements which have shifted over time. Logically, all three should be consistent.

In general, there are three types of functions the Committees are expected to perform. However, only the advisory task is well established in all three decisions. By contrast, their contribution to consistent implementation and their role of converging supervisory practices is only mentioned in the case of CEBS and CEIOPS. The requirement for the Level 3 Committees to enhance supervisory cooperation is only mentioned in the case of CEBS.

This presents drawbacks. For example, because of the lack of a reference to supervisory convergence and cooperation in the Decision establishing CESR, its role cannot be referred to in Level 1 directives.

The Commission will consider what changes to modify the current legal framework would be appropriate. Options include (i) modification of the Commission decisions constituting the three Level 3 Committees to align their functions for reasons of inter-sectoral convergence and consistency; and (ii) modification of the relevant Level 1 directives to significantly strengthen cooperation requirements and to enhance the supervisory competences of the three Level 3 Committees. A first step has been made in the proposal for the Solvency II directive which explicitly refers to CEIOPS in its operational provisions to confer it mediation tasks and one specific decision-making power<sup>8</sup>. The Commission will consider how this approach could also be applied to CEBS and CESR.

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<sup>8</sup> CEIOPS is required to mediate between supervisors if they cannot agree on the validation of an internal risk model of an insurance undertaking; it can take binding decisions to identify which authority should assume the function and responsibilities of the 'group supervisor' of a cross-border insurance group.



### **4.3. Building mutual trust to ensure better implementation – practical obstacles at European and national levels**

#### *4.3.1. Decision-making processes within the Level 3 Committees*

As a general rule, the charters adopted by the Level 3 Committees provide for decisions to be taken by consensus. This applies to the adoption of standards/guidelines as well as decisions concerning the implementation of operational projects. The only exception to the consensus-based decision making concerns the provision of technical advice to the Commission where decisions can be taken by qualified majority vote. To date the Level 3 Committees have proceeded generally on the basis of consensus and have never used the possibility of qualified majority voting.

Consensus-driven decisions carry considerable weight. However these decisions can lead to lowest common denominator solutions or, at worst, no solution at all. Where the Committees cannot reach a solution by consensus they have turned to the Commission to find solutions to sometimes highly technical issues, for example, certain issues relating to the application of MIFID's best execution rules, branch supervision arrangements or transaction reporting.

It is essential to further enhance efficiency and effectiveness of the decision-making procedures of the Level 3 Committees. They could introduce in their charters qualified majority vote for all advice to the European Commission and any measure aimed at fostering the convergence of European supervisory practice. The Council and the European Parliament should agree a joint declaration according to which the Level 3 Committees would amend their own decision making procedures in this sense. Alternatively, if this is not possible, the Commission Decisions setting up the Level 3 Committees could be changed in this sense.

The Commission considers it would also be useful for the Level 3 Committees to reach an "agreement" among their members that the members in the minority would agree to apply the will of the majority. Such a commitment could include a safeguard clause whereby Level 3 members may be allowed not to agree to apply guidance/non-binding standards under certain clearly defined circumstances as e.g. if the proposed measure exceeds the scope of national legal competences. In such cases, the Committee member could be obliged to provide its legal reasons for non-compliance with the recommendation or guidance in question. And a clear explanation by the concerned Committee members should be given in the Level 3 reports to the European institutions and made public.

If a Committee member does not comply with the measure agreed by the Level 3 Committee, and does not comply with the conditions for being excluded from the application of this decision either (or even refuses to comply or explain), the Commission would invite the Level 3 Committee to foresee in its charter some form of disciplining.

#### *4.3.2. Implementation at national level*

Whichever form they take, the decisions adopted at Level 3 are non-binding. The Committee of Wise Men considered that, although non-binding, such decisions "*clearly carry considerable authority*". However, this has not always turned out to be the case so far. Experience has rather shown that measures agreed at Level 3 have not been applied consistently enough in the day-to-day supervisory practice of the national supervisors<sup>9</sup>. This is sometimes reinforced by the fact that some regulators issue at national level guidance diverging from guidance agreed in the Level 3 Committees. This inflation of guidance is a

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<sup>9</sup> The degree of supervisory convergence achieved by CEBS was assessed by the industry as rather unsatisfactory (2006/2007 CEBS Performance Assessment Online Study).

source of confusion for market operators; it affects the integration of markets and jeopardises the efficient application of Community law. The Commission is therefore of the view that, in those areas where Level 3 guidance has been issued, national regulators should refrain from adopting any additional measures.

Although providing the Level 3 Committees with some independent regulatory powers is not politically feasible, the practical issue is how to ensure compliance with Level 3 measures by Member States regulators and supervisors on the basis of non-binding instruments. Member States should request their supervisors/regulators to agree to the full application of Level 3 common standards and guidelines and state so in an ECOFIN declaration.

#### 4.3.2.1. Powers of national supervisors and sanctions

Some financial services legislation contains a list of minimum powers supervisors should have. This is notably the case in the securities sector. The banking directive contains a list of wide-ranging specific powers for supervisors. National regulators, in particular in the securities sector, do not need to have identical supervisory powers to implement both EU directives and Level 3 standards/guidelines. But they should have the necessary and sufficient minimum powers and tools (including sanctions) to fulfil their obligations. This is essential for efficient functioning of the home/host relationship.

The Commission and the three Level 3 Committees are analysing the extent to which there is sufficient convergence in rules, powers and practices among Member States. The first results indicate significant divergences in both national legal powers and the way they are applied in practice. In particular there is a high variance in the scope of sanctioning powers and penalties. For instance, the valuable mapping exercise carried out by the CESR Review Panel in June 2007 on the powers of the supervisors pursuant to the Prospectus and Market Abuse Directives reveals wide differences between Member States in this area.

To address this issue, the Commission will initiate a wide-ranging cross-sectoral survey on supervisory powers and systems of sanctions in the securities, banking and insurance sectors to identify where uneven powers might undermine cooperation among regulators. In addition, the Commission will consider the need to reinforce the provisions on minimum supervisory powers in the Level 1 legislation. Much greater convergence with regard to sanctions is necessary, as is a political debate on whether, in general, European sanctioning regimes are too weak across the board.

#### 4.3.2.2. Operational independence of national supervisory authorities

An effective system of European supervision implies clear responsibilities and objectives for supervisory authorities, and requirements to carry out their tasks in a transparent, independent and accountable manner.

There are four main dimensions to operational independence: institutional, regulatory, supervisory and budgetary. First, supervisors should be independent from both political authorities and commercial interference in the exercise of their powers and functions. Second, supervisors should have sufficient autonomy in setting technical prudential rules. Third, supervisors should be able to exercise their judgments and powers independently, and in a non-discriminatory manner, with respect to licensing, inspections, sanctioning, and enforcement actions. Finally, supervisors should have sufficient flexibility to determine their budgetary needs.

Even though supervisory independence and accountability are gaining in importance, these developments are overshadowed by occasional evidence that politicians in some parts of the EU do not grant sufficiently full operational independence to supervisory authorities.

This situation can be worrying. The Commission will raise Member States' awareness of the situation in the EU and urge them to adopt these basic principles to ensure the operational independence of their national supervisors. The Commission will monitor the progress made towards operational independence and will not hesitate to propose appropriate action if significant progress is not achieved in the short term.

#### 4.3.2.3. Cooperation between home and host regulators

Delegation of tasks and responsibilities is an important tool to optimise the functioning of cross-border supervision and cooperation between EU supervisors. As pointed out by the EFC, delegation could be an incentive for the host countries to sign a cooperation agreement, which can be implemented in case of a potential financial crisis.

Cross-border delegation requires legal provisions for it to function. The Commission is considering the introduction of explicit legal provisions to allow supervisors to delegate tasks to another Member State's supervisor, as is provided for in the CRD (Article 131) and in Article 13 of the Prospectus Directive (2003/71/EC).

Cooperation between home and host regulators should be further enhanced in the supervision of groups active on a cross border basis. Work of this nature had been underway in banking supervision since 1992 and is underway in relation to branches in the context of MiFID. To complement existing legislation, the Level 3 Committees should play a key role in fostering mutual confidence and ensuring a level playing field. This could be done, for instance, through the development of multilateral memoranda of understanding between supervisors and/or the development of common templates for such memoranda focusing on the practical application of certain provisions of the Level 1 and Level 2 texts. In the banking area, the Commission is considering adjustments to the home-host balance in the Capital Requirements Directive. The October 2007 ECOFIN Council has invited the Commission to examine possible enhancements to clarify the nature and extent of the legal obligations for supervisory authorities to exchange information and to cooperate and in this context: increase the information rights and involvement of host countries, clarify the role of the consolidating supervisors and facilitate the timely involvement of relevant authorities in a crisis situation. The Commission will examine and report to the EFC by the end of 2007 whether legislative changes are necessary. This will also include the reinforcement of the legal requirement for supervisory collaboration and information sharing.

Reinforcing the role and powers of the 'lead' supervisor for cross-border financial institutions<sup>10</sup> can also bring important efficiencies to the current supervisory system. Initial steps were made in the CRD for cross-border banks. The Commission must ensure that the role and powers of 'lead' supervisors follow market developments and are updated and strengthened, where appropriate. The Commission therefore intends to make legislative proposals to strengthen the powers of the 'lead' supervisor for cross-border banking groups in October 2008. These adjustments will extend the current powers to include 'Pillar 2' decisions and reporting requirements for cross-border banking and investment firm groups. Enhancing the role of a 'lead' supervisor of a cross-border financial group is strongly connected to the proper functioning of a 'college' comprising all of the relevant host country supervisors of that group.

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<sup>10</sup> Referred to as the 'consolidating supervisor' in the CRD, the 'coordinating supervisor' in the Financial Conglomerates Directive, and the 'group supervisor' in the Solvency 2 proposal.

#### **4.4. Colleges of supervisors**

Cross-border group supervision and convergence in the EU supervisory system would be significantly enhanced by the existence of colleges of supervisors to facilitate cooperation between supervisory authorities involved in the oversight of specific cross border firms. Experience is already positive in the banking area; it is emerging in the insurance sector. Colleges provide a solid basis for resolving the current problems between home/host competences. By developing some common risk assessment policies and at the same time sharing relevant data concerning the financial group in question they could serve as a forum to deal with the first signals of potential stress in a specific institution and thus improve crisis management as suggested by the EFC. Colleges of supervisors can also encourage more frequent use of delegation of tasks and responsibilities.

An optimal functioning of Colleges of supervisors requires legal underpinning in EU-Directives and a number of adjustments to the present approach. Clear internal decision-making procedures are needed for cases where no agreement is found. A requirement for all participants to comply with the College's decisions should also be secured. The Level 3 Committees should develop a set of common standards for the operation of the Colleges, the responsibilities of its "leading" supervisor and associated "host" supervisors.

#### **4.5. Cross-sector cooperation**

Cross-sector cooperation between the Level 3 Committees is based on a Joint Protocol on cooperation signed between CESR, CEBS and CEIOPS in November 2005. Cooperation is provided for only in cases where added value can be expected from a joint action, i.e. where i) there is a high risk of disruptive regulatory arbitrage, ii) cross-sector cooperation can deliver obvious gains in the effective conduct of supervisory activities and iii) cooperation between the Level 3 Committees could bring about real efficiency gains. Level 3 Committees have agreed on joint annual work programmes since 2006.

One of the priorities of the annual joint work programmes since 2006 has been financial conglomerates. In 2006, an Interim Working Committee on Financial Conglomerates (IWCFC) was set up by the Level 3 Committees. The IWCFC is now up and running. It is delivering work on a certain number of mandates. It is too early to decide whether improvements are needed. In the coming months, the Commission will conduct a review of the functioning of the Conglomerates Directive (2002/87/EC) and it intends to address the status of the IWCFC.

Another priority for the Commission is the development of common reporting standards. Under the joint work programme for 2007, the Level 3 Committees will produce a report on this topic and will analyse the case for further action.

#### **4.6. Crisis management**

All three Level 3 Committees should ensure that they are prepared to act efficiently and collectively in the case of a major market disturbance or financial crisis. Rapid crisis information procedures should be ensured so all EU supervisors are informed of developments.

#### **4.7. Resources and budget**

The Level 3 Committees are financed by their members, who contribute annually to the Committees' budgets according to their internal rule of procedure which defines the way contributions are calculated and the modalities of payment. However, Level 3 Committees are under increasing pressure to finance projects that derive from legal obligations stemming from the EU regulatory framework. An example is the financing of the day-to-day running of

the transaction reporting exchange mechanism that CESR is setting up in accordance with the MiFID Directive.

Another necessity is the building up of a common financial supervisory culture in all the supervisory areas. One practical idea is for the Level 3 Committees to develop a common, cross-sectoral, pan-European training capacity. Such a platform should enable staff from national supervisory authorities to deepen their knowledge of EU regulatory processes, to share practical experience in their day-to-day supervisory activities and to develop common practices.

While fostering the common supervisory culture in the EU, the common training programmes could gradually be extended to involve officials from third countries who are in the process of building their regulatory systems. Their participation in the training programmes would be aimed at raising awareness and improving their knowledge of the EU regulatory system and therefore helping to promote the EU's regulatory approach as international best practice to build a sustainable network between global regulators.

The Commission considers that some financial assistance may be appropriate to encourage European supervisory convergence, provided it meets existing EU regulatory and budgetary provisions. The Commission is examining possible modalities of contributing to the financing of both specific projects stemming from legal obligations under existing directives and of cross-sectoral training schemes for EU supervisors in a first instance and non-EU supervisors subsequently. The Commission will examine the intensions of the Level 3 Committees and, if they can be met under existing regulatory and budgetary constraints, will come forward with a concrete proposal in 2008.

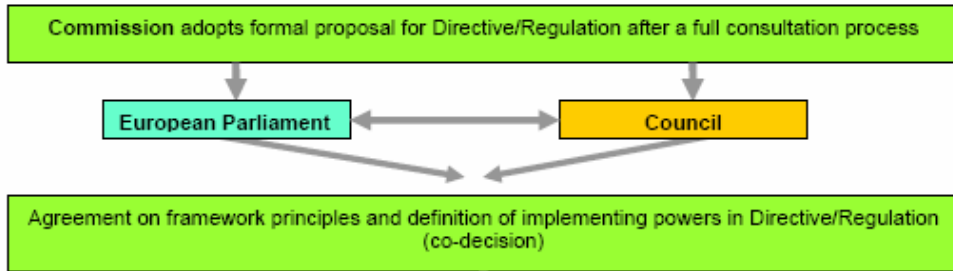
## **5. CONCLUSIONS**

The recent turmoil on financial markets has clearly demonstrated growing interconnectivity and globalisation of financial markets. Even though risks have been widely spread, the European financial industry has been affected. Fortunately, to date there have been no major cross-border systemic consequences. This recent experience further underscores the need to adopt a globally convergent approach to regulation and supervision, with sound prudential rules and a consistent approach to supervision. The Level 3 Committees and national supervisory authorities have a key role to play in this respect. Among the issues the Commission will be working on in 2008, together with other actors at EU and international level, that are relevant for this Communication will be converging supervision in the financial sector, and in particular the need to examine how to strengthen cooperation between supervisors.

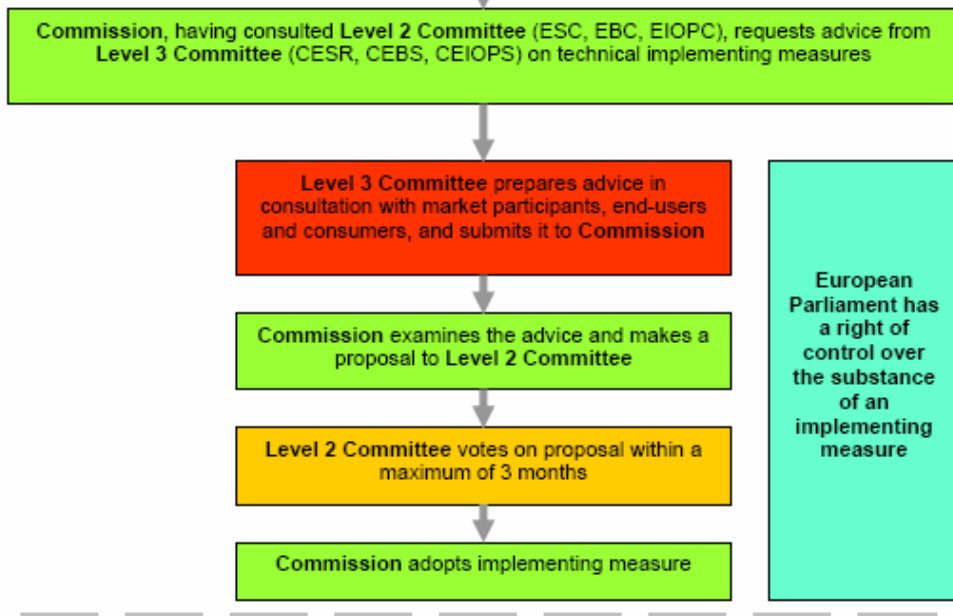
The Commission therefore calls on the Council, European Parliament and the Level 2 and 3 Committees to endorse as a matter of priority the initiatives outlined in this Communication with a view to reaching greater convergence of supervisory practices in the EU. It intends to monitor on a continuing basis the implementation of these initiatives, and the overall operation of the Lamfalussy framework, to ensure that it remains fully adapted to market developments and fit for purpose.

## ANNEX I: THE FOUR-LEVEL PROCESS

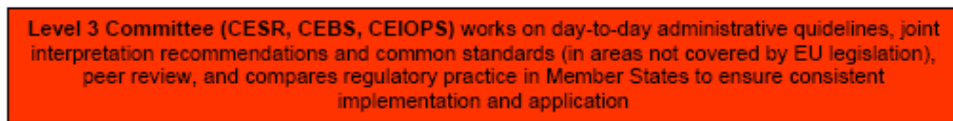
### Level 1



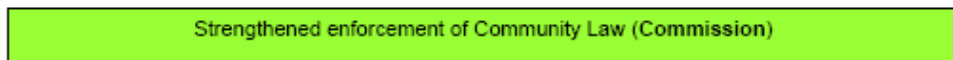
### Level 2



### Level 3



### Level 4



## **ANNEX II: Achievements**

### **Securities**

#### **Level 1 "framework" legislation**

- Directive of the European Parliament and of the Council of 21 April 2004 on markets in financial instruments amending Council Directives 85/611/EEC and 93/6/EEC and Directive 2000/12/EC of the European Parliament and of the Council and repealing Council Directive 93/22/EEC (2004/39/EC)
- Directive of the European Parliament and of the Council of 28 January 2003 on insider dealing and market manipulation (market abuse) (2003/6/EC)
- Directive of the European Parliament and of the Council of 4 November 2003 on the prospectus to be published when securities are offered to the public or admitted to trading and amending Directive 2001/34/EC (2003/71/EC)
- Directive of the European Parliament and of the Council of 15 December 2004 on the harmonisation of transparency requirements in relation to information about issuers whose securities are admitted to trading on a regulated market and amending Directive 2001/34/EC (2004/109/EC)

#### **Level 2 "implementing" legislation**

- Commission Directive of 22 December 2003 implementing Directive 2003/6/EC of the European Parliament and of the Council as regards the definition and public disclosure of inside information and the definition of market manipulation (2003/124/EC)
- Commission Directive of 22 December 2003 implementing Directive 2003/6/EC of the European Parliament and of the Council as regards the fair presentation of investment recommendations and the disclosure of conflicts of interest (2003/125/EC)
- Commission Regulation of 22 December 2003 implementing Directive 2003/6/EC of the European Parliament and of the Council as regards exemptions for buy-back programmes and stabilisation of financial instruments ((EC) No 2273/2003)

- Commission Directive of 29 April 2004 implementing Directive 2003/6/EC of the European Parliament and of the Council as regards accepted market practices, the definition of inside information in relation to derivatives on commodities, the drawing up of lists of insiders, the notification of managers' transactions and the notification of suspicious transactions (2004/72/EC)
- Commission Regulation of 29 April 2004 implementing Directive 2003/71/EC of the European Parliament and of the Council as regards information contained in prospectuses as well as the format, incorporation by reference and publication of such prospectuses and dissemination of advertisements ((EC) No 809/2004)
- Commission Directive of 8 March 2007 laying down detailed rules for the implementation of certain provisions of Directive 2004/109/EC on the harmonisation of transparency requirements in relation to information about issuers whose securities are admitted to trading on a regulated market (2007/14/EC)
- Commission Directive of 10 August 2006 implementing Directive 2004/39/EC of the European Parliament and of the Council as regards organisational requirements and operating conditions for investment firms and defined terms for the purposes of that Directive (2006/73/EC)
- Commission Regulation of 10 August 2006 implementing Directive 2004/39/EC of the European Parliament and of the Council as regards record-keeping obligations for investment firms, transaction reporting, market transparency, admission of financial instruments to trading, and defined terms for the purposes of that Directive ((EC) No 1287/2006)

#### **Level 3 measures**

- Stabilisation and Allotment – European Supervisory Approach; CESR/02-020b (9/4/2002)

- A European Regime of Investor Protection – The Harmonisation of Conduct of Business Rules; CESR/01-014d (9/4/2002)
- A European Regime of Investor Protection – The Professional and Counterparty Regimes; CESR/02-098b) (8/7/2002)
- Standards for Alternative Trading Systems; CESR/02-086b (8/7/2002)
- Standard No. 1 on Financial Information; CESR/03-073 (1/3/2003)
- Recommendation for additional guidance regarding the implementation of International Financial Reporting Standards (IFRS); CESR/03-323e (31/12/2003)
- Standard No. 2 on Financial Information - Co-ordination of enforcement activities; CESR / 03-317c (22/04/2004)
- Standards for securities clearing and settlement systems in the European Union; CESR/04-561 (4/4/2006) (22/10/2004)
- CESR's guidelines for supervisors regarding the transitional provisions of the amending UCITS Directives (2001/107/EC and 2001/108/EC); CESR/04-434b (3/02/2005)
- CESR's recommendations for the consistent implementation of the European Commission's Regulation on Prospectuses n° 809/2004; CESR/05-054b (10/02/2005)
- Market Abuse Directive - Level 3 – first set of CESR guidance and information on the common operation of the Directive; CESR/04-505b (11/05/2005)
- CESR Recommendation on Alternative Performance Measures; CESR/05-178b (03/11/2005)
- CESR's guidelines to simplify the notification procedure of UCITS; CESR/06-120b (29/06/2006)
- CESR's Level 3 Guidelines and recommendations on Publication and Consolidation of markets data; CESR/07-043 (09/02/2007)
- CESR's Level 3 Recommendations on the List of minimum records under Article 51(3) of the MiFID Implementing Directive; CESR/06-552c (09/02/2007)
- CESR's guidelines concerning eligible assets for investment by UCITS; CESR/07-044 (19/03/2007)
- Guidelines - CESR Level 3 Guidelines on MiFID Transaction reporting; CESR/07-301 (29/05/2007)
- Recommendations - Inducements under MiFID; CESR/07-228b (29/05/2007)
- Q&A on Best Execution; CESR/07-320 (29/05/2007)
- Protocol on MiFID Passport Notifications; CESR/07-317 (29/05/2007)
- Recommendations - The passport under MiFID; CESR/07-337 (29/05/2007)
- Market Abuse Directive - Level 3 – second set of CESR guidance and information on the common operation of the Directive to the market; CESR/06-562b (12/07/2007)
- Guidelines - Level 3 guidelines on the classification of hedge fund indices as financial indice; CESR/07-434 (17/07/2007)

## **Banking**

### **Level 3 measures**

- CEBS Guidelines on prudential filters for regulatory capital (21/12/2004)
- CEBS Guidelines on supervisory disclosure (1/11/2005)
- CEBS Guidelines on financial reporting (recast of 15/12/2006; amendments of 24 July 2007) (16/12/2005)
- CEBS Guidelines on common reporting (recast of 16/10/2006) (13/1/2006)
- CEBS Guidelines on the recognition of external credit assessment institutions (20/1/2006)
- CEBS Guidelines on supervisory review process (25/1/2006)
- CEBS Guidelines on supervisory cooperation for cross-border banking and investment firm groups (25/1/2006)



- CEBS Guidelines on validation (04/04/2006)
- CEBS technical guidelines on interest rate risk in the banking book (03/10/2006)
- CEBS Guidelines on outsourcing (14/12/2006)
- CEBS Additional technical guidelines on concentration risk (14/12/2006)
- CEBS Additional Guidelines on stress testing (14/12/2006)

## **Insurance**

### **Level 3 measures**

- CEIOPS Guidelines for Coordination Committees in the Framework of the Insurance Groups Directive; CEIOPS-DOC-02/05 (February 2005)
- CEIOPS Recommendations regarding the Implications of the IAS/IFRS Introduction for the Prudential Supervision of Insurance Undertakings; CEIOPS-DOC-05/05 (September 2005)
- Statement on the Role of the Lead Supervisor; CEIOPS-DOC-07/06 (December 2006)

### ANNEX III

#### MAIN ACTIONS PROPOSED IN THE COMMUNICATION

| <b>GENERAL</b>   |  |  |                           |
|--|--|--|---------------------------|
| 1)   | Abolition of sunset clauses in financial services legislation  | European Parliament, Council             | End 2007                  |
| 2)   | Publication of study on costs of compliance  | Commission                               | 1 <sup>st</sup> half 2009 |
| <b>ADOPTION OF LEGISLATION – LEVELS 1 AND 2</b>          |  |  |                           |
| 3)   | Future alignment of transposition deadlines for directives and implementing measures   | Commission, European Parliament, Council | Ongoing                   |
| 4)   | Extension of impact assessment to implementing measures  | Commission                               | Ongoing                   |
| 5)   | Impact assessments for any substantive amendments in the legislative process and the technical advice by the Level 3 Committees  | Council, Level 3 Committees              | Ongoing                   |
| 6)   | Limitation of any regulatory additions ("goldplating") and obligation to justify to the Commission   | Member States                            | Ongoing                   |
| 7)   | Systematic publication of responses to consultation and summary reports of hearings organised as part of consultations on the internet   | Commission, Level 3 Committees           | Ongoing                   |
| <b>SUPERVISORY COOPERATION AND CONVERGENCE – LEVEL 3</b> |  |  |                           |
| 8)   | Adoption of political statement indicating the main achievements expected from the Level 3 Committees  | Commission, European Parliament, Council | Starting in 2008          |
| 9)   | Regular reporting on the achievement of these objectives   | Level 3 Committees                       | Starting in 2008          |
| 10)  | Inclusion of the requirement to cooperate with other supervisors at European level in the constitutive charters of national supervisors  | Member States / Commission               | 1 <sup>st</sup> half 2008 |
| 11)  | Reinforcement of the legal status of the Level 3 Committees (possible modification of Commission decisions setting up the three Level 3 Committees / changes in framework Level 1 legislation) | Commission, European Parliament, Council | 2008                      |
| 12)  | Extension of the qualified majority voting in decision-making of the Level 3 Committees  | Level 3 Committees / Commission          | 1 <sup>st</sup> half 2008 |
| 13)  | Political commitment to the full application of Level 3 common standards and guidelines  | Level 3 Committees, Member States        |                           |

|     |  |  |                           |
|-----|--|--|---------------------------|
| 14) | Cross-sectoral survey on supervisory powers and systems of sanctions and assessment of the need to reinforce the provisions on minimum supervisory powers in the framework legislation | Commission                               | End 2008                  |
| 15) | Political debate on operational independence of national supervisors   | Commission / Member States               | 1 <sup>st</sup> half 2008 |
| 16) | Introduction of explicit legal provisions in financial services directives to allow supervisors to delegate tasks to another Member State's supervisor                                 | European Parliament, Council, Commission | End 2008                  |
| 17) | Legislative proposal to strengthen the powers of the 'lead' supervisor for cross-border banking groups   | Commission                               | October 2008              |
| 18) | Development of a set for common standards for the operation of the colleges for cross border operations  | Level 3 Committees                       | 1 <sup>st</sup> half 2008 |
| 19) | Report on the development of common reporting standards  | Level 3 Committees                       | End 2007                  |
| 20) | Decision on possibility and modalities of contributing to the financing of Level 3 Committees  | Commission                               | End 2008                  |