# “Lamfalussy Architecture” – A Model for Consolidating the Financial Markets’ Supervision

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***Abstract.*** *The enhancement of convergence in the supervisory practices, both by increasing the quality of the legal framework and of the regulations in the field of financial services and by improving the consultation process, represents a prerequisite for setting up the Single Market for financial services at EU level. In order to reach this goal a new approach, known as “Lamfalussy Architecture”, has been developed. The implementation of this model will increase the efficiency of the regulatory and supervisory framework within the financial markets, by removing the obstacles in the way of their integration into the Single Market. At the same time, setting up an EU Single Market implies a thorough monitoring of the financial stability through a constant review of the regulatory and supervisory framework.*

**Key words:** “Lamfalussy architecture”; Financial Services Action Plan (FSAP); convergence; supervision; single financial market; Level 3 committess 3(L3C).

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**JEL Codes:** G18, G21.
**REL Codes:** 11B, 11C.

## Introduction

Setting up a Financial Services Single Market is one of the long-term objectives of EU. In such a market, the financial institutions authorized to provide specialized services in a member state should be also able to perform, in similar conditions, in any other member state, in an adequate competitive environment, harmonized with the legal framework in this field.

The consequences of the setting up of the financial Single Market have been analyzed and evaluated right from the moment when this new concept was launched. Thus, the Cecchini Report on 1998 emphasized the fact that setting up a Single Market of totally integrated financial services would increase the IGP with 1.5%. The advantages coming from this have been subsequently highlighted in other reports(1) addressed to the EC (European Commission) or to the European Financial Services Round Table, as well as in other papers in this field.

Given the importance of the intensification of the integration process, and, respectively, of the setting up of the Single Market for financial services in EU, the need to identify and create the infrastructure necessary for sustaining this objective implicitly occurred. Therefore, in June 1998, the European Council requested the European Commission to set up a framework to contribute to the development of the Single Market for financial services.

In May 1999, the European Commission Statement regarding the Financial Service Action Plan (FSAP) was published, approved by the European Council 11 months later, respectively in March 2000. FSAP's goal was to set up a Financial Single Market in EU. In this respect, FSAP initiated a set of measures to eliminate all the national differences and obstacles until 2005, so that an adequate legal framework for supporting the financial services' integration process in EU is created. These measures envisaged mainly the gross market (securities issuance and their trading, securities settlement, accounting); retail market (insurance, saving through pensions funds and mutual funds, payments, electronic currency and money laundering prevention), as well as fields like financial supervision, companies' insolvency, taxation of incomes from savings etc.

The adopted measures have been transposed, partially, into Communitary Regulations, whose main particularity was their direct application in the internal law of the member states. But most of the FSAP measures can be found in the European Directives, which need to be transposed in the legislation of each member state. As far as the other measures are concerned, we have to stress that they are mainly in the form of Statements and Recommendations of the European Commission.

The new perspective on the regulation framework introduced by FSAP included 42 legislative and non-legislative proposals, its main goal being to sustain the integration process of the financial markets in EU. Based on this program, the national regulatory and supervisory authorities developed their own strategies with regard to the future priorities, according to their statutory attributions.

Having in view the size of the consequences of the FSAP measures' adoption and implementation process, respectively of such a large number of Regulations and Directives, in July 2000, ECOFIN set as its main objective the creation, until 2003, of the Single Capital Market in EU.

At the same time, FSAP represented the starting point for the complex and difficult integration process of setting up the Financial Services Single Market, subsequently supported by launching a new approach in the legislative and regulatory framework of this field. This new approach, known as *Lamfalussy Architecture*[(2)], after the name of the president who founded this committee – the baron Alexandre Lamfalussy, was based on the recommendations of the Committee of "*Wise Men*", as a premise of the supervisory practices convergence.

## 1. "Lamfalussy Architecture" – a new framework for the consolidation of the supervisory practices' convergence within EU

As we already mentioned, a new approach has been developed, under the name of *Lamfalussy Architecture*, in order to increase the efficiency of the EU legal framework, to respect the FSAP terms and to expand the convergence of the supervisory practices, both by enhancing the quality of the legal framework and of the regulations on financial services, and by improving the consultation process.

The new model[(3)] applied, for the first time, in 2001, on the capital market (CESR) was also extended in 2004 for the banking market (CEBS) and, respectively, for the insurance and pensions market (CEIOPS), following the ECOFIN decision in December 2002. Setting up this architecture was the result of many discussions on the identification of the most adequate institutional structure able to improve the quality of the rules specific for each sector of the financial market, and, at the same time, to provide the efficiency of the supervision activity for these markets within EU. This new institutional formula was founded on the principle of the necessity of supervision and regulation to adapt to the dissimilarity of the national markets, in the detriment of some opinions supporting the idea of setting up a single regulatory and, respectively, supervisory authority in EU. Therefore, the main purpose of this new approach was to conceive and transpose in practice an efficient mechanism for making the convergence within the supervision of the European financial market, a prerequisite for setting up a communitary flexible legislative system to answer promptly to the market's evolutions.

According to this new approach, the legislative process has been structures as follows:

*Level 1.* Setting up the main core principles and defining the prerogatives for their implementation, through regulations and directives. These are adopted through the co-decision of the EU Council of the European Parliament, subsequent to the consultation process developed in the spirit of the best practices related to regulation.

*Level 2.* Adopting the measures for implementation, consisting of technical details on the applicability of the directives. The implementation measures are advised, as a preliminary, by the competent regulatory committees, respectively CEBS[4], CESR, CEIOPS (*Level 3 Committees*), following the procedure of consultation of Level 2 Committee, respectively European Securities Committee, European Banking Committee and European Insurance and Occupational Pensions Committee (ESC, EBC[5], EIOPC). Within the procedures related to this level, the European Commission has in view the position adopted by the European Parliament.

*Level 3.* Intensification of the cooperation between supervisory authorities, based on the Level 3 Committee's (CEBS, CEIOPS, CESR) Guidelines, with a view to the current activity of the regulatory and supervisory authorities, common standards (where there is no community legislation) and recommendations regarding the directives and regulations. The activities regarding the comparison of the regulatory practices, carried out at this level by the 3 committees, also improve the implementation process.

*Level 4.* Intensification of the application of the acquis communitaire (European Commission)

Of course, the *Lamfalussy Architecture* results in benefits for the traditional process of legiferation, including, without being exhaustive, a more constant interpretation of the community legislation, a better convergence of the national supervision practices as well as an intensified increase of the quality of the legislation regarding the financial services.

2007 also represented the moment when the benefits from the Lamfalussy procedure were reviewed, as provided by Directive 2005/1/CE (which introduced a new organizational structure for the 3 committees in the financial services' field, beginning with March 2005). We would like to mention that this obligation is in accordance with the above mentioned directive and the deadline is the end of 2007.

In the recent years, the EU financial markets went through few major changes, such as: the acceleration of the integration process; the extend of the activity of the financial institutions over the borders; the amplification of the process of concentrating the markets at the same time with increasing the complexity of the financial products and innovations; the intensification of the mergers and acquisitions processes both at a cross-border and inter-sectoral level etc. Moreover, the recent turbulences demonstrated, on one hand, the markets' interconnectivity, and, on the other hand, the necessity to adapt the EU supervisory framework to the markets' reality.

In this context, in October 2007, the ECOFIN Council agreed the idea of intensifying the efforts to improve the financial stability within EU. Therefore, reviewing the *Lamfalussy Architecture* is a necessary step in achieving this goal. The moment of the *Lamfalussy Architecture*'s review appeared in a context which justifies the necessity of developing this process, having in view the consequences of the decisions following this assessment, but also implies the taking into consideration of the characteristics of each sector where the new vision on the legislative process has been applied.

The reports of the European Parliament and of the Inter-institutional Monitoring Group (IIMG), as well as the official positions adopted by CEBS, CEIOPS and CESR, communicated to the European Commission, and the Position of ECOFIN[6] reveal the general conclusion according to which the results of the Lamfalussy process are positive.

## 2. The assessment of the "Lamfalussy Architecture" results

*The European Commission Communication*[7] issued at the same time as its presentation of the conclusions revealed from the assessment of the *Lamfalussy Architecture*, according to which although the process has mostly reached the settled objectives, states the fact that *it is still necessary to make certain significant changes meant to increase its efficiency, regarding the functioning of the Level 3 Committees, as well as the contribution brought to the enhancement of the cooperation and convergence in supervisory activity*. Also, according to the *European Parliament Report*[8] from 2007, the Lamfalussy process has significantly contributed to the development of a much more flexible regulatory system, and also to the establishment of the appropriate conditions for a better cooperation and convergence in the supervisory field. At the same time, the decisions are being taken much faster and in a more efficient manner. The conclusions registered in the above mentioned reports are completed by those from the *Final Report (the third) al IIMG*[9], which was published on the 15th October 2007.

This report[10] examined the functioning of the Level 3 Committees and assessed their capability to generate the desired results when given the challenges which should be handled, but also the existent dysfunctions. It also presented the recommendations which were necessary in order to improve the process of issuing regulations and applying them. Therefore, when focusing on the conclusions referring to the functioning of the Level 3 Committees, from the mentioned report, in our opinion the following main areas can be distinguished:

- *Progresses*: on account of the recognition of the progresses registered by the Level 3 Committees, regarding the consultancy activity, as well as the cooperation and convergence in supervisory activity, the continuation of the integration process of the European financial markets and the changes brought to the regulatory framework point out the improvement of these committees' activity, when referring to the obtained performance as well as possible fields in which they could get involved.
- *Challenges*: the Level 3 Committees should serve as a platform, their objective being to facilitate both the coordination in the regulatory and supervisory activity, as well as to promote new supervisory instruments and methods which should contribute to the enhancement of the trust between the national supervisory authorities. Therefore, the following objectives could be regarded as being most important:
  - Contribute to full and high quality implementation of the EU legislation by giving technical assistance to national competent authorities, including the issue on implementing guidelines as a pre-condition of achieving a consistent application of EU law across Member States, as well

as the identification of any legislative or practical obstacles to cooperation.

– Enhance supervisory convergence and cooperation: the Committees should identify any duplications or gaps in supervisory practice or, in specific fields, as well as to identify opportunities for delegation of tasks.

– Improve cross-border group supervision in the banking and capital market sectors. Thus, the concept of lead supervisor/consolidating for large cross-border groups and financial conglomerates needs to be more precisely defined and take into account the potential financial and political impacts.

– Facilitate market infrastructure/ transactions oversight: the Committees should serve as a platform for exchange of information between national supervisors on a range of issues including national markets, cross-border activities and specific technical expertise.

▪ *Equipment*: the Level 3 Committees should be provided with a clear EU mandate, complemented by an annual working program, which should be endorsed by the European Parliament, the Council and the European Commission, and also with a sufficient legal basis covering their activities. At national level, a clear requirement to cooperate at EU level and to support the EU convergence process should be included in mission statements of national regulatory and supervisory authorities. *We would like to underline the fact that this IIMG recommendation was endorsed by the ECOFIN Council in October 2007, when the Member States were invited to decide upon the opportunity of including an EU component to the mandates of the national supervisory authorities.* Also, the decision making procedures of the Level 3 Committees should differ depending on the type of activity. Another important issue which should be taken into account is the necessity of an uplift of the committees' financial means and resources in order for them to be able to perform their tasks. As a result, the current model of financing may need to be revised accordingly.

▪ *Crisis management*: the analysis of the relationship(11) between the supervisory activity and the evolutions registered in the crisis management field exceeds the IIMG mandate. Thus, the improvements made to the crisis management arrangements, in the last years, have had direct implications to the supervisory activity. On account of the pivotal role that these authorities have in detecting crisis situations, we must not forget the conclusion regarding the lack of a water-tight separation between the phases of crisis prevention and crisis management.

Considering this issue, we find as being notable the extension of the Level 3 Committee's guiding role, from the involvement in the well functioning current activities towards the one targeting the cooperation on crisis management, as it results from the Common Guidelines(12) issued by CEBS and the Baking Supervision Committee (BSC) within the European Central Bank.

The rhythm of Lamfalussy process differed within the 3 sectors (banking, capital market and insurance), as it can be seen from the scoreboard of the transposition process at EU Member States level, both for the Financial Services Action Plan Directives (FSAP)[13] and for the Level 1 and Level 2 Lamfalussy Directives[14], published on the Commission website and updated twice a month.

Although there are certain differences regarding the rate of transposition, based on the conclusions of the European Council drawn in December 2007 concerning the review of the *Lamfalussy Architecture* and on the self assessment of the three Level 3 Committees, the Chairs of CEBS[15], CEIOPS and CESR have embraced a common stand when referring to the necessity of consolidating the outcomes. In this regard, the following common priorities were settled for the future activity:

- Home-host cooperation, with emphasis on the establishment of a common framework for the delegation of supervisory duties;
- Consistency of the regulatory and supervisory framework regarding the treatment of the "rival products", such as the investment funds and the insurance policies;
- Self-regulatory standards and regulatory approaches coordinated towards the rating agencies;
- Consistency in the issue of the requests for the internal governance, which result from different directives;
- Financial conglomerates;
- Assessment of the financial illiquid instruments, based on the weaknesses discovered during the recent turbulence of the market.

In completion of these, each of the 3 Committees has settled its own priorities, from which, following the purpose of the present study, there will be mentioned the ones settled by CEBS for the banking industry:

- The contribution for the reviewing of the Directive concerning the capital Requirements: Capital Requirement Directive (CRD).
- Actions to take as a result of the turbulence of the market, with emphasis on: the supervision of the liquidity risk; increasing the transparency of the exposure towards the structured financial products; the enhancement of the standards regarding the assessment of the illiquid financial instruments; weaknesses of the market in the field of the default credits and the so called "monoline" risk.
- The endorsement of the efficiency of the process for the EU Single Market, with emphasis on the continuous development of the operational structure for the purpose of improving the functioning of the colleges of supervisors and the supervision of the cross-border groups, the implementation of a uniform reporting framework, the solving of certain aspects which derive from the implementation of the Pillar 2.

Thus, it is shown that the moment chosen for the implementation of the detailed analysis of the *Lamfallusy Architecture*, more precisely the end of the year 2007, was fully justified, for it was a critical point in the establishment of a new approach in supervision and regulation activity, so that these two, combined, could actively contribute to removing of the remained barriers for the implementation of the convergence of supervisory practices, a precondition of an efficient supervision.

The assessment of the *Lamfallusy Architecture* contributed, on one hand, to the identification of those components which did not function according to the expectations and the actions taken for their improvement, and on the other hand, to the establishment of a new approach within each of the levels of this architecture.

Given the context, in our opinion, the results of the *Lamfallusy Architecture* assessment indicate, when referring to the component on which the present study focuses, the necessity of reviewing the mandates of the Level 3 Committees (CEBS, CEIOPS, CESR) and, on this basis, of the decisions regarding their establishment, which is a precondition of the enhancement of the supervisory practices in all the sectors of the financial services market. This reviewing should not imply the detailed description of tasks or the setting up of an exhaustive task list, but rather it should concern the following key coordinates:

- The elimination of constant dysfunctions in the activity of these Committees regarding the convergence in the supervisory practices of the cross-border financial groups;
- The importance of developing a common culture in the field of supervision, by using adequate means and by establishing the necessary instruments for accomplishing the statutory prerogatives;
- Emphasizing the role which these Committees could have in the EU financial stability;
- Stating in their mandates, the necessity of a cross-sectoral coordination of the regulatory activity, which is a condition for reaching an efficient and functional framework of the common activities performed;
- The clarification of the palette of available resources for each of them.

## Conclusions

In our opinion, the *Lamfallusy Architecture* is the main catalyst for the acceleration of the integrating processes of the EU financial markets. The implementation of this model will lead to a more efficient regulatory and supervisory framework within the financial markets, by removing the obstacles in the way of their integration into the Single Market. Setting up an EU Single Market also implies a thorough monitoring of the financial stability through a constant review of the regulatory and supervisory framework. At the same time, the crisis registered on the sub-prime mortgage market in the US and its impact on the European financial markets has confirmed the importance and the necessity of a constant review of the EU regulatory and supervisory framework.

## Notes

(1) London Commission, Price Waterhouse Coopers and Oxford Economic Forecasting, Qualification of the Macro-economic Impact of Integration of EU Financial Markets, November 2002, ZEW and IEP- Zentrum fur Europaische Wirtschaftsforschung and Institut fur Europische Politik, Report for the European Financial Services Round Table.

(2) See http://en.wikipedia.org/wiki/lamfalussy_process.

(3) Decision of the European Commission 2001/527/EC for setting up the CESR (the Committee of European Securities Regulators), Decision of the European Commission 2004/5/EC for setting up CEBS (the Committee of European Banking Supervisors) and, respectively, Decision of the European Commission 2004/6/EC for setting up CEIOPS (the Committee of European Insurance and Occupational Pensions Supervisors).

(4) National Bank of Romania is member of CEBS.

(5) National Bank of Romania is member of EBC.

(6) Council Conclusions on Review of the Lamfalussy process – http://www.consilium.europa.eu/Newsroom.

(7) European Commission, Communication on the review of the Lamfalussy process, Brussels, 20 Nov. 2007.

(8) European Parliament, Report on Better Regulation in the EU, par. 18 and 19, 2007.

(9) Inter-institutional Monitoring Group (IIMG) is a group which was re-established in 2005, as a result of the expansion of the Lamfalussy process, up to its present structure, as its name points out, being applicable to all the relevant areas from the financial field. The Group's mandate, which was given by the European institutions and which ends on the 31st December 2007, with the possibility of being extended and/or revised by the European Parliament, European Commission and the European Council, consists in "the assessment of the registered progress in the implementation of the Lamfalussy process in order to provide a more efficient regulatory system for financial services and to identify any possible necking within this process.

(10) Inter-institutional Monitoring Group, Final Report Monitoring the Lamfalussy Process, Brussels the 15th of October 2007.

(11) The assessment of the current of the EU framework regarding the prevention of the crisis is left to the European Council, under the aegis Economic and Financial Committee.

(12) In 2006, CEBS and BSC founded Task Force on Crisis Management, in order to improve the cooperation arrangements for the management of potential financial and banking crisis.

(13) See http://ec.europa.eu/internal_market/finances/actionplan/index_en.htm#transposition

(14) See http://ec.europa.eu/internal_market/securities/transposition/index_en.htm

(15) CEBS was set up by the Decision of the European Commission from November the 5TH 2003, as being an independent consultancy group and which, given its status, provides the European Commission, on a regular basis, with reports regarding the recorded progresses. At the same time, CEBS is a private company financed by its members' contribution.

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Council Conclusions on Review of the Lamfalussy Process

European Commission, Communication on the *Review of the Lamfalussy process,* Brussels, 20 nov.2007

European Parliament, *Report on Better Regulation in the EU, par.18 si 19, 2007*

Inter-institutional Monitoring Group, *Final Report Monitoring the Lamfalussy Process*, Brussels, 15 October 2007