

3. The Lamfalussy Process:

Polyarchic Origins of Networked Financial Rulemaking in the EU

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Over less than a decade, EU policymakers transformed the regulation of the European financial services industries. The overhaul accelerated the formation of capital and auxiliary markets inside Europe,¹ adding to already intense pressures on governments and social programs. Internationally, it is the single, most important factor behind the end of US financial hegemony and has triggered the cooperative management of longstanding transatlantic disputes over cross-border activity of banks, broker-dealers, insurance companies, exchanges, auditors and other financial services providers (Posner 2006).

Because financial arrangements affect all industries and the risks borne by citizens and governments, the EU financial regulatory transformation raises questions about its real-world implications. Will the emerging financial system be qualitatively different from the US variety? Will it set off regulatory competition and, if so, will it be a race to the top or the bottom? In short, how will it alter the distribution of financial resources inside and outside Europe and the ease and cost by which governments, citizens and firms obtain financing?

Many of the answers to these questions lie in the Lamfalussy Process, the new EU procedures for devising, transposing, implementing, and enforcing the regulations that

govern European financial services industries. The Lamfalussy process marks a historic shift away from a regulatory regime that kept the lion's share of rulemaking and supervision at the national level. Under the new regime, the Council of the EU and the European Parliament (EP) extended comitology procedures (i.e. the delegation of implementation powers to the European Commission) to the existing co-decision rulemaking arrangement and added a prominent role for formalized networks of national regulatory authorities. Most rules now originate in Brussels, and although national authorities are responsible for on-the-ground implementation and supervision, EU coordination and enforcement mechanisms deeply constrain their actions.

Introduced in February 2002 in securities and in 2003 in banking and insurance, the Lamfalussy Process is still very new. This chapter, focused only on the securities sector, thus contributes to a growing body of necessarily preliminary empirical analysis on the origins and operations of these new procedures (Bergström et al 2004; Alford 2006; Mügge 2006; Posner 2007; Quaglia 2007). It describes the new regime and explains why widespread pressures for more coordinated, coherent and inexpensive financial regulation in Europe gave rise to the Lamfalussy Process, rather than to a more hierarchical governance scheme or some other set of arrangements.

In so doing, the chapter also contributes to this volume's aim of identifying common conditions that lead policymakers in the EU and beyond to adopt similar regulatory solutions across multiple sectors with differing histories and problems. Its immediate theoretical ambitions thus respond to compelling empirical observations by Sabel and Zeitlin and the other contributors to this volume. The new regime in European financial regulation not only represents a deviation from prior rules and procedures but

also combines distinctive governance tropes present in a number of other EU sectors. The incomplete list of shared governance forms includes two levels of legislation, European Commission rulemaking that relies on networks of national regulators, peer review, open consultation and built-in mechanisms for monitoring and reviewing the regime. A key goal of this chapter is to explain why these governance modes – comprising an experimentalist architecture, in the sense used by Sabel and Zeitlin – emerged in EU financial regulation and to explore whether similar conditions are responsible for the observed pattern across sectors.

My analysis yields two main findings. First, the new formal arrangements in finance are largely the outcome of EU politics (i.e. unsettled inter-institutional and intergovernmental bargains) combined with thirty years of capacity building in financial regulation at the European level. Thus, rather than “competition politics” driven by a global pattern of securitization and increased US competition (Mügge 2006), the formal setup of the Lamfalussy Process stems primarily from causes endogenous to the EU. This finding is consistent with approaches that envision EU political development as an autonomous historical force (Posner 2005 and 2008; Meunier and McNamara 2007). It also speaks directly to a major theme of this volume: polyarchy’s deeply constraining effects on policymakers’ choices about how to respond to demands for regulatory reform. Fragmentation of political authority all but eliminated the possibility of adopting the US agency model – a Securities and Exchange Commission (SEC) for Europe – and has thus far fostered unrelenting pressure for deliberation among existing national authorities to generate functionally equivalent regulation.

Second, the early evidence suggests that a transgovernmental body, comprised of national securities regulators, has emerged as the actual fulcrum of rulemaking and supervision – a development similar to those observed in the chapters on the regulation of data privacy, food safety, and energy. Created as an advisory committee, the Committee of Securities Regulators (CESR) has become a supranational body that is larger than its constituent parts.² CESR, along with the European Commission, leaves its imprimatur on most stages of the rulemaking process. Given the formal arrangements and the well-developed literature on Brussels' entrepreneurship, however, we might expect the Commission to have considerable influence.³ Explaining CESR's role, by contrast, means paying attention to new research on transgovernmental networks (Newman 2007; Eberlein and Newman 2008) and moving beyond analysis of formal delegations of power (Coen and Thatcher 2008a). CESR's authority and considerable autonomy is in large part traceable to widespread legitimacy among market participants, the European Parliament, the European Commission, the Council and foreign regulators such as the US Securities and Exchange Commission (SEC). Some of this legitimacy arises from the technical expertise and domestic-level legal powers of its members and their established relations to market participants. However, it also derives from the mandated practices of open consultation, coordination of policy implementation, and especially peer review.

The evidence on CESR presented below adds to our understanding of transgovernmental networks of national regulators and their role in the EU's experimentalist architecture. It provides a vivid illustration of how the birth of a new autonomous political actor flowed from the decisions of policymakers – intent on regulatory reform, deeply constrained by the politics of a fragmented polity, and therefore

inclined to make use of pre-existing actors and institutions. Building on existing networks of national regulatory authorities, however, is more than a risk-averse, pragmatic and second-best alternative route for achieving governance goals. It also unleashes potential for autonomous political authority.

The conclusion shows how CESR's existence has permanently changed the ongoing politics of financial regulatory reform. It also uses the chapter's findings to address a host of questions about the future of EU financial regulation: Will the new arrangements in European securities regulation – taken to their limits – be up to the task? Will EU policymakers resort to more classic governance to create the desired 'legal certainty'? And will the political pressure, borne from the 2007-2008 financial crisis, to improve Europe-wide prudential safeguards (an area of regulation excluded from the original Lamfalussy process) lead to another sweeping overhaul of EU financial governance?⁴

Historical Background⁵

The Lamfalussy Process is a core part of the broader transformation of EU financial arrangements. By financial transformation, I mean substantive rule changes and procedural reforms that have taken the EU significantly closer to an integrated financial market. As a whole, these changes amount to a shift of financial regulation from the national level to a multilevel and networked arrangement and put in place much of the institutional and political foundations necessary for integrated financial markets.

The forging of such a market was among the earliest goals of European cooperation and was reinforced in the single market program (Story and Walter 1997; Jabko 2007). Yet until the late 1990s, progress was slow and uneven, and financial

regulation trailed behind other parts of the post-SEA (Single European Act) project. The liberalization of capital accounts⁶ was a necessary but woefully insufficient step, and a raft of legislation, applying the principle of mutual recognition to banking, insurance and investment services proved too weak to overcome differences in national regulations, legal systems and cultures and was plagued by inconsistent implementation (Story and Walter 1997: 314-15). Scholars agree that governments considered financial arrangements as extensions of national sovereignty (Story and Walter 1997; Mügge 2006; Jabko 2006). Obstacles to cooperation reflected resistance to changing distinct and largely incompatible financial systems. Few if any scholarly accounts from the mid-1990s expected this “battle of the systems” to change, let alone within a few years and rapidly.⁷ While some analysts made vague predictions that the euro’s advent would eventually lead to a single financial market, the research investigating the new currency’s effects offers no theoretically driven explanation for why, when and how EMU might prompt policymakers and companies to alter their stances towards financial integration (Gross 1998; Dermine 1999).

EU financial transformation began with a burst of legislative activity. In March 2000, the Council endorsed the Financial Services Action Plan (FSAP), a list of 42 proposed EU laws designed to sweep aside the obstacles to financial regulatory integration (Commission 1999). Unlike other components of the Lisbon Agenda, EU decision makers adopted almost all of the planned laws in accordance with the Commission’s timetable and have now entered the next stage centered on coordinated implementation and enforcement and on improving badly performing legislation (Dombey 2004; FT 2004; Commission 2005 and 2006). These changes in substantive

rules continued to combine principles of mutual recognition and harmonization.

Compared to post-SEA legislation, however, they differ in magnitude (i.e. the number of new laws), scope (i.e. the breadth of issues addressed), and quality (i.e. the degree to which EU legislators employed the principles of harmonization and convergence). Some new legislation was distinct from 1990s initiatives in a fourth respect: it mandated, to a greater extent, procedures for cooperation and dispute management among national supervisors.⁸

The Formal Arrangements of the Lamfalussy Process

In its final stages, this legislative activity was accompanied by the Lamfalussy Process, an inter-institutional agreement that alters rule-making procedures and bolsters cross-border coordination mechanisms for transposition, implementation, supervision and enforcement (Lamfalussy 2001). There are four official levels and one additional formal feature (Bergström et al. 2004 and 2006). At the first level, the Commission initiates framework legislation following a consultation process with market participants and having sought advice from a newly established committee, the European Securities Committee (ESC). ESC is comprised of member state representatives and chaired by a Commission representative. CESR also has a role, as it may offer the Commission advice on its own or the latter's initiative (Commission 2001). Once the Commission submits a proposal, the normal co-decision procedures apply. At the second level, the Commission implements the legislation by devising detailed rules with the assistance of ESC (acting in its second capacity as a regulatory committee) and CESR. After consulting ESC, the Commission asks CESR for advice. CESR develops its views through broad and open consultations with stakeholders. The Commission then draws on

CESR's advice to propose measures that ESC must approve. At the third level, CESR coordinates transposition and ensures consistent implementation and supervision by its members, who retain their national responsibilities to oversee domestic securities markets. At the fourth level, the Commission acts as the overseer of the treaty, monitoring compliance and initiating legal action when necessary. Finally, an inter-institutional monitoring group (IIMG), comprised of six independent experts chosen by the Commission, Parliament and the Council (two each), identifies blockages and ensures that the Lamfalussy Process is meeting its stated goals of speedier and more flexible rulemaking. The presence of "sunset clauses" (four-year expiration dates on the Commission's implementation powers) in framework laws also guarantee that the EU's institutions will periodically revisit the basic foundations of the arrangements.

The designers obviously intended at least some of these formal arrangements to function in accordance with the four key elements of the experimentalist architecture Sabel and Zeitlin identify in this volume. Levels two and three separate the creation of broad legislative goals by politicians from the elaboration of detailed rules by civil servants. The role of the IIMG implies a built-in monitoring and reporting mechanism; peer review was explicitly mandated as part of CESR's coordination role; and Ecofin, the EP and the Commission left the "independent regulators committee" to devise its own rules of procedures and operational arrangements (Commission 2001; European Council 2001, pt. 6). The EP's insistence on using "sunset clauses," moreover, incorporated into these new procedures a formal recursive mechanism, which recently took the form of a new comitology bargain. The result was an increase in the EP's oversight powers – and not only in the area financial regulation (Almer 2006).⁹ Finally, it is possible to think of

CESR as a “bridging device.” The established and accountable national authorities who comprise the body lend legitimacy to the gradual transition from old domestic regimes to supranational and networked modes of governance.

The Origins of the Lamfalussy Process

Because of its current effects and future potential impact inside and outside Europe, the EU financial transformation has become the subject of study for scholars interested in the origins of financial governance arrangements. Two recent contributions differ on a critical point: To what degree were large financial services providers the main drivers behind change? Mügge (2006) argues that in the 1990s large national financial services companies, which used to be part of government-finance coalitions in favor of protecting distinct domestic arrangements, switched their public policy preferences towards the development of pan-European markets and regulations. By contrast, finding little evidence of early political mobilization by these firms, I argue in previous work that the new preferences of financial services companies represented more a reaction to than a cause of financial regulatory change – a finding also consistent with Grossman’s evidence (Grossman 2004; Posner 2007). The transformation, I maintain, is primarily the product of a slow-moving institutional change process; in the late 1990s, policy entrepreneurs were able to quicken the pace by turning the euro’s introduction and rising US competition into an opportunity for the pro-integrationist agenda.

This chapter does not engage this core issue of the debate. Yet in investigating whether and how autonomous EU politics and processes caused and shaped the form of

the Lamfalussy Process, it contributes to one aspect of it. The near-consensus among national finance ministries, market participants, Brussels civil servants and members of the European Parliament to adopt the new arrangements makes it difficult to identify the policy entrepreneurs and to map out the winning and losing coalitions. Sold as a way to facilitate the passage, implementation and effectiveness of the FSAP legislation, the Lamfalussy Process is a spillover of the earlier program and its creation reflects the momentum it generated. Alexandre Lamfalussy's Committee of Wise Men invoked the apparently persuasive argument that procedural change was an urgent matter, necessary to speed up the legislative program and ensure that regulation did not diminish its potential benefits (Lamfalussy 2001: 7-8). Nobody wanted to be on the record as impeding procedural reforms.

It is somewhat easier to explain the form the Lamfalussy process took by conducting a genealogical investigation. Doing so suggests the inadequacy of explanations based on global ideological diffusion and material pressures, as the specific components of the formal arrangements and their aggregation display a deep genetic linkage to increasingly standard modes of EU governance. First, the division between framework and detailed legislation and the extension of comitology procedures to financial regulation binds the disparate parts of the Lamfalussy Process into a single whole and connects finance to the governance of other sectors as described by Sabel and Zeitlin. Why do we find this common thread across sectors? Governance arrangements in the financial arena, like in others, are very much an expression of unsettled inter-institutional and intergovernmental political bargains.¹⁰ In particular, the adoption of the Lamfalussy Process marks a breakthrough in a long-standing impasse (Pollack 2003: 140-44;

Bergström et al. 2004). Ever since the Commission first proposed it in 1989, governments (unwilling to cede powers to the Commission in a highly sensitive area) and the EP (seeking to rebalanced asymmetric oversight powers) had blocked the extension of comitology to securities regulation (Bergström et al. 2004: 7-10).

Inter-institutional and intergovernmental EU politics thus account well for the extension of comitology to financial services and, specifically, for the Commission's formal rule-making role and the creation of ESC as a consultative and oversight body. It also helps to explain the procedures in the Lamfalussy Process that distinguish between framework laws and detailed rules and institutionalize open consultation. Delegating implementation, to be effective, implies leaving the detailed rules to civil servants in conjunction with technical experts, and to be perceived as legitimate, needs mechanisms that give access to affected parties. These approaches to EU law making evolved gradually from the introduction of comitology procedures (Sabel and Zeitlin **2008**), made their way into the Commission's 1998 "Financial Services" document (Commission 1998), and reflected the Prodi Commission's approach to EU governance in general (Almer and Rotkirch 2004), rather than global best practice or a functional solution to the problems of regulating financial services in an age of mobile capital.

EU balance-of-power politics, however, is an insufficient explanation for the creation of CESR and its formal and informal roles in the Lamfalussy procedures. The European Commission originally proposed the introduction of comitology in the financial sectors with ESC but without CESR. The Lamfalussy Committee, concerned less about inter-institutional and intergovernmental battles and more about feasible ways to improve financial rulemaking capacity, emphasized the need for a body that could provide

technical and regulatory expertise and garner widespread respect among market participants (Lamfalussy 2001: 86). Its recommendation to create CESR by formalizing the Forum of European Securities Commissions (FESCO) was thus based largely on pragmatism, reflecting an EU pattern of formalizing networks of national authorities across multiple regulatory domains including data privacy, telecommunications and energy (Newman and Eberlein 2008; Coen and Thatcher 2008a, b). Instead of choosing an ideal model like the risky French plan for a European SEC that would have had to be forged from scratch, the Committee's recommendations built organically on what was already in place (*Economist* 2001). This approach – which won broad appeal – ensured that arguably the most important innovation of the new Lamfalussy Process (see below) is in fact an incremental addition to a small and largely unnoticed attempt to coordinate EU securities regulation five years earlier (*Economist* 2001; *Euromoney* 1999. *Financial Times* 2000.) Given the widespread reluctance to risk the creation of a single regulator for Europe, the Wise Men felt they had no real other alternative. FESCO was already organized and national securities regulators, responsible for devising and implementing financial rules at home, were the only actors with pre-existing expertise and legitimacy.

In sum, by the time the Lamfalussy Committee consulted with market participants in 2000 and 2001, financial services firms had had two years to mobilize in response to the FSAP and substantially directed the Wise Men toward pragmatic solutions. Nevertheless, their choices were deeply constrained by EU politics and previous efforts to integrate EU financial regulations.¹¹ Given that EU politics in this context is an outgrowth of a polity characterized by multiple poles of authority, my conclusions about the origins of the Lamfalussy Process generally support Sabel and Zeitlin's claim that

polyarchy is a key condition of experimentalist governance across EU sectors. But my evidence also reveals how the presence of national authorities lends itself to a particular governance form: regulatory bodies that foster and formalize transgovernmental networks.

The Operation of the Lamfalussy Process

The genesis of the Lamfalussy process, then, lies in forces tied to the European integration process. How does it operate in practice? The evidence is still thin. At the time of writing, it had only produced four EU framework laws in the area of securities regulation.¹² I am aware of only a few early scholarly assessments of its operations (Bergström et al. 2006; Coen and Thatcher 2008b). Its recent introduction is not the only reason that analysis is in short supply. The new balance between multiple levels and types of financial governance in Europe feeds into an existing methodological bias that diverts attention away from EU-level governance phenomena. At least in political science, analysts tend to study finance at either the international or domestic level.¹³ Research projects that begin at the domestic level in Europe, however, will likely underestimate the importance of the Lamfalussy Process and EU legislative initiatives. This is because regional rules have gradually formed an increasingly thick layer atop existing, albeit changing, domestic financial systems. In the current division of labor, national securities regulatory agencies (which, for the most part, only date to the 1980s and 1990s) are still legally responsible for implementing and enforcing transposed EU rules. On the ground, it is easy to conclude that seemingly distant developments such as rule-making through co-decision and comitology or cross-border supervisory cooperation

have little effect on nation financial governance. Yet in the estimation of one of Lamfalussy's Wise Men with intimate knowledge of British financial regulation, 90 percent of national rules today originate in Brussels.¹⁴

There are competing and complementary expectations about the operations of the Lamfalussy Process. Several scholars have expressed skepticism that the Council and EP will in practice delegate rulemaking within the sector (Bergström et al. 2006: 12-18.). According to this view, detailed regulations governing finance have too many distributive consequences for the EU's legislators to delegate rules of any importance to the Commission and CESR. The expectation is that detailed rules would make a mockery of so-called "framework" legislation, that the Lamfalussy Process would not make rule-making faster or more flexible; and that CESR's role (along with that of the Commission) at Level 2 would be relatively unimportant (Coen and Thatcher 2008a). In related arguments addressed in subsequent sections, real influence at Level 3 either stays in the hands of national supervisors (leaving CESR stunted in a classic intergovernmental cooperation trap) or rests with the largest banks and other financial services companies (Mügge 2006).

Evidence from the creation process of two directives, presented in the most comprehensive study to date on the subject, suggest that concerns about the separation of framework and technical rules have been overblown and oversimplified. The EP and the Council have made ample use of the newly established implementation procedures, demonstrating that both bodies have relinquished control over implementing measures, even contested ones. In addition, the legislative process has moved more quickly than in the past (Bergström et al. 2006). The IIMG's January 2007 interim report, based on wide

consultation with practitioners, offers additional evidence (that includes the two later directives) of faster and more efficient rule-making processes (IIMG 2007, Part III).

While widespread usage of CESR's Level 2 consultation process by market participants does not necessarily indicate meaningful delegation,¹⁵ it is hard to imagine why firms would expend so much energy and resources on an impotent legislative body.¹⁶

Even if some framework directives contain more detail than Lamfalussy's team hoped (and there is evidence of both the Council and EP maintaining control by insisting on minute details in Level 1 legislation), CESR has been asked to advise the Commission on measures of extraordinary importance to financial companies. In fact, because the EP and Council could not find common ground in the creation of MiFID at Level 1, difficult political issues were left for CESR to decide at Levels 2 and 3.¹⁷ The 2006 inter-institutional agreement on comitology, moreover, diminishes Parliament's incentives to include technical details in framework legislation by giving it more power over Level 2 measures. Lastly, there has also been a general call for all parties – CESR, Commission, EP and Council – to reduce the amount of details at all levels to avoid overly legalistic behavior on the part of market participants (IIMG 2007).

Another skeptical hypothesis dismisses the relevance of the Lamfalussy process and new modes of governance in general, arguing instead that EU rulemaking is increasingly driven by formal processes and judicialization (Kelemen 2006). Scholars tend to agree that one legacy of the Americanization and liberalization of European finance in the 1980s and 1990s is increased juridification. But they disagree on its effects and meaning (Kelemen and Sibbit 2004, 2005; Levi-Faur 2005). Although this chapter examines some of the preliminary evidence in later sections, no studies yet systematically

assess the variant of this proposition that attributes a rise in adversarial legalism for determining financial rules to deepening levels of European integration (Kelemen 2006; Kelemen and Sibbitt 2004). Such a study would have to show: one, a Europe-wide rise in levels of judicialization; two, different levels of judicialization before and after the EU financial transformation; and, three, a causal connection between the two phenomena.

A final hypothesis, by contrast, not only expects the Council and EP to delegate authority to the European Commission but also for the implementation stages of the experimentalist architecture and, in particular, the Lamfalussy Process to become increasingly autonomous from inter-institutional and intergovernmental battles (Posner 2005; Newman 2007). Contrary to the expectations of skeptics grounded in principal-agent theory (Coen and Thatcher 2008a), early evidence suggests that such a pattern has emerged in the rise of CESR as an independent body (Bergström et al. 2006; Mügge 2006).

CESR's Expanded Role

CESR's influence has seeped beyond its mandate as an advisor at Level 2 and a coordinator at Level 3. Several types of evidence support this claim. Market participants consider CESR to be influential within the EU legislative framework. In response to CESR's July 2007 questionnaire about its own performance, 18 of 24 respondents described its influence as "quite high" or "very high" and none "quite low" or "very low."¹⁸ The Commission, Parliament and Council, moreover, have taken measures to push CESR back within the boundaries of their respective interpretations of its mandate (Bergström et al. 2006). For example, CESR's propensity to initiate work on Level 2 rules before the ink was dry on framework legislation (so-called parallel working) was

not mentioned in the Lamfalussy Report and raised concerns about indirect and inappropriate influence on Level 1 directives.¹⁹ Parallel working has the potential to quicken the legislative process. There have been efforts to limit it to already agreed and uncontroversial measures (a process requiring the EP and Council feed CESR early drafts). Still, the Commission and Parliament continue to exhibit discomfort, frequently invoking the limits to Level 3 committee powers (EP 2007, pts 53 and 61; EP 2004, pt 20; Commission 2005: 3.1 (2)). And other evidence of “pushback” is plentiful. In addition to the mandated annual reports to the Commission (Commission 2001), both the Ecofin Council and the EP forged new mechanism to improve oversight of and communications with CESR. In 2005 in order “to develop regular relations with CESR and to increase their democratic accountability,”²⁰ the EP’s Economic and Monetary Affairs committee initiated on-site visits and insisted that CESR send Parliament all documents that the Commission, ESC and Council receive. In 2007 Ecofin asked CESR to report on its supervisory operations directly to the Council’s Financial Services Committee (Council of the EU 2006; EU Financial Services Committee 2006).

Ecofin’s closer monitoring is largely a reaction to the most significant display of CESR’s expansive new role. While early attention focused on CESR’s influence in rule-making at levels 1 and 2, its success in shaping the debate on supervisory arrangements did even more to establish its status as an independent and important player in EU securities regulation. As the FSAP legislative program neared completion in 2004, CESR stormed out of the supervisory starting box with the October “Himalaya Report,” stealing the initiative from the European Commission and others (CESR 2004). Ecofin’s May 2006 clarification of the EU supervisory framework demonstrates the degree to which

CESR's sometimes power-enhancing ideas about fulfilling a vague mandate for converging supervision became the focal points of subsequent discussion for all three Level 3 committees and gained widespread acceptance and support.²¹ Not every measure in the Himalaya Report resonated beyond CESR's Paris offices. For instance, the suggestion of new legal powers to make binding EU decisions (and thereby revisiting the basic Lamfalussy bargain) was likely a strategic move and went nowhere at the time (though similar recommendations began to circulate with the advent in 2007 of the subprime mortgage crisis).²² Still, in its May 2006 conclusions, Ecofin highlighted four of CESR's main recommendations for enhancing supervisory cooperation: that member states ensure convergence of supervisory powers; that CESR experiment with internal mediation mechanism for dealing with conflicts among members; that CESR members test delegating supervisory powers to other members; and that CESR set up IT data sharing arrangements.

CESR has similarly demonstrated an ability to act independently and as a unified actor in other debates. In the aftermath of the Enron and Parmalat scandals, for instance, CESR's members, acting in unison, used their memberships in IOSCO to outmaneuver national politicians considering new oversight for rating agencies (Mügge 2006, 1015-1016). Before making a report to the Commission in April 2005, CESR's members voted in favor of an IOSCO initiative that left the status quo largely in place and simultaneously ended serious debate in Europe – at least until the 2007 financial crisis began to gather steam.

CESR has also assumed other international roles, placing it in a legal no-man's land. It has working programs with the US Securities and Exchange Committee and the

US Commodity Future Trading Commission and informal ties to the US Treasury as well.²³ These roles emerged as the Treasury and European Commission (also without a clear legal mandate) entered an institutionalized dialogue to resolve long-standing financial regulatory disputes (Posner 2006). CESR was the natural European counterpart of the SEC and CFTC for advancing greater transatlantic regulatory coordination.

In sum, CESR pushed beyond its anticipated role in the legislative process, established itself as a central agenda setter in the debates about fulfilling mandates to overcome cross-border differences in supervision, and represents the EU, sometimes behaving independently, in international contexts. Like all political actors, CESR does not win every battle or decisively shape every piece of legislation. But the above observations put to rest notions that CESR remains closely tethered to a “discretion zone” anticipated in the original delegation of powers. The organization has clarified, defined, and stretched its own rulemaking and supervisory mandates set by the Council, the EP and the Commission. As illustrated in the chapters by Eberlein, Newman and Vos, moreover, the position of CESR in the EU’s new financial arrangements has striking parallels to similar bodies comprised of national regulators in the governance of other sectors.

Explaining CESR’s autonomous role

What explains CESR’s ascendance? Some of its newfound informal authority no doubt derives from its members’ expertise, legally-based national powers, and ability to self-fund the new body, as recent research on transgovernmentalism would lead us to expect (Newman 2007). Serendipity also played a part, as CESR’s unsought international roles bestow stature and legitimacy. Yet CESR’s emergence as an

autonomous body, bigger than its constituent parts and more independent than the formal delegation of powers would suggest, is probably also the product of two governance modes, typical of the EU's experimentalist architecture, and therefore traceable to the polity's unsettled and fragmented political authority.

First, CESR's institutionalized open consultation process has enhanced its reputation as a expert technical body in touch with fast-changing market developments and the preferences of key financial participants. Although several respondents to CESR's July 2007 questionnaire made suggestions for improving the consultation process and expressed numerous complaints about its early operations, taken as a whole these comments illustrate CESR's awareness of practitioners' concerns and conflicts, integrating them into its advice to the Commission and guidance on supervision, and thereby deriving legitimacy as a financial rulemaker and supervisor.²⁴ Such legitimacy from market participants creates pressure, especially on the Commission, to accept CESR's advice and justify deviations from it. The IIMG, for one, has urged the Commission to provide explanations wherever it veers from Level 3 committees (IIMG 2007: pt 39).

Second, CESR's authority has benefited from internal capacity-building processes that include coordination through peer review, transparent benchmarking, ongoing deliberation and, more recently, conflict-resolution mechanisms.²⁵ CESR's ability to coordinate implementation and supervision will be the most crucial test. Thus far, however, as the Himalaya Report and the other activities of CESR exemplify, it has succeeded in creating political and organizational capacities. As the previous sections demonstrate, CESR can act as a single unit, advance an independent agenda, and

maneuver effectively within the EU political framework. At its best, CESR accurately estimated the political temperature on the extent to which it could press for more powers. In hindsight, given its unclear legal parameters, it might have adopted some of the new supervisory mechanisms on its own (e.g. internal mediation mechanisms, informational sharing devices and experiments in delegating authorities). But in winning widespread support first, it has increased the tools available for carrying out tasks with firm political backing.

CESR's application of a vague mandate to carry out peer review shows how new governance modes contribute to organizational capacity and political skills. CESR created a permanent group, comprised of "internal coordinators" from each member and observer state, which reviews the national implementation of EC laws as well as CESR guidelines and standards.²⁶ The group establishes criteria for judging implementation, issues opinions on each country's performance, gives views on specific problems and creates ad hoc groups to address particular technical problems. CESR has been able to use the results and the experience of the peer-review process to develop and promote an autonomous agenda. The ongoing interactions among members appear to have built trust and eased internal decision-making, allowing for bold initiatives, like the Himalaya Report.²⁷ More concretely, CESR has used the results of the peer-review process to create new political facts and advance its positions. The Himalaya Report argues that coordinated implementation requires equivalent powers among supervisors. It contains evidence, derived from the peer review process and later used by other political actors, of asymmetries of power among national securities regulators (CESR 2004, Annex 3; EUFSC 2006).

Alternative perspectives

The above analysis dealt explicitly with several, but not all, of the competing hypotheses presented above. Before concluding, I therefore address the others. Some commentators, as we have seen, depict EU arrangements like the Lamfalussy Process as vehicles of economic globalization that further the agenda of transnational companies. Their expectation is that the Lamfalussy Process and especially the establishment of open consultations provide preferential access to well-organized interests, namely, large financial services providers with pan-European businesses. Preliminary evidence suggests that CESR has become an ally of pro-integrationist firms (Mügge 2006; Bergström et al. 2006). There are, however, problems with drawing such conclusions about inherent institutional proclivities from CESR's early positions. To some extent, its decisions have reflected prominent voices in the open consultation process as well as best practice as established in international forums traditionally dominated by US officials. Both of these influences are likely to change. Responding to criticism of lopsided participation in the open consultation process, for example, the European Commission created the Financial Services Consumer Group (FSCG) to give a political voice to alternative interests (Lamfalussy 2005).²⁸ European representatives in international financial forums have not used their new bargaining powers to challenge basic governance principles established under US financial hegemony. But the distinctive rule-creation processes, especially the deliberative exercises housed within CESR, may (especially in the turmoil of financial crises) produce regulatory solutions that diverge from those produced in the US. Were such contrasting ideas about best practice to

emerge in the future, European regulators would be well positioned to pursue an independent course and generate international support for it.

Finally, there are conflicting expectations about the effects of supranational financial governance in Europe. Will deeper regulatory integration in a politically fragmented Europe give rise to an autonomous and influential rule-making body that relies on informal processes, or will it spur formalism and adversarial legalism? In evaluating the judicialization proposition, it is important to distinguish between two different logics. One argues that formal rulemaking and thereby rising levels of adversarial legalism flow more or less directly from financial liberalization. The other contends that political fragmentation leads to adversarial legalism. It is entirely possible that only one of these explanations captures the pattern of adversarial legalism observed by Kelemen and others in the area of financial regulation. In the politics of finance literature, for example, levels of judicialization are linked more convincingly to the 25 years of national financial liberalization than to degrees of political fragmentation (Moran 1991).

There are additional reasons to take a skeptical view of the political fragmentation thesis. Fragmented polities do not necessarily produce formalization. The evidence presented above lends support to Sabel and Zeitlin's opposing argument that multi-polar or polyarchic distributions of power may also be scope conditions of experimentalist governance. Debate in response to the Himalaya Report appears to bolster their argument further. A near-consensus has emerged in favor of pushing networked governance to its limits, intensifying CESR's non-binding deliberation and decision-making mechanisms without replacing them with hierarchical forms. Few national or EU decisionmakers

have preferred more formalization in the form of a European agency or increased formal powers for Level 3 committees – despite tremendous pressure to lower regulatory costs, increase flexibility, improve safeguards against systemic risks and establish legal certainty for market participants.²⁹ Instead, as the conclusion demonstrates, policymakers have thus far insisted on reforming the current non-binding decision-making apparatus.

This evidence combined with the findings in other chapters cautions against applying the judicialization proposition in an overly deterministic fashion. The drive for legal certainty by market participants in the context of multi-polar power distributions might well result in formalization and adversarial legalism. But the constraints of polyarchy act as a countervailing force, at least over long spans of time. Recognizing these constraints and wanting to stretch the new governance arrangements in European finance as far as they will go, EU member governments, the European Commission and the EP have placed CESR and its sister committees in banking and insurance under tremendous pressure to improve their capacity to converge national implementation, interpretation and supervision (Ecofin 2007). In order to achieve this aim, policymakers have shown surprising creativity by being willing to discuss issues and make adjustments unimaginable just a few years ago. Currently on the table are the harmonization of sanctioning powers among national regulators, the insertion of EU coordination as part of national agencies' mission statements and the replacement of consensus-based decisions with qualified majority voting (though keeping the non-binding nature of such votes). If implemented, this list would blur the line between classical hierarchical and experimentalist forms of governance, making it impossible to know a priori the extent to

which rule interpretation by judges or other “final” traditional decision-makers might be balanced or replaced by rulemaking by such a body. More broadly, it suggests there is a false dichotomy between the choices presented in recent policy analyses between evolutionary consensus-building among national authorities and a new EU agency-like body with a single rulebook and sanctioning powers (Veron et al. 2007: 6-8). A CESR, enhanced along the above lines, would be a new type of creature, fitting neatly into neither category and raising the critical question of whether it could satisfy the regulatory needs of markets and governments.

Conclusion

In sum, the Lamfalussy Process, a variant of the experimentalist architecture found across multiple sectors within the EU, largely reflects unsettled political relationships rooted in balance-of-power struggles. In the context of immense pressures to produce pragmatic regulatory solutions, such contests pushed policymakers to build on existing arrangements. These findings not only help to explain CESR’s central role but also suggest that analogous causal paths lie behind the emergence of similar groupings of national authorities in other regulatory areas.

In addition, the empirical record reveals the potential for such bodies to transform themselves into powerful and autonomous political actors. In the case of EU financial regulation, the presence of CESR and its ability to advocate for itself and reshape the political environment in which it operates has profoundly altered the debate about future governance.³⁰ By early 2008, it was clear that new models for reforming the original Lamfalussy set-up (should it prove inadequate) had replaced the traditional idea of resorting to a Europe-wide hierarchical agency modeled on the SEC.³¹ The existence of

CESR and the other so-called Level 3 committees (CEBS, the Committee of European Banking Supervisors, and CEIOPS, the Committee of European Insurance and Occupational Pensions Supervisors) is among the main reasons for this change.

As the 2007-2008 financial crisis unfolded, the need to reform prudential arrangements to ensure against the risks of systemic banking crises – a topic too politically sensitive for the Lamfalussy Committee to address in 2000 and 2001 – overwhelmed all regulatory reform discussions, including those concerning the conduct of business and maintenance of securities markets (Council 2008). Within a few months, the reform agenda had shifted. The question of whether a rulemaking body comprised of independent authorities – relying on deliberation and consensus rather than binding decision-making powers – could satisfy the regulatory needs of markets and governments was swept aside by urgent questions about the ability of the Lamfalussy process to mitigate a run on banks and a crisis of confidence. The attention to systemic risk will likely mean a new layer of governance to coordinate the three separate realms of EU financial regulation: securities, banking and insurance. Mirroring calls in the US to cast aside depression-era arrangements that separate the regulation of commercial and investment banks, EU policymakers have already moved in this direction (Council 2008). Whatever the final form of the future coordination mechanism, EU power politics will constrain the available choices, making it likely that CESR and its banking and insurance counterparts will remain intact and continue rulemaking via some form of the current experimentalist techniques.

Finally, EU financial governance transformation has already brought an end to US regulatory dominance at the international level.³² In the first post-hegemonic phase, EU

representatives have successfully pressured US officials to compromise over long-standing conflicts. The resulting transatlantic cooperation – and therefore continuation of the current global financial regime – stems in large part from shared principles established under decades of American leadership. What will happen in future phases if distinctively American style financial regulation loses its luster and appeal in the aftermath of the current crisis? The presence in the EU of the new experimentalist governance arrangements is likely to be among the most decisive factors.

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¹ See the European Commission's *Financial Integration Monitor*, europa.eu; the ECB's *Financial Integration in Europe*, www.ecb.int; and reports by the Capital Markets and Financial Integration in Europe Network, www.eu-financial-system.org.

² Commission Decision of June 6, 2001 (2001/527/EC).

³ I discuss this literature in Posner 2008, Chapter 2.

⁴ Prudential regulation aims to reduce the risk of systemic crises. The architects of the Lamfalussy Process limited the new regime to the regulation of markets and conduct of business (Lamfalussy 2000 and 2001).

⁵ Parts of this section are based on Posner 2007.

⁶ Council Directive 88/361/EEC.

⁷ The term “battle of the systems” comes from Story and Walter 1997. Several authors, however, do consider the post-SEA EC financial legislation as a significant achievement (Coleman and Underhill 1995 and Jabko 1999).

⁸ See, for examples, Art. 129 of the Capital Requirements Directive (Directive 2006/48/EC of the EP and of the Council, June 14, 2006) and Chapter 2, Arts. 56-62 of the Markets in Financial Services Directive (Directive 2004/39/EC of the EP and Council, April 12, 2004).

⁹ Council Decision of July 17, 2006 (2006/512/EC) amending Decision 1999/468/EC. Even with the inter-institutional agreement, Parliament’s continued demands promise frequent review of the basic delegation agreement. For example, the EP continues to press for observer status in Level 2 committees (i.e. ESC). See EP 2007, point 44.

¹⁰ For evidence that financial regulation is a central forum for the on-going inter-institutional power struggles, see Almer 2006.

¹¹ Jabko 2006; Posner 2005.

¹² The four are the Market Abuse Directive, Prospectus Directive, Transparency Directive and Markets in Financial Instruments Directive (MiFID). A modified version of Lamfalussy Level 2 and 3 procedures also apply to the implementation of the UCITS III Directive because the UCITS Contact Committee transferred its responsibilities to the ESC and CESR. See www.CESR-EU.org.

¹³ Exceptions include Coleman and Underhill 1995; Story and Walter 1997; Underhill 1997; Posner 2005 and 2008; Jabko 2006; Mügge 2006.

¹⁴ Comment made at “The New Transatlantic Agenda and the Future of Transatlantic Economic Governance” Workshop, the Robert Schuman Centre for Advanced Studies at the European University Institute, Florence, June 18-19, 2004.

¹⁵ Large financial services firms can easily produce commentary at the EU-level, while continuing to rely on traditional national lobbying channels (Coen 2007). Also, Grossman argues that firms revert to conventional relationships with national officials when facing uncertain political arrangements (Grossman 2004).

¹⁶ See CESR’s consultation sections, especially on MiFID level 2 measures, www.cesr-eu.org.

¹⁷ See UBS Investment Bank comments in response to CESR’s July 2007 Questionnaire on the Assessment of CESR’s Activities, www.cesr-eu.org.

¹⁸ The question reads: “How would you assess the influence of CESR in the EU legislative framework?” The possible answers were: “Very Low, Quite Low, A Fair Amount of Influence, Quite High and Very High”. (www.cesr-eu.org)

¹⁹ IIMG 2007 gives an overview of the issue.

²⁰ Quoted from press release, May 19, 2005, www.henri-weber.fr/article/articleview/2202/1/1870/.

²¹ At that meeting, Ecofin endorsed FSC and Commission reports that adopted much of CESR’s agenda. Commission 2005; Council of the EU 2006; Financial Services Committee 2006; McKee 2006.

²² See Tommaso Padoa-Schioppa’s letter to Ecofin, dated November 26, 2007

²³ www.cesr-eu.org. See “Documents” for CESR’s role in EU-US relations.

²⁴ “Questionnaire on Assessment of CESR’s Activities Between 2001 and 2007,”
www.cesr-eu.org.

²⁵ CESR’s website (www.cesr-eu.org/index.php?page=groups&mac=0&id=23).

²⁶ See CESR’s website (www.cesr-eu.org/template.php?page=groups&id=23&keymore=1&BoxId=1).

²⁷ According to CESR’s charter, unlike decisions related to Level 1 and 2, decisions concerning the coordination of supervision require unanimity. It is unclear whether this applied to the Himalaya Report.

²⁸ ec.europa.eu/internal_market/finances/fscg/index_en.htm.

²⁹ Council 2006; EU FSC 2006; Commission 2005; EP 2006 and 2007; Also, see comments in response to CESR 2004, www.cesr-eu.org. An important exception can be found in Italian Finance Minister Tommaso Padoa-Schioppa’s letter to Ecofin, dated November 26, 2007. Also of note are Veron 1997 and Pauly 2007.

³⁰ For a similar conclusion about CESR’s path-changing role as well as that of other EU bodies of national regulators, see Thatcher and Coen 2008.

³¹ The Lamfalussy reports discuss the infeasibility of a European SEC (Lamfalussy 2000, 2001).

³² Thatcher and Coen 2008.