

## REGEM Analysis 13

**The Participation of Interest Groups in the Lamfalussy  
Process.****A New Quality of Participatory Legitimacy?**

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**Abstract**

A new EU regulatory procedure, the “Lamfalussy Process“, is currently extended from securities to insurance and banking. One of its main features is the emphasis placed on formal and transparent consultations of interest groups. The paper analyses the design of the Lamfalussy Process as well as its implications on the securities sector, where the dialogue between regulators and private actors has intensified after a start-up time. It is concluded that EU financial market regulation benefits from the legitimacy generated through enhanced opportunities for participation, since it supports the acceptance of regulation among the affected private actors.

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## Introduction

Until recent years, the integration of financial markets developed slowly compared to other economic sectors. Effective regulation at the EU-level and thus a harmonisation between the Member States was missing. In order to promote the creation of a single financial market, a new regulatory process for the securities sector was introduced, which should speed up regulation and increase the participation of market actors in the decision-making procedure: the “Lamfalussy Process”. Not much has been written about this new process, which sets the rules for activities on the stock markets in the EU and therefore plays an important role in guaranteeing economic stability as well as the competitiveness of the EU in a globalised world. Literature about securities market regulation in the EU largely focuses on the question whether a pan-European Single Financial Authority should be established as a regulator. This idea was rejected in favour of the Lamfalussy Process, which relies on national regulatory authorities for implementing regulation. With its extension to banking and insurance in 2004 it is now applied to the regulation of the entire financial sector.

The financial sector is a highly regulated industry, as regulators have to deal with information asymmetries in order to provide fair market conditions. However, regulators inevitably set rules, which harm the business of some market participants, but prove to be positive for others. Thus, it is essential that securities market regulation is viewed as legitimate, since the importance of legitimacy does not only derive from a normative belief that a regulator should be one, which is seen as justified and acceptable by the regulated.<sup>1</sup> Instead, legitimacy can also be seen from a quite functional or practical point of view: if the regulator is regarded as legitimate, its authority is more stable. The function of legitimacy beliefs is therefore to ensure effective government and it rests on trust in institutional arrangements.<sup>2</sup> Consequently, the success of regulation adopted through the Lamfalussy approach is influenced by the legitimacy of this regulatory procedure.

This working paper is restricted to the application of the Lamfalussy Process to the securities sector. It introduces to the structure and main features of the Lamfalussy

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<sup>1</sup> See Walker, Neil (2003), “The White Paper in Constitutional Context”, *Symposium: Mountain or Molehill? A Critical Appraisal of the Commission White Paper on Governance*, Jean Monnet Center, NYU Law School, New York, <http://www.jeanmonnetprogram.org/papers/01/011001.html> [11.07.2003].

<sup>2</sup> See Scharpf, Fritz (2003), “Problem-Solving Effectiveness and Democratic Accountability in the EU”, *MPIfG Working Paper*, No. 03/1, Max Planck Institute for the Study of Societies, Cologne, <http://www.mpi-fg-koeln.mpg.de/pu/workpap/wp03-1/wp03-1.html> [08.06.2003].

Process and gives an overview to the interaction of private and public actors in securities market regulation at the EU-level. Reflecting the practical implications of the Lamfalussy Process so far, it will be suggested that the new regulatory process profits from the participatory legitimacy that is created through the enhanced participation of the market actors.

## 1. The Need for Regulation

Definitions of regulation vary, but in this work the term means “sustained control exercised by a public agency over activities that are generally regarded as desirable to society”.<sup>3</sup> Regulation is distinctive from legislation as it refers exclusively to industries or economic sectors and is therefore not universally valid. It includes not only rule making, but also the supervision of market participants as well as enforcement and sanctioning of breaches of the rules.<sup>4</sup> The necessity of regulating markets derives from the fact that markets are not natural arrangements, which can exist without preconditions. Instead, they need a constituting framework of rules like the provision of property rights and contract law.<sup>5</sup>

The securities market plays a crucial role in the economy by mobilizing savings and channelling capital to profitable companies. Nowadays, economic growth is said to be highly interconnected with an efficient financial market in which the securities market constitutes the “organized and unorganised markets for financial securities, such as stocks, bonds, bills as well as derivative securities with stocks, bond and bills as underlying securities.”<sup>6</sup> At the same time, the systemic risks are especially high in this sector and it inherently has a substantial asymmetry of information – between company insiders or analysts and small investors, for example - that is larger than in other economic sectors.<sup>7</sup>

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<sup>3</sup> Selznick, Philip (1985), “Focusing organizational research on regulation”, in, Noll, Roger (ed.), *Regulatory policy and the social sciences*, Berkeley, pp. 363 - 367, here: p. 363.

<sup>4</sup> See Heilmann, Sebastian (2001), “Der chinesische Aktienmarkt (I): Staatliche Regulierung und institutioneller Wandel”, *China Analysis*, No. 3, Trier University, <http://www.regem.org> [12.06.2004], p. 5.

<sup>5</sup> See Eberlein, Burkhard (2000), “Regulierung und die Konstitution von Märkten in Europa”, in, Czada, Roland / Lütz, Susanne (eds.), *Die politische Konstitution von Märkten*, Wiesbaden, pp. 89-106, here: p. 90, fn. 2.

<sup>6</sup> Niemeyer, Jonas (2001), “Where to Go after the Lamfalussy Report? - An Economic Analysis of Securities Market Regulation and Supervision”, *SSE/EFI Working Paper Series in Economics and Finance*, No. 482, Stockholm School of Economics, <http://swopec.hhs.se/hastef/papers/hastef0482.pdf> [10.06.2003], p. 6.

<sup>7</sup> See Kern, Steffen (2002), “EU on the bumpy road to a single market in financial services”, *Financial Market Special*, Deutsche Bank Research, [http://www.dbresearch.de/PROD/DBR\\_INTERNET\\_EN-PROD/PROD000000000043773.pdf](http://www.dbresearch.de/PROD/DBR_INTERNET_EN-PROD/PROD000000000043773.pdf) [14.06.2003], p. 12.

The need for regulation of the securities sector is therefore broadly accepted.<sup>8</sup> Regulating securities markets, however, is far from easy as public regulation is expected to enforce competitive markets and to correct undesirable social and political effects of functioning competitive markets at the same time.<sup>9</sup> Facing the potential conflicts between market-making and redistributive market-correction and thus between competition and public interest, the regulators are from time to time confronted with contradictory political objectives.<sup>10</sup> It is questionable from the perspective of democratic legitimacy, whether regulators not subject to accountability through democratic elections, should deliberate about those objectives.<sup>11</sup> This is especially true for the regulation of securities markets as it has not only an impact on economic growth and stability, but also influences the political and social systems of modern political economies.<sup>12</sup>

Although less vulnerable than emerging markets, industrialised states like the United States (US) or the European states can be severely affected by regulatory scandals in the field of securities markets – not only in economic but also in political terms. The public showed a lot of interest in the Enron and Worldcom scandals in the US and their links with the political system.<sup>13</sup> Hence, a policy field like the regulation of securities markets, which does not attract much public attention in the absence of scandal, can rapidly become a salient public issue. Due to the complex nature of the field, it is difficult to find monitoring attention outside a narrow circle of experts. Regulatory failures, however, might rapidly question the legitimacy of the existing regulatory approach or even the whole government. As a consequence, the design of a regulatory procedure is highly relevant for the acceptance of regulation, since it identifies the responsible political institutions and outlines the chances and rules for market actors to participate in the decision-making process.

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<sup>8</sup> See *The Economist* (2001), “Global capital rules, okay?”, March 3<sup>rd</sup>.

<sup>9</sup> See Eberlein, op. cit., p. 91-93.

<sup>10</sup> See Caporaso, James (1996), “The European Union and Forms of State: Westphalian, Regulatory or Post-Modern?”, *Journal of Common Market Studies*, Vol. 34 No. 1, pp. 29-52, here: p. 43.

<sup>11</sup> See Eberlein, op. cit., p. 97.

<sup>12</sup> Heilmann therefore speaks of capital markets as the “central nervous system” of modern political economies (Heilmann, Sebastian (2003), “Capital Market Reforms as an Economic and Political Process”, *REGEM Analysis*, No. 1, Trier University, <http://www.regem.org> [07.06.2004], p. 1.

<sup>13</sup> See Gottwald, Jörn-Carsten (2003), “Finanzmärkte und staatliche Gesetzgebung. Warum Finanzmärkte für Politik und Politikwissenschaft so wichtig sind”, *REGEM Analysis*, No. 2, Trier University, <http://www.regem.org> [07.06.2004], p. 13/14.

## 2. The Launch of the Lamfalussy Process

Until recent years, despite the often-advocated benefits of a single financial market, integration developed slowly, lagging far behind in comparison to other economic sectors embraced in the Single Market Programme forty years ago. The realisation of a single market in financial services differs from that in other economic sectors as more efforts are required. For example, regulations have to take into account the wide variety of products and services that exist, as well as the diversity of providers ranging from small firms to multinational companies. Financial services are also subject to special supervision by regulators to minimize systemic risks and asymmetric information. Thus, each national financial market is regulated by a number of national laws and often supervised by several authorities.<sup>14</sup> This strong fragmentation is a significant barrier to harmonisation as the Member States proved reluctant or adverse to the prospect of changing their regulatory tradition, which had grown over a long period of time.

The awareness that a lack of European regulation is “a major handicap”<sup>15</sup> for the integration of the financial market in various areas led to the adoption of the European Commission’s Financial Services Action Plan (FSAP) by the Member States at the Lisbon European Council in March 2000. The FSAP consisted of 43 measures that aimed at creating a single European wholesale market, open and secure retail markets, prudential supervision, and other conditions for a single financial market. They should be implemented (and transposed into national law where necessary) by 2005, measures relating to the single investment market as early as 2003.<sup>16</sup> However, experts from the private and public sector doubted that these deadlines could be met, since the highly needed legislation progressed at an “escargot’s pace”<sup>17</sup>. At that time, in order to pass a piece of regulation, the European Commission had to submit a proposal both to the Council of Ministers and the European Parliament, who then made their decision based on a complex co-decision procedure, outlined in Art. 251 of the Treaty. Across all policy domains, this procedure needed on average two years before final agreement was reached and it took even longer in the financial services area.<sup>18</sup> That time-

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<sup>14</sup> See Kern, op. cit., p. 4/5.

<sup>15</sup> Committee of Wise Men (2001), *Final Report of The Committee Of Wise Men On The Regulation of European Securities Markets*, European Commission, [http://europa.eu.int/comm/internal\\_market/en/finances/general/lamfalussyen.pdf](http://europa.eu.int/comm/internal_market/en/finances/general/lamfalussyen.pdf) [02.06.2003], p. 11.

<sup>16</sup> See Kern, op. cit., p. 9.

<sup>17</sup> *The Economist* (2000), “Europe’s regulatory muddles: A single market and a single currency demand a single set of financial rules”, June 10th.

<sup>18</sup> See Committee Of Wise Men, op. cit., p. 13/14.

consuming decision-making process delayed the benefits of a single financial market and was judged not to be appropriate to the regulation of rapidly changing securities markets, which demand instant reactions by regulators.

In July 2000 the European finance ministers therefore mandated seven “Wise Men”, who were central bankers and market participants, to design a new and speedier regulatory procedure for the securities markets. The Committee of Wise Men, which was chaired by Alexandre Lamfalussy, published its report in February 2001 and recommended a four-level-approach of regulation often referred to as the Lamfalussy Process, which was adopted at the Stockholm Council in 2001. This new approach should speed up the decision-making procedure and cope with the increasing demand for transparency, for example by obliging the Commission to consult market participants on forthcoming proposals. In addition, it should improve the implementation of agreed regulations and directives in the Member States.<sup>19</sup>

The Lamfalussy Process consists of four levels.<sup>20</sup> On Level 1 the Council of Ministers and the European Parliament decide on the basic political choices through the normal co-decision procedure. The technical details needed for implementation (implementing measures), however, are added on Level 2. The co-legislators delegate the task and scope of Level 2 legislation to the Commission on a case-by-case basis.<sup>21</sup> Implementing measures are then adopted according to a rule-making procedure called “comitology”, already operating in a variety of other issue areas in the EU. Comitology is the existence and activity of committees in the European Union in which members of the Commission co-operate with delegates of the Member States in order to implement European political programs.<sup>22</sup> The Lamfalussy Process makes use of a slightly modified comitology procedure since two committees were set up: the Committee of European Securities Regulators (CESR) and the European Securities Committee (ESC). CESR operates outside the comitology procedure and is an independent body of experts on securities markets, composed of high-ranking representatives of the national

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<sup>19</sup> See *Ibid.*, p. 24/25.

<sup>20</sup> See also table on page 10.

<sup>21</sup> See Inter-Institutional Monitoring Group (2003), *First Interim Report Monitoring the New Process for Regulating Securities Markets in Europe (The Lamfalussy Process)*, EU-Commission, [www.europarl.eu.int/compar/econ/lamfalussy\\_process/iimg/monitoring](http://www.europarl.eu.int/compar/econ/lamfalussy_process/iimg/monitoring) [12.06.02003], p. 42/43.

<sup>22</sup> See Töller, Annette Elisabeth (2002), *Komitologie: theoretische Bedeutung und praktische Funktionsweise von Durchführungsausschüssen der Europäischen Union am Beispiel der Umweltpolitik*, Opladen, p. 15.

regulators.<sup>23</sup> On Level 2, CESR acts as an advisor for the Commission, preparing a proposal for implementing measures after consultation with market participants.<sup>24</sup> The European Securities Committee (ESC) is the comitology committee, composed of high-ranking representatives of the Member States (usually the deputy finance ministers).<sup>25</sup> The ESC votes on the implementing measures proposed by the Commission, which takes into account the technical advice of CESR. Co-ordinating and ensuring the consistent implementation of the measures through national regulators and supervisors, CESR is the main actor on Level 3. Level 4 deals with the enforcement of EU legislation by member states, which is in the responsibility of the Commission.<sup>26</sup>

One of the main features of the Lamfalussy Process is therefore the decomposition of legislation into framework legislation (Level 1) and technical implementing measures (Level 2). In the future, the technical details of a directive passed through the Lamfalussy Process can be changed and adapted to market needs by the Commission and the committees on Level 2 – and thus without going through the long co-decision procedure of Level 1 again. Moreover, the tasks and interaction of decision-makers are better defined than before. For example, the national regulators, previously organised in the only informal “Forum of European Securities Commissions” (FESCO) now co-ordinate in CESR as a formal committee. Thus, they have institutionalised rights and responsibilities since CESR is the advisor for the Commission (Level 2) and coordinator between the national regulators (Level 3). In order to profit from the expert knowledge of market participants, the Wise Men demand extensive consultation through several stages of the process.

The recommended Lamfalussy Process received a mixed welcome, some were enthusiastic and others were sceptical. Failing of the new process could lead to a “vote by feet”, where market participants, especially in the wholesale market, might leave for other legislatures.<sup>27</sup> Since its introduction, the process has changed the mode of interaction among public and private actors, which is specified in the following chapters.

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<sup>23</sup> The correspondent institution to CESR in the insurance sector is the Committee of European Insurance and Occupational Pensions Supervisors (CEIOPS) and in the banking sector the Committee of European Banking Supervisors (CEBS).

<sup>24</sup> See Committee Of Wise Men, op. cit., p. 31/32.

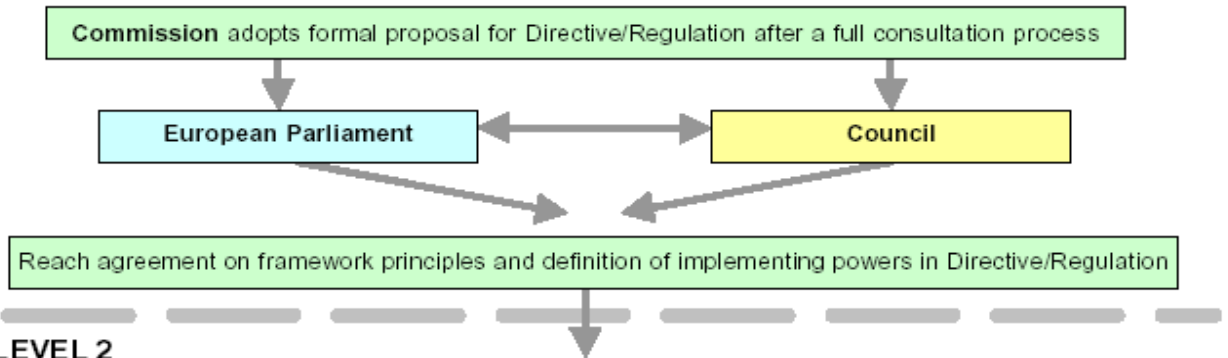
<sup>25</sup> The equivalents of the ESC in the insurances and banking markets are the European Committee on Insurance (EIOPC) and the EU Banking Committee (EBC).

<sup>26</sup> See Committee Of Wise Men, op. cit., pp. 30/31, 46/47.

<sup>27</sup> See Walter, Norbert (2003), “The Lamfalussy Framework: A View from the Inside”, *Presentation at the ZEW-Conference ‘Regulation and Supervision of Financial Markets and Institutions in the EU’*, Zentrum für Europäische Wirtschaftsforschung, Mannheim, unpublished.

## THE FOUR-LEVEL APPROACH RECOMMENDED BY THE COMMITTEE

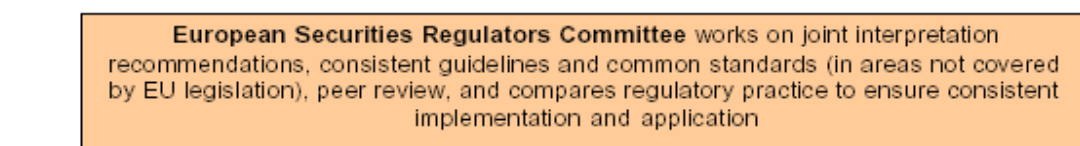
### LEVEL 1



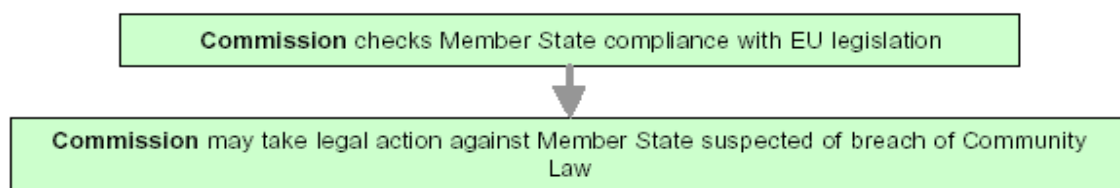
### LEVEL 2



### LEVEL 3



### LEVEL 4



Source: Committee of Wise Men (2001), *Final report of the Committee of Wise Men on the Regulation of European Securities Markets*, European Commission, [http://europa.eu.int/comm/internal\\_market/en/finances/general/lamfalussyen.pdf](http://europa.eu.int/comm/internal_market/en/finances/general/lamfalussyen.pdf) [02.06.2003], p. 9.

### 3. Interaction between Public and Private Actors

Across all policy areas Brussels experienced a sharp increase in the number of lobbyists and interest groups in the recent years. It is estimated that over 10000 persons work in this business in Brussels today, including profit and non-profit organizations.<sup>28</sup> Lobbyists seek to shape political decision-making in their own or in their clients' best interest. Researchers on European Politics largely agree that lobbyists, who observe a line of conduct are necessary and healthy for decision-making, since they analyse the likely impact of measures and suggest changes. Thus, politicians can gain from the expertise and information of lobbyists, which is decisive for the quality of laws.<sup>29</sup> However, “[c]ivil servants and politicians would be well advised to treat lobbyists as what they are: a source of information which may be partial!”<sup>30</sup>

Lobbying in Brussels is said to have its own special features. It is more heterogeneous in terms of culture, attitudes and standards of living and the lobbyists have to take into account the possible effects of the translation of legislation into the various languages of the Union. Besides, the complex institutional structures and procedures of decision-making in the EU require a lot of knowledge from lobbyists.<sup>31</sup> Since the Amsterdam Treaty, which came into force in 1999, most laws are drawn up under the co-decision procedure, in which the weight of the Council and the European Parliament is equal. Thus, a lobbying campaign has to influence the drafting process in the Commission as well as the important committees and working-groups in both the Council and the Parliament. Even after the adoption of a rule, the lobbyist has to care whether implementation will follow and be in line with the directive.<sup>32</sup> Moreover, he has to compete with his counterparts on the European, regional, national and even subnational level.<sup>33</sup> This environment does not only produce a complex business of lobbying but also works as a safeguard against corruption: several political institutions at the EU-

<sup>28</sup> Michaelowa, Axel (1998), “Übertragung des Demokratiemodells der Neuen Politischen Ökonomie auf die Klimapolitik“, *HWWA-Diskussionspapier 53*, HWWA-Institut für Wirtschaftsforschung, [http://www.hwwa.de/Publikationen/Discussion\\_Paper/1998/53.pdf](http://www.hwwa.de/Publikationen/Discussion_Paper/1998/53.pdf) [02.05.2004], p. 31.

<sup>29</sup> See Michalowitz, Irina (2004), “The EU in search for its balance: democratic standards, political autonomy, and the influence of interest groups. Examples from the IT and transport sector”, *Conference on Interest groups in the 21st century in France and Europe. An inter-disciplinary perspective*, Paris; Hirst, Paul (1990), *Representative Democracy and its limits*, Oxford; Bouwen, Pieter (2002), “Corporate Lobbying in the European Union. The Logic of Access”, *Journal of European Public Policy*, Vol. 9 No. 3, pp. 230-254; Coen, David (1997), “The Evolution of the Large Firm as a Political Actor in the European Union”, *Journal of European Public Policy*, Vol. 4 No. 1, pp. 91-108.

<sup>30</sup> Pedler, Robin / Van Schendelen, Marinus (1994), *Lobbying in the European Union. Companies, Trade Associations and Issue Groups*, Aldershot, p. 310.

<sup>31</sup> See Euroconfidential S. A. (2001), *Lobbying in the European Union*, Genval, p. 6/7.

<sup>32</sup> See *Ibid*, p.13/14.

<sup>33</sup> See Töller, op. cit., p. 36.

level and also in the Member States are involved in the decision-making process in a way that gives them the power to veto decisions or at least to significantly amend them. The use of bribes is therefore often pointless and regulatory capture unlikely, since a private actor would need to control multiple veto-positions in the decision-making process.<sup>34</sup>

Concerning securities market regulation, a large number of political institutions in the EU are engaged in this policy field: At the level of the Commission, the two Directorates Financial Markets and Financial Institutions of the Directorate-General Internal Market are the main players. In the context of retail markets, the DG Consumer Protection sometimes participates by emphasizing the interests of private investors. In the Council of Ministers, the ECOFIN Council that represents the national Finance Ministries, and the respective council working groups are involved. The interest groups try to establish a continuous relationship with the Financial Attachés of the Permanent Representations of the Member States, which participate in and prepare the meetings of ECOFIN. In the European Parliament the main stakeholder is the Committee on Economic and Monetary Affairs (ECON), with several of its members having a good reputation in the industry for their expertise on securities markets regulations.<sup>35</sup> Under the Lamfalussy Process the cooperation between national regulators, previously organised in the informal Forum of European Securities Commissions (FESCO), gained formal status through the establishment of CESR.

In order to shorten the whole process of adoption, CESR starts working and consulting on the technical details of measures when the Council and the Parliament are still negotiating about the political principles and the final split between Level 1 and Level 2 legislation. CESR is then working on the basis of provisional mandates, which do not prejudice the ongoing negotiations between the co-legislators. The official permission in the shape of a formal mandate is sent to CESR once the Council and the Parliament have adopted a directive. Thus, lobbyists have to deal with the negotiations between the co-legislators and those in CESR at the same time. They also need to ensure national contacts to gain information on developments in the ESC.<sup>36</sup> This enhances pressure on

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<sup>34</sup> See Moravcsik, Andrew (2001), "Despotism in Brussels?", *Foreign Affairs*, May/June, pp. 114-122. here: p. 120.

<sup>35</sup> See Mijs, Wim / Puebla, Asunción Caparrós (2002), "Making the Single Market in Financial Services a Reality", in, Pedler, Robin (ed.), *European Union Lobbying. Changes in the Arena*, New York, p. 262/263; *FT.com site* (2004), "Credit due to Brussels' achievement", April 18<sup>th</sup>.

<sup>36</sup> See Dombey, Daniel / Guerrera, Francesco / Mann, Michael (2002), "The power that sits over Europe", *Financial Times*, August 22<sup>nd</sup>.

lobbyists, who have to try to influence several institutions at once.<sup>37</sup>

Among private actors, the FSAP attracted the attention of numerous European and national trade and business associations, consumer interest groups as well as the representatives of big companies.<sup>38</sup> A comparison of European profit and non-profit organizations concerned with issues like the FSAP displays existing inequalities in the organization of consumer and business interests in the securities sector. Alexandre Lamfalussy himself admitted that it was obvious that investor groups were “very poor organised”<sup>39</sup> in the legislative processes for the prospectus and takeover directives, although decisive consumer interests were at stake and the Enron scandal should still have been in mind. For this working paper a survey was conducted in June 2003 among the members of the ECON about the representation of consumer interests. One member of the ECON stated that in four years neither the European Consumers “Le Bureau Européen des Unions de Consommateurs” (BEUC) nor the European Small and Medium Enterprises Association have contacted her office regarding securities legislation. European and national shareholder activists suffer from poor organisation and a lack of funding. Most of them are non-profit organisations, depending on membership fees for funding, but membership spreads slowly despite the growth of an “equity culture” in the European population. The Europe-wide activist group Euroshareholders cannot fund the post of a full-time secretary-general. Moreover, shareholder groups lack unity. For example, Britain’s biggest associations, the “ProShare” and “the Guild of Shareholders”, as well as others are not part of Euroshareholders.<sup>40</sup>

In the press and academic analysis, however, there are hardly any complaints about a neglect of consumer interests in respect to securities market regulation, but more often about too much consumer protection.<sup>41</sup> Nearly all members of the ECON participating in the survey also reject the assumption that European institutions involved in the Lamfalussy Process pay more attention to the interests of the industry than to those of consumers and small and medium sized enterprises (SMEs). The European Parliament,

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<sup>37</sup> See Walter, op. cit.

<sup>38</sup> There are for example the British Bankers Association, Federation of European Securities Exchanges, Union of Industrial and Employers’ Confederations of Europe, European Federation of Accountants, the French Banking Fédération, the activist group Euroshareholders and the British shareholder group “ProShare”.

<sup>39</sup> *Financial Times* (2002), “Standing up for shareholders is a toil in Europe: Activists are suffering from poor organisation and a lack of funding”, March 12<sup>th</sup>.

<sup>40</sup> See *Financial Times*, op. cit.

<sup>41</sup> Survey of articles in the *Financial Times*, *The Economist* and *Handelsblatt* from February 2001 onwards.

in particular, places emphasis on the interests of the public, consumers and small and medium sized companies during open hearings and other forms of consultation.<sup>42</sup> Being the only European institution directly accountable to the electorate, the European Parliament's self-conception became more autonomous over time and it focuses on the defense of the electorate's interest. The European Parliament, more powerful after the Maastricht Treaty in 1992, raises obstacles for the Council of Ministers since it can veto decisions and thus has to be dealt with.<sup>43</sup> Whereas in the Council, national preferences do often prevail in closed negotiations, the European Parliament as a whole is relatively in favour of integrationist politics and transparency in decision-making.<sup>44</sup> Although still lacking important features of "normal" national Parliaments, such as the right of initiative in legislation, the European Parliament is an autonomous supranational institution, which the Member States cannot surpass or control.<sup>45</sup> Almost the same applies to the European Commission that holds the monopoly of legislative initiative in the EU. Over the years it has learnt to coordinate with some Member States against others to pursue its goals.<sup>46</sup> Thus, on the one hand, it might be possible that in some cases the interests of the well-organised business groups dominate the drafting and consultation process in the European Commission because of their financial resources and organisational power, despite the existence of DG Consumer protection. On the other hand, the veto-position of the European Parliament in the co-decision procedure on Level 1 assures that diffuse consumer interests have a voice.

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<sup>42</sup> See Schwaiger, Konrad (2003), "The Lamfalussy Model from the Perspective of the European Parliament", *Presentation at the ZEW-Conference 'Regulation and Supervision of Financial Markets and Institutions in the EU'*, Zentrum für Europäische Wirtschaftsforschung, Mannheim, unpublished.

<sup>43</sup> The Maastricht Treaty in 1993 introduced the codecision procedure. Under the Amsterdam Treaty, the codecision procedure is simplified and extended to other issue areas. (See European Parliament (2002), *Powers of the European Parliament*, [http://www.europarl.eu.int/presentation/default\\_en.htm#powers](http://www.europarl.eu.int/presentation/default_en.htm#powers) [10.08.2003].

<sup>44</sup> See Töller, op. cit., p. 248.

<sup>45</sup> See Muntean, Andrei (2000), *The European Parliament's Political Legitimacy and the Commission's 'Misleading Management': Towards a 'Parliamentarian' European Union?*, European Integration Online Portal, <http://eiop.or.at/eiop/texte/2000-005a.htm> [05.08.2003], p. 5.

<sup>46</sup> See Töller, op. cit., p. 36, fn 18.

#### 4. Practical Challenges for the Lamfalussy Process

The Committee of Wise Men consulted market participants and the public on their plans of establishing the Lamfalussy Process. All respondents supported the committee's analysis of the demands of the European stock markets and also the four-level-approach of the Lamfalussy Process. They emphasized, however, their wish for transparency and broad consultation of market participants since they perceived their past opportunities for participation as insufficient and subject to the "good will" of the EU-institutions.<sup>47</sup> The final report of the committee therefore advised the European institutions to make use of and become obligated to develop consultative papers throughout the Process. In this manner, the participation and consultation of interest groups would be institutionalised and less uncoordinated and uncertain than before.

Hence market participants got upset and disillusioned, when the European Commission presented its proposals of the first two FSAP directives that should be adopted through the Lamfalussy Process, i.e. the "Directive on Prospectuses"<sup>48</sup> and the "Market Abuse Directive" (MAD)<sup>49</sup>: the Commission had not consulted the public and industry, although this was intended in the Lamfalussy report. The disappointment of the securities business turned into scepticism towards the whole FSAP:

"The mood has swung from hope to gloom to finally a determination to make the best of what many believe is a bad idea. The plan, which was widely welcomed at its launch because of its promise of opening up a single European financial market, fell foul of London's investment banking community after the Commission put forward proposals for the directive on prospectuses in May last year."<sup>50</sup>

Since then, the European Commission revised its proposal and has paid much attention to consultation.<sup>51</sup> In this case, the relevance of consultation for the legitimacy of regulation can be seen. Experiencing insufficient consultation, market participants assume that those who draft the legislation are not competent and that regulation results in a threat for business. The resulting regulation is consequently less respected by the main addressees:

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<sup>47</sup> See Committee Of Wise Men, op. cit., p. 46/47.

<sup>48</sup> This directive deals with documents that help investors to assess issuers who want to have their securities traded.

<sup>49</sup> The market abuse directive addresses insider-dealing and market manipulation.

<sup>50</sup> Guerrero, Francesco/ Norman, Peter (2002), "European leaders invested heavily in building a single capital market to rival the US. But the plan has met opposition from vest", *Financial Times*, December 4<sup>th</sup>.

<sup>51</sup> See *FT.com site* (2002), "Back on track", February 4<sup>th</sup>.

“The Commission’s original proposals, drawn up by an Italian official with no experience of the wholesale markets, threatened to dismantle parts of the international capital market in Europe and increase costs for issuers, financial intermediaries and regulators. ‘It left an appalling taste in the mouth,’ said one senior City figure.”<sup>52</sup>

The Council, the Commission and the Parliament each nominated two experts as independent members of the “Inter-Institutional Monitoring Group” (IIMG), which was set up to review the progress of the Lamfalussy Process and report the results to the institutions and publish them on the internet twice a year. Observing the development of the consultation process in its first report of May 2003, the group published a questionnaire asking for the opinion of market participants. The answers concerning consultation in the Lamfalussy Process were largely positive since it was accepted that the process has just started and all participating parties still have to learn.<sup>53</sup> Market participants agreed that co-operation between them and decision-makers had improved, particularly with respect to the Commission. However, consultation documents are often too long and the timeframe for answers too short. The latter is in particular a problem of consultation by CESR.<sup>54</sup> Market participants see this as an inappropriate way of consultation, resulting from the ambitious deadlines of the FSAP that force the Commission to shorten the decision-making process in CESR. This has resulted in widespread concerns that the quick adoption of the FSAP measures might lead to less quality and efficiency of the legislation due to defective consultation.<sup>55</sup> The Commission recognized this and now advocates the importance of embracing the expertise of interest groups through consultation procedures:

“The time invested in consultation at the start of the legislative process will therefore be gained in later stages as the quality of our collective work and its suitability for the market will improve significantly. The analysis of the expected economic impact of legislation should also become a routine part of the EU legislative process.”<sup>56</sup>

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<sup>52</sup> Guerrero/ Norman, op. cit.

<sup>53</sup> See Inter-Institutional Monitoring Group, op. cit., p. 5.

<sup>54</sup> See Ibid, p. 9.

<sup>55</sup> For example: See Matthias, Steffen (2003), “FEFSI’s comments on the first interim report by the Inter-Institutional Monitoring Group on the Lamfalussy Process”, *Comments received on the report of the Inter-institutional Monitoring Group for securities markets*, European Commission, [http://europa.eu.int/comm/internal\\_market/en/finances/mobil/docs/lamfalussy/2003-07-comments-efsi\\_en.pdf](http://europa.eu.int/comm/internal_market/en/finances/mobil/docs/lamfalussy/2003-07-comments-efsi_en.pdf) [15.07.2003], p. 2; See McKee, Michael (2003), “BBA comments on Lamfalussy process”, *Comments received on the report of the Inter-institutional Monitoring Group for securities markets*, European Commission, [http://europa.eu.int/comm/internal\\_market/en/finances/mobil/docs/lamfalussy/2003-07-comments-bba\\_en.pdf](http://europa.eu.int/comm/internal_market/en/finances/mobil/docs/lamfalussy/2003-07-comments-bba_en.pdf) [15.07.2003], p. 2.

<sup>56</sup> European Commission (2003), *Financial Services. Nine months left to deliver the FSAP*, [http://europa.eu.int/comm/internal\\_market/en/finances/actionplan/progress8\\_en.pdf](http://europa.eu.int/comm/internal_market/en/finances/actionplan/progress8_en.pdf) [15.07.2003], p. 12.

Thus, the realisation of the Lamfalussy Process and its obligations of consultation then enabled a wide-ranging input of interests by both civil actors and the involved political institutions.

## 5. Participatory Legitimacy

The elements of participation in the Lamfalussy Process display the diverse and complex multi-level system of the European Union. Not only do Member States interact with the European supranational institutions, but multiple relationships among member states, European supranational actors and the various subnational, national and transnational interest groups exist.<sup>57</sup> The governments of Member States are highly influential when negotiating the Treaties, but in every-day politics supranational institutions should not be regarded simply as the helping hands of Member States. Controlling the European Parliament and the Commission is difficult for the Member States as they exist as a “multiple principal”, encountering problems to act unanimously. The Court of Justice, on the other hand, enjoys independence with its judgements binding for the Member States and – most important in this argument – the political content of its judgements can be highly unwanted for member states.<sup>58</sup>

The Lamfalussy Process achieved a higher involvement of interest groups in the regulatory process by institutionalising consultations. Thus, the information and knowledge of market participants can be accumulated in a more transparent and coordinated way. The European Commission and CESR, in particular, use the Internet to publish consultation papers and the responses of interest groups. This trend generates a new source of input-legitimacy for regulatory processes, which is usually secured through the participation of the citizens of a state. As noted in the beginning of the paper, securities market regulation is a policy field that only receives very little attention outside the circle of experts. The question is how legitimacy and therefore the acceptance of regulation can be achieved under these circumstances?

Applying the requirements for legitimacy of the democratic modern states to the EU would give a disillusioning picture: a collective identity as well as pan-European political

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<sup>57</sup> See Töller, *op. cit.*, p. 37/38.

<sup>58</sup> See *Ibid.*, p. 36.

discourses, parties and media are missing and unrealistic to come into existence in the near future. Input-oriented legitimacy is also very limited: on the one hand, the citizens of the Member States elect the European Parliament since June 1979 and the political rights of the Parliament have steadily increased.<sup>59</sup> On the other hand, however, no pan-European parties are elected, but national ones and research has displayed that the electorates base their decision on national political issues, not European ones. The accountability of European representatives is therefore limited. The same criticism is valid for the Council, which is composed by members of democratically elected national governments, but those elections are not targeted on Europe.<sup>60</sup> The Commission, which has the important monopoly in drafting law, is not elected at all by the people of the Member States. In the literature, several ideas how to solve the democratic deficit of the EU by constitutional changes can be found. However, a pan-European public cannot be built up rapidly by direct election of the president of the Commission or by the adoption of a common constitution. Instead, those ideas can just be the start of a long way or even might be “only utopian, monistic or old-fashioned blueprints, which do not fit the multidimensional legitimacy problem of European governance at all.”<sup>61</sup>

Annette Töller proposes to go back to Robert Dahl in order to develop requirements for legitimacy applicable to the EU. Dahl states that the requirements for democratic legitimacy in the Greek polis and the modern territorial state are different, because direct democracy is less practical in the latter due to the considerably increased size of the population in modern societies. Transferring a part of decision-making to the European level, results in another transformation of the regulatory system into a bigger entity.<sup>62</sup> Along with this transfer, the individual citizen loses some of his opportunities to participate in the political process: “[...] the opportunities for (and importance of) citizen participation decrease with the number of citizens.”<sup>63</sup> Thus, direct democracy was practicable in the Greek polis and representative democracy is in the modern territorial state, but other requirements for democratic legitimacy might be suitable for the EU. Dahl sees a conflict between system effectiveness and citizen participation as a

<sup>59</sup> See Scharpf, Fritz (1999), *Regieren in Europa - Effektiv und Demokratisch?*, Frankfurt am Main, p. 167/168 (English title: “Governing in Europe. Effective and Democratic?”, Oxford).

<sup>60</sup> Kielmansegg, Peter Graf (1996), “Integration und Demokratie”, in, Jachtenfuchs, Markus / Kohler-Koch, Beate (eds.), *Europäische Integration*, Leverkusen, pp. 47-71, here: p. 52/53.

<sup>61</sup> See Hoereth, Marcus (1998), “The Trilemma of Legitimacy - Multilevel Governance in the EU and the Problem of Democracy”, *ZEI Discussion Paper*, C 11, Bonn, [http://www.zei.de/download/zei\\_dp/dp\\_c11\\_hoereth.pdf](http://www.zei.de/download/zei_dp/dp_c11_hoereth.pdf) [02.02.2004], p. 30.

<sup>62</sup> See Dahl, Robert (1994), “A democratic dilemma: System Effectiveness versus Citizen Participation”, *Political Science Quarterly*, Vol. 109, No. 1, pp. 23-34, here: p. 26/27.

<sup>63</sup> *Ibid.*, p. 29.

transformation has to take place to retain problem-solving capacity in the face of globalisation. As a consequence, a kind of citizen participation has to be found at the European level, which is appropriate to its structure of governance and its problem-solving capacity.

It can be argued that European citizens are represented through the diverse business and non-profit organizations in the EU: the landscape of interest groups is already impressively complex, diverse, and to some extent representative although they are not elected by the people. Those civil actors have an influential role as well as good access to the decision-making process, especially in comparison to national politics. Given the heterogeneity and size of the EU, this is often seen as the only way to ensure democracy besides the direct election of a Parliament with less power, without losing output efficiency.<sup>64</sup>

The plausibility of this argument becomes clear when looking at securities market regulation in the EU. The issue is already complex at the national level, raising little attention amongst the general public, but it is even more complicated at the European level. The different cultures, laws and economic systems of 25 states have to be taken into account. Even issue areas which are accessible for the general public on the national level, are too complex at the European level since they automatically embrace international aspects. For that reason, insiders have the responsibility of monitoring regulation and participating in it. The governance system of the EU should therefore strive to optimise this kind of input-legitimacy by ensuring equal representation as far as possible. Extending the supervisory powers of the elected European Parliament in the field of comitology is one way. There are other controversial ideas, particularly those expressed by environmental groups, that the EU should help non-profit organizations with funds to achieve a more representative landscape of interest groups. With respect to securities market regulation that could mean subsidizing European shareholder interest groups and maybe also organisations that deal with the interests of small and medium sized enterprises.

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<sup>64</sup> See “, Hermann (2001), “Willensbildung und Interessenvermittlung in der Europäischen Union”, *Workshop on European Citizenship: Beyond Borders, Across Identities*, Brussels, [http://www.mzes.uni-mannheim.de/projekte/manifestos/schmitt/citizenship\\_workshop.pdf](http://www.mzes.uni-mannheim.de/projekte/manifestos/schmitt/citizenship_workshop.pdf) [17.07.2003]; Töller, op. cit., p. 188/189.

## 6. Conclusion

Participation of interest groups through consultation has become more formal and transparent under the Lamfalussy Process. The new framework gives market participants and political organizations besides the Council of Ministers a greater role in delivering input into decision-making in the form of ideas, expertise and interests. This generates a new quality of participatory legitimacy for securities market regulation at the EU-level, which improves the acceptance of regulation among the market participants as the main addressees. Although the process is new for all participating organizations and still far from routine, the institutionalised participation of market participants is seen as an innovative model of regulation in the EU and is largely praised by both market participants and political actors. Thus, regulation of securities markets in the EU is going to have more characteristics of an “embedded” type of regulation in contrast to a more hierarchical approach. Consequently, a high number of the interest groups in the insurance and banking sectors pushed for the extension of the Lamfalussy Process to their policy field and now hope for comparable improvements.

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