

**REGEM Analysis 16****Evaluating the Efficiency of the Lamfalussy Process:  
the Prospectuses Directive, Takeover Directive and  
MIFID as Case Studies****Lotte Frach, MA**

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**Abstract**

In order to establish a single financial market, in 2002, the European Union introduced a new procedure for securities market regulation: the "Lamfalussy Process". This paper evaluates the efficiency and particularly the output-legitimacy of the new process by analysing three directives, namely the Prospectuses Directive, Takeover Directive and Markets in Financial Instruments Directive (MIFID). It also discusses the inter-institutional conflict between EU institutions concerning comitology procedures such as the Lamfalussy Process. Common complaints about the new legislative procedure, for example the lack of quality and enforcement, are also addressed. It will be argued that the Lamfalussy Process has the potential to improve the quality and speed of regulation. However, whether the benefits of the approach can be fully brought to bear depends on the political will of the concerned actors. In the past, national protectionism has delayed the adoption of directives. Yet, national protectionism is a fundamental problem of EU-Politics, which the Lamfalussy Process cannot be expected to solve. Consequently, the new process should be considered as a well-designed regulatory approach that enables the EU to cope with the challenges of today's securities market regulation.

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**Please cite as:****Autor: Frach, Lotte****Titel: Evaluating the Efficiency of the Lamfalussy Process: the Prospectuses Directive, Takeover Directive and MIFID as Case Studies****REGEM Analysis No. 16, Februar 2008, Trier University****<http://www.regem.org>**

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## Introduction\*

For decades, the integration of financial markets in the EU lagged behind in comparison to other economic sectors. In order to remove the shortcomings of European regulation in this field, the European Commission proposed a Financial Services Action Plan (FSAP). Consisting of 43 measures, the plan aims at establishing a single market in wholesale financial services, open and secure retail markets as well as reinforced rules on prudential supervision. The Member States agreed on the FSAP at the Lisbon European Council in March 2000. However, enthusiasm failed to appear among market participants, politicians and scientists, since they had experienced that the legislative process on EU level was far from efficient: instead, rule-setting for the financial market was famous for progressing at an “escargot’s pace”<sup>1</sup>, being subject to national protectionism and characterized by a lack of transparency and constant consultation with private actors.

The Committee of Wise Men, inaugurated for speeding up the time-consuming EU co-decision procedure with respect to securities market regulation, published its report (“Lamfalussy Report”) in February 2001. It recommended a four-level approach to regulation, often referred to as the “Lamfalussy Process”, in order to ensure the timely adoption and implementation of the FSAP as well as an appropriately flexible and speedy regulation of securities markets afterwards.<sup>2</sup> The Lamfalussy Process has been applied to the EU securities market since 2002 and was extended to the banking and insurance sector in 2004.

Has the new process proved efficient in replacing the “remarkable cocktail of Kafkaesque inefficiency”<sup>3</sup> of the old system? In a previous paper the author has already illustrated the Lamfalussy Process and showed that the participatory legitimacy of EU securities market regulation was enhanced by upgrading the involvement of private actors.<sup>4</sup> In turn, this paper focuses on the efficiency and therefore on elements of output-legitimacy. It presents the successes as well as the “bottlenecks” of the Lamfalussy

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\* State of data: August 2005

<sup>1</sup> *The Economist* (2000), “Europe’s regulatory muddles: A single market and a single currency demand a single set of financial rules”, June 10<sup>th</sup>.

<sup>2</sup> For a more detailed description and assessment of the functionality of the Lamfalussy Process see the author’s previous working paper (Frach, Lotte (2005), “The Participation of Interest Groups in the Lamfalussy Process. A New Quality of Participatory Legitimacy”, *REGEM Analysis 13*, [www.regem.org](http://www.regem.org).)

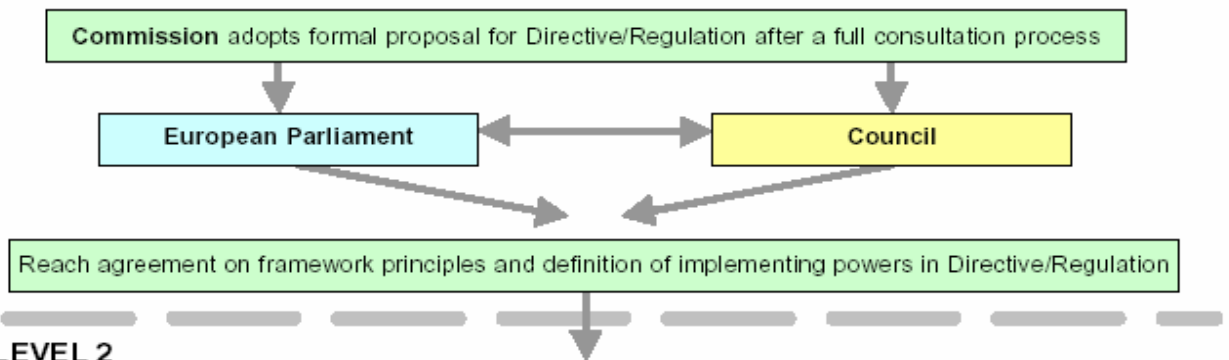
<sup>3</sup> European Commission (2001), *The Chairman of the Committee of Wise Men, Baron Alexandre Lamfalussy’s, opening comments to the Press*, [http://europa.eu.int/comm/internal\\_market/en/finances/general/comments.pdf](http://europa.eu.int/comm/internal_market/en/finances/general/comments.pdf), p. 1.

<sup>4</sup> See Frach (2005), op. cit.

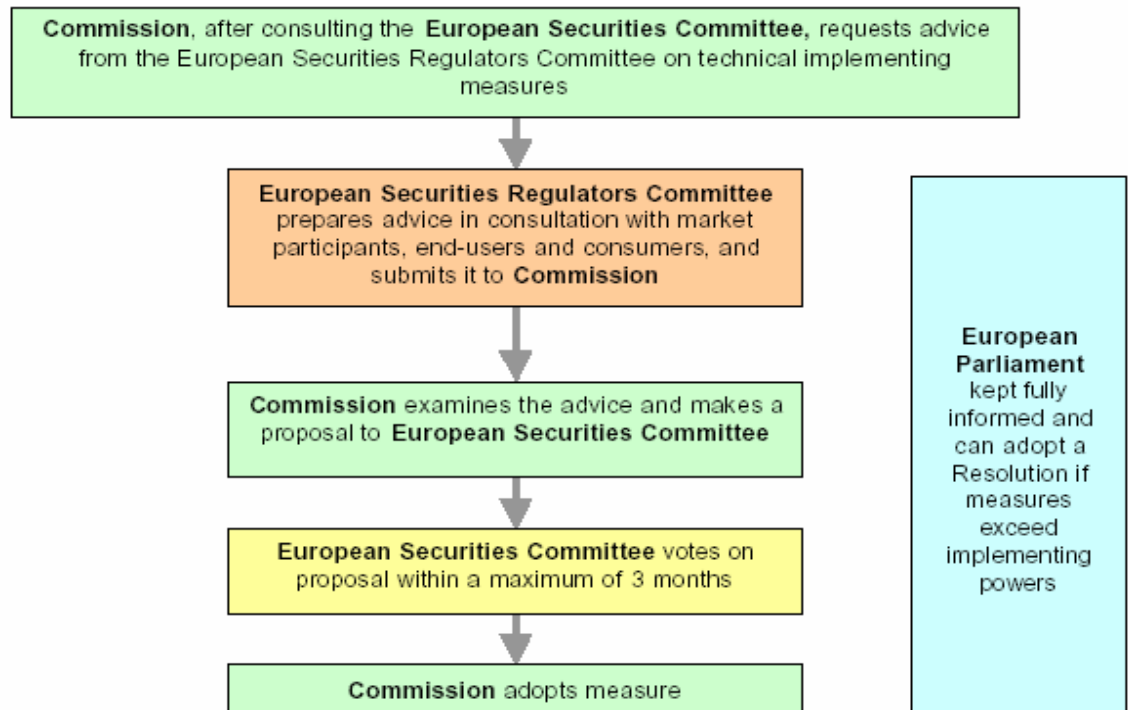
Process, concentrating on how institutions and actors operate within its institutional framework. Therefore, three directives are discussed as case studies.

## THE FOUR-LEVEL APPROACH RECOMMENDED BY THE COMMITTEE

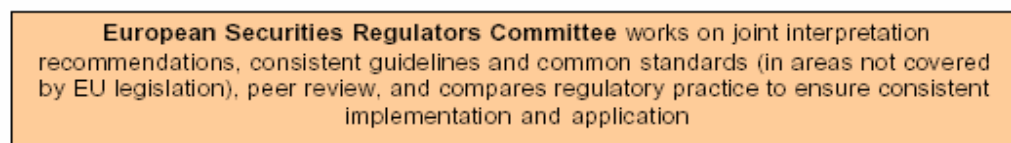
### LEVEL 1



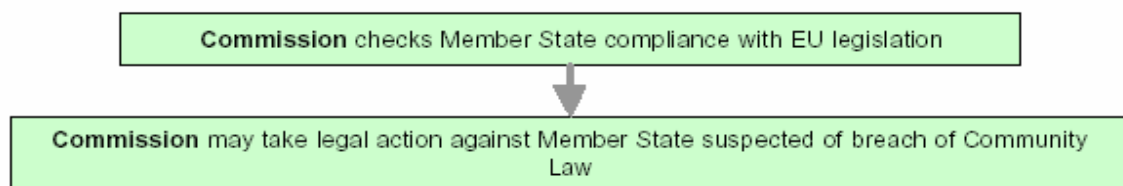
### LEVEL 2



### 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), p. 9.

## 1. Efficiency and Democratic Legitimacy

According to Fritz W. Scharpf legitimacy beliefs ensure effective government in democracies:

“... [L]egitimizing arguments invoking shared legitimacy beliefs imply a socially sanctioned obligation to comply with government policies even if these violate the actor’s own interests or normative preferences, and even if official sanctions could be avoided at low cost. In the absence of such beliefs, government would either be ineffective or would have to transform the liberal polity into a police state.”<sup>5</sup>

Input legitimacy through citizen participation in decision-making and output legitimacy that relies on effective solutions to problems with the goal to further public interest constitute the two complementary branches of democratic legitimacy. A political system relying exclusively on input-legitimacy would need to focus on consensual decision-making. This would, in practice, lead to the inability to adopt any effective solution to problems which cannot be solved individually. Therefore, modern democracies normally rely on electoral accountability as a feature of input-oriented legitimacy combined with elements of output-oriented legitimacy.<sup>6</sup>

Applying these legitimacy requirements to the European Union reveals that sources of input-legitimacy are very limited. However, the legitimacy of the EU should not be judged “by the direct comparison of its institutions with those of national constitutional democracies.”<sup>7</sup> The European Union is a complex negotiating system, designed for working out transnational problem solutions.<sup>8</sup> This argument mirrors the notion of increasing complex interdependence between states as analysed by Keohane and Nye.<sup>9</sup> The close interconnection between states especially in economic and ecological issues leads to challenges for the democratic nation state: issues and problems of transnational dimensions can only be dealt with by negotiations. The belief that “under conditions of interdependence, some cooperation is a necessary condition for achieving op-

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<sup>5</sup> 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>.

<sup>6</sup> Scharpf, Fritz (1999), *Regieren in Europa: effektiv und demokratisch?*, Schriften des Max-Planck Instituts für Gesellschaftsforschung, Frankfurt/Main, S. 16/17.

<sup>7</sup> Scharpf (2003), op. cit.

<sup>8</sup> See Scharpf, Fritz W. (1996a), “Economic Integration, Democracy and the Welfare State”, *MPIfG Working Paper*, No. 96/2, Max Planck Institute for the Study of Societies, Cologne, <http://www.mpi-fg-koeln.mpg.de/pu/workpap/wp96-2/wp96-2.html>.

<sup>9</sup> See Keohane, Robert / Nye, Joseph S. (1989), *Power and interdependence*, Glenview, p. 8/9.

timal levels of welfare [...]”<sup>10</sup> can be seen as one argument for the process of European integration. A governing mode like the Lamfalussy Process on the EU-level should therefore deliver efficient solutions for problems which can be dealt with more efficiently at the EU level than on the national level.

## 2. Inter-Institutional Conflict over Comitology

By now (2005), nearly all 43 measures of the FSAP are implemented, but only a minority of them through the Lamfalussy Process.<sup>11</sup> This is partly due to a conflict between the European Parliament (EP) and the Member States over the rights of the Parliament to control comitology procedures. The Lamfalussy Process with its “European Securities Committee” (ESC) and the “Committee of European Securities Regulators” encompasses a slightly modified comitology procedure.<sup>12</sup> Thus, the proposal to introduce the Process revived the historic disagreement of the EP and the Member States over the employment of comitology procedures.

The EP rejected the proposal that Level 2 legislation would be supervised by delegates of the Member States in the ESC through a non-binding supervisory role of the EP. As a consequence, the EP approved the goals of the Lamfalussy Report, particularly the creation of a single financial market and the fast adoption of the FSAP, but insisted on its earlier demand for a “call-back” mechanism for Level 2 legislation: the call-back mechanism would have given the EP the right to insist that a measure of the Commission has to pass the standard legislative procedure.<sup>13</sup> The Member States, the Commission and even the Committee of Wise Men rejected this idea, as it would have slowed down the adoption of regulation and would have been inconsistent with the Treaties.<sup>14</sup>

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<sup>10</sup> Keohane, Robert (1984), *After Hegemony: Cooperation and Discord in the World Political Economy*, Princeton, p. 11.

<sup>11</sup> See Kern, Steffen (2003), “Reform of EU regulatory and supervisory structures: progress report”, *Financial Market Special, Deutsche Bank Research*, [http://www.dbresearch.de/PROD/DBR\\_INTERNET\\_EN-PROD/PROD000000000060268.pdf](http://www.dbresearch.de/PROD/DBR_INTERNET_EN-PROD/PROD000000000060268.pdf), p. 3.

<sup>12</sup> Comitology is the existence and activity of committees in the EU in which members of the Commission co-operate with delegates of the Member States in order to implement political programs (See Töller, Annette (2002), *Komitologie: theoretische Bedeutung und praktische Funktionsweise von Durchführungsausschüssen der Europäischen Union am Beispiel der Umweltpolitik*, Opladen, p. 15)

<sup>13</sup> See Randzio-Plath, Christa (2001), *Reforming Capital Adequacy (Basel II) – the view of the European Parliament*, Website of MEP Christa Randzio-Plath, [http://www.randzio-plath.de/artikel/Rede11Apr2001FES\\_London.html](http://www.randzio-plath.de/artikel/Rede11Apr2001FES_London.html); Norman, Peter (2001), “Lamfalussy set for battle on securities market regulation: EU states, Commission and parliament are at odds,” *Financial Times*, February 15<sup>th</sup>.

<sup>14</sup> Dombey, Daniel / Guerrerera, Francesco / Mann, Michael (2002), “The power that sits over Europe”, *Financial Times*, August 22<sup>nd</sup>; Committee of Wise Men (2001), *Final Report of The Committee Of Wise Men On The Regulation of*

In February 2002, the parties moved forward after the EP voted in favour of the “von Wogau Report” and thereby distanced itself from its maximum demand of the right to call-back. On this basis, the Commission proposed to grant the EP safeguard measures: firstly, “sunset clauses” will be inserted in each Level 1 measure. This clause delegates the enactment of Level 2 measures to the Commission, but only for a limited time. Secondly, the EP has now a three-month period to scrutinise all new Level 2 legislative proposals. Thirdly, full transparency for the EP and wide public consultation on all stages of the process were granted.<sup>15</sup> After the EP’s vote in favour of the compromise, the Lamfalussy Process could finally be applied.<sup>16</sup> However, the inter-institutional conflict blocked the application of the Lamfalussy Process for nearly a year. It is hard to judge how much this encroached upon the regulatory process in general, since regulatory decisions had to be passed following the “old” procedure of co-decision. Articles in the Financial Times assume that the 11-month-blockade of the EP has endangered the adoption of the FSAP within the set deadlines.<sup>17</sup> Christa Randzio-Plath, chairman of the Committee on Economic and Monetary Affairs (ECON) of the EP, however, emphasizes the constructive and speedy work of the EP during the inter-institutional dispute. Parallel to negotiating the Lamfalussy Process, the first proposals to be adopted by the new procedure were prepared and others adopted through the former co-decision procedure in record time.<sup>18</sup>

Even after the compromise with the EP, insiders report that the Lamfalussy Process is still the place and framework for inter-institutional quarrels about balance of power and preserving institutions’ turfs. The EP, for example, is said to leave the space for secondary legislation small, suspicious towards the “devilish details”<sup>19</sup> that the comitology procedure on Level 2 could add. However, it must be kept in mind that all participants of the new procedure are still in a “learning-by-doing mode”. Trust and cooperation between the involved institutions has to develop to enable a smooth functioning of the

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*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), p. 34.

<sup>15</sup> See Norman Peter (2002b), “Dispute over EU financial plans resolved”, *Financial Times*, February 1st; Norman, Peter (2002a), “Reform of EU securities rules moves a step closer”, *Financial Times*, January 23<sup>rd</sup>.

<sup>16</sup> See Norman, Peter (2002c), “Financial reforms proposals win backing”, *Financial Times*, February 6<sup>th</sup>.

<sup>17</sup> See Brill, Stefan (2002), “The Euro and EU Economic reform – the jury is still out”, *EurActiv.com*, January 23th; *FT.com site* (2002), “Back on track”, February 4<sup>th</sup>.

<sup>18</sup> See Randzio-Plath, Christa (2002), “Europe parliament wants securities reform”, *Financial Times*, January 26th.

<sup>19</sup> Dombey, Daniel / Guerrero, Francesco / Mann, Michael (2002), “The power that sits over Europe”, *Financial Times*, August 22nd.

Lamfalussy Process. So far, routine is not in sight.<sup>20</sup>

### 3. Impact of National Preferences in the Lamfalussy Process

Members of the ECON state that they see national interests and hence time consuming decision making in the Council of Ministers and in the ECOFIN Council that represents the national Finance Ministries, as the major obstacle to a speedy and coherent completion of the FSAP.<sup>21</sup> In the past, national preferences led to compromises that watered down the content of measures and endangered the construction of a harmonised single financial market in the EU.<sup>22</sup> Moreover, the outcomes were not consequently implemented in the Member States, leaving market participants frustrated about the ignorance of states.<sup>23</sup> The Lisbon summit of the European Council in March 2000 raised hopes that national protectionism in the field of securities markets will finally fade away: after the launch of the Euro, the leaders of the Member States set the ambitious goal to make the European Single Market “the most competitive and dynamic knowledge-based economy in the world.”<sup>24</sup> They emphasized the importance of a single financial market for this target and approved the Commission’s FSAP. This chapter will evaluate whether the course of negotiations in the ECOFIN justifies this enthusiasm.

The Commission started its work on the FSAP with less controversial measures to gain momentum early on. The Lamfalussy Process was proposed later and should facilitate the adoption of the remaining and politically more important measures.<sup>25</sup> The following analysis will focus on three directives and their adoption on Level 1. Those three directives, namely the “Directive on Prospectuses”, the “Takeover Directive” and the new “Investment Services Directive” (ISD-2), which was renamed as “Markets in Financial Instruments Directive” (MIFID), were especially essential for the creation of a single financial market.<sup>26</sup>

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<sup>20</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.

<sup>21</sup> Survey among members of ECON in August 2003

<sup>22</sup> Underhill, Geoffrey (1997), “The Making of the European Financial Area: Global Market Integration and the EU Single Market for Financial Services”, in, Underhill, Geoffrey (ed.), *The New World Order in International Finance*, New York, pp. 101-23, here: pp. 105, 113/114.

<sup>23</sup> See Committee Of Wise Men, op. cit., p. 11/12; *The Economist* (2001a), “A ragbag of reform”, March 3<sup>rd</sup>.

<sup>24</sup> *Council of the European Union* (2000), *Presidency Conclusions of the Lisbon European Council*, Newsroom, <http://ue.eu.int/Newsroom/LoadDoc.asp?BID=76&DID=60917&from=&LANG=1>.

<sup>25</sup> See Guarrera, Francesco / Norman, Peter (2002), “Europe’s fragile dream of a single financial market”, *FT.com site*, December 3<sup>rd</sup>.

<sup>26</sup> See *The Economist* (2001a), op. cit..

### 3.1 Case Studies

#### a) Case Study 1: Directive on Prospectuses

The Commission's first proposal of the Directive on Prospectuses was published on May 30<sup>th</sup>, 2001. The Directive aims at enabling issuers to sell their securities in more than one member state on the basis of a single prospectus.<sup>27</sup> The market participants were highly disappointed about both the Commission's neglect of consulting the industry and the content of the proposal.<sup>28</sup> In contrast, the EP consulted market participants excessively on the Commission's proposal and came up with a list of 64 amendments in February 2002.<sup>29</sup> Giving in to its critics, the Commission published a second, revised proposal on the August 9<sup>th</sup>, 2002, embracing the majority of the amendments proposed by the EP.<sup>30</sup>

The Council of Ministers, i.e. ECOFIN, found it difficult to agree with the main issue of the proposal, namely whether the issuer must obtain an approval for the prospectus from the competent authority in his home country. The alternative would have been to allow him to choose between the authority in his home country and the Member States in which he plans to offer his securities. Market participants argued in favour of the second and more liberal version. They pointed out that otherwise non-European companies are advantaged since they need first an approval by the authority of the state their securities will be listed. Moreover, participants in the Eurobond market criticized the home-country principle, because the authorities in the countries where the bonds are listed – mainly in Luxembourg and the UK – have more expertise to approve their prospectuses.<sup>31</sup>

Despite these arguments, cleavages in the Council remained. Fearing further migration of issuers based in their country to the authorities and stock exchanges of some northern countries and especially the UK, states of South Europe like Italy, France and Spain ("Club Med") first insisted on the validity of the home country principle without excep-

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<sup>27</sup> See Skorecki, Alex (2003), "European bond issuers get passport", *FT.com site*, June 30<sup>th</sup>.

<sup>28</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>29</sup> See Neundörfer, Nikolaus Dominik (2002), "EU Prospectus Directive on the home straight", *Financial Market Special, Deutsche Bank Research*, [http://www.dbresearch.de/PROD/DBR\\_INTERNET\\_EN-PROD/PROD0000000000050098.pdf](http://www.dbresearch.de/PROD/DBR_INTERNET_EN-PROD/PROD0000000000050098.pdf), p. 10.

<sup>30</sup> See Freshfields Bruckhaus Deringer (2003a), "The Prospectus Directive", *Freshfields Corporate Publications*, <http://www.freshfields.com/practice/corporate/publications/pdfs/4968.pdf>, p. 1.

<sup>31</sup> See Neundörfer, op. cit., p. 8/9.

tion.<sup>32</sup> They tried to protect their domestic financial markets and stock exchanges. Seeking an agreement, the Council distinguished between equity securities and non-equity securities (principally bonds). Negotiations on the Commission's first proposal delivered the compromise that issuers of non-equity securities with a minimum denomination of 100.000 Euros should be allowed to choose the competent authority. Arguing that at least all issuers of bonds should have an unrestricted option, market participants and the EP, the latter especially concerned about the rights of small and medium sized enterprises (SMEs), started confrontational negotiations with the Council. Then, the Council working group proposed a minimum denomination of EUR 50.000, which was adopted in the Commission's second proposal. Later on, the Council even approved a denomination as low as EUR 5.000.<sup>33</sup> However, pressure from lobbying market participants and the EP remained strong. By the end of June 2003, the EP and the Council agreed on enabling all issuers of bonds worth more than 1.000 EUR – and therefore approximately 95 % of all bond issuers – to choose between the regulator of their home country or the market where they issue debt.<sup>34</sup> The financial press interpreted this deal as a victory of the united pressure of the EP and market participants:

“The deal on the prospectus directive comes after months of negotiations between the parliament and national governments and fierce lobbying by the financial services industry. [...]“Club Med” countries - France, Italy and Spain - had resisted the measure, fearing that most issuers would choose to be regulated in London or Luxembourg, the centres of the €1,400bn eurobond market. However, pressure from MEPs and countries such as the UK and Germany forced the three countries to back down.”<sup>35</sup>

The cleavage between South and North European states also came to the surface in other issues of the Prospectus Directive: CESR prepared a draft dealing with the disclosure requirements for equities, bonds and other securities. Regulators of North European states thought that the proposed requirements for bonds were too excessive and therefore an unnecessary burden for issuers. However, South European regulators traditionally wanted a very high level of investor protection. As a consequence, they supported the proposal that the IOSCO standards for equities should also apply to bonds, although for bonds information requirements are generally less stringent. In addition, different national regulatory traditions in South and North Europe made agreement on vetting periods difficult. The Council had to take into account that in Italy vetting encom-

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

<sup>33</sup> See Freshfields Bruckhaus Deringer (2003a), *op. cit.*, p. 11.

<sup>34</sup> See *FT.com site* (2003), “Bonds foreign and financial”, July 1<sup>st</sup>.

<sup>35</sup> *Ibid.*

passes material accuracy of the prospectus content. Thus, the prospectus' approval is delayed and therefore longer vetting periods were needed.<sup>36</sup>

In the case of the prospectus directive national protectionism and preferences played an important role and demarcated lines of conflict. It is interesting that the pressure of market participants and an industry supporting, pro-integrationist EP led to a compromise much more in line with the target of a single financial market than the Council's first agreement.

### b) Case study 2: Takeover Directive

So far, regulation of company takeovers in the EU was only subject to national legislation. The differences between Member States were great, not only regarding the content of legislation: in Germany, Austria, France, Italy and Spain for example, takeovers were regulated by binding legislation, in the UK, Sweden and Netherlands only by codes of conduct that acquired force of law over time.<sup>37</sup> However, the 30-year-old "saga of the Takeover Directive"<sup>38</sup> was a disappointing one. This is not surprising since the issue raises national emotions of a greater scale than any other directive of the single financial market. The idea that continental European companies should open themselves to the threat of a hostile takeover met and still meets resistance.<sup>39</sup> In order to enhance the pressure for its adoption, the directive became part of the FSAP. Many argued that without a minimum harmonisation of takeover regulation, a real single European financial market would not exist.<sup>40</sup>

In 2001, a proposal for a Takeover Directive failed in the EP, mainly because of the opposition of German members of the European Parliament (MEPs). In their opinion, the directive would not create a level playing field in the EU, because the directive dealt not with the issue of multiple voting rights and golden shares. Those special rights have already been abolished in Germany. Consequently, the German government and MEPs

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<sup>36</sup> See Neundörfer, op. cit., p. 11.

<sup>37</sup> See Wagner, Oliver (2003), "EU Takeover Directive – Success after 30 years of discussion?", *Financial Market Special, Deutsche Bank Research*, [http://www.dbresearch.de/PROD/DBR\\_INTERNET\\_EN-PROD/PROD0000000000060033.pdf](http://www.dbresearch.de/PROD/DBR_INTERNET_EN-PROD/PROD0000000000060033.pdf), p. 4.

<sup>38</sup> Freshfields Bruckhaus Deringer (2003b), "Final bid for Takeover Directive", *Freshfields Newsletter 'Forecast'*, June/July 2003, <http://www.freshfields.com/practice/comptrade/publications/newsletters/forecast/200306.pdf>, p. 3.

<sup>39</sup> See Plender, John (2003), "The complete M & A gamut from A to B And all thanks to the Portuguese", *Financial Times*, June 9<sup>th</sup>.

<sup>40</sup> See *The Economist* (2002), "Scrapping over the pieces; European financial services" March 9<sup>th</sup>.

feared that their enduring existence in other countries would lead to a competitive disadvantage for German companies.<sup>41</sup> A minority shareholder with multiple voting rights could, for example, successfully block a takeover or raise the costs of a bid significantly.<sup>42</sup> In Italy and Spain the state is allowed to retain so-called “golden shares” in some companies. Both countries argued that they need golden shares to make their domestic energy companies less vulnerable to takeover by France’s state-owned Electricité de France, which has grown tremendously due to an insufficiently liberalized energy market in France. This example illustrates that the FSAP measures are not negotiated in a vacuum, but can be seriously affected by blockages in other issue areas.<sup>43</sup>

After reviewing the recommendations of the “High Level Group” (which was set up because the last draft failed in the EP), the Commission’s last proposal on a Takeover Directive was published on October 2<sup>nd</sup>, 2002.<sup>44</sup> The legal experts advised the inclusion of a regulation on squeezing out minority shareholders, strict neutrality requirements for the offeree company’s management and supervisory boards, and a so-called “break-through rule”, which sets aside multiple voting rights, golden shares and restrictions on voting rights at least for takeovers. With the exception of the latter proposal, the advice was incorporated into the Commission’s latest proposal.<sup>45</sup> Commissioner Bolkestein explained that the proposal did not outlaw the use of multiple voting rights during a takeover bid, because this could be interpreted as some kind of expropriation.<sup>46</sup> However, it was doubtful whether a level-playing field without full endorsement of the “one share, one vote” principle could be realised.<sup>47</sup>

Surprisingly, not only Germany criticized this aspect of the Commission’s proposal. Instead, several Member States in the Council favored the amendments to article 11, in order to abolish the use of multiple voting rights in the case of a takeover. The Scandinavian countries, however, remained strong proponents of the Commission’s version, because multiple voting rights are common in these countries. They argued that there is at least no empirical evidence for the assumption that those special rights are obstacles to takeovers.<sup>48</sup> Germany still allowed the offeree company to take defensive measures

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<sup>41</sup> See *The Economist* (2001c), “Takeover troubles”, May 12<sup>th</sup>; Wagner, op. cit., p. 5.

<sup>42</sup> See Wagner, op. cit., p. 9.

<sup>43</sup> See *The Economist* (2001d), “So much for dynamic”, November 11<sup>th</sup>.

<sup>44</sup> See Plender, op. cit.

<sup>45</sup> See Wagner, op. cit., p. 6/7

<sup>46</sup> See European Parliament (2002), “Bolkestein presents new takeover directive: MEPs focus on multiple voting rights”, *News Report*, October 3<sup>rd</sup> 2002.

<sup>47</sup> See Dombey, Daniel (2003a), “EU search for common rules on takeovers stalls again”, *Financial Times*, June 24<sup>th</sup>.

<sup>48</sup> See Wagner, op. cit., p. 8/9.

against a bidder without first seeking approval by its shareholders.<sup>49</sup> Article 9 of the new draft abolished this tactic and Germany was only willing to give in to that under the condition that the amendments to article 11 were approved.<sup>50</sup> As a consequence, the Council was deadlocked. Portugal came up with a compromise in June 2003, which said that states should be allowed to choose whether or not to implement article 9 and/or article 11.<sup>51</sup>

Germany did not approve this compromise and continued its attempts to find allies against the Takeover Directive: first, Germany and the UK made a deal. Germany would support the British disapproval of a separate directive on temporary workers, providing basic protection for those workers. In return, the UK would help Germany fighting off aspects of the takeover directive it does not like.<sup>52</sup> As a next step, French President Jacques Chirac and German Chancellor Gerhard Schröder entered into an informal agreement in which both “showed understanding of the other’s priorities.”<sup>53</sup> In practice, Germany would help France to water down the reforms of the farm subsidy regime and France would support Germany’s views on the takeover directive.<sup>54</sup>

Another compromise text submitted by Italy paved the way to the final approval of the Takeover Directive by both the Council<sup>55</sup> and the EP and its subsequent adoption in April 2004. However, Commissioner Bolkestein regarded this final version of the directive as even worse than another failure of the negotiations: As proposed by Portugal, Member States are now able to opt out from requiring the management to consult shareholders before applying defensive measures (article 9) as well as from the break-through provisions (article 11). In addition, the directive includes reciprocity provisions, which allow companies residing in Member States to implement Article 9 in order to use ‘poison pills’ without the consent of shareholders if the bidder itself had such defences. Thus, all the controversial bits are now merely optional and nothing is effectively changed from the status quo.<sup>56</sup>

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<sup>49</sup> See *Ibid*, p. 6.

<sup>50</sup> See van den Burg, Ieke (2003), “Power play halts progress in EU”, *Financial Times*, June 19<sup>th</sup>; Dombey, Daniel (2003a), *op. cit.*

<sup>51</sup> Companies in countries that apply none of the two or only one of the articles would have the right to submit themselves voluntarily to the rules in Art. 9 and 11. The adoption of these rules by a company would be irreversible. In the case of a takeover, Art. 9 and 11 would only apply, if both the bidder and the offeree are subject to the rules. (See Plender *op. cit.*)

<sup>52</sup> See van den Burg, *op. cit.*

<sup>53</sup> *Financial Times* (2003), “A contemptible deal”, June 13<sup>th</sup>.

<sup>54</sup> See *Idem*.

<sup>55</sup> The Council voted unanimously as was required since the Commission opposed the compromise text.

<sup>56</sup> See Dombey, Daniel (2003b), “Italians seek to win approval for EU takeover law”, *FT.com site*, October 13<sup>th</sup>; Dombey, Daniel (2003c), “Parliament backs deal on European takeover directive”, *Financial Times*, December 17<sup>th</sup>;

Looking back on the negotiations of the Council on this directive, national protectionism has become most visible. Too many safeguards exist within the different states: besides the ones that were discussed, some are not dealt with at all in the directive, i.e. the double voting rights common in France and the golden shares in Italy and Spain. Moreover, the “horse trading”<sup>57</sup> between Germany, France and the UK displays how national priorities are pushed through by making sidepayments in other issue areas.<sup>58</sup> With those tactics, the Member States retain a veto, despite the qualified majority vote in the Council.

### c) Case Study 3: The Markets in Financial Instruments Directive (MIFID)

The MIFID<sup>59</sup> was the first directive to which the Lamfalussy Process fully applies, i.e. the consultation process on the Commission’s draft took place under the recommendations of the Lamfalussy report. The Commission was praised for extensively consulting market participants and the public as well as for the draft proposal informed by these inputs.<sup>60</sup> As a consequence, the shock and anger about the final proposal, presented to the Council and EP, was tremendous: It included pre-trade transparency requirements for investment firms, which had not been on debate in the drafts before.<sup>61</sup>

Under those provisions firms have to publish fix bid and offer prices on which the client can close. This enhances the risk for the provider, because the firm has to make these prices available to other interested parties and therefore the firm is exposed to price risks for the period of the quote. It is said that the result are price increases for off-exchange executions, as the firm has to respond to this risk by increasing the trading margin. In effect, these pre-trade transparency rules for investment firms give a competitive advantage to stock exchanges.<sup>62</sup> Yet, (small) investors might not be able to find the best price unless investment firms publish pre-trade quotes. Moreover, pre-trade

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European Commission (2003b), “Results of the Competitiveness Council of Ministers”, Press Release, [http://europa.eu.int/rapid/start/cgi/guesten.ksh?p\\_action.gettxt=gt&doc=MEMO/03/245|0|AGED&lg=EN&display=](http://europa.eu.int/rapid/start/cgi/guesten.ksh?p_action.gettxt=gt&doc=MEMO/03/245|0|AGED&lg=EN&display=)

<sup>57</sup> *Financial Times* (2003), op. cit.

<sup>58</sup> See *European Commission* (2003b), op. cit.

<sup>59</sup> In the beginning of the legislative process the MIFID was known as the ISD-2, since it revises the former Investment Services Directive of 1993.

<sup>60</sup> See *Financial Times* (2002), “The Prodi plot”, November 19<sup>th</sup>.

<sup>61</sup> Guerrero, Francesco (2002), “Inside Brussels: A transparent mess”, *FT.com site*, November 24<sup>th</sup>.

<sup>62</sup> See Hörth, Ellen (2003), “The new ISD – better regulations for EU investment services?”, *Financial Market Special, Deutsche Bank Research*, [http://www.dbresearch.de/PROD/DBR\\_INTERNET\\_EN-PROD/PROD000000000056336.pdf](http://www.dbresearch.de/PROD/DBR_INTERNET_EN-PROD/PROD000000000056336.pdf), p. 9.

transparency rules are necessary for preserving liquidity pools at stock exchanges that enable transparent and meaningful price building.<sup>63</sup>

Whether, in the final analysis, the late amendment was positive or not, many were disappointed since it seemed to mirror extensive last-minute lobbying by Italian and French stock exchanges. Romano Prodi himself is said to have interfered, advocating Italian interests.<sup>64</sup> This strongly impairs beliefs in a fair and transparent consultation procedure under the Lamfalussy Process. In France, Italy and several other EU Member States the trading of shares off-exchange is banned. These states argued in favour of harsher pre-trade transparency rules for investment firms in the Council. Germany and the UK, together with a large number of investment firms operating in the off-exchange trade of securities, raised objections.<sup>65</sup> Consequently, both sides as well as market participants engaged in massive lobbying, focusing on the “key controversial item”<sup>66</sup> of pre-trade transparency requirements.

The proposal was amended by the EP in September 2003 and the Council again revised the new text. Negotiations between the EP, the Council and the Commission before the proposal's second reading in the EP led to the approval of a compromise text by the EP in April 2004, which was also acceptable to the Council. In the final text, the pre-trade transparency obligation is limited to transactions up to “standard market size”, which shall prevent the submission of European wholesale markets to the rule. It also includes a set of protective measures for investment firms, for example the possibility to update and withdraw their quotes in order to reduce their risks.

A proposal by the Commission based on transparent consultation and taking into account the arguments of both sides, would have certainly led to a more legitimised and accepted agreement. However, the negotiations on the MIFID display that national protectionism does not only hinder the adoption of framework principles on Level 1 in the Council or in the EP, but also impairs decision-making in the Commission.

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<sup>63</sup> See Boland, Vincent / Guerrera, Francesco (2002), “Dealing in Shares: Pitfalls lurk in drawing up new trading rules”, *Financial Times*, September 28<sup>th</sup>:

<sup>64</sup> See Cruickshank, Don (2003), “What Single Market?”, *Speech at the Conference on the Impact of the EU Financial Services Action Plan on the Regulation of the EU Securities Market*, London Stock Exchange Newsroom, <http://www.londonstockexchange.com/newsroom/speeches/speech19.asp>; Levitt, Malcolm (2002), “Adopting legislation is not the same as creating a single European market”, *Financial Times*, December 17<sup>th</sup>; Guerrera, op. cit.; *Financial Times* (2002), op. cit.

<sup>65</sup> See Hörth, op. cit., p. 11; Guerrera (2002), op. cit.

<sup>66</sup> Levin, Mattias (2004), “The Never-Ending Story – Transparency and the ISD”, *Centre for European Policy Studies (CEPS)*, [http://www.ceps.be/Article.php?article\\_id=126](http://www.ceps.be/Article.php?article_id=126).

### 3.2 Evaluation of the Case Studies

Officially, the Member States want to make Europe the most competitive market in the world. “Unofficially, it is a bargaining game between European financial centres – London, Frankfurt and Paris.”<sup>67</sup> The urgency to focus on the European dimension of reforms decreased after the summit in Lisbon: in 2000, the European leaders had to face an US economic growth-record in contrast to their less effective European economies. One year later, the US economy faced hard times, making difficult reforms in Europe less necessary to compete with the American market.<sup>68</sup> However, this attitude encompasses only a short-time perspective and furthers the opinion that defending national safeguards for strategic domestic sectors is the real goal.

Norbert Walter regrets that public opinion in Member States still tends to support special interests of the domestic industry in the belief that this also serves national interests best.<sup>69</sup> Public opinion was mainly supportive of the rejection of European takeover rules that might enhance the chance of hostile takeovers of domestic companies by foreign firms. In contrast, those expecting an extra 0.5 – 0.7 % growth in European GDP through the integration of Europe’s financial market hardly find public attention. Even warnings against the migration of wholesale markets to other markets in the case of not delivering the FSAP satisfactorily, are ignored.<sup>70</sup> A pan-European retail market would also provide significant benefits for consumers, as it would be more competitive and diverse. At least occasionally, special interests capture the argument of small investor protection to further their own interest.<sup>71</sup>

Under these circumstances it is doubtful whether national veto-positions and “horse tradings” between Member States are desirable. Intransparent issues like securities market regulation are particularly useful for gaining the support of well-organised minority interest groups of the industry without fearing to loose votes in the population - at least as long as there is no scandal.<sup>72</sup> “Behind-closed-doors” deals, for example the understanding between the UK, Germany and France concerning the takeover directive, and Prodi’s intervention in the drafting of the MIFID, affect the legitimacy of those measures. The belief that regulation results from fair consultation is weakened and this might

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<sup>67</sup> The Economist (2002), op. cit.

<sup>68</sup> See *The Economist* (2001b), “From Lisbon to Stockholm”, March 31<sup>st</sup>.

<sup>69</sup> See Walter, op. cit.

<sup>70</sup> See *Ibid.*; *The Economist* (2002), op. cit.; Cruickshank, op. cit.

<sup>71</sup> See *FT.com site* (2002), op. cit.; Cruickshank, op. cit.

<sup>72</sup> See Behrends, Sylke (2001), *Neue Politische Ökonomie. Systematische Darstellung und kritische Entwicklungslinien*, Munich, p. 13/14.

might lead in the long-run to less formal and transparent participation and therefore to less input-legitimacy as well as to a decreasing willingness to comply with regulations.<sup>73</sup>

National protectionism certainly has to be taken into account when evaluating the efficiency of the Lamfalussy Process. However, the fact that national protectionism plays a salient and constraining role in the negotiations on measures to be passed through the Lamfalussy Process does not mean that the process has failed. Firstly, the Lamfalussy Process is not designed to deal with the problem of national protectionism. It would be inappropriate to blame this process for a problem that has existed for so many years and the Lamfalussy group never had the power to find a solution for it.<sup>74</sup> Moreover, the measures now dealt with through the Lamfalussy Process encompass those of highest political importance and therefore sensitiveness.<sup>75</sup> Thus, they are particularly endangered to be subject to national protectionism.

Second, it is still too early to judge whether or not the Lamfalussy Process can positively influence this long existent feature of European Politics.<sup>76</sup> The case of the Directive on Prospectuses clearly shows that the enhanced dialogue between the participating political institutions and market participants provides significant opportunities for forming coalitions and issuing pressure against national protectionism. Appropriate consultation and the focus on Level 1 framework legislation offer genuine opportunities to limit controversial issues dealt with in the co-decision procedure.<sup>77</sup> The co-ordination and co-operation of national securities regulators in CESR on Level 3 might as well prove helpful in overcoming national protectionism which might otherwise hinder consistent implementation of regulation in all Member States.<sup>78</sup>

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<sup>73</sup> See *Financial Times* (2003), op. cit.

<sup>74</sup> See McKee, Michael (2003b), *The unpredictable future of European securities regulation. A response to Four Predictions about the Future of EU Securities Regulation by Gerard Hertig & Ruben Lee*, The British Bankers Association, [http://europa.eu.int/comm/internal\\_market/en/finances/mobil/docs/lamfalussy/2003-07-comments-bba1\\_en.pdf](http://europa.eu.int/comm/internal_market/en/finances/mobil/docs/lamfalussy/2003-07-comments-bba1_en.pdf), p. 8.

<sup>75</sup> See Guerrero / Norman (2002), op. cit.

<sup>76</sup> See McKee (2003b), op. cit., p. 3.

<sup>77</sup> See *Ibid*, p. 12

<sup>78</sup> See *Ibid*, p. 8

## 4. Wide-spread Concerns about the Lamfalussy Process

### a) Time versus quality

The objective of the Lamfalussy report was to speed up regulation of securities markets in order to achieve rapid adoption of regulation to the needs of the changing market. From the very beginning, there were concerns whether this is possible without a decrease of quality in legislation. Trying to solve this predicament, the Wise Men around Alexandre Lamfalussy argued for proper consultation on Level 1 and Level 2 in order to guarantee that the expertise of market participants would be taken into account during the drafting, adoption and implementation processes of directives.<sup>79</sup>

However, in practice, this advice was not easily followed. The Commission is under pressure from the FSAP deadlines set by the European Council. As a result, market participants fear that the Commission's proposals lack quality, because it might spend less time on drafting in order to meet the timetable.<sup>80</sup> These concerns were especially raised after the contentious draft of the directive on prospectuses. After the extensive two-year consultation on the MIFID, criticisms ebbed away and focused more on national protectionism as a possible source of inefficiency.<sup>81</sup> Yet, the Commission obviously was and is struggling to meet the deadlines and therefore subjects the CESR, which drafts proposals for implementing measures on Level 2, to strict timetables, too. This again raised concerns about the sufficiency of consultation with market participants by the CESR and, consequently, the quality of Level 2 measures.<sup>82</sup> Gérard Hertig and Ruben Lee even argue that the Lamfalussy Process is therefore in a No-Win situation: if the Commission sacrifices quality for speed, the Lamfalussy Process will be regarded as not good enough. If the Commission focuses on quality and does not meet the deadlines, the Lamfalussy Process will be judged as being too slow.<sup>83</sup>

The FSAP deadlines, however, have been drawn up already in 1999, preceding the inauguration of the Lamfalussy Process. Thus, whether the Lamfalussy Process really finds the right balance between time and quality should be judged after some years of

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<sup>79</sup> See Committee of Wise Men, op. cit., p. 4.

<sup>80</sup> See *FT.com site* (2002), op. cit.; Hertig, Gérard / Lee, Ruben (2003), *Four Predictions about the Future of European Securities Regulation*, European Capital Markets Institute, [http://www.ecmi.es/files/hertig\\_lee.pdf](http://www.ecmi.es/files/hertig_lee.pdf), p. 9.

<sup>81</sup> See *Financial Times* (2002) op. cit.; Guerrero / Norman (2002), op. cit.; Cruickshank, op. cit.

<sup>82</sup> See McKee (2003b), op. cit., p. 6.

<sup>83</sup> See Hertig/Lee, op. cit., p. 9.

operation under the constraining deadlines of the FSAP. Additionally, all participants have to get used to the new process before its problem-solving capacity can be evaluated.<sup>84</sup> Michael McKee emphasizes that several years would pass until the real and at the moment often underestimated benefit of the process gets visible: under the Lamfalussy Process the adoption of the technical details of directives and regulations is delegated to the Commission and the two committees. This should save time, because the EP and the Council only have to agree on basic political choices.<sup>85</sup> However, the particular benefit of the process is that the technical details can be changed without going through the lengthy standard EU primary legislative process again. The Commission and the committees will therefore be responsible for renewing and adapting existing directives and regulations to future market needs, constrained by the framework principles set out on Level 1.<sup>86</sup>

### b) Threat of Overregulation

In order to fully benefit from the opportunity to update technical details on Level 2, the co-legislators (EP and the Council) have to resist the temptation to regulate too many details on Level 1. National protectionism and the mistrust of the EP in the comitology procedure might lead to very detailed framework principles. Walter warns from overregulation through tight framework legislation to which the CESR adds even more details in order to preserve its turf. Overregulation increases the costs for the industry and might lead to competitive disadvantages of the EU financial market to the US.<sup>87</sup>

### c) Resources

Regarding the pivotal role of the Commission in the Lamfalussy Process, its resources for securities markets regulation are insufficient. Only about 100 people at the Commission are working on financial services. Consequently, the staff is overburdened with the tasks of drafting, consulting and negotiating with other involved institutions and en-

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<sup>84</sup> See McKee (2003b), op. cit., p. 11.

<sup>85</sup> See *The Economist* (2001d), op. cit.

<sup>86</sup> See McKee (2003b), op. cit., p. 7.

<sup>87</sup> See European Parliamentary Financial Services Forum (2002), *The Financial Services Action Plan: The Outlook After Barcelona*, Website of the European Parliamentary Financial Services Forum, [http://www.epfsf.org/meetings/2002/briefings/briefing\\_9apr2002.pdf](http://www.epfsf.org/meetings/2002/briefings/briefing_9apr2002.pdf), p. 2.

forcement.<sup>88</sup> Walter argues that it is problematic to find people, having the expertise and qualifications to draft legislation, which shall create a single financial market out of 15 and soon 25 different national financial markets.<sup>89</sup> Even on the national level, ministries and regulators occupied with securities markets lack qualified personnel.<sup>90</sup>

#### d) Enforcement

The Commission is responsible for supervising the compliance of Member States' laws with the directives and regulations adopted under the Lamfalussy Process (Level 4). Lacking staff, the Commission concentrates on meeting the FSAP deadlines; consequently, there is a lack of human resources for enforcement.<sup>91</sup> Hertig and Lee argue that enforcement in the field of securities markets regulation in the EU has ever been weak and will remain so under the Lamfalussy Process. In their opinion, the Commission does not want to risk its good working relationship with Member State governments by opening a case against them. They also call the Lamfalussy report's suggestion to rely more on the private sector in the field of enforcement into question: companies fear retribution from national governments, if they report insufficient implementation of EU legislation.<sup>92</sup>

However, the problem of insufficient enforcement has existed for many years and although it was never assumed that the Lamfalussy Process would fully solve it, at least the co-ordination of national regulators in CESR goes into the right direction. Taking into account the effect that poor implementation had in the case of ISD-1, enforcement is surely an important part of measuring the efficiency of the Lamfalussy Process. Michael McKee expects that Level 3 of the process will prove successful since CESR puts pressure on national regulators through review measures, for example questionnaires.<sup>93</sup> Having completed the FSAP, the Commission will be able to transfer more staff to enforcement. In addition, McKee reports, the Commission is thinking about new ways of

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<sup>88</sup> See *The Economist* (2002), op. cit.

<sup>89</sup> See Walter, op. cit.

<sup>90</sup> See *The Economist* (2002), op. cit.

<sup>91</sup> See McKee (2003b), op. cit., p. 8.

<sup>92</sup> See Hertig/Lee, op. cit., p. 10.

<sup>93</sup> See McKee (2003b), op. cit. p. 8.

enforcing EU legislation, such as consequent monitoring, research reports and the co-operation with the DG Competition.<sup>94</sup>

## 5. Efficiency as a Source of Legitimacy

An assessment of the efficiency of the Lamfalussy Process for the time being is largely positive<sup>95</sup>: market participants in particular praise the process for increasing the dialogue between market participants and politicians. This does not only enhance the democratic legitimacy through participation, but also the quality and practicability of regulation:

“A central plank of that process was the need to ensure that law-makers (Council and Parliament), policy formulators (the Commission), regulators (CESR) and market participants [...] spoke to each other, and learned from each other, within a framework which improved the quality of pan-European development of securities laws and regulatory rules.”<sup>96</sup>

Moreover, it is realistic to hope that the process will speed up regulation: formal consultations reduce issues and the technical details of an adopted measure can be easily amended in the future. It remains to be seen whether the institutions fully endorse the benefits and chances of the process in their routine day-to-day work after the completion of the FSAP. As Walter reports, until now, every directive is a battle of its own.<sup>97</sup> National protectionism can skip every attempt of creating a level-playing field for securities in the EU. The Lamfalussy Process should not be measured on the scale how much dynamic it produces to make national protectionism less prevalent. It seems impossible to imagine a legislative procedure respecting the provisions in the EU Treaty and being at the same time a real safeguard against national protectionism.

The Lamfalussy Process is a coherent and workable framework for regulation. A lack of problem-solving capacity in the case of some directives is not due to the design of this process, but to its political-institutional environment: at times the EU works like an inter-

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<sup>94</sup> See *Ibid.*, p. 7; Cruickshank, *op. cit.*

<sup>95</sup> The Inter-Institutional Monitoring Group (IIMG), assessing the progress and deficits of the Lamfalussy Process on a regular basis, also emphasizes the benefits of the process so far, but has several policy advices for further improvements concerning the shortcomings mentioned above. Following the extension of the Lamfalussy Process to the banking and insurance sector, the IIMG has been re-established in July 2005 under the mandate to evaluate developments in the three sectors. (See *European Commission* (2005), “Financial markets: Inter-institutional Monitoring Group for financial services re-established”, Press Release, July 25<sup>th</sup>).

<sup>96</sup> McKee (2003b), *op. cit.*, p. 2.

<sup>97</sup> See Walter, *op. cit.*

national negotiation system that allows for informal methods of pushing national preferences and that often only leads to the smallest denominator between the Member States.

## **6. Conclusion**

The Lamfalussy Process enhances the interaction between market participants and the involved political institutions, which in turn increases its input-legitimacy and the acceptance of regulation by market participants. At the same time, due to the various veto-positions along the process, securities markets regulation in the EU is unlikely to be subject to regulatory capture.

The efficiency of the Lamfalussy Process largely depends on political will. National protectionism and the slow pace of negotiations in the Council are fundamental problems of decision-making in the EU. Thus, it is down to the content of individual measures, whether securities markets regulation through the Lamfalussy Process has the characteristics of multi-level governance or an international negotiation system for Member States. However, it is too early to make a final judgement. An evaluation of the output-legitimacy of the process might be very positive some years in the future: then, amendments to the technical details through smooth co-operation between the Commission, the CESR and the ESC might lead to flexible regulation of the securities market that is able to react instantaneously to changing market conditions. The Lamfalussy Process is a sophisticatedly designed regulatory approach – maybe the most workable under the constraints of the Treaties and the current political-institutional environment of the EU.

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