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Widen the market, narrow the competition : the emergence of supranational governance in EU capital markets

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CHAPTER 7: EU CAPITAL MARKET INTEGRATION AND THE EMERGENCE OF SUPRANATIONAL GOVERNANCE

A decade after the re-launch of European financial market integration in 1998, the policy field has been thoroughly Europeanized. The lion's share of new rules and regulations is now European in origin while national legislative room for manoeuvre is restricted. Two new committees have been created to assist the Commission in drafting new legislation and designing implementing measures. The influence of the European Parliament has been expanded whereas that of the Council has been reduced. Industry consultations now largely take place at the European level and have been formalized through the establishment of several 'expert committees' that assist supranational bodies in policy-making. The industry itself uses European associations more than ever before, and only in divisive issues such as clearing and settlement do national positions (and hence national associations) retain precedence. All of this is the flip-side of the transnational ambitions and business models that have emerged within the financial industry over the past two decades. As these changed market structures inspired new regulatory preferences among industry insiders, they generated a constituency in favour of integrated patterns of governance, as well.

This chapter traces the creation of the supranational institutions that govern European capital markets today. Central to the story is the adoption of the so-called Lamfalussy process by the Council in 2001 and the European Parliament in 2002 (see Committee of Wise Men 2001). This new legislative procedure was crucial in institutionalizing the role of two new European committees, the European Securities Committee (ESC) and the Committee of European Securities Regulators (CESR). This chapter uses first-hand empirical material—in particular interviews with policymakers and industry representatives—to show how industry support and the competitive implications of governance arrangements were crucial for institutional change. Whereas national financial industries earlier relied on national governments to represent their interests, larger firms now prefer a supranational and much more technocratic approach to rule-

setting. This, it is thought, will enhance the 'quality' of regulation while reducing the scope for protectionism.

Theories of supranationalism suggest that the preference for supranational governance reflects a preference for supranational solutions to policy problems (Stone Sweet and Sandholtz 1998). Supranational governance, so the idea, is more likely to overcome collective action problems and distributive struggles and thus generate efficient solutions (Scharpf 1997b, 2001). In the economic realm, this translates into the expectation that the larger the transnational component of a firm's business or ambitions, the more strongly it will support some form of supranational governance (Schmitter 1970, cf. Weber and Hallerberg 2001). In Mattli's words,

[as] new technologies increase the scope of markets beyond the boundaries of a single state, actors who stand to gain from wider markets will seek to change an existing governance structure in order to realize these gains to the fullest extent. (Mattli 1999: 46)

This idea is both plausible and borne out by the evidence presented in this chapter.

At the same time, the basic idea would benefit from refinement. The state and political institutions are not just empty shells occupied by societal actors to arrive at collectively binding decisions, as some of the game-theoretic models of multi-level governance suggest (cf. Scharpf 1997a). States, and by extension EU bodies, are large organizations run and controlled by people who themselves have bureaucratic and political objectives (Nordlinger 1981, Krasner 1984, Skocpol 1985). For large firms, patterns of governance should match the scope of their preferred policy solutions but the public actors within them should not become too powerful in their own right. In most cases societal actors with a stake in transnational integration will favour supranational governance *without* a single supranational entity free to ignore societal pressures. This is particularly true of actors who hope to exert influence. Consumers of financial services may feel they are best served by a Leviathan to protect them from the vagaries of financial innovation and charlatany. Large firms, in contrast, should prefer an institutional architecture made up of competing public actors whose bureaucratic power depends on industry support.

Supranational cooperation before Lamfalussy

The idea of supranational cooperation in the field of securities markets dates back to the first round of capital market negotiations which produced the ISD and the CAD. The draft directives had envisioned a ‘Securities Committee’ staffed by member state representatives able to update small, specified parts of the legislation together with the Commission. The Commission would draft these updates; the Securities Committee would adopt, reject, or if necessary adapt them. Though this foreshadowed the comitology procedures implemented a little less than a decade later, it differed from it in important respects: the Securities Committee would have allowed member states to renegotiate small, previously decided bits of legislation without having to reopen the overall bargain. In contrast, the Lamfalussy process went a step further and saw member states giving up this power at the expense of supranational actors, not least the Commission itself.

While the implementing powers built into the ISD and CAD were limited, distrust between member states nevertheless led to the scrapping of any reference to a Securities Committee in the directives’ final versions. They only stated that the Council would retain implementing powers until another arrangement was agreed through a separate directive (*Financial Regulation Report 1995c*). The idea of a Securities Committee had already elicited industry support in the mid-1990s (e.g. Interview 240506.b). As implementing powers were clearly circumscribed, technical aspects could be updated without upsetting the fundamental bargain.

Member states’ appetite for further integration in the field of financial markets had ebbed following agreement on the ISD (Jabko 2006). Nevertheless, the Commission proposed a separate directive to establish a Securities Committee in 1995, reminding member states that in doing so it was only implementing what had been agreed two years earlier (*Financial Regulation Report 1995b*). Given the extensive powers of the new committee—it promised to keep national governments in control of changes to existing legislation—member states were largely in favour of it. The European Parliament also indicated its support for some form of a Securities

Committee (*Financial Regulation Report* 1996e). But sensitive to the balance between its own competencies and that of the member states represented in the Council, it envisaged a committee with fewer powers than that proposed by the Commission (*Financial Regulation Report* 1996d). This conflict remained unresolved in the years that followed (*Financial Regulation Report* 1997, 1998c), with no actor on the European stage compelled to cut the Gordian knot. By the time the Commission tabled the first draft of its Action Plan in 1998 (European Commission 1998), the ‘committee’ directive had effectively disappeared from the EU agenda.

Partially in response to this lack of progress within the official EU architecture, national regulators began to coordinate their activities. The Federation of European Securities Commissions (FESCO), as the new body was christened, was a joint initiative of the *Commission des Opérations de Bourse* (COB), the French capital market regulator, and Tommaso Padoa-Schioppa, who at the time worked for the Italian regulator CONSOB and is often credited with being one of the visionaries of EU financial market integration and an architect of the euro (Interview 210306). Early in 1997, the COB organized a dinner to which it invited the heads of all European capital markets regulators as well as Commissioner Monti. There it floated the idea of some sort of institutionalized cooperation. Eight months later FESCO was officially established with a secretariat at the COB in Paris (Interview 190506).

FESCO’s practical achievements, however, were limited, largely owing to the regulators’ lack of legal and institutional leeway. It had no formal powers to make rules; at best it could try to agree on common interpretations of European rules where national legislation left it sufficient room. FESCO’s main accomplishment was a multilateral Memorandum of Understanding (MoU), an agreement for cooperation in the fulfilment of regulators’ supervisory tasks that replaced previous bilateral ones. More importantly from the perspective of the financial industry, it tackled the vague definitions that had circumscribed the market-opening effects of the ISD. Article 11 of the directive allowed member states to impose ‘host country rules’ on firms dealing with residents if the latter were ‘retail’ rather than ‘professional’ investors. These terms were

nowhere defined, effectively allowing governments to enlarge the former category as they wished. FESCO tried to find common definitions and indeed published a compromise in 2000 (Federation of European Securities Commissions 2000). In spite of heavy lobbying by financial firms, the agreement still fell short of what leading banks had hoped for (Interview 270206, Mijs and Caparrós Puebla 2002).

With hindsight, one of the most remarkable things about FESCO is that before 1997, there was no forum in which European regulators could coordinate their activities. This shows how far matters have since evolved: national regulators today are embedded in a network with their European partners while supranational cooperation has become an integral part of contemporary regulation, both as a set of rules and through the actual day-to-day operations of the respective national authorities. At the time of writing, the Committee of European Securities Regulators (CESR) is a central actor in EU capital market politics; at the time of the adoption of the FSAP, FESCO as CESR's predecessor played no significant role in the Commission's efforts to reinvigorate EU financial market integration.

It would be wrong, however, to judge FESCO's impact solely against the material changes it produced. FESCO was the first embodiment of a nascent transnational epistemic community for securities markets regulation in Europe (P. Haas 1992, Kapstein 1992). It provided a forum for regulators to meet, exchange ideas and formulate common positions with fewer hesitations than in actual negotiations. As regulators discovered how far their ideas had already converged, FESCO spurred their *esprit de corps* (Interview 210306).

Launching institutional change

Following the adoption of the FSAP, there was widespread feeling that some sort of institutional change to finish its work programme within the envisaged six years was desirable. The Commission had indicated as much in the report itself (European Commission 1999c). One lobbyist for a large bank confided that for him, institutional change had been an integral part of the FSAP enterprise—and thus effective market integration and the reordering of the

competitive landscape—from the beginning (Interview 231105). This support for some form of supranational governance, it emerged, was widespread throughout the industry, even among firms that otherwise were competitive rivals such as large investment banks and stock exchanges. On the question of supranational governance, their transnational business ambitions brought them together.

For many continental firms, the support for institutional change sprang from their interest in pan-European rule harmonization. The Conseil du Marchés Financiers (CMF)'s president Lepetit had called for rule harmonisation in the light of announced stock market consolidations in 1998 (*Les Echos* 1999). Deutsche Bank's Rolf Breuer decried the 'regulatory nightmare' in European securities markets and bluntly called for a single regulatory institution (*The Economist* 1999). French banks presented a list of grievances reminiscent of the complaints usually coming from the City of London (Association Française des Banques 2000c). Even the otherwise cautious European Savings Bank Group called on the Commission to 'examine the burdensome legislative process and in particular the length of the entire procedure' and suggested the use of comitology (European Savings Banks Group 1998).

The necessity for EU rules to pass through the regular co-decision process, often taking years, was suitable for the low degree of top-down harmonisation envisioned at the time of the ISD. Co-decision now proved unable to cope with detailed legislation. The Association Française des Banques, hitherto one of the more protectionist forces in the field, described its support for change as follows:

Private firms have now begun to think in European terms. They are in need of a secure and unified legal framework in order to let the European financial market function efficiently. French banks in particular have developed European and international strategies in the fields of fund management, commercial and investment banking and custody. Thus, current regulation lags behind market developments. The [ISD] is seven years old. It currently constitutes an inadequate response to the changes of the last few years, and therefore a range of legal and regulatory problems currently remain unresolved. (Association Française

des Banques 2000b, translation from French by the author)

The Brussels lobbyist for a large European bank came to a similar conclusion:

The main advantage of this procedure is its flexibility. [...] When we change a directive according to EU procedures, that is, in co-decision, then that is not only the framework directive. But the discussion in parliament goes down into the tiniest detail of a technical nature.
(Interview 231105)

The gap between market evolution and EU provisions widened precisely where detailed European rules were needed. This comes as no surprise as Story and Walter found the ‘average adaptive efficiency’ of international public bodies to be lower than for any other group (national authorities, SROs, etc.) (Story and Walter 1997: 131f). Frustration in the industry grew to the extent that a group of investment banks, headed by bulge bracket firms Morgan Stanley, Goldman Sachs and Merrill Lynch, reportedly entertained the idea of drafting their own standards which could eventually form the basis of a pan-European rule book (*The Economist* 2000).

In its report, the European committee charged with proposing avenues for institutional change came to similar conclusions, finding that drafting detailed agreements in the Council more often than not added unnecessary complexity to the attempt to fit 15 regulatory regimes into one set of rules (Committee of Wise Men 2001: 14). The resulting ambiguity of the provisions was easy prey to stretching to fit local arrangements. The Committee report in its final assessment aptly described the situation:

Whilst part of the problem concerns the incomplete regulatory coverage at European level, the greater part of the responsibility lies in the way in which European Union legislation has been decided (or left undecided) and ‘implemented’ (or not ‘implemented’). The problem is the system itself. (Committee of Wise Men 2001: 13)

Chapters 3 and 4 of this thesis addressed the links between interest constellations filtered through national policy communities, the desire to create a single market without rule harmonisation, and intergovernmental negotiations as the setting of choice to manage regulatory

interdependence. The two former conditions were now of the past, leaving only an inappropriate institutional arrangement unable to live up to changed expectations. While the creation of FESCO was a step in the right direction, it did nothing to change the cumbersome and inefficient co-decision procedure.

Negotiating Lamfalussy

Institutional overhaul was to prove difficult. Even if reforms appear sensible from the outside, they tend to be considered in policy-making circles only after solutions within established frameworks have been found grossly insufficient (Hall 1993, Crouch and Farrell 2004). While the overall conditions highlighted the sensibility of basic change, distributional conflicts and distrust resurfaced within negotiations. Even as the financial industry pushed for change, the final row was essentially in governments' hands (cf. Quaglia 2006).

In the FSAP the Commission had again raised the issue of *institutional* change in the governance of securities markets, tentatively proposing a single regulatory authority while lamenting 'the absence of a committee of appropriate standing to assist the EU institutions in the developing and implementing of regulation for investment services and securities markets' (European Commission 1999c: 14). The idea of installing a regulatory committee following comitology procedures was likewise raised by Howard Davies, head of Britain's FSA (Financial Services Authority 1999). In March 2000, the European Council convened in Lisbon in an ambitious mood. But while it acknowledged the problems listed in the FSAP and called for their solution over the following five years, it failed to propose institutional mechanisms to achieve this, calling only for 'more intensive co-operation by EU financial market regulators' (European Council 2000).

Whenever institutional change in the governance of European securities markets had been debated, one of the—hotly contested—options was the creation of a single regulatory authority. Proud of their newly established FSA and generally wary of European institutions, British authorities as well as most market participants—while in principle supportive of more

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pan-European co-ordination—disliked the idea (Financial Services Authority 1999). Apart from rare exceptions such as Deutsche Bank’s Rolf Breuer, industry response was muted. The Federation of European Securities Exchanges (FESE) for example voiced its strong belief that a ‘European SEC’ was *not* the way to go (Federation of European Securities Exchanges 2000). Contrary to Quaglia’s (2006) findings, this was not an isolated view within the European financial industry. An overly powerful pan-European regulator potentially threatened industry interests while its advantages over a well-thought out committee system were far from obvious.

The idea of a single regulator did, however, find friends in the French financial establishment, notably in political circles (Interview 190506). One of the main reasons was that according to ‘European logic’, the location for such an institution would almost by default be Paris. Germany had only managed to bring the European Central Bank (ECB) to Frankfurt after a face off with France, while the UK, not being a member of the eurozone, had practically watched from the sidelines. France was thus next in line. France was also already hosting FESCO, making Paris the natural choice for a more formalized body for regulatory cooperation in Europe.

One month before France assumed the EU presidency in July 2000, Laurent Fabius, French finance minister, proposed to his ECOFIN colleagues a ‘Committee of Wise Men’ to study the governance of capital markets in Europe. As one Commission official closely involved with the Committee of Wise Men recollects:

The idea was explored—and is still there—of a single regulator for Europe. The French were working at the time to create a single regulator. By creating such a group, one of its resolutions or conclusions would be to have a single regulator. That was why it was the French. (Interview 141205)

Though the single regulator was rarely mentioned explicitly, Fabius’ initiative was widely perceived as a step in that direction. Suspicion further heightened when the name of Alexandre Lamfalussy surfaced as chairman of the committee. Lamfalussy was known as a federalist and strong supporter of supranational arrangements. Especially Britain and Germany—which

opposed a single regulator—were cautious about mandating a report. The core issue was again one of competition: paralleling the tension between mutual recognition and harmonization, a single regulator was perceived in the City as possibly eroding its competitive advantages (Interview 141205). Most of the smaller EU members felt that they stood to gain from the French initiative. For them, the eventual choice would be between moving closer to the regulatory structures of the large European markets, leaving them with most of the costs of convergence, or all parties making concessions to create a single regulatory authority with the EU framework.

But without British *and* German support, the initiative for a single regulator stood little chance. Rather than abandoning the committee in the face of resistance, Fabius took a more cautious approach and retreated from the idea of a pan-European regulator (Crooks and Norman 2000). Michel Prada, head of the French *Autorité des Marchés Financières*, also conceded late in 2000 that the time for a pan-European regulator had not yet come (Prada 2000). The French climb-down on the issue gained the backing of almost all EU members for the committee of ‘wise men’—only the UK still voiced formal opposition to the idea (Osborn 2000). As noted above, making use of comitology procedures had been advocated by Davies the previous year; the problem for British authorities had been how to pre-empt a report advocating a single regulator. Changing strategy, the Treasury now pushed for the committee’s mandate to be as wide and vague as possible and for Sir Nigel Wicks to be one of the ‘wise men’. Wicks, who had served as the head of the powerful EU monetary committee, shared the general British line of caution in conferring regulatory powers to ‘Brussels’ and to more integrated forms of regulation.

EU finance ministers finally agreed to establish the committee at the ECOFIN meeting on 17 July 2000. Several aspects of the mandate are noteworthy. In its definition of the ‘problem’, reference was mostly made to unsatisfactory implementation and transposition of EU rules; institutional arrangements for rule-*making* were not explicitly criticised (ECOFIN 2000). The committee was comprised of seven instead of the initially envisaged five members, due to the

British insistence on having Nigel Wicks on the committee. The mandate to consider institutional adjustments was almost hidden at the end of the document; it asked the committee to propose ‘scenarios for adapting current practices to ensure greater convergence and co-operation in day-to-day implementation’. As a disincentive to any proposals for a single authority, prudential supervision was explicitly excluded from the scope of the inquiry.

Less than two months after the mandate was given, the Committee of Wise Men made it clear that it was no longer pursuing the idea of a single regulator (Norman 2000a). The reason given in the first report, published in November 2000, was that it would require a change in the Treaties, and would thus take several years and an intergovernmental conference to accomplish (Committee of Wise Men 2001: 67-114). Lamfalussy himself reiterated the point in an interview with *Business Week* in January 2001 (Echikson 2001). Political will was simply lacking, with most stakeholders pushing for a comitology solution of some sort. As the head of one business association remembers,

In Europe, we need a system that is not too rigid. If you have a long-term, almost eternal piece of Community legislation, a Directive, you must have the flexibility. And when Lamfalussy and David Wright [Director in charge of financial services at the EU Commission] and his team came here, they sat upstairs and we had them for five and a half hours, we took them straight through this model, and it is pretty much what they came out with. Now whether that was our brilliance I have no idea, but what I am able to say is that we were very heavily involved with Sir Nigel Wicks and some of the other key members of the Lamfalussy group. Once it began to generate activity we were very enthusiastic. And once it began to gather speed we coordinated with our fellow associations in Europe to improve the consultative procedures.
(Interview 300306)

As the respondent points out, it is difficult to establish with any certainty how much credit his organization and its allies deserve in giving the Wise Men’s committee its ideas. At the very least, the result was clearly in line with industry thinking. When the preliminary report was published on 7 November 2000, it was met with wide sympathy—as well as relief in its absence of a call for a single authority—from financial industry associations such as the Federation of European

Securities Exchanges (FESE) and the London Investment Banking Association (LIBA) (Norman 2000b).

The essence of the Wise Men Committee's suggestions became known as the Lamfalussy process, which splits the policy cycle into four 'levels' (Committee of Wise Men 2001). The procedure had already been outlined in the initial report; the final version, published in mid-February of the following year, altered it only slightly. With minor deviations, this is the legislative procedure that was implemented; it remains in use at the time of writing.

The approach favoured by the Committee of Wise Men can be characterized as comitology-plus. In common with procedures that are widely applied throughout the EU (Bergström 2005), comitology divides legislation in two: at level 1, the European Parliament and Council decide 'framework legislation' through the regular co-decision procedure on the basis of drafts prepared by the Commission. Such framework legislation consciously brackets specific 'technical' questions. For these, it confers 'implementing powers' to the European Commission, which can then 'fill in the details' at level 2. In the variant adopted for capital markets, the Commission's implementing measures are scrutinized by a 'regulatory committee', in this case the European Securities Committee (ESC).

The ESC consists of member state delegates and is meant to ensure that the Commission uses its implementing powers in line with the mandate conferred upon it in the framework legislation; it is effectively meant to function as a 'watchman' of the Commission (cf. Dehousse 2003). In line with the general rules agreed by the European Parliament, the European Council and the Commission on the functioning of comitology in 1999,⁴¹ the regulatory committee needs a qualified majority—a supermajority of more than 70 per cent of the weighted votes—to stall the Commission's plan to adopt a particular implementing measure (cf. Inter-Institutional Monitoring Group 2003: 40). The measure in question is then put before the Council, which has three months to reject the measure definitively, again with a qualified

⁴¹ Council Directive 1999/468/EC.
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majority. Otherwise the Commission can proceed to adopt the measure in its original form. The ESC and the Council can thus reject Commission proposals but cannot amend them or make suggestions of their own, at least not formally. The bluntness of the ESC's policy instrument is meant to deter its excessive use.

The real innovation of the Lamfalussy process, however, lies in its creation of a second committee, one which easily overshadows the ESC: the Committee of European Securities Regulators, commonly known as CESR. Like its predecessor FESCO, CESR brings together capital market regulators from all the EU member states. But in contrast to FESCO, CESR has a formal role in the European legislative process. Officially it fulfils two functions. First, it advises the Commission on the implementing measures to be adopted on level 2. In concrete terms, it makes suggestions for the gaps that have been left open in framework legislation at level 1. The idea is to have 'experts'—the regulators—deal with the technical details instead of the Council, the EP or the Commission. Formally, CESR's role is only advisory at this stage. In practice, however, the Commission is expected to justify its deviations from CESR's advice, giving CESR a central role in capital market legislation.

CESR's second function is placed at level 3 of the new procedure. There, CESR is meant to coordinate the transposition of European legislation into national law lest discrepancies in national implementation defeat the goal of a harmonized rule set. Again, CESR cannot exert any formal pressure on member state parliaments when it comes to the adoption of national laws. The idea is to use moral suasion to ensure smooth transposition, and to detect potential defections from commonly agreed rules as early as possible. Finally, at level 4, the Commission is charged with systematically monitoring implementation and, if necessary, using its legal powers to challenge members states in front of the European Court of Justice (ECJ).

The industry response to the publication of these ideas was overwhelmingly positive as they resonated with firms' preferences. Praise came from both Paris (Association Française des Banques 2000a) and the City. The latter made its views known through the Federal Trust, a UK

think-tank. The Federal Trust report on the Lamfalussy procedure was written by a working group of 17 people including the chief EU lobbyists of many of the most active banks and business associations, including Goldman Sachs, Morgan Stanley, Barclays, LIBA, the International Securities Markets Association and the International Primary Market Association (Federal Trust 2001a). The secretary general of the Federation of European Securities Exchanges (FESE) and the former head of the Amsterdam Stock Exchange were also part of the group—showing that in spite of the competitive struggles to come between investment banks and stock exchanges, they were thinking in the same direction on the issue of supranational governance. Other prominent lobbyists soon joined the group, including representatives from the two most active continental banks, Deutsche Bank and ABN Amro (Federal Trust 2001b).

The working group's evaluation of extant legislation was damning:

The initial directives were fudged. They were slowly implemented by most governments and weakly enforced by the Commission. National bargaining in Council led to a protectionist atmosphere. Regulators did not trust each other and so Directives became excessively detailed. (Federal Trust 2001a: 1)

It therefore welcomed the thrust of the latest report. Among the shortcomings it nevertheless identified, one stuck out: lack of transparency and institutionalized industry consultation. Indeed, ever since the publication of the first Lamfalussy report, the issue of formal private input into policy-making had been one of the focal points of industry attention. Lobbyists kept pushing the point. One of them, who was also a member of the Federal Trust working group, found that

[i]nsisting on that sort of discipline [that consultative procedures are adhered to] has been one of the single most important things I have ever done in my life. Because it is alien to any organisation that wants to retain its power [...]. So we would constantly be talking to Alexander Schaub [EU Commission Director General for financial services at the time] and asking: why didn't we see that thing in advance? Could we please have longer to reply to it? (Interview 300306)

After the publication of its first report, the Wise Men committee held extensive consultations with both industry groups and national governments in an effort to make its recommendations

more acceptable and to buttress the report's legitimacy.

The final report was published on 15 February 2001 and addressed many of the issues that had been raised in the consultations. It clarified the roles of the different parties in the procedure and formalized private sector input (for industry evaluations of the final report, see e.g. Federal Trust 2001b). The British Bankers Association (2001) for example praised the degree to which industry concerns had been taken up by the Wise Men. It was now up to governments and the European Parliament to sign on to the committee's suggestions.

While the enthusiasm European leaders had mustered at the Lisbon summit had already cooled, momentum was maintained in the overhaul of securities regulation. It was only shortly before the Stockholm Council in March 2001 that governments' adoption of the proposals was again put in doubt. Given the prominence of British officials in the securities markets department in DG Internal Market, the German government was wary that integration privileging the role of the Commission would benefit the City more than Frankfurt (Brown-Humes and Norman 2001). It resolved to accept the new process only if the bar for member state intervention on level 2 measures was lowered. Fearing yet another dead-lock after the take-over directive had been blocked by the German government for years, the financial industry demanded adoption of the report without delay, with individual companies as well as the European Banking Federation publicly voicing their concerns (de Larosière and Lebègue 2001, Norman 2001a, Walker 2001). As was the case with legislation, firms were ahead of their governments on institutional issues as well (Quaglia 2006). Agreement was reached at the last minute when the Commission committed itself 'to avoid going against predominant views which might emerge within the Council' on 'particularly sensitive' issues (European Council 2001, Groom and Norman 2001). This so-called 'Aerosol clause' was widely interpreted as meaning that a simple majority would be enough to block things in the Council (Inter-Institutional Monitoring Group 2003), thus circumventing the 'official' comitology rules that require a qualified majority to reject the Commission's

implementing measures. The effect of this nebulous phrase remains unknown—at the time of writing it has never been invoked—but it is unlikely to deflect the thrust of institutional change.

Nevertheless, the immediate political repercussions were enormous: supranational bodies and institutions had escaped the grasp of their former principals and had begun to live lives of their own (cf. e.g. Pollack 1997, 1998). The European Parliament had already felt underrepresented in the proposed legislative procedures before the Council negotiated extra concessions from the Commission and endorsed the Lamfalussy process (Norman 2001b). After inclusion of the Aerosol clause, the EP clearly saw the inter-institutional balance between itself, the Commission and the Council upset. From the EP's perspective, it was a matter of principle; it demanded influence equal to that of the Council, including over implementing measures. The political sensitivity of power-sharing between the different Brussels bodies delayed adoption by almost a year.

In effect the EP was demanding the right of 'call back'—to be able to review the Commission's implementing measures. Its position was spelt out in an April 2001 letter from Christa Randzio-Plath, Chair of the EP's Committee on Economic and Monetary Affairs, to Frits Bolkestein, at the time Commissioner for the Internal Market (Randzio-Plath 2001). In its reply the following month, the Commission suggested a range of 'trust building' measures between the institutions but refused to give in to the EP's main demand (Bolkestein 2001). To make matters worse, the Commission had already included comitology procedures within its drafts of the Market Abuse and Prospectus Directives in May 2001, long before institutional matters had been settled (Interview 221105). A month later it established the ESC and CESR, again before any formal agreement had been reached with the EP (European Commission 2001). Both of these steps only increased the EP's resistance.

In this spat the industry largely sided with the parliament (e.g. Federal Trust 2001a). Lobbyists saw the EP as one of their major partners in Brussels. The EBF for example had repeatedly found the EP a crucial ally (Interview 221105), as had another lobbyist for the

Prospectus directive in particular Interview (140306.b). Yet another lobbyist said the same regarding work on the MiFID, adding that

there is definitively a shift of power, towards the EP. [...] The EP is one of the main ways to get legislation changed. All the amendments are published, and MEPs are quite open to discuss things. In the parliament it is much more clear on the trade-offs. National trades are not that common anymore. (Interview 021205.a)

Indeed, industry representatives had already in 1998 taken the initiative to set up a so-called 'inter-group' on financial services, a public-private forum 'composed of several MEPs and several banks and financial services associations' (Mijs and Caparrós Puebla 2002: 263). The body's name was later changed to the European Parliamentary Financial Services Forum (EPFSF), whose members included many of the most important EU lobbyists in finance. But in spite of the breadth suggested by its name, the EPFSF has no consumer representatives or other non-corporate stakeholders among its members.

As pointed out previously, private actors have an interest in the fragmentation of supranational power among public actors and a system of checks and balances that prevents the 'excessive' autonomy of any single actor. Public bodies are then not only forced to listen to private interests; in a conflict between public actors, industry support may be crucial and eagerly sought. This is particularly true for the EP, which generally commands less expertise than the Commission or CESR. Within the legislative process, the EP's power largely lies in the amendments it can make. More than once, amendment proposals were copied directly from lobbyists' suggestions (Interview 021205.a). This turned into particular embarrassment when several MEPs tabled identical proposals, suggesting a common source outside the EP.

As the dispute between the Commission and the EP continued to smoulder during the summer of 2001, it became increasingly clear that the call-back right the EP demanded would in all likelihood require a change in the Treaties, particularly to Article 202 which concerns the delegation of legislative powers to the Commission (Inter-Institutional Monitoring Group 2003: 41). The search for a different arrangement thus began; a compromise was finally found in the

form of the ‘sunset-clause’ which lets the Commission’s implementing powers expire automatically after four years (European Parliament Committee on Constitutional Affairs 2001). Implementing measures then have to be renewed—a deterrent for the Commission to adopt them in the face of EP opposition, particularly in cases where the EP feels that the Commission is acting *ultra vires*. Two weeks after the group of MEPs charged with finding a way out of the impasse had published its report, the suggestions were officially adopted by the EP. The Commission gave its assent without delay and the new Lamfalussy procedure could finally be implemented (European Commission 2002).

Supranational governance in practice

On the drawing board the Lamfalussy process has clear supranational elements. But these are tempered by the fact that the two new committees, the ESC and CESR, are composed of member state representatives. How radically does the Lamfalussy process depart from previous governance arrangements?

By agreeing to both the FSAP and the Lamfalussy process, member states have effectively Europeanized capital market governance. With the FSAP completed and the updating of its provisions in the hands of the Commission and CESR, the scope for independent national action in the field of capital market regulation is now minuscule. Only in fields where competitive differences remain very strong—clearing and settlement is a clear example—have no legislative powers been transferred to the Commission. At the very least, governments have ‘pooled’ their sovereignty (Hoffmann 1966).

Yet upon closer inspection the *practice* of contemporary capital market governance deviates significantly from what the formal layout of the process suggests. This is particularly true in two respects: first, the ESC—officially the ‘watchdog’ of the Commission’s use of its implementing powers—is widely seen as failing in its function. Providing its chairman and effectively running its meetings, the Commission has managed to co-opt the ESC in questions of policy (Interview 131206). The ESC has no independent staff, consultation procedure or powers

to propose actual changes to implementing measures; it does not function as an instrument of member state control. Indeed, one interviewed member state representative worried that regulatory authorities were de facto assuming legislative tasks (Interview 071205.b). The relative weakness of the ESC resonates with what other scholars have found about the functioning of comitology in the EU in general. Concerned with accountability and democratic control, both Rhinard (2002) and Dehousse (2003) are highly sceptical as to whether comitology committees are nearly as effective as they seem on paper.

Lobbyists agree that the ESC plays a small role in contemporary capital market governance. In most interviews the ESC was never mentioned whereas CESR always received considerable attention. As one respondent found,

[t]he ESC is for when we have a big problem. They don't do consultation or anything. It is really CESR... (Interview 211105.b)

Where, after all, would the ESC get its cue to intervene? National regulators—the experts in the field—are already active in CESR and the issues most dear to national finance ministries have already been addressed in framework legislation at level 1. At best the ESC is an additional veto point interested stakeholders can use to stop unpopular rules—hardly an instrument of ‘national’ oversight.

Second, CESR functions much more as a single, supranational entity than its official committee structure suggests. Representatives of national regulatory authorities expressed a strong *esprit de corps* in interviews while parties involved were unanimously impressed by the level of cooperation achieved thus far (Interview 160506.b, Interview 160306, Interview 030506, Interview 190506). In the execution of their tasks, BaFin and FSA still function as national authorities. But in policy-making, they invariably see themselves as part of a larger European network. This resonates with the well-established, if elusive, claim by neofunctionalists that the supranationalization of institutions is capable of generating shifts in loyalty among bureaucrats (E. Haas 1958, Risse 2005, Niemann 2006). Collaboration has allowed regulators to assert

themselves in the face of increasingly integrated financial markets in Europe. Regulatory structures were indeed 'behind the curve' and for regulators who take their tasks seriously, being organized on a European level makes sense. It also affects their standing in the wider world of public actors.

This is particularly relevant given the competition among the different bodies involved in European policy-making. Various respondents have pointed to the cool relations between CESR and the Commission; the tension is unsurprising as both feel themselves to be the centre of EU capital markets regulation (Interview 190506). The Commission solicits 'reports' from CESR in its level 2 work rather than suggestions for draft legislation. The Commission wants to keep the drafting of legislation for itself, whereas CESR clearly feels it performs more than an 'advisory' role. On several occasions the Commission has significantly amended CESR's advice for level 2 implementing measures (notably for the MiFID), prompting CESR members to claim that 'politics' had unduly trumped 'expertise' (Interview 160506.b). More positively, the competition between the Commission and CESR has fostered close cooperation among regulators.

Indeed, the regulators themselves appear to have become a force for further integration. Unsurprisingly, few would suggest the establishment of a pan-European regulator which would abolish the independence of national authorities. But intensive cooperation has created possibilities for new arrangements, for example the supervision of cross-border stock exchanges such as Euronext. Close cooperation within CESR has furthermore encouraged the sharing of competencies in ways that would have been considered intrusions onto each other's turf just a few years earlier. The CESR's Himalaya Report (Committee of European Securities Regulators 2004) has been the clearest initiative in this direction. Leading European firms had long been calling for a 'lead-supervisor' (European Financial Services Round Table 2004), meaning a single authority to supervise a financial conglomerate's activities throughout Europe. In effect this would extend the idea of the European passport for services provision to supervision as well. It quickly emerged that the lead supervisor idea in its pure form would run afoul of the present

treaty and national laws. But receptive to the idea, CESR's Himalaya Report outlined possibilities within the legal framework for working towards a similar sort of supervisory structure. Even among leading firms, this was seen as a progressive move.

In a similar spirit CESR set up a mediation mechanism among European regulators in 2006 (Committee of European Securities Regulators 2006b). CESR members thereby commit to a procedure for solving disputes among themselves, for example over the interpretation of common positions. The industry was again delighted by the prospect of a mechanism to iron out mismatches among national rule sets. Even though mediation was not meant as an appeal mechanism, industry firms have asked CESR to allow them access to mediation when they have grievances with the local implementation of EU rules. CESR not only granted such access, even if indirectly, but also allowed firms to use host country regulators to raise problems with their own home authorities (Committee of European Securities Regulators 2006a). Though not an appeal process in name, CESR's mediation mechanism comes close to one in practice. With it, firms have further emancipated themselves from their home regulators and reinforced the supremacy of CESR as a supranational body.

Conclusion

With the coming into force of the Lamfalussy process, EU capital market governance has largely been supranationalised and at least a temporary equilibrium has emerged between market structures and patterns of governance. Policymakers stopped short of creating a single European regulator, a step that would have required changes in the treaties of the European Union.

Formally, member states still retain significant influence in the two new committees at the core of the Lamfalussy process. One of them, the European Securities Committee, has largely failed to fulfil its function as a 'watchdog' over the exercise of implementing powers delegated to the European Commission. The second, the Committee of European Securities Regulators, has been very active and visible in EU capital market policy. Though made up of member state regulators, it functions more like a single supranational entity than its design on paper suggests. CESR's

evolution since its inception fits the neofunctionalist notion of *engrenage*—the supranational socialization of bureaucrats involved in collective governance (Niemann 2006).

Member states have far from abrogated their influence over EU capital market policy; the current decision-making process resembles Scharpf's image of 'joint decisions' much more closely than his image of 'hierarchical direction' (Scharpf 2001). Given the centrality of financial markets in economic policy, this comes as no surprise. Within the financial industry as well, only a small minority of firms favoured more far-reaching steps such as a single European regulator. In an industry consultation about the functioning of the Lamfalussy process in 2003, European banks submitted a positive joint response together with the Federation of European Securities Exchanges and a whole host of other transnational professional associations, demonstrating just how broad general industry support for this kind of arrangement was (FESE et al. 2003). Multi-level governance suits transnationally active firms, particularly in light of the perceived 'danger' of an overly powerful EU regulator at liberty to ignore industry positions. The present system is replete with access points for industry lobbyists while political competition between public actors turns financial firms into their potential allies. This, however, does not mean that the supranationalization of capital market policy has been a smooth and automatic process—the agency of specific actors remains crucial for understanding the timing and process of change. Looking back on the emergence of the Lamfalussy process, one Brussels lobbyist observed that

[i]t is like all great plans, and lobbying is the same. If you have great plans and you try to lobby on something, usually you will achieve something, but it often isn't really what you set out to do. And that is true of the French, who saw [triggering institutional change] as a means to get some more control of [EU financial market politics]. And to a degree that has happened. Because the Lamfalussy committees are taking back some of the power to the member states. But in practice, because it is a collective taking back, it has not given the individual members states back so much control. (Interview 021205.a)

This chapter has argued that strong industry support for integrated governance was a crucial precondition for its emergence. In keeping with the argument of the previous chapter,

such 'private influence' is impossible to isolate as an explanatory factor and hence immeasurable. However, it is indisputable that financial firms were core proponents of the kind of governance structure that eventually emerged. And given firms' ability to insert their preferences into the EU policy process, it is implausible that member state governments would have endorsed such a process in the face of industry opposition. Indeed, the following chapter will show that even with EU capital markets governance heavily supranationalised, the ability of firms to dominate rule-making has far from disappeared: in the renegotiation of the ISD, competition politics still ruled, only this time with transnational alliances rather than national blocks.