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CESR's preliminary progress report "Which supervisory tools for the EU securities markets?"
An analytical paper by CESR October 2004 (ref. 04/333f)

Comments by FESE
(Federation of European Securities Exchanges)

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1. **FESE** (the Federation of European Securities Exchanges) is the Brussels-based representative trade association of Europe's regulated financial market operators. FESE's members encompass cash, equity and derivatives markets, specialized commodities markets as well as clearing houses and associated organizations. One of FESE's principal aims is to work towards the accomplishment and enhancement of Europe's integrated capital markets, providing a level playing field for all market participants. In the recent past, FESE has made a significant contribution to, inter alia, the rapid introduction of the Euro, the acceptance of the Lamfalussy recommendations and the progressive establishment of the Financial Services Action Plan.

2. The Federation considers this **discussion paper by CESR to be an extremely important contribution to further dialogue** on the evolving European regulatory and supervisory structures. This should be considered not only in a European context, but also in a global one since there will definitely be an impact on Europe's competitive position.

   The timing of steps forward has of course to be carefully modulated, both in terms of market developments and FSAP implementation.

3. FESE applauds the **openness and flexibility of CESR in its consultation** process and expresses the hope that regulatory institutions like CEBS and CEIOPS will be in a position to maintain such a constructive approach.

   However, we understand that CESR plans to accept also non-disclosed comments. We disagree with this acceptance of secrecy. In the case of FESE's submission, we are very happy for it to appear on the CESR web site, and indeed, we will put our comments on our own web site as well.

4. We have read the CESR Discussion Paper in the context **of the views** by the **ECOFIN Council** as worded in their FSC Report as well as the views by the **European Parliament**, partially still under discussion in the form of the Van den Burg report and the successive reports by the **Inter Institutional Monitoring Group**.

5. The importance of the CESR Paper goes well **beyond the securities sector**. Without any doubt, the outcome of this dialogue will set a precedent for the positioning and the functioning of CEBS and CEIOPS in the banking, insurance and pension funds sectors. We believe therefore that the active participation of financial market participants beyond the strict securities markets is extremely valuable in the current discussion.

6. We would like to compliment the **logic inherent in** the CESR paper and the **provisional character** of many of the points and questions. We believe that by approaching difficult issues in this manner, CESR makes clear that this is the beginning of the debate about supervisory and regulatory structures in Europe's securities markets and not the end of it.

   FESE would like to propose that the debate be opened and the issues aired at our forthcoming **2005 Convention** at the end of May in Brussels. The Chairs of CESR, CEBS and CEIOPS have all indicated that they will be participating at that occasion.

7. In November 2004, FESE published the "**Lefebvre Report**" which sets out our views on post-FSAP priorities and developments. This report contains a number of paragraphs on supervisory and regulatory structures as well (especially B.2 on page 10 and following: see www.fese.org/initiatives/fese_reports/2004/post_fsap_priorities.pdf). We would point out that in many other aspects, our report concurs with CESR's preliminary progress report and that we therefore support some of CESR's main suggestions.

   The most important issue of substance is our insistence on an **evolutionary, step-by-step and gradual development** and evolvement of CESR and its functions, roles and powers. Out of a concern for the effectiveness of the EU- and of national legislation and regulation, we would object to dramatic leaps forward that might appeal to those who favour rapid European integration but that would not add to but detract from the effective regulation which is the goal in the post-FSAP environment.

8. Within European national capital markets, it is often difficult to prevent double and even triple **supervision** and regulation. That this of course adds to cost levels is clear enough. FESE strongly supports the approaches outlined in the CESR paper that aim to prevent double or triple supervision and regulation in the even more complicated combination of EU and national regulatory structures. We need to take an imaginative and flexible approach in order to maximise the chances for developing structures that fulfil on the one hand national accountability requirements and on the other produce a regime that is effective and does not impose undue burdens on financial markets participants.

9. As CESR stresses too, **market confidence** is crucial in all markets, not only in financial and capital markets. It is vital not only for listed companies but for all other market participants as well. In this respect we would emphasise that securities markets should not, as CESR's paper defines them, be limited to equity cash markets. They should be seen as to encompass bond and derivative markets as well. Furthermore, there are broader classes of instruments like those traded on commodity markets, some of which take pride of place in the European environment. It is important for CESR to recognise that such broader areas cannot be seen as disenfranchised or marginalised.

10. As mentioned above in the context of the **Lefebvre Report**, it is very important at this stage to make choices which are right in the short term and to decide the priorities for the next steps to take.

    There are some who argue in view of the current post-FSAP phase for no action whatsoever. FESE believes that a r**egulatory pause** may be sensible in some areas but in others new and improved legislation is required. However we believe that first steps must be limited to **practical improvements** in current policies and practices by national regulators. One example

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could be in joint investigations. Beyond that we would stress that between national regulators and CESR there are a great number of intermediate phases. Putting it more clearly, cross border is not synonymous with a pan-European approach.

In the short term, the concept of a **coordinating regulator** might help when market-led changed structures require a different approach. This would obviate the need for additional national or EU legislation. Out of such a co-ordinating regulator, one might derive the concept of the **lead regulator** perhaps particularly in the area of capital adequacy. This might be easier to apply than on broader levels. Even such lead regulator would remain nationally based but he would have to recognise the accountability of his colleagues in other countries that are nationally based too.

11. A further step that one could imagine but which seems at this stage too early, would be to transfer powers formally to such a lead regulator, again based only on national legislation.

12. We would be very reluctant if the comments in the previous paragraph were seen as inducement to go down that road too quickly. Clearly any initiatives to go much further ought to come from the Commission in the first place. We therefore believe that an interesting intermediate but immediate step might be to take a decision to set up a **pilot project** of a coordinating or a lead regulator, to be applied in the securities business of OMX or Euronext or separately to both.

13. Such a **pilot project** would emphatically not be an EU mechanism but a test consisting of the relevant regulators only. The current co-operation between the regulators overseeing OMX- or Euronext businesses provides an appropriate basis for such a pilot. With sufficient and appropriate **transparency, this pilot scheme** would provide the lessons to be learned in other areas and for other regulators. A time period should be set to evaluate the experience.

14. One may take for granted that steps that go much further, such as maximum or gradual **harmonisation the powers of national regulators** and of the areas for which they are responsible, can only be taken after much wider discussions. In such discussions, it might be suggested that we look at the ultimate outcome of, say, a **Directive** that would arrange for common supervisory tools for securities market supervisors and possibly a Treaty for European supervisor securities for markets. Although such an approach might be interesting, FESE firmly rejects such discussions for now. They might be more appropriate in the light of market developments over this and perhaps even over the next decade.

15. In the CESR paper, the idea of a **network of regulators** is suggested. FESE believes this has much to commend it. It is an interesting concept for which however the legal basis does not seem to exist at the EU level nor can it be easily based on Lamfalussy procedures. One should not lose sight of the fact that currently regulators are exclusively based in their national legal structures and contexts.

CESR suggests it might take over tasks prescribed in the Markets in Financial Instruments Directive and the Transparency Directive, such as transaction reporting or the **storage of regulated information** of issuers. Since CESR so far lacks the technological know-how to establish and operate such complex IT operations, we would argue that especially for issuer information, commercial service providers with a track record in the distribution of financial

information are to be preferred. Many Exchanges too have well assessed experience and expertise in this field.

16. The suggestion by CESR to review home/host arrangements seems to us commendable. We would most certainly wish to join in further discussions on such issues. We note however that cross border market operators today already have several home regulators and potentially no host. This is a fact that simply has to be dealt with.

For entities with cross-border activities, it could indeed come as a relief if they were supervised by only a single regulator or by a lead supervisor. Such a streamlining of regulatory responsibilities could involve significant synergies both on the part of the authority and the regulated entity. It is, however, not acceptable that "market infrastructures", as CESR calls them, should be given a special treatment in comparison to banks and other financial services providers. This would contradict the principle of functional regulation, i.e. the equal regulatory treatment of equal functions, irrespective of the institution by which they are performed.

We agree that the home/host concept in other contexts remains highly relevant and therefore support the proposed review.

17. In the CESR Paper we find suggestions relating to powers of enforcement of national regulators. We do believe that regulators should be empowered to be effective enforcers in case of market abuses. If within national structures there are out of date strictures that form barrier against effectiveness, we would advocate that such barriers be eliminated. However in most if not in all Member States, there is a clear distinction between criminal law prosecution on the one and administrative and civil law on the other hand. Such distinction is politically and historically determined and has among others to do with the evolving criminal law systems and the important protections they contain against abuse as practiced in the further past.

It seems to us far too early to consider CESR Members individually let alone collectively, moving into enforcement with instruments going beyond those available under administrative and civil law approaches. From an effectiveness point of view, it is important that regulators may impose fines but to go beyond that in the area of criminal law would seem to us neither effective nor politically advisable. We would find more favour with further efforts in many Member countries with training and education of prosecutors and courts relating to securities legislation. The establishment of an EU-wide sanctions database would, we believe, be helpful. Disclosure of actions actually taken by CESR would form an important preventive instrument.

Beyond this we would repeat the position we have taken in the discussions on the Market Abuse Directive which is that national legislation should allow and keep a place for self-regulatory disciplinary approaches as well.

Exchanges, among other parties, make constructive contributions to their regulatory environment including proper investor protection standards. CESR should bear this in mind also from an overall cost-benefit standpoint.

18. **Accountability** based on transparency has been a mainstay of the recommendations of the Lamfalussy Committee. Therefore we support further discussions about solutions for alleged democratic deficiencies both at the level of ECOFIN Council Committees (level II) or at the level of CESR's advisory work (level III).

19. One of the other crucial points in the Lamfalussy recommendations was its insistence on effectiveness of the application of the EU legislation on the ground in the actual capital markets. Part of that effectiveness as we see it is to provide for **redress mechanisms** that are fast, cheap, effective and professional. We repeat our belief that official bodies by tradition, culture, inclination or by law are not always fast, efficient, effective and cheap. It is from that perspective and in order to harvest discontent and complaints among capital market participants that we have made the proposal which we have termed "The FESE Ombudsman". We recognize for legal and political reasons that the choice of the term Ombudsman is perhaps ill-advised but we will continue to seek support and have open discussion on the substantive merits of our proposal to settle disputes between professionals in Europe's capital markets and regulators other than their own. FESE is open to discuss with CESR and the Commission as well as with any other interested party how to embed such a dispute resolution service in the wider European Union framework.

20. We would favour a review of the composition and the nomination procedures of current **CESR's Advisory Panels**. We would like to ensure that different sectors of financial services providers are represented. Above all, the composition of such panels needs to be balanced and measurable. Our sole aim in this respect is to improve and enhance the quality of the advice that CESR receives from such panels. FESE would be ready to entertain the idea of a senior Exchanges' panel if CESR would find this beneficial.

21. As we remarked earlier one cannot dissociate discussions at the EU level from the **global context**. The competitiveness of the European economy and of its service providers is of the greatest possible concern to us. By way of example we would like to point out that in the jurisdiction of the CFTC, US Exchanges have unprecedented freedom and are permitted among others to self-certify rules which are reviewed post-event. We would like to stress that many of these Exchanges are competing directly with EU Exchanges and vice versa. We would therefore be concerned about suggestions of subjecting significant product **innovations** to a wide or pan-EU assessment at an early stage. In the competitive environment in which FESE Exchanges operate, there is a need to respond quickly. We would not argue against a coordinated response but it should not be at the expense of process longevity . It should continue to allow national regulators to approve rules when they are closer to the national markets.

22. FESE and its Members look forward to continued discussions of the issues involved and welcome broad participation in such debates on a transparent basis.

Brussels,
16th March 2005