Problems and Opinions

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The Constitutional Moment: The Lamfalussy and de Larosière Reforms and Contemporary Challenges

Abstract

This study examines changes in European regulation, particularly the way economic regulations have been proposed and implemented – with a particular focus on financial markets – since the introduction of the Lamfalussy architecture and the proposals of the de Larosière Group. It also offers proposals for addressing future challenges. Market fragmentation within the EU, national protectionism, and divergent supervision hinder the effective functioning of the single financial market. Europe needs massive private investment to increase competitiveness, defense potential, and technological leadership. This requires, among other things, integrated capital markets and profound legislative changes. This includes a shift from directives to regulations and an increased role for EU agencies (e.g., ESMA, EBA, EIOPA) in creating and implementing European law. Furthermore, the growth of cross-border financial interconnections requires centralized supervision, which could reduce transaction costs and increase the efficiency of law enforcement. Unfortunately, the supervisory functions of EU agencies are limited by national supervisory structures and the dominance of the home country principle. However, member states fear a loss of sovereignty, and critics of centrali-

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zation invoke the Meroni Doctrine, arguing that the EU lacks treaty-based powers over prudential supervision. Hence, the growing role of EU agencies in the legislative process raises questions about their legitimacy and democratic oversight.

Keywords: fragmentation of EU markets, Lamfalussy report, De Larosière Group, EU regulations

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In the history of European integration, there have been constitutional moments that have led to changes transforming the structures, institutions and governance of the European Union and adapting them to the requirements of the future. The current constitutional moment involves far-reaching reforms aimed at increasing the global competitiveness of the European economy, building its defence and security capabilities, and strengthening Europe's position on the international stage. Behind all these challenges lie enormous investment needs and a shift from crisis management thinking to strategic thinking. An important factor influencing this change may be the restructuring of the way Europe regulates its economic and financial reality. With the recent enlargements of the Union to the east, the Union's single market has become more heterogeneous and fragmented, characterised by a low level of integration of economic structures and a high degree of diversity in economic bases. Over the years, this process has been further exacerbated by the entrenchment of fragmentation based on the pursuit of national sovereignty, linked, among other things, to the growing role of national institutions, which are increasing their role at the national level. In this context, it is not surprising that, in order to reduce fragmentation tendencies and strengthen the single market, the Commission has for years been inspiring new approaches to the way in which the Union regulates and legislates, in particular by intensifying reform efforts in the area of economic and financial services regulation.

The aim of this study is to draw attention to changes in European economic regulations, the way they are proposed and implemented, with particular emphasis on financial markets. The point of reference is the Lamfalussy and de Larosière reforms, and the context is the challenges facing the European Union.

1. Lamfalussy and de Larosière

The good news for political efforts to rebuild the EU is that there is tangible evidence of the evolution of European financial market regulation. In 1985, before the Maastricht Treaty was signed and the European Union was created, the Commission's White Paper on the creation of a single market focused on regulatory differences that constituted barriers to trade. The document contained a long list of recommendations considered necessary for the development of a single market for financial services. However, many of these recommendations proved difficult

to negotiate due to the prevailing structural differences and conflicts of interest between national financial sectors. This turned the harmonisation process into a conflict between different national interests, as Member States sought to adopt EU rules that best suited their preferences. Due to divergent national realities, Member States regularly opted for vague compromises that were difficult to implement, as national competent authorities tended to interpret both the law and needs differently. Divergent interpretations, 'gold-plating' and inconsistent implementation of regulations fragmented the single market according to the preferences of national jurisdictions. The fragmentation caused by the lack of legislative harmonisation was exacerbated by the fact that, until the beginning of the 21st century, the management of economic regulations was based on the powers of the Commission and the comitology system. This proved to be an inflexible management method that failed to keep pace with the rapid development of financial markets or compensate for the insufficient harmonisation of law within the internal market.

To address the shortcomings in the management of EU economic regulations, in July 2000 the French Presidency of the Council asked a group of experienced market practitioners, chaired by the Belgian economist of Hungarian origin Alexandre Lamfalussy, to identify reforms that would increase the effectiveness of the economic regulation process. The Lamfalussy Report (2001) recommended dividing economic regulation into four levels.

- At level 1, the European Parliament and the Council would adopt the basic rules proposed by the Commission under the traditional co-decision procedure. According to the Lamfalussy report, this procedure, due to its complexity and time-consuming nature, should only be used to define the framework rules;
- At level 2, the Commission would adopt and update technical implementing measures with the assistance of advisory bodies. In other words, the Council and Parliament could focus on key policy decisions, while the technical details of implementation would be worked out later by the Commission.
- At level 3, committees of national supervisory authorities would be responsible for advising the Commission on the adoption of level 1 and 2 acts and for issuing guidelines on the implementation of the rules.
- At level 4, it was recommended that the Commission's role in ensuring the correct enforcement of EU rules by national governments be strengthened.

The four-level regulatory approach recommended in the Lamfalussy report was first adopted for securities and then extended to banking, insurance, occupational pensions and asset management. It enabled a more flexible decision-making process and resulted in improved quality of legislation. Overall, the Lamfalussy reform restructured the governance system and improved its procedural efficiency, while also discouraging the pursuit of overly detailed and prescriptive legislation and its inconsistent transposition and interpretation. However, it also increased the complexity and costs of implementing EU legislative harmonisation, and replicated the same "rigidity" that existed in the previous system.

The Lamfalussy reform was implemented only a few years after the 2004 enlargement, thus failing to enable a significant modification of the regulatory framework that would have protected the EU-25 from the effects of the 2007–2008 financial crisis. However, the experience of the crisis provided a strong impetus for further regulatory reform, covering both the content of the regulations and the framework for their management. In 2009, a committee of experienced experts and politicians, chaired by Jacques de Larosière, based on the Lamfalussy procedure (widely considered a success), developed a plan for a regulatory response to the crisis. The reforms proposed by de Larosière recommended, among other things, upgrading the supervisory committees introduced by Lamfalussy to the level of European Supervisory Authorities (ESAs). These reforms were supplemented by around 30 financial regulation packages between 2009 and 2014. Numerous supervisory institutions were established at European level: the European Securities and Markets Authority (ESMA), the European Banking Authority (EBA), and the European Insurance and Occupational Pensions Authority (EIOPA). They have become independent EU agencies with legal personality and are directly accountable to the European Parliament and the Council.

A novelty in de Larosière's governance model was the granting of certain secure supranational powers to agencies by replacing the old comitology procedures with delegated and implementing acts introduced by the Treaty of Lisbon. Under the de Larosière reform, the European Supervisory Authorities could, in certain situations, take decisions addressed directly to national authorities, issue binding decisions and address decisions directly to individual financial institutions. In such cases, the agencies effectively replace national authorities and act as a supranational body, which is probably the most important innovation of the de Larosière reform – and one that has caused considerable controversy in the Council.

2. Regulations, directives and level 2

The Lamfalussy and de Larosière reforms were necessary because the traditional Community method failed to harmonise single market regulations in the 1990s. The Community method relied mainly on directives as the preferred legal instrument, which resulted in a large number of inconsistent solutions. It also relied heavily on coordination mechanisms such as committees, guidelines and expert reviews, which made the law more flexible. The Lamfalussy and de Larosiere multi-level division of the regulatory process more effectively redistributed the regulatory burden, but also expert knowledge, allowing the Commission and co-legislators to focus on the basic principles contained in the framework legislation and to delegate further work on clarifying these provisions to the bodies responsible for them. At the same time, the use of the possibility of delegating powers to agencies weakened the democratic legitimacy of the resulting regulations. Most of them were legitimised only indirectly, through accountability mechanisms linking the European Supervisory Authorities to the European Parliament and the Council.

According to critics of the system, this led to a transfer of power to experts and industry insiders. From a legal point of view, questions arose about the admissibility and long-term stability of an economic governance framework in which important details are delegated from co-legislators or the Commission to unelected bodies such as the European Supervisory Authorities. The legal basis for such delegation can be found in the Treaty on the Functioning of the European Union (TFEU), in particular Article 114, which grants the EU legislator general competence to adopt measures to approximate national law when their aim is the establishment and functioning of the internal market.

As early as 1970, the Court of Justice of the EU ruled that a distinction should be made between legal acts based directly on the Treaties, which define the 'essential elements of the matter in question', and secondary legal acts, which 'aim to ensure their implementation'.However, the Treaties do not contain any provisions describing the tasks and nature of the powers of EU agencies, and there is a lack of clarity as to their place in the EU's constitutional structure. The CJEU has repeatedly confirmed that the EU legislator may create agencies and delegate powers enabling them to adopt legal acts, but it has also emphasised the importance of a regulatory framework and the need for the EU legislator to limit the powers of agencies through 'criteria and conditions'. The misuse of Article 114 TFEU has often been challenged before the Court of Justice of the EU, usually by one or more governments that have failed to block the Council's approval of a specific legal act. However, the Court has shown relative leniency towards EU legislators, allowing them to interpret for themselves the scope of their powers to adopt measures to approximate national law on the establishment and functioning of the internal market. Another element of reflection on the legal trends that can be observed in EU economic regulations is the use of directives as opposed to regulations. During the first ten years after the entry into force of the internal market reform (1993), the EU introduced four times more directives than regulations into its legal order, using Article 114 TFEU as the legal basis. This trend then began to reverse. The turning point, when regulations became the main instrument, coincided with the entry into force of the Treaty of Lisbon and with certain declared political initiatives, such as the capital markets union. It is worth noting that during the financial crisis, the predominant use of directives was increasingly criticised. Among other things, the transposition of directives was seen as too slow to keep pace with the dynamics of the financial market, allowing for excessive divergence in regulations.

Final remarks

The change initiated by Lamfalussy and de Larosière brought about a fundamental transformation in the way economic regulations are conceived, created and implemented. On the path to deeper integration of European financial markets, regulations have for years prevailed over directives, and supranational bodies such as EU agencies, which are increasingly responsible for important legislative work

at Level 2, have gained in importance. However, there is no doubt that the need for change in the way laws are made is at least as strong today as it was two decades ago. The challenges are indeed real, linked to the need for trillions of euros of private capital to finance investments that increase the competitiveness of the European economy, build the Union's defence capabilities, anchor Europe in advanced technologies and consolidate its role as a global player. These challenges require a deep, fluid and integrated European capital market, a market without barriers that stimulates the flow of capital where it is most needed. The fragmentation of the single market and short-sighted protection of national interests are hampering the Union's growth potential and competitiveness. The debate on the need for European solutions in the field of financial supervision, particularly with regard to the capital market, has been going on for many years. ESMA and other agencies have been set up to contribute to policy-making. They are designed to strengthen the resilience of the economy and increase interpretative convergence in the implementation of EU law. In addition to contributing to the development of EU financial market regulations, ESMA and other agencies play a fundamental role in supervising the activities of market participants. However, most European financial regulation still has its roots in the realities of the Member State in which a financial firm is registered or headquartered, and supervision is based on the principle of home country control. With the increasing interconnectedness of global financial markets, the structure of market participants has changed significantly, and many European firms now have significant operations in multiple jurisdictions where they may pose systemic risks to the host country. These market developments pose numerous challenges to the existing EU regulatory and supervisory framework. Cross-border links cannot be effectively supervised by individual Member States due to differences in institutional capacity for implementation and enforcement. The fundamental difference between the past and the future is that financial crises in Europe are likely to have greater cross-border implications compared to past financial crises. A centralised supervisory authority would promote a level playing field in supervisory practices by overseeing the activities of Member State authorities and coordinating cross-border supervision and enforcement. A European supervisory authority could potentially reduce the high transaction costs associated with monitoring and enforcing EU law across borders. There are recognised benefits to a centralised, institutional supervisory structure at European level in the context of expanding cross-border activities in the financial sector, which provides a natural justification for the involvement of these institutions in shaping legislation. Political resistance has led to fragmentation of supervision in Europe, which weakens the consistency of the system and enforcement of regulations, and also carries the risk of regulatory arbitrage and inefficiency. The need to exploit the Union's full development potential and all its strengths requires an end to the debate on the perception of an integrated Europe as the sum of its Member States and the creation of a European capital market.