The primary purpose of the House of Lords European Union Select Committee is to scrutinise EU law in draft before the Government take a position on it in the EU Council of Ministers. This scrutiny is frequently carried out through correspondence with Ministers. Such correspondence, including Ministerial replies and other materials, is published where appropriate.

This edition includes correspondence from 9 May 2012 – 31 October 2012

ECONOMIC AND FINANCIAL AFFAIRS
(SUB-COMMITTEE A)

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Letter from the Chairman to Mark Hoban MP, Financial Secretary, HM Treasury

Thank you for your letter, dated 23 March 2012, on EM 6360/12: Alert Mechanism Report. The House of Lords European Union Sub-Committee on Economic and Financial Affairs considered this document at its meeting on 22 May 2012.

We are grateful for your response to our queries, and would ask you to keep us informed about further developments in relation to the Commission’s in-depth review of the UK. We would also be grateful for an update on the visit of Commission officials on 27-28 March. We would also reiterate our request that you provide the Committee with early sight of the Commission’s analysis, as well as the Government’s response to it.

29 May 2012
Letter from the Chairman to Mark Hoban MP, Financial Secretary, HM Treasury

Thank you for your Explanatory Memorandum, dated 26 June 2012, on the Commission proposal for a Directive establishing the framework for the recovery and resolution of credit institutions and investment firms. The House of Lords European Union Sub-Committee on Economic and Financial Affairs considered this document at its meeting on 10 July 2012.

In the light of the publication of this proposal, as well as the steps towards Banking Union outlined at the EU/euro area summits in Brussels on 28-29 June, we have decided to launch an inquiry into the EU banking sector. We intend to report towards the end of the year, and will take full account of the Commission’s proposals in our deliberations.

In the meantime we would be grateful for some clarification in relation to the proposal. What is the Government’s assessment of the relationship between the proposed Directive and the steps towards Banking Union that were set out at the summit? To what extent, if at all, do you anticipate the policy content and timetable for consideration of the Directive being altered in light of these developments? Specifically, you state that the timetable for the negotiation of the proposed Directive through the Council will be determined by the Presidency. What is your view of the Presidency’s likely approach to the timetable of negotiations?

We note that the Government broadly welcome the proposal, and argue that it should contribute towards reducing reliance on public support when a financial institution fails, and help break the self-perpetuating link between the banking and sovereign crises. We also note your recognition of the Commission’s argument that only action at Union level can ensure that Member States use sufficiently compatible measures to deal with failing institutions. Notwithstanding this, you state that the Government are considering the text carefully in terms of whether it breaches the principle of subsidiarity. What conclusion have you come to on this question? Is there any danger that the Directive as currently drafted will, as you suggest it could, curtail the ability of Member States and their national authorities to take steps to enhance the resolvability of institutions and to take resolution action? For our own part, our initial assessment is that the concerns you raised relate more to the question of proportionality than to that of subsidiarity. However, we would be grateful for clarification of the Government’s position, and bearing in mind the tight timescale that applies in relation to the reasoned opinion procedure, we would urge you to provide such clarification as a matter of urgency.

We note the Government’s concern about the large number of delegated acts and in relation to the EBA’s powers. Which specific delegated powers are you concerned about? Can you elaborate on your concerns in relation to the powers of the EBA? In particular, we would be grateful for further information of the Government’s concern about the implications of the roles of the Commission and EBA for Member States’ ability to establish effective cooperation with third country authorities.

We note your support for the proposed bail-in tool, although we note your view that its effectiveness is dependent upon its design. What is your assessment of the proposed design as set out in the Directive? What is your assessment of the other proposed minimum resolution tools? In our view these are important proposals but they also carry significant risks in terms of their potential impact. What is your own view of the implications of such proposals?

In relation to the proposed special manager tool, you express concern that use of the tool may run counter to its initial intentions. Can you elaborate on these concerns?

Finally, we would be grateful if you could advise us what discussions the Government have held with bodies with an interest in the proposals, including, notably, the Bank of England? What is their assessment of the proposals? To what extent do you believe that this proposal will provide an adequate response to future banking crises, as well as the current crisis?

We would be grateful for a swift response to these queries. In the meantime, and in light of our forthcoming inquiry into the EU banking sector, we have decided to hold the document under scrutiny.

10 July 2012
Letter from Mark Hoban MP to the Chairman

Following on from the EU Sub-Committee A evidence session on Tuesday 17 July, I am writing to respond to a number of questions that the Committee raised during the session. I will follow-up with a separate letter on the questions related to the EU budget.

You sought urgent clarification on the issue of subsidiarity. The Government is continuing to carefully consider whether the proposal for the Bank Recovery and Resolution Directive is consistent with the principles of subsidiarity and proportionality – which we are also considering in light of the links between this proposal and discussions on a Eurozone Banking Union. There may be a case for asserting that certain elements of the Directive, such as the proposed role for the Commission and EBA in recognising resolution arrangements in third countries, and EBA’s role in issuing binding decisions on resolution action, may be inconsistent with the general principles governing the circumstances in which the Union may legislate in an area of shared competence.

In addition, there are questions as to whether the proposed extensions of EBA’s role and the proposed resolution financing arrangements between Member States are proportionate to the aims identified by the Commission in pursuance of the single market objective. Similarly, many of the proposed roles for the Commission and the EBA to adopt certain delegated acts and prepare binding technical standards respectively raise issues both from a proportionality and workability perspective.

I hope you will agree that as we consider the compatibility of the proposal with the principles of subsidiarity and proportionality, we should balance between clear signalling of UK concerns whilst gauging how our messaging may impact our ability to achieve UK objectives elsewhere in the dossier but also within the Banking Union debate.

You also referred to the letter of 10 July from Lord Boswell, which raised several areas for clarification on the Bank Recovery and Resolution Directive. Due to an internal procedural error on our part, Treasury officials have only just seen the letter on 18 July, for which I apologise. However, I shall of course provide a detailed response to the specific areas raised in due course.

In particular, given that some of the issues raised may be subject to deliberation at a forthcoming Council working group in Brussels, it would be important for us to be able to reflect impressions from those discussions in our overall response to you on this.

The Committee also asked for statistics on UK banks’ exposure to sovereign and private debt within the euro area. As an annex to this letter, I have attached a table [not printed] with the latest information as published by the Bank of International Settlements. Exposure data for individual UK banks is available from their respective financial accounts which are also publically available.

On the matter of the Committee’s letter of 20 June 2012 on the Government’s response to the Financial Transaction Tax report, I have written separately to the Chairman of the European Union Committee (letter dated 17 July 2012) on the issue and I enclose a copy of the letter to Lord Boswell [not printed].

19 July 2012

Letter from the Chairman to Mark Hoban MP

Thank you for your letter, dated 19 July 2012, in relation to EM 11066/12 on a Directive establishing a framework for the recovery and resolution of credit institutions and investment firms. The House of Lords European Union Sub-Committee on Economic and Financial Affairs considered this document at its meeting on 24 July 2012.

We are grateful to you for responding to the Committee’s request for clarification as a matter of urgency of the Government’s position on this proposal in relation to the question of subsidiarity. However we note that the Government’s position remains that they are continuing carefully to consider whether the proposal is consistent with the principles of subsidiarity and proportionality, in particular in light of the links between this proposal and discussions on a euro area banking union. We would stress the importance of the Government coming to a rapid view of whether legislative proposals breach the subsidiarity principle, and to ensure that the Committee is in receipt of a comprehensive analysis of the issues in time for it to consider whether to recommend that the House of Lords issue a Reasoned Opinion. In the case of this proposal, the fact that the Government have not yet come to a final view means that we are not able to take this into account, in terms of deciding whether to make such a recommendation, before the Reasoned Opinion deadline expires.

The Committee has today launched a new inquiry into Reform of the EU Banking Sector, in which context we will be examining these proposals in more detail, including in the context of the emerging
proposals for Banking Union. In the meantime we will continue to hold the proposed Directive under scrutiny, and will continue to consider the questions of subsidiarity and proportionality that you raise. We look forward to receiving further clarification from you on this matter, as well as your response to the other queries raised in our letter of 10 July, and urge you to provide this response as soon as possible to aid the Committee’s scrutiny of these important proposals.

24 July 2012

Letter from Mark Hoban MP to the Chairman

Thank you for your letters of 10 and 24 July, regarding the Treasury’s Explanatory Memorandum 11066/12 in which you raised specific questions regarding the Government’s assessment of the proposed Directive. I address these below.

RRD AND BANKING UNION

On the relationship between the RRD and the Eurozone banking union, we consider that the former is generally an EU27 proposal aimed at strengthening the single market, while the latter relates to Eurozone Member States wanting to advance closer economic, fiscal and even political integration to ensure a stable currency.

As we and others have pointed out, some RRD provisions, such as the mutualisation and obligatory lending aspects of the resolution financing appear to constitute elements of a Eurozone banking union. At a recent RRD Council Working Group, many Member States stressed the importance of considering these proposals alongside, if not as part of, the forthcoming banking union proposals on a single Eurozone supervisor, before furthering progress on agreeing the Directive.

In terms of timetable, the Government understands that the European Commission is keen to reach political agreement on the Directive by the end of this year. At ECOFIN on 10 July, the Cypriot Presidency also outlined its plans to seek Council agreement to a general approach on the RRD by December 2012. This timetable is clearly fairly ambitious, especially given the complex nature of the RRD provisions, but the Presidency is likely to try and hold at least two working groups per month during the autumn to move negotiations along.

The Government will, of course, continue to work constructively with European partners to progress the Directive. However, we remain of the view that we should resist any pressures to proceed with undue haste, as the RRD proposals would need to be examined alongside any forthcoming Eurozone banking union legislation to assess any impacts of the latter on the internal market.

RRD NEGOTIATIONS

The Cypriot Presidency held a Council Working Group on 25 July and sought high-level comments from Member States on priority issues. In general, there was broad support for the Commission’s proposals. However, many emphasised that negotiations should not pre-empt forthcoming Eurozone banking union proposals. Member States also raised important points about the appropriate balance of power between home and host supervisory authorities.

Several queried the potential fiscal implications of EBA’s binding mediation role in resolution planning and action, and posed design questions around the treatment of deposit guarantee schemes and short-term liabilities in bail-in. There was lively discussion on the resolution financing provisions, with many reservations or strong objections to the cost mutualisation and obligatory lending aspects. Concerns were also raised about the adequacy of the Treaty base (Article 114 TFEU), with some noting that this Treaty base cannot be used for “fiscal” measures or to adopt measures not concerned with harmonisation and the single market. We expect part of the Council negotiations in September to focus on this point.

SUBSIDIARITY AND PROPORTIONALITY

Further to my letter of 19 July, the Government has further considered the RRD’s compatibility with the general principles of subsidiarity and proportionality. We conclude that while there may be a case for arguing that some third country and resolution financing provisions within the RRD give rise to subsidiarity issues, the Government’s primary concerns relate to the issue of proportionality and legal base.
For example, the proposal for EBA to play a significant role in regulating relations with third countries in resolution action raises subsidiarity concerns, on the basis that Union level action in this area does not appear necessary or desirable for improving the well-functioning of the single market. However, the Government recognises that this could in some circumstances be a helpful role in harmonising practice in areas such as the resolution of branches of third country institutions operating in the EU, and ensuring information confidentiality.

The Government, however, considers that some of the provisions in this area concerning the extension of EBA and the Commission’s role in relation to agreements with third countries are disproportionate to what is strictly necessary to achieve internal market objectives. This is particularly since the proposed responsibilities would cut across the existing discretion of national authorities to take independent judgements on resolution action, taking into account potential fiscal consequences at a national level.

The RRD’s resolution financing mutualisation provisions also raise some subsidiarity concerns. In our view, ongoing discussions around a Eurozone banking union suggest that Union level action – to harmonise and secure the well-functioning of internal market objectives – on resolution financing within the RRD would not be appropriate. Rather, collective action on resolution financing arrangements should only apply to those Member States wanting to participate in closer fiscal and economic integration, which is the objective of banking union.

However, the Commission and others are likely to argue – quite forcefully – that Union level action on some aspects of resolution financing, such as ex-ante funds or enabling deposit guarantee schemes to contribute to the resolution financing costs, may be justified to harmonise practices among Member States. Therefore, the Government intends to argue that individual provisions relating to resolution financing, including certain Commission delegated acts on, for example, refusing third country proceedings, are much too prescriptive or extensive as judged against what is necessary and proportionate action at Union level to achieve single market objectives.

In summary, the Government’s primary concerns, in line with your initial assessment, relate to the issue of proportionality and the legal base. Initial discussions in the Council Working Group suggest that it is unlikely that the required number of national Parliaments will intervene on subsidiarity grounds, as it is clear that some other Member States think that Union level action may be justified. At this stage we know that some other Member States have also raised concerns about proportionality although we, of course, will need to be careful that this argument is not used as a means to water down the content of the Directive. I shall keep you informed with developments during negotiations.

ROLE OF THE EBA AND COMMISSION DELEGATED ACTS

The Government considers that EBA has an important role to play in taking forward aspects of the Directive, such as improving the quality and consistency of banking supervision across the EU. However, there are several areas in the RRD where it is proposed that EBA should prepare binding technical standards. We consider that in certain areas, such as the circumstances for using resolution powers, EBA guidelines are probably more appropriate than detailed binding technical standards, given that circumstances of resolution tend to be institution-specific, rather than sector specific.

In other areas, it is proposed that the Commission should adopt delegated acts in relation, for example, to setting minimum requirements for eligible liabilities for bail-in, and refusing third country resolution proceedings. We are continuing to examine the implication of these clauses, but in line with our proportionality concerns above it would be important to ensure Commission delegated acts do not affect Member States discretion, or do not duplicate or conflict RRD provisions that already provide an agreeable level of prescription.

More broadly, EBA’s proposed role envisaged in the RRD should be considered in light of further discussions on the arrangements for Eurozone banking supervision, resolution, and mutual lending agreements, as well as the review of the European Supervisory Agencies (ESA), scheduled for 2013.

SPECIAL MANAGER TOOL

This proposed early intervention tool would provide supervisors, before the point of non-viability, with the power to replace the management body of a financial institution with a ‘special manager’. This person would take measures to restore financial soundness and/or reorganise its business so as to ensure the restoration of an institution’s viability at an early stage.
However, the Government considers that the appointment of such a special manager may result in a significant risk of a loss of confidence in the distressed bank, and an erosion of whatever franchise value it retains, therefore further exacerbating the problem and speeding up an institution’s failure, rather than restoring the institution’s viability.

**RESOLUTION TOOLKIT**

You sought an assessment of the RRD’s proposed minimum resolution tools. The UK’s Special Resolution Regime (SRR), established under the Banking Act 2009, already provides UK authorities with the sale of business and bridge institution tools. We will work to ensure that the design of the RRD’s proposed tools does not significantly differ significantly from those already available to the UK authorities.

Notably, however, the asset separation tool would be additional to the powers currently available under the SRR and its benefits are currently unclear. Therefore, it is important to ensure that there is no obligation within the RRD to use the tool at this stage.

**BAIL-IN RESOLUTION TOOL**

The Government strongly supports the inclusion of the bail-in within the RRD, and is currently consulting on the design of the bail-in tool through the Banking Reform White Paper. Subject to responses received, we consider that, for the bail-in tool to be credible and effective across EU Member States, the RRD should ensure national authorities have statutory bail-in powers that cover a broad scope of liabilities and that this should be supplemented with a Minimum Requirement for Eligible Liabilities (which is similar to the PLAC requirement recommended by the ICB). The RRD proposals currently provide for this.

The Government is continuing to consider whether the proposed scope of the bail-in tool could be further refined, to minimise regulatory arbitrage and to align it to that set out under the Financial Stability Board’s (FSB) ‘Key Attributes of Effective Resolution Regimes for Financial Institutions’ (“Key Attributes”). More broadly, even though bail-in is likely to increase bank funding costs, the Government believes its benefits, including mitigating the perceived implicit guarantee and moral hazard as well as increasing market discipline greatly outweigh these costs. The impact assessment to the Banking Reform White Paper sets these out in more detail.

**STAKEHOLDER ENGAGEMENT**

The Government has been engaging closely with the Bank of England and the Financial Services Authority throughout the period leading up to the publication of the Commission’s legislative proposal. We are continuing to work intensively together to formulate the UK’s position as negotiations progress.

Broadly, the UK authorities are supportive of the overall direction of the proposed Directive, and believe that its provisions are an important step forward in strengthening the bank recovery and resolution regimes within the EU as they are broadly in line with the international standards embodied in the FSB’s “Key Attributes”. However, as highlighted above, there are aspects of the proposal – such as the role of EBA in resolution action and resolution financing – that require further discussion among EU Member States, particularly given their links with the wider banking union debate and the forthcoming ESA review.

There are also some technical issues, for example around the conditions for resolution, objectives, the specific design of individual resolution tools such as bail-in and relevant safeguards that need to be further addressed. The Government is continuing to draw on the views of private sector stakeholders, bodies and relevant experts to inform its position on these and other key policy issues within the proposal, and we will of course continue to keep Parliament informed as RRD negotiations progress.

Finally, thank you for informing me about the House of Lords European Sub-Committee inquiry on the EU banking sector. I look forward to responding to your call for evidence in the autumn.

*29 August 2012*
Letter from the Chairman to the Rt. Hon Greg Clark MP, Financial Secretary, HM Treasury

Thank you for the letter from your predecessor, Mark Hoban MP, dated 29 August 2012, on EM 11066/12 on a Commission proposal for a Bank Recovery and Resolution Directive (RRD). The House of Lords European Union Sub-Committee on Economic and Financial Affairs considered this document at its meeting on 18 September 2012.

We are grateful for your response to our queries, and we would be grateful if you could pass on our thanks to Mr. Hoban for all his assistance to the Committee during his time as Financial Secretary to the Treasury.

We note the Government’s position in relation to the question of subsidiarity and proportionality. We note in particular that the Government’s primary concerns relate to the issue of proportionality and legal base, in line with our initial assessment. Whilst we are grateful for the detailed response to the Committee’s queries on this matter, we would once again stress the importance of ensuring in future that the Committee is in receipt of a comprehensive analysis of the issues in time for it to consider whether to recommend that the House of Lords issue a Reasoned Opinion.

On the question of the legal base of the proposals, what further detail can you give us of the Government’s concerns? You state that concerns have been raised in Council about the adequacy of the Treaty base, and that you expect negotiations in September to focus on this point. What update can you give us on these negotiations, and the substantive points that have been raised in relation to the legal base?

We are also grateful for your comprehensive response to the Committee’s other queries, which we will take into account in our new inquiry into reform of the EU banking sector, which includes detailed consideration of the RRD. We will publish a detailed report, setting out our position on these proposals, in due course. In the meantime, we would express sympathy with your observation concerning the ambitious nature of the timetable and the need to ensure that undue haste is avoided, in particular in the context of the newly published proposals on banking union.

Given this we would welcome further updates as negotiations progress. In the meantime we will continue to retain the document under scrutiny.

18 September 2012

Letter from the Rt. Hon Greg Clark MP to the Chairman

Thank you for your letter dated 18 September 2012, on the European Commission’s proposed Recovery and Resolution Directive (RRD), in particular with relation to the legal base of the proposal.

As you may know, Article 114 Treaty on the Functioning of the European Union (TFEU) has been proposed as the legal treaty base for the RRD. This article is designed for measures that support the functioning of the internal market. This is the correct legal base for the majority of the proposal, for instance in relation to the provisions on recovery and resolution planning and resolution tools, where it is necessary to have common tools to ensure a level playing field in Europe. However, I think it is inappropriate for some elements of the proposal to be enacted under this legal base. Article 114(2) states expressly that Article 114 TFEU cannot be used for “fiscal provisions.”

The Treasury’s legal advisors have given consideration to the legal issues raised in particular by the European System of Financing Arrangements provisions (Title VII) within the proposal, particularly those concerning mutualisation and obligatory lending (Articles 97-98). They take the view that this aspect of the proposal contains fiscal provisions, for which Article 114 TFEU is not the appropriate legal base.

An alternative legal base for the Title VII provisions could be Article 115 TFEU. This Article does allow fiscal provisions, but also requires unanimity, as opposed to Article 114 which requires qualified majority voting (QMV). However, this Article would also not be an appropriate legal base because the common lending and mutualisation provisions do not constitute “measures for the approximation” of Member State provisions and do not “have as their object the establishment and functioning of the internal market.” These provisions have been brought forward to address the specific risks within the euro area rather than address disparities within the internal market. I do not think an internal market treaty base can be used.

In the absence of a specific treaty base, the legal advice that I have received is that Article 352 TFEU is a more appropriate legal base for Title VII. Article 352 requires unanimity in the Council, rather than QMV as required by Article 114 TFEU.
You also asked for an update on the substantive points that have been raised in negotiations in relation to the legal base. On 3 September, the Cypriot Presidency held a Council Working Group where broad discussions were held on several articles of the RRD. This did not cover discussion on Title VII or the issue of the legal base. Most Member States were waiting for the Banking Union proposals to be published, given the interlinkages with this dossier, before fully engaging on the RRD proposal. However, I do understand that the Swedish Parliament has issued a reasoned opinion, in which they conclude that the proposals for mutual financing mechanisms are contrary to the principles of subsidiarity and proportionality.

The next planned Working Group is on 28 September, in which the European System of Financing Arrangements (Title VII) has been raised as an agenda item. I will keep you updated as negotiations progress.

30 September 2012

Letter from the Chairman to the Rt. Hon Greg Clark MP

Thank you for your letter, dated 30 September 2012, on EM 11066/12 on the Commission’s proposal for a Recovery and Resolution Directive (RRD). The House of Lords European Union Sub-Committee on Economic and Financial Affairs considered this document at its meeting on 16 October 2012.

We are grateful to you for the explanation of the Government’s position concerning the most appropriate legal base for the RRD. Whilst we note the Government’s view, our initial assessment is that Article 114 TFEU would be an appropriate legal base. Not only is it well-established that proposals for legislation on an internal market legal basis can have other important motives, provided there is a genuine internal market dimension to the proposal, but, as the Commission points out, “the extent of interdependencies between institutions creates a risk of systemic crisis when problems in one bank can cascade across the system as a whole”. We note that Council Legal Services are preparing their opinion on the legal base of Title VII of the proposal, on the European System of Financing Arrangements provisions, and would be grateful for an update as and when this opinion is set out.

We are also grateful for the update on negotiations. We would be grateful for further updates in due course. In the meantime we have agreed to retain the proposal under scrutiny.

17 October 2012

SINGLE SUPERVISORY MECHANISM / BANKING UNION (13682/12, 13683/12, 13854/12)

Letter from the Chairman to the Rt. Hon Greg Clark MP, Financial Secretary, HM Treasury

Thank you for your Explanatory Memorandum, dated 2 October 2012, on EMs 13682/12: Regulation conferring specific tasks on the European Central Bank concerning policies relating to the Prudential Supervision of Credit Institutions, 13683/12: Regulation amending the Regulation establishing a European Supervisory Authority (European Banking Authority) as regards its interaction with the regulation conferring specific tasks on the European Central Bank, and 13854/12: Communication on a roadmap towards a Banking Union. The House of Lords European Union Sub-Committee on Economic and Financial Affairs considered these documents at its meeting on 16 October 2012.

You will be aware that these documents are a fundamental element of our current inquiry into Reform of the EU Banking Sector. We are grateful to you for submitting written evidence in relation to this inquiry, and we look forward to your appearance before us on 30 October. We will consider this evidence carefully as we reach our conclusions. In the meantime we would be grateful if you could answer a number of questions in relation to these proposals.

On the ECB Regulation, you state that “overall, the UK supports this set of proposals”, although you note that “the detailed aspects of the ECB Regulation remain under review”. You also state that the “governance and decision-making arrangements remain under consideration by the Treasury”. What update can you give us on the Government’s analysis of these elements of the proposal? What amendments, if any, are you seeking to make?

On the EBA Amending Regulation, you state that you will seek to secure sufficient changes to the EBA voting arrangements to protect the interests of non-participating Member States. What specific changes do the Government believe would alleviate these concerns?
We would also be grateful if you could give us your view of the likely impact on the ESRB of these proposals.

Your EM largely focuses on the two Regulations. We would be grateful for further detail of the Government’s view of the proposed Road Map towards a Banking Union. What is the Government’s position in relation to the proposals as set out in the Road Map? What do you anticipate will be the likely timetable for these proposals to be brought forward?

On the timetable more generally, how realistic is the Commission’s aim of establishing the Single Supervisory Mechanism by 1 January 2013? The evidence we have so far heard suggests that this timetable will not be met. What are the implications of this?

We note your statement that technical working groups began on 27 September with the intention of reaching a political agreement at the October European Council. In that context we would be particularly grateful for an update on discussions at the October European Council.

In order to inform our meeting with you on 30 October, we would be grateful to receive a response to these questions by 29 October. In the meantime we will continue to hold these documents under scrutiny.

17 October 2012

Letter from the Rt. Hon Greg Clark MP to the Chairman

Thank you for your letter of 17 October 2012, in response to our Explanatory Memorandum on 2 October on the European Commission’s two Regulations and Communication on Banking Union. I am writing to respond to the additional questions you have raised. I am sure you will understand that as the subjects of these questions are still being negotiated there will be some areas where I will be unable to comment in detail in order to avoid compromising the UK’s position.

Detailed Aspects of ECB Regulation

Our interests in the ECB Regulation are focused on the powers the ECB will have in its new role, the scope of those powers, and on the ECB’s governance. Importantly, we are working with other Member States to ensure that the ECB will be held accountable for the decisions that it takes given that these decisions could affect banks with UK interests. In this regard the UK is seeking to amend the proposed legislation to make it clear that the ECB has an ongoing duty to have regard for the integrity and unity of the single market. This includes adding an objective requiring the ECB to perform its tasks in a manner that is non-discriminatory and consistent with the proper functioning of the internal market.

Voting Changes

The European Banking Authority has rightly been identified as a responsible body for ensuring that a level playing field remains between participating and non-participating Member States. We wish to see changes to voting modalities that reflect this role and ensure that those Member States outside the Single Supervisory Mechanism cannot be systematically outvoted by those participating in the Mechanism.

We therefore welcome the agreement at the October European Council that an acceptable and balanced solution is needed regarding changes to voting modalities and decisions under the Regulation amending the EBA Regulation. We recognise that it is difficult to finalise on what voting mechanism is suitable and what other processes could be built in to ensure that decisions are taken with the objective of ensuring the unity and integrity of the Single Market.

Impact on ESRB

The ESRB is tasked with the macro-prudential oversight of the EU’s financial system and no proposal has been made to change their role at this time. The ECB as Single Supervisor is likely to be given a responsibility to co-operate closely with the ESRB, within the establishment of its supervisory function in the ECB Regulation.
ROADMAP TOWARDS BANKING UNION

The roadmap does not set out detail on the further elements of Banking Union that will follow the proposals on the Single Supervisory Mechanism. The Government supports the development of a full Banking Union, which requires the Eurozone to go beyond the existing proposals on supervision, to add elements that will mutualise financial sector risk. As the Prime Minister said on 22 October in the House: these elements are critical to breaking the dangerous link in the Eurozone between sovereign debt problems and the stability of Eurozone banks.

"But we do need Eurozone members to get on and form a banking union.

And at this Council I joined those arguing for progress to be made on the plan announced in June.

Put simply, it is not enough having a banking union stripped of the very elements like mutualised deposit guarantees, a common fiscal backstop and a framework for rescuing banks that are needed to break the dangerous link in the Eurozone between sovereign debt problems and the stability of Eurozone banks."

DISCUSSIONS AT THE OCTOBER EUROPEAN COUNCIL AND FUTURE ELEMENTS

At the summit on 25-26 October, the European Council endorsed the Commission's timetable for the Single Supervisory Mechanism, agreeing the objective of seeking political agreement on the proposal by 1 January 2013. We view this timetable as ambitious and it will require all involved to push hard for a compromise that meets the needs of those participating as well as those who choose to remain outside the new supervisory structure. The relevant text from the European Council conclusions is attached as Annex A [not printed].

As part of the completion of Banking Union, the European Council also agreed that existing dossiers on Recovery and Resolution and Deposit Guarantee Schemes should be finalised by the end of the year. The Commission has indicated that it will then bring forward proposals for a single resolution mechanism in 2013. The Government continues to encourage the Eurozone and the Commission to treat this, and other risk mutualisation elements of Banking Union, as an urgent early priority.

I look forward to discussing these issues at the session on 30 October.

26 October 2012

CENTRAL SECURITIES DEPOSITORIES (7619/12)

Letter from the Chairman to Mark Hoban MP, Financial Secretary, HM Treasury

Thank you for your Explanatory Memorandum, dated 23 March 2012, on the proposal for a regulation on improving securities settlement in the EU and on Central Securities Depositories (CSDs). The House of Lords European Union Sub-Committee on Economic and Financial Affairs considered this document at its meeting on 22 May 2012.

We note the Government's broad support for the Commission's objectives in relation to this proposal, and we too acknowledge the vital role that CSDs play in the effective functioning of financial markets. We too acknowledge the general aims that the Commission has set out. However we would be grateful if you could outline your assessment of the likely implications on OTC transactions taking place within the UK financial market. We would also be grateful for clarity as to the impact of the proposal on private sector participants that act as securities depositaries, as well as your assessment of the likely impact on CREST. You state that the Government have already consulted with a number of bodies and organisations affected by the proposal. What is their assessment of the Commission's proposals?

We sympathise with your concerns in relation to some aspects of the proposal, including the implications for the UK in particular of dematerialisation. Nonetheless, we recognise the case for seeking to bring about the dematerialisation of securities. We acknowledge your concern to ensure that unnecessarily inflexible “one size fits all” rules on settlement periods and discipline should not have a deleterious effect on financial markets. Nonetheless, we agree with you that the harmonisation of rules on securities settlement would be a worthwhile achievement. How do you think that such harmonisation can be achieved without imposing an unhelpful degree of inflexibility? We agree with you that the proposal needs to more clearly explain when and how the national law of the issuing
company for those securities or the national law of the CSD where those securities are held is applied, in order to minimise legal uncertainty.

The EM does not explicitly comment on a number of notable elements of the Commission’s proposal, including the proposal to place a limit on the services that CSDs provide, the proposed passport regime, the proposal that, exceptionally, CSDs can seek authorisation to act as a CSD and as a limited purpose bank, the arrangements for ESMA and the Commission to recognise Third Country CSDs providing services in the EU, and the broader role of ESMA in relation to CSDs. What is the Government’s assessment of these aspects of the proposal? We would also be grateful for clarification as to the degree to which this proposal goes beyond the existing regulatory regime that operates in the UK under the FSA and the Bank of England.

We would be grateful for a response to these queries within the standard ten working days. In the meantime we have agreed to hold the document under scrutiny.

22 May 2012

Letter from Mark Hoban MP to the Chairman

Thank you for your letter dated 22 May 2012 on the Commission’s proposal for a Regulation on improving securities settlement in the EU and on CSDs (CSDR). You requested further information on various aspects of the CSDR.

GENERAL IMPACT OF CSDR

The regulatory regime proposed in CSDR is likely to only have a small impact on CREST (the UK CSD operated by Euroclear UK & Ireland) as it is already subject to similar requirements under the FSA and the Bank of England’s existing regulatory regime for CSDs. The CSDR should not have any significant impact on OTC transactions as both exchange traded and OTC transactions are settled on CSDs. The CSDR should not have any direct impact on ‘private sector participants that act as securities depositories’ (by which I assume you are referring to custodians) as the regulation is designed only to capture entities acting as CSDs.

STAKEHOLDER CONSULTATION

In general, stakeholders are mainly concerned about the Commission’s ‘one size fits all’ approach towards securities settlement rules. They are concerned that two-day settlement periods might reduce the current flexibility for market participants to agree arrangements to facilitate the settlement of their transactions. They are also concerned that the settlement discipline regimes rules might impact on the liquidity and attractiveness of less liquid retail markets that support SMEs. Some stakeholders are concerned about the possible impact of dematerialisation on shareholder rights.

SECURITIES SETTLEMENT RULES

Securities settlement rules can be harmonised without being made inflexible by the CSDR’s provisions looking to harmonise common functions shared across CSDs, whilst at the same time being tailored to recognise the different aspects and needs of domestic markets and their participants. For example, the same general type of penalty could apply across different markets, but their application and severity might differ in order to accommodate the functioning of different markets. Such an approach should address stakeholders’ concerns above.

SCOPE OF CSD SERVICES

The CSDR’s general approach, which is sensible, is to enable CSDs to provide services that support their core securities settlement services but to restrict CSDs from providing other services which could pose a risk to the provision of the CSD’s core securities settlement services.

PASSPORTING

The CSDR provides CSDs with a similar passporting right to other financial services entities in other such EU financial services legislation to provide their services in other EU host member states based on their home member state authorisation. There may be a case to consider for host authorities to
have some more controls before a CSD can use their passport to start providing services, depending on the nature of those services.

**Banking Services**

The Commission proposes a model whereby CSDs can seek a derogation to act as a CSD and a limited purpose bank. However, the Commission’s proposals on banking services are generally underdeveloped. Member States are considering the suitability of such a derogation, on what basis such a derogation might be applied, and who should apply such a derogation. Further clarification is required on how the two banking services models identified in the CSDR might operate in practice and how they would mitigate any perceived risks to the CSD’s core services.

**ESMA**

ESMA’s role in this regulation mainly relates to developing underlying technical standards necessary for implementing the CSDR once political agreement has been reached on the main text. There is also a role for ESMA in helping to resolve disagreements that may arise between national authorities in some areas. These powers fall within those set out in the ESMA regulation.

**Third Countries**

CSDR includes provisions requiring the legal and supervisory arrangements of third countries to be equivalent to those in the CSDR and for third countries to provide equivalent recognition to EU CSDs. The Government’s view is that the EU needs to design third country provisions so that they do not act as a barrier to the competitiveness of EU CSDs or unnecessarily disrupt global trade. We will push to ensure that the final outcome is proportionate in balancing regulatory concerns and competitiveness.

**Existing UK Regulatory Regime**

The Commission’s proposal largely covers the same regulatory and prudential requirements as the FSA and the Bank of England’s existing regimes. One of the CSDR’s objectives is to encourage the development of a single market in CSD and settlement services across the EU. Consequently, cooperative arrangements for the authorisation and supervision of CSDs are likely to entail that the Bank of England and FSA involve other relevant EU national authorities in their arrangements for CREST.

**Negotiations**

There have been two Council Working Groups with high-level discussions on the Commission’s proposals. The next Council Working Group is on 6 June.

29 May 2012

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**Letter from the Chairman to Mark Hoban MP**

Thank you for your letter, dated 29 May 2012, on EM 7619/12, on the proposal for a regulation on improving securities settlement in the EU and on Central Securities Depositories (CSDs). The House of Lords European Union Sub-Committee on Economic and Financial Affairs considered this document at its meeting on 26 June 2012.

We are grateful for your comprehensive response to our questions, and are content at this stage to clear the proposal for scrutiny. However, we are conscious that negotiations continue, and we note in particular your view that the Commission’s proposals on banking services are underdeveloped. We would therefore be grateful to receive further updates as negotiations progress.

28 June 2012
Letter from Mark Prisk MP, Minister of State for Business and Enterprise, Department for Business, Innovation and Skills, to the Chairman

Further to my previous correspondence to Lord Roper, I am writing to update you on the package of regulations on cohesion policy, published by the Commission on 11 October.

Because the Danish Presidency announced late in the day its intention to seek partial general approach on some blocks at the 24 April General Affairs Council, it was unfortunately not possible to give you much notice of the likely discussion there. I wanted to make sure this time you have early notice.

I understand that the Danish Presidency is likely to seek a partial general approach on a three further blocks at the next General Affairs Council on 26 June: thematic concentration; financial instruments; and revenue generating projects. I have attached a list of the relevant articles.

On thematic concentration, the Presidency will aim to get agreement to the scope of the funds and their specific objectives. This will include provisions to focus future European Regional Development Fund (ERDF) programmes on innovation, SME competitiveness and shifting to a low carbon economy and the European Social Fund (ESF) on only four priorities to be chosen by each Member State from a menu of 18. As set out in the explanatory memoranda we have submitted, the UK supports the principle of thematic concentration but has concerns about the rigidity imposed by the specific ring-fences for low carbon and social inclusion.

On financial instruments, the UK Government wants to see greater use made of repayable assistance, venture capital and equity financing, as an alternative to grants. It is important however that such instruments are designed in a way that works with the markets and leverages private investment. The UK has worked successfully with the European Investment Bank to put in place some of these instruments in the current programmes (known as JESSICAs and JEREMIES). We and the EIB are concerned that such arrangements would not be possible under the rules proposed by the Commission, particularly in terms of the restrictions on preferential remuneration in Article 38 and we are pressing for changes that allow greater scope for preferential remuneration where it is justified by a rigorous ex ante assessment. We also want more certainty at the beginning of the programming period and are concerned at the number of delegated acts in this part of the Common Provisions Regulation. Financial instruments take time to set and we need to know the rules at an early stage. Furthermore, once contracts with financial intermediaries are signed, it is difficult for changes subsequently to be made.

The rules on revenue-generating operations are also technical, setting out what adjustments need to be made to take account of any income that may come from projects. Substantial amendments have been proposed to reflect the growing importance of public-private partnerships (PPPs). I attach these, as they are new. The UK Government has been involved in developing these ideas and supports them as an effective way of engaging private sector partners in large projects supported by the structural and cohesion funds.

Negotiations on the three blocks are still continuing at working level and the texts to be presented to the General Affairs Council are likely to be revised further. I will update you again when the texts are closer to being finalised, around the time of the discussion in the Committee of Permanent Representatives (COREPER) later in June.

I would point out that, as before, agreement at the Council is likely to be on the basis that “nothing is agreed until everything is agreed”. However, Council agreement will signal key its priorities to the European Parliament, which is considering its own reports on the various Regulations and will be voting in Committee on these in July and September.

There will still be some issues outstanding at the end of the Danish Presidency (these include the provisions on information and communication and on territorial development). Furthermore, we will need to look horizontally at the specific regulations for the funds covered by the Common Provisions Regulations, including those for the European Agricultural Fund for Rural Development and the European Maritime and Fisheries Fund in order to ensure consistency between them and to maximise the opportunities for harmonising the rules to reduce burdens for final recipients and authorities. We would hope that this could take place during the Cypriot Presidency.

25 May 2012
Letter from Mark Prisk MP to the Chairman

Further to my previous correspondence, I am writing to ask you to consider providing a waiver of scrutiny to enable the United Kingdom to vote in favour of a partial general approach on elements of the cohesion package of regulations at the General Affairs Council on 26 June 2012. Your Committee is currently holding the above EMs under scrutiny. EM 15247/11 was submitted by the Minister for Employment.

It may be helpful if I set out upfront why I believe that in this case it is a very useful way of taking forward the negotiations and securing UK objectives.

First, this is a complex negotiation. Not only is the Common Provisions Regulation a lengthy piece of legislation, with 147 Articles and five annexes, but there are five interlinked regulations too as part of the cohesion package, let alone the separate regulations for the European Agricultural Fund for Rural Development and the European Maritime and Fisheries Fund which are being negotiated through different council formation. In my view, it makes sense to break this down into bite-sized chunks that bring together the key themes in each regulation. It means ministers can focus on particular problems and issues within the blocks rather than being overwhelmed by having to consider everything at the same time. It means we can pocket gains without having to become involved in a large-scale trade of different objectives across different pieces of legislation.

Second, the funds are due to become operational from 1st January 2014, although of course this depends on the settlement of the multiannual financial framework (MFF). I want to see effective and efficient spend of the significant sums devoted to cohesion policy across the EU. That means proper preparation and planning, with robust economic assessment of needs. That takes time and that works needs to start as soon as possible if the money is to be spent wisely. Agreeing elements through partial general approaches gives Member States some confidence of the shape of the final regulations to enable them to start planning.

Third, all the Regulations this time round will be co-decided with the European Parliament. Rapporteurs in the European Parliament have already prepared draft reports and these will be voted on in the respective committees over the next few weeks. Agreeing partial general approaches gives the Presidency of the Council of Ministers scope to enter into discussions with the European Parliament. Timely implementation of the regulations is going to require the Parliament and the Council to work closely together. The partial general approaches will facilitate this.

It is important to leave flexibility to take account of changes that might arise from other negotiations that impact on the structural funds, for example the ongoing discussions on the cross-cutting Financial Regulation and the Multiannual Financial Framework itself. That is why we pressed at the last council for the Presidency to write into the minute that the partial general approach was adopted on the basis of “nothing is agreed until everything is agreed” and the Presidency have confirmed they will do the same this time.

Finally, the Government does not believe that agreeing a partial general approach on these regulations represents a risk to overall budget size or prejudicing the MFF deal as a whole.

Turning to the substance, I said in my letter of 26 May that the Presidency was aiming to seek agreement on three blocks: financial instruments; thematic concentration and revenue generating operations, including public private partnerships. They have now added a fourth: performance framework.

FINANCIAL INSTRUMENTS

As I mentioned in my letter of 26 May, the Commission’s proposals on financial instruments were problematic for the UK and would have prevented the use in the UK of instruments such as JEREMIES and JESSICAs where parts of the UK have worked with the EIB to set up funds to provide financing for SMEs and urban development. We also wanted more certainty at the beginning of the programming period and were concerned that the number of delegated acts in this part of the Common Provisions Regulation precluded this. The text that will be presented to the General Affairs Council meets all the UK’s objectives. The changes to Article 38 will provide proper incentives for the EIB and private investors to support financial instruments funded by the funds governed by the Common Provisions Regulation. Furthermore, we have been successful in removing several delegated acts and getting the provisions instead written into the main regulation or changed to implementing acts with Member State oversight. So now the requirements for ex ante assessment and the funding agreement will be known from the start, and Member States can start the lengthy work to prepare these, without having to wait for the Commission to bring forward delegated acts. Furthermore,
because the requirements are now written into the Regulation, the scope for the Commission to bring in new rules midway through period, and therefore upset agreements already made with the private sector, is limited. Other delegated acts are subject to a time limit, so the Commission have to bring them forward promptly. These changes will help leverage private sector investment and have been warmly supported by the EIB. I would like to say clearly at the General Affairs Council that we welcome these changes and we do not want to see them watered down.

THEMATIC CONCENTRATION

On thematic concentration, the Presidency will aim to get agreement to the scope of the funds and their specific objectives. The Minister for Employment will write about the provisions in the European Social Fund. I will deal here with the other provisions.

I welcome generally the Commission’s approach to thematic concentration. As the Minister for Employment and I said in the various explanatory memoranda we have submitted, we believe it is important, particularly at times of fiscal constraint, that the funds are focused on a few objectives to maximise their impact and that we need to avoid excessive fragmentation. It is also important that they are concentrated on the key drivers of growth. However, we were concerned that specific earmarking of funds in a top down fashion by the European Commission was too prescriptive and risked missing the real challenges facing Member States. We want where possible to ensure that decisions are based on economic evaluation of needs. The Commission had proposed in Article 84 of the Common Provisions Regulation that there should be minimum shares for the European Social Fund. That is, of the allocation for structural finds, at least 52% in more developed regions should be for ESF, 40% in transition regions and 25% in less developed regions. This took no account of national and regional needs. However, the text to be presented to the General Affairs Council proposes a range for the minimum share within which Member States can negotiate with the Commission and is based on objectives rather than arbitrarily by fund. This introduces significant flexibility for the UK and other Member States to take account of national and local needs but still ensures a focus of spending on tackling the challenging for employment, knowledge, youth and social inclusion. Greater flexibility has also been introduced into the ring-fences for low carbon in the European Regional Development Fund and for social inclusion in the European Social Fund to recognise the contribution that other investments can make to these goals.

The Government wants clarity as to what areas are eligible for spend from the ERDF. The Commission had proposed excluding investment in infrastructure providing basic services to citizens in more developed regions. This exclusion would have covered ICT and transport, both areas which businesses in the UK believe are important for our competitiveness. It is not clear what basic services would comprise nor how you could differentiate infrastructure for citizens from infrastructure for enterprises. I therefore welcome the changed text which removes this exclusion. Such investment would still be subject to constraints to prevent unnecessary subsidies to large companies and to the overarching principles of thematic concentration.

REVENUE GENERATING OPERATIONS AND PUBLIC PRIVATE PARTNERSHIPS

As I said in my letter of 26 May, the rules on revenue-generating operations are technical, setting out what adjustments need to be made to take account of any income that may come from projects. The Presidency has also proposed new text on public-private partnerships. The Government welcomes measures that facilitate greater involvement of the private sector in projects, particularly if this can also reduce the size of public commitments, including from the EU budget. The measures proposed are sensible ones that the UK should support at the Council.

PERFORMANCE FRAMEWORK

The Presidency has made clear that the issue of the 5% performance reserve will be settled as part of the overall agreement on the multiannual financial framework. Other parts of Articles 19 and 20 of the Common Provisions Regulation can be considered now and have been discussed sufficiently to be presented to Ministers. The Government has two concerns. First, it wants a strong and robust performance framework. It does not believe that poorly performing programmes should expect to continue to be funded. If targets are repeatedly missed, there should be consequences. However, and as the second concern, the Government believes that managing authorities cannot be held responsible for factors outside their control. The text to be presented to the General Affairs Council achieves the right balance between both these concerns.
Finally I mentioned in my letter of 26 May that we will need to look horizontally at the specific regulations for the funds covered by the Common Provisions Regulations, including those for the European Agricultural Fund for Rural Development and the European Maritime and Fisheries Fund in order to ensure consistency between them and to maximise the opportunities for harmonising the rules to reduce burdens for final recipients and authorities. I am asking for a declaration to this effect to be added to the minutes of the General Affairs Council.

18 June 2012

Letter from the Chairman to Mark Prisk MP

Thank you for the letters, dated 25 May 2012 and 18 June 2012 on EMs 15243/11, 15247/11, 15249/11, 15250/11, 15251/11 and 15253/11. The House of Lords European Union-Sub Committee on Economic and Financial Affairs considered these documents at its meeting on 19 June 2012 (with the exception of EM 15247/11, which is under the scrutiny of the Sub-Committee on the Internal Market, Infrastructure and Employment).

We are grateful to you for the information you provide on the four further blocks where the Danish Presidency will be seeking a partial general agreement on 26 June, and we note your request for a scrutiny waiver in relation to these blocks.

As you will be aware, the Select Committee’s report on The Multiannual Financial Framework 2014-2020 was published on 3 May and was debated by the House on 19 June. Chapter 3 of the report sets out the Committee’s views in relation to the various elements of the Cohesion funding package. In the light of this, we are now content to clear EMs 15243/11, 15249/11, 15250/11, 15251/11 and 15253/11 from scrutiny. However, we would wish to continue to be kept informed about the progress of negotiations in relation to these aspects of the next Multiannual Financial Framework, and would particularly ask you to notify the Committee if there are any planned substantial changes to the proposal.

21 June 2012

Letter from the Rt. Hon Michael Fallon MP, Minister of State for Business and Enterprise, Department for Business, Innovation and Skills, to the Chairman

This letter seeks to update you on some issues that may be considered at the General Affairs Council on 16 October. I apologise that this letter is sent relatively late. However, we still do not know for definite what issues will be presented to the General Affairs Council.

Our current understanding is that the Cyprus Presidency will seek a partial general agreement to at least four further blocks: certain financial aspects not covered by the Multiannual Financial Framework; information and communication, technical assistance and articles in the Regulation on European Territorial Cooperation not yet agreed. These papers were considered by Coreper on 3 October. I have set down below the main issues in each block and have listed the specific articles in annex A [not printed].

It may also seek agreement on indicators for the European Regional Development Fund, European Social Fund, Cohesion Fund and European Territorial Cooperation. Now that a political settlement has been reached on the overarching Financial Regulation, the Presidency has been reviewing the articles in the Common Provisions Regulation that deal with management and control, and may present these to the General Affairs Council on 16 October. If it does so, they will be considered beforehand at Coreper on 11 October. In case they are put to the General Affairs Council for agreement, I have explained below the main issues and listed the articles in annex A [not printed].

FINANCIAL ASPECTS NOT COVERED BY THE MULTIANNUAL FINANCIAL FRAMEWORK

This concerns only articles in the Common Provisions Regulation. The main issue is additionality. The Government supports the principle of additionality in that the EU budget should not be used to substitute for expenditure that would in any case have been spent by Member States. However, it was concerned that the procedure to verify this proposed by the Commission to verify this placed excessive and disproportionate burdens on Member States for whom receipts from structural and cohesion funds represented only a small proportion of GDP (or indeed, of national public spending). Under the Commission’s proposal, the Government would have needed to demonstrate in each less developed and transition region that it had maintained the level of Gross Fixed Capital Formation
over the whole period, with exceptions to take account of changes in macroeconomic conditions. Furthermore, the UK stopped collecting data on gross fixed capital formation at NUTS II level (at which less developed and transition regions are defined) in 2002. The Government has secured changes so that the UK would no longer have to verify additionality at regional level, although it will continue to provide data on gross fixed capital formation at national level as part of its convergence report.

**Information and Communication**

This also concerns only the Common Provisions Regulation. The Government supports greater transparency in how EU funds are spent in order to encourage greater financial accountability, but this needs to be balanced against the need to avoid unnecessary administrative burdens. The Government has been successful in seeking the removal of some excessively burdensome requirements, for example the requirements for summaries of projects to be provided in another EU language. It has also secured the removal of references to the EU flag in annex V, with a requirement instead for each managing authority to show the EU emblem, for example on a sign or plaque that can describe its role.

**Technical Assistance**

Technical assistance is that part of the funds set aside to provide administrative support or build capacity at either national or EU level. The Government’s main concern on technical assistance is the increase proposed in the Commission’s own allocation (from 0.25% to 0.35% of the overall budget for structural and cohesion funds). This will be considered as part of the negotiations on the multiannual financial framework. The Government has however secured changes to the Common Provisions Regulation so that the Commission’s plans for use of technical assistance have to be approved by the relevant committee.

**European Territorial Cooperation**

The European Territorial Co-operation (ETC) objective is financed by the European Regional Development Fund (ERDF) and supports cross-border, transnational and interregional co-operation programmes. The Commission had originally removed the current provisions for flexibility for Member States to switch 15% of their allocation across the components of ETC and also the provisions relating to the peace and reconciliations activities in Northern Ireland and the border counties of Ireland. These have both now been inserted into the regulations in the Council’s compromise position.

**Indicators**

These provisions concern the Regulations for the European Regional Development Fund, the European Social Fund, the Cohesion Fund and European Territorial Cooperation. There are articles in each regulation that set out how the indicators will be used, and there is an annex in each that describes the common indicators that will apply across the EU. These indicators are used only where relevant and they must be supplemented by programmes-specific indicators that the Member state or managing authority chooses itself. These programme-specific indicators will need to reflect the results that programmes wish to achieve, consistent with the new performance management arrangements. The list of core indicators is largely as proposed by the Commission but the Government has been successful in stripping out some unnecessary indicators, in ensuring the indicators reflect the achievements of the funds and that the indicators are well defined in a way that UK can effectively report against them.

**Management and Control**

On management and control, the Danish Presidency had secured a partial general approach in April on some provisions. The Cyprus Presidency’s draft text now takes account of the political settlement on the overarching Financial Regulation. This means that designation of authorities is required for bodies administering the structural funds under shared management, rather than the more formal and bureaucratic accreditation system that applies to the CAP. The Presidency text sets out the criteria to be applied, rather than leaving these to a delegated act as the Commission would prefer. The Government believes the text strikes a balance between providing effective discipline and budgetary control and reduced burdens for administrations.
Finally, I have submitted separately an explanatory memorandum covering the amended proposal for a Common Provisions Regulation issued by the Commission on 11 September. As I explain there, the Cyprus Presidency would like if it can to get agreement to the Common Strategic Framework which is included as an annex to the new proposal. However it has decided not to put this issue to the General Affairs Council on 16 October.

I will write again to update you post Council.

8 October 2012

COLLECTIVE INVESTMENT IN TRANSFERABLE SECURITIES (12397/12)

Letter from the Chairman to the Rt. Hon Greg Clark MP, Financial Secretary, HM Treasury

Thank you for the Explanatory Memorandum from your predecessor, Mark Hoban MP, dated 29 August 2012, on EM 12397/12, on a Directive on the coordination of laws, regulations and administrative provisions relating to Undertakings for Collective Investment in Transferable Securities (known as UCITS V). The House of Lords European Union Sub-Committee on Economic and Financial Affairs considered this document at its meeting on 9 October 2012.

Like you, we broadly welcome the Commission’s efforts to ensure that retail investors have a consistent and suitable level of protection. Nevertheless, we note your statement that when the Alternative Investment Fund Managers Directive (AIFMD) is transposed into the national laws of Member States in July 2013, funds aimed at professional investors will have substantially greater investor protection requirements than UCITS funds which are aimed at retail investors. How would you justify this assertion, given that hedge funds tend to carry greater risk?

We also note the concerns that you raise about the potential impact of specific elements of the proposal. You state that the Commission has significantly understated the effects of its proposal to prevent unsuitable institutions from acting as depositaries. We note with particular concern your reference to the effect on UK firms. Although you state that you support the Commission’s aim, with which we also agree, you do not offer an alternative proposal. What other mechanism do the Government believe could meet the Commission’s aim without such deleterious consequences? You state that you have informally consulted with the UK industry. What are their views on this element of the proposal, and how it should be amended? You state that a number of longstanding and suitable specialist organisations in a number of Member States would be forced to restructure. What is the position of other Member States and their industry representatives in relation to this proposal?

Likewise, whilst you raise concerns about the impact of the depositary liability provisions upon investment in developing countries, and state that you will seek a solution that will maintain a suitable level of investor protection without unduly restricting freedom to make appropriate investments, you do not offer an alternative model. What alternative solution would you recommend?

In relation to sanctions, you state that the text should be brought into line with the Transparency Directive and other pieces of legislation. In what way is the text as currently drafted inconsistent with such legislation, and what would be the consequences of such inconsistency? It is proposed to set out a non-exhaustive catalogue of administrative sanctions and measures. What such sanctions do you anticipate being included?

You state that it is expected that a UCITS VI will follow shortly to address the remaining imbalances in investor protection as well as bringing wider reforms to UCITS funds. Can you be more specific about the measures that you expect to be included in UCITS VI, and the prospective timetable for its introduction? In light of the administrative burden incurred in seeking to adapt to the legislation, why is it proposed to bring forward two revisions to UCITS in quick succession? Has any thought been given to combining UCITS V and UCITS VI in one proposal?

We would also welcome further details of the proposed timetable for the current proposal.

We would be grateful for a response to these questions by 24 October. In the meantime we have agreed to retain the document under scrutiny.

10 October 2012
Letter from Sajid Javid MP, Economic Secretary, HM Treasury, to the Chairman

The European Union Committee has requested further information regarding a number of points regarding these proposals. I am replying as Minister responsible for this policy area.

AIFMD

The Committee has noted that AIFMD allows fund investment strategies of a substantially riskier nature than those permitted under UCITS and suggest that it is therefore appropriate that UCITS should not need equivalent levels of investor protection in place.

Many of the requirements of UCITS V, particularly the provisions relating to remuneration, are devised to address conflicts of interest and ensuring inappropriate risk management is not incentivised. Many of the depositary requirements also relate to protections in the event of negligence or criminal acts. They do not, therefore, relate directly to the risk profile of the investment strategies of funds operating under the framework.

Furthermore, UCITS funds can operate a wide range of investment strategy, and indeed some have adopted hedge fund-like strategies. This is an issue that is likely to be discussed as part of UCITS VI.

ELIGIBLE DEPOSITARIES

The Committee asks what solution might be acceptable to address the Commission’s aim without bringing about damaging consequences to the UK depositary industry. My preferred solution would be to allow Member States to continue to operate national authorisation regimes though to subject them to additional requirements of operational capital to ensure only suitable institutions will be permitted. The current minimum requirement in the United Kingdom is £4,000,000 so I suggest that a figure around this level would make a good starting point for discussion.

UK depositaries and fund managers have both expressed their concern with the new eligible depositary requirements. The depositary sector has called for all a grandfathering provision that would permit depositaries that are already authorised to continue to operate indefinitely. While this is an avenue that could be explored, my inclination is that while it would protect our existing firms, it would create an uneven playing field and barrier to entry for new depositary firms, and any grandfathering could also permit unsuitable institutions to continue to operate as depositaries.

Member States that currently operate national regimes for depositaries have all voiced their concern at this proposal. They also argue that national regimes should be preserved in some form. Member States that are not affected have, for the most part, accepted the proposed restriction though a number have indicated that they would be open to considering alternative proposals.

CONTRACTUAL DISCHARGE OF LIABILITY

The Committee has asked for a proposed solution to the lack of a mechanism for contractual discharge of liability. AIFMD has a strict set of criteria under which contractual discharge is permitted. This would be the most appropriate solution. If that cannot be agreed then it would form a useful starting point for discussion and additional criteria reflecting the retail nature of UCITS can be considered.

SANCTIONS

In negotiations we are seeking to align the text with similar EU legislation. The types of breaches covered currently includes This includes carrying out the business of an investment company without authorisation, unauthorised breaches of investment rules, and failure to provide required information to competent authorities or investors. We are particularly seeking to ensure that the text is clear that Member States have discretion to decide whether supervisory measures, administrative sanctions or criminal provisions are appropriate and to make clear that the list of breaches and disciplinary powers are non-exhaustive.

UCITS VI

The European Commission is currently consulting on a wide range of issues relating to the UCITS Directive. We anticipate that any legislative proposals resulting from the consultation are likely to be adopted at some point in 2013, possibly during the third quarter.
Questions are asked regarding eligible investments, efficient portfolio management techniques, over-the-counter derivatives, extraordinary liquidity management rules, a depositary passport, money market funds, a retail regime for funds undertaking long term investments, and improvements to UCITS IV. It is not certain at this stage whether all of these areas will be covered by any proposals.

The policy areas covered in the consultation all need significant further work to be developed into concrete proposals and will need to draw on parallel work currently being carried out by the FSB, ESMA, and IOSCO. The proposals are also likely to be politically contentious and progress is likely to be slow. The requirements of UCITS V have been considered and discussed extensively in the context of the Alternative Investment Fund Managers Directive (AIFMD) and so we believe that the Commission are preparing separate legislative proposals in the hope that the UCITS V measures can be agreed relatively swiftly.

While it is generally preferable to bring in new rules through as few legislative instruments as possible to reduce disruption, having separate revisions in UCITS V and VI should not be excessively problematic. UCITS V is extremely narrow in scope and will only affect a small number of quite specific areas on UCITS rules. Furthermore, managers will be able to draw on experience from the implementation of AIFMD as many of the changes brought by UCITS V will be the same or similar.

TIMING

The Presidency has indicated that a further Council working group will take place in mid to late November. We do not anticipate that this will go to Ministers until the Irish Presidency in 2013 at the earliest.

20 October 2012

COMMON COMMERCIAL POLICY (7455/11, 11762/11, 5091/06)

Letter from Norman Lamb MP, Minister of State for Employment Relations, Consumer and Postal Affairs, Department for Business, Innovation and Skills, to the Chairman

You have asked to be kept informed of progress on three dossiers which fall for consideration in the Commercial Questions Council Working Group (CQG). I am writing to do this following the end of the Danish Presidency and as we approach the summer break.


You were last updated on this proposal by my letter of 7 March. Since that time it has been subject to intensive discussion in CQG, both between Member States (MS) and between MS and the Commission. The measure was also subject to a Plenary vote in the European Parliament (EP) in the same week as the Scrutiny Committee vote.

The Danish Presidency had hoped to be able to reach a consensus in Council to allow formal triilogue negotiations with the Parliament and the Commission to conclude before the summer break. However, while substantial progress has been made a Council mandate for the triilogue negotiations has still to be agreed. This is now most likely to come soon after the break. All sides recognise the importance of a balanced package.

You may recall that the Government’s main concerns with the proposal related to proposed changes to the EU basic anti-dumping and anti-subsidy regulations and that there were two main issues between MS and the Commission on these:

— **MS consultation**: MS were united in their opposition to the Commission intention to eliminate consultation for a number of events during an anti-dumping/anti-subsidy investigation. Significant and positive progress has been made on this issue. Subject to an acceptable overall balance, agreement has been reached on provisions safeguarding MS access to information at all stages of an investigation and a Commission declaration that this will be provided in time to allow MS to contribute to the decisions made.
Investigation timetables: the Commission remain concerned about the effect of new procedures upon timeframes for investigations. We are optimistic that they now accept that there should not be an increase in the overall time for investigations.

The main outstanding issue to be resolved between MS concerns the reference (in Article 21.5) to the Commission’s obligation to take into account views expressed by MS on the Union (public) interest (i.e. the extent to which non-producer interests – users, importers, retailers, consumers – might outweigh the benefit to producers of trade defence measures). The current wording has to change because it implies a procedure that is inconsistent with the provisions of the horizontal comitology regulation (HCR). However, a number of MS, including the UK, are unhappy with the Commission proposal to simply delete the reference and insist on retaining the substance in order to maintain the balance of the current Regulation. The more producer-minded MS are opposed to this arguing that the Union interest is covered by more general wording elsewhere. Several rounds of negotiations have not resolved the issue but both sides are working together to try to find a compromise.

The **EP** Plenary supported amendments proposed by its International Trade Committee (INTA) confirming its focus on the investigation timeframes, the balance in decision-making procedures between examination (MS vote) and advisory (MS consultation), and the nature of MS involvement beyond decisions with a legal effect (the EP appear to support the MS wish for an appropriate level of involvement) and regular reporting to the EP by the Commission on measures under the regulations. It is likely that the main focus for the trialogue negotiations will be on the decision-making arrangements. The Danish Presidency believed that, on the basis of informal talks with the INTA Secretariat, the compromise package being developed represents a good starting point for negotiations.


You were last updated on this dossier by the Department’s letter 18 October to the Rt Hon Lord Roper. This dossier has taken second place to the Omnibus I proposal. Since our update, CQG carried out a regulation by-regulation consideration of the Commission’s proposed package at the end of last year and, in the last two months, discussed a presentation of the Commission’s initial reaction to the INTA amendments (the Plenary discussion is scheduled for later in the year).

UK concerns remain as set out in the previous BIS letter, ie

— preference for fixed rather than indeterminate periods for powers delegated to the Commission – here however the EP have helpfully and consistently proposed amendments to change this to a 5 year term with tacit renewal, a proposal the Commission have indicated they are prepared to accept;

— the seemingly routine provision for urgency procedures – the Commission are considering the need to be more specific about the reasons for use of the urgency procedures; and

— the use of delegated acts for safeguard action in the case of textiles and clothing products under the textiles regulations covered by Omnibus II. This is in contrast to the requirement in trade defence instruments for such action to be subject to the examination procedure. As yet there has been no movement on this issue though the Commission have acknowledged the MS concerns.

The next steps will be agreement on a Council mandate for the trialogue process based on discussions in CQG of a Presidency compromise reflecting MS comments. It is possible that this can be agreed and an agreement reached for the EP Plenary first reading tentatively scheduled for November.

3. **EM 5091/06: PROPOSAL FOR A COUNCIL REGULATION ON THE INDICATION OF THE COUNTRY OF ORIGIN OF CERTAIN PRODUCTS IMPORTED FROM THIRD COUNTRIES (ORIGIN MARKING/"MADE IN").**

You were last updated on this dossier by the Department’s letter of 16 January. Since then the issue was considered at the January meeting of the CQG. It agreed, in view of the continuing disagreement between MS on a compulsory scheme, that the Commission would produce a discussion paper on a
possible voluntary labelling regime. This was initially scheduled for discussion in March but other more pressing legislative work in the Committee means we still await the paper.

16 July 2012

COMMON STRATEGIC FRAMEWORK FOR STRUCTURAL FUNDS (7752/12)

Letter from the Chairman to Mark Prisk MP, Minister of State for Business and Enterprise, Department for Business, Innovation and Skills

Thank you for your Explanatory Memorandum, dated 8 May 2012, on the Commission Staff Working Document on elements for a Common Strategic Framework 2014 to 2020 for the European Regional Development Fund, the European Social Fund, the Cohesion Fund, the European Agricultural Fund for Rural Development and the European Maritime and Fisheries Fund. The House of Lords European Union Sub-Committee on Economic and Financial Affairs considered this document at its meeting on 12 June 2012.

We agree with you regarding the importance of achieving greater strategic alignment between the various structural funds in order to allow Member States and regions to use them in a more integrated manner, thereby increasing their effectiveness and efficiency. We therefore welcome in principle the concept of a Common Strategic Framework (CSF), but agree with you that it must reflect the investment priorities agreed in relation to each of the funds, the provisions of which we note are still subject to negotiations.

Given the importance of such a Framework, we agree with you that it would be inappropriate for it to be the subject of a delegated act. We also note your concerns that much of the material in the Working Document would be inappropriate in the form of a legal text, and that the risk of confusion between the key actions in the CSF and the investment priorities in the fund-specific Regulations should be minimised.

In the light of this, we wish to be kept informed about steps towards the publication of the CSF, including progress of negotiations about its form and content in the context of ongoing discussions on the Commons Provisions Regulation. In the meantime we have agreed to clear this document from scrutiny.

12 June 2012

CUSTOMS 2020 (13265/12)

Letter from the Chairman to Sajid Javid MP, Economic Secretary, HM Treasury

Thank you for your Explanatory Memorandum 13265/12, dated 20 September 2012, on the Commission proposal for a Regulation establishing an action programme for customs in the European Union for the period 2014-2020 (Customs 2020). The House of Lords European Union Sub-Committee on Economic and Financial Affairs considered this document at its meeting on 23 October 2012.

We have previously expressed our view that a merger between the Customs 2013 and Fiscalis 2020 was undesirable. We therefore welcome the Commission’s decision to separate the FISCUS proposal into two separate legal elements. In the light of this decision we are content to clear EM 16901/11, on the original FISCUS proposal, from scrutiny.

In relation to the original combined FISCUS programme, the Committee stated that we were unconvinced of the need of an increase of 39% over the combined budgets of the previous programmes. Our concerns remain in light of the Commission’s proposal of a 45% increase in the amended proposal, and we reiterate our support for the Government’s efforts to limit the financial consequences of this draft Regulation. You state that you will be seeking a “re-prioritisation of activities to focus on those of greatest benefit to Member States.” We would be grateful for further details of what you have in mind.

Notwithstanding these concerns, we, like you, support the work of the existing Customs 2013 programme, and wish to see it continue. What is the view of other Member States on the proposal?
Finally, we note your assertion that the UK opt-in applies to this proposal even though it does not have a legal basis falling within Title V of Part Three of the TFEU. As with other matters where this question has arisen, we re-iterate that we do not consider that the UK opt-in is engaged in the absence of such an express legal basis, and we therefore consider the UK automatically takes part in the adoption and application of the entirety of this proposal. We accept however in this case that the difference does not have any practical effect given that the UK opt-in has been, or will be, exercised. We would be grateful for an update on your discussions with the Council on this point.

We would be grateful for an answer to these questions, as well as an update on negotiations, when significant progress is made, and at the latest before the end of the year. In the meantime, we will retain EM 13265/12 under scrutiny.

23 October 2012

ENERGY TAX DIRECTIVE (9267/12, 9270/12)

Letter from Sajid Javid MP, Economic Secretary, HM Treasury to the Chairman

With the Parliamentary summer recess over, I thought it would be useful to update your committee on the progress of negotiations on revising the Energy Tax Directive, taking into account a Ministerial discussion at the ECOFIN Council held at the end of the Danish Presidency and Cypriot intentions for taking the dossier forward during their Presidency.

Progress under the Danish Presidency was slow and uneven. It became fairly clear at an early stage that their original aspiration to secure Council agreement to a general approach by the end of their Presidency was overly ambitious.

However, at ECOFIN on 22 June the Danish Presidency was able to secure the agreement of 26 Member States (with Poland dissenting) to a set of orientations to guide future work.

Specifically the 26 Member States agreed that:

— minimum tax levels should be laid down in the Directive and these rates should take as their reference points the energy content and CO2 emission levels of energy products;

— the concrete means to do this should be further explored in a pragmatic manner;

— Member States should retain maximum flexibility to determine the structure of their national energy taxes, provided that the minimum levels are respected; and

— the “proportionality principle” of the Commission proposal (referred to as the “relativities requirement” in the correspondence my predecessors have had with you) “may” have to be deleted and the Directive should ensure equal access for all to tax reductions or exemptions regardless of the structure of their national tax systems.

The Government welcomes the progress on this dossier made at ECOFIN. In particular we strongly support the clear statement that Member States should be free to structure their national tax systems as they wish, provided that EU minimum rates of taxation are respected and the negative sentiment.

We also welcome the explicit recognition that the proportionality principle is unlikely to be negotiable. It is already clear that the Cypriot Presidency intends to delete the principle from the proposal in taking work forward.

Taken together these two developments remove many of the most problematic elements of the Commission’s proposals for the UK, with a focus instead on the EU agreeing minimum rates rather than prescriptive rules on the structure of national taxation. This approach is in line with that taken in the version of the Directive currently in force.

On the issue of the level of minimum rates, the Government is open to the principle that energy content and carbon emissions should be factors in setting minimum rates for different fuels to improve the environmental coherence of the Directive.
However, in practice it seems highly likely that, to secure agreement, other social and economic factors will also need to be taken into account one way or another in setting the matrix of minimum rates.

As Justine Greening said in the original Explanatory Memorandum submitted on this file, the Government will scrutinise very carefully any proposals that would require an increase in UK duty rates.

The Cypriot Presidency intends to hold up to five Council working group sessions during its Presidency and hopes that ECOFIN will be able to reach a political agreement on certain key points before the end of the year. However, negotiations will remain difficult, particularly on the very sensitive issue of the level of minimum rates. We would not therefore expect final agreement to be reached under the Cypriot Presidency. Indeed, in practice the early indications are that they will avoid any discussion of the level of minimum rates and instead focus on turning the orientations agreed by 26 Member States in June into a (inevitably partial) legislative text.

Apart from the deletion of the proportionality principle, initial Presidency drafts of legislative texts for the opening articles of the Directive suggest that they also favour deleting the automatic indexation of minimum rates. They will have the strong support of the Government on both points.

I hope you find this information helpful. I will update the committee again when there are significant developments in the negotiations.

27 September 2012

Letter from the Chairman to Sajid Javid MP


We are grateful for your comprehensive update on the progress of negotiations. Whilst it appears that a number of significant barriers have been overcome, arguably the most controversial element of the proposal is yet to be agreed on: the level of minimum rates. The Committee is in agreement with you over the significance of any proposal that requires an increase in UK duty rates. We would like to reaffirm the need to ensure that the impact on UK competitiveness and the need to support the UK’s manufacturing base are taken into account in any further negotiations over this key issue. We will continue to hold this document under scrutiny and would be grateful for further updates as negotiations proceed.

23 October 2012

THE EU FINANCIAL REGULATION (5129/11)

Letter from Mark Hoban MP, Financial Secretary, HM Treasury to the Chairman

I am writing to inform you of the outcome of negotiations between the European Commission, European Parliament, and European Council on the new iteration of the EU Financial Regulation (FR), which sets out the overarching rules for financial matters in the European Union.

As the committee is aware, the FR represents an important step in the Commission’s simplification agenda for future EU spending.

The Government is a strong supporter of the principle of simplification, and agreed with the Commission’s assessment of the existing complex regulatory landscape and its link to high error rates, wasted funds, disproportionate bureaucracy, and disincentives to beneficiaries that might otherwise participate and add value to Union programmes. However, simplification must be balanced with robust systems to ensure effective financial management, propriety and transparency.

The Government has approached the FR negotiations guided by these principles. In particular, the Government has pushed for improvements with a view to improving EU financial management and reducing the rate of error in EU transactions.

The remainder of this letter sets out some of the main elements of the final outcome and how these relate to the Government’s policy objectives.
THE INTRODUCTION OF THE PRINCIPLE OF TRANSPARENCY (CHAPTER 8)

The Government is a strong supporter of enhanced transparency, both domestically and abroad. The new FR makes several important steps forward in delivering greater transparency for EU citizens. A few key examples are: all proceeds from assigned revenue must now be included in draft budgets; a specific reference to the need to disclose the amount of grants and to whom they have been given; strong provisions for the transparency of criteria used to award grants and prizes; new powers of scrutiny and disclosure of the management of the Union's real estate; and robust monitoring of newer tools such as financial instruments and EU trust funds.

The Government will monitor how these principles are put into practice by the Commission.

THE FR AS A GENUINELY OVERARCHING DOCUMENT

Key to ensuring simplicity was to enshrine the FR as a piece of legislation that sits above others. Common rules should exist in the FR wherever possible, not be duplicated elsewhere, and it should only be deviated from where expressly stipulated. The Government is pleased to see that this principle has been followed through.

COMMON STRATEGIC FRAMEWORK FOR THE MANAGEMENT OF EU FUNDS (ARTICLE 56)

The Government broadly supports the rationalisation of programmes, which should produce efficiency gains and reduce administrative burdens and rates of error. The Government was keen to see, and did achieve, common rules that allow enough flexibility within complementary sector-specific rules. The challenge now is to ensure that harmonisation, with simplification, is reflected in those rules. We will guard against needless complexity as these are negotiated.

LESS ONEROUS REQUIREMENTS IN ADMINISTRATION, INCLUDING SIMPLIFIED FORMS OF GRANTS (TITLE VI)

The Government was generally supportive of these proposals. Some (such as allowing the submission of documents and grant applications via IT – Article 122) are merely an essential modernisation of processes. The abolition of the need for interest-bearing bank accounts for beneficiaries (with interest paid back to the Commission) represents a proportionate loss of revenue against a reduction of burdens and disincentives on beneficiaries (Article 20). Acceptance of usual accounting practices (provided those practices are adequate) is a positive step for simplicity, as is the introduction of proportionate administrative burdens for low-value grants.

The Government welcomed simplified forms of grants, but worked to guarantee appropriate safeguards. For example, we achieved appropriate provisions for openness and transparency in the awarding of prizes, with additional safeguards for those over €1m, whilst opposing amendments introducing additional complexity put forward by the European Parliament.

INTRODUCTION OF A TOLERABLE RISK OF ERROR (TRE) (ARTICLE 29)

The Government opposed Commission proposals to introduce TRE, which would allow it to set a flexible maximum error rate threshold for each policy area, rather than the present flat rate of two per cent. This change would have moved the goalposts of error rates. Two per cent is, rightly, a rigorous standard. The Commission should continue to improve their systems rather than seek to control the maximum error rate.

The Government succeeded in limiting TRE to being, in effect, a predicted error rate for management purposes, rather than an acceptable threshold for different policy areas.

FINANCIAL INSTRUMENTS (ARTICLES 130 AND 131)

Financial Instruments have existed across the EU for many years but without a common set of rules to govern them. They include loans, guarantees, equity investments, quasi-equity investments and risk-sharing instruments, and have the potential to significantly leverage the initial injection of Union funds.

The Government’s priority was to ensure those new rules included provisions for initial assessment (to ensure they are the most effective means of achieving policy outcomes), non-duplication of market conditions, transparency, regular reporting, and provisions for adjusting or winding them down when not performing. I am pleased that these conditions have been met in the final FR, thanks to strong lobbying by the UK and its EU allies.
EU TRUST FUNDS FOR EXTERNAL ACTIONS (ARTICLE 178)

EU trust funds have the potential to usefully pool the resources of various donors for emergency, post-emergency, or thematic actions. However, again the Government was clear of the need to ensure adequate levels of scrutiny, transparency and oversight. We achieved this, with provisions to prevent duplication of other actions; for trust funds to add clear value over other methods; and be the best tool by which to achieve an agreed outcome. The Council and European Parliament will have scrutiny powers, and comitology arrangements will be in place to assure adequate governance.

MANAGEMENT OF THE EU ESTATE (ARTICLE 195)

The FR introduces provisions for greater scrutiny of the Commission’s management of the EU estate. The Government negotiated hard to guarantee powers of veto for both the Council and European Parliament over proposed building projects with significant financial implications. This will provide the UK, through those institutions, with a powerful check against any future vanity projects proposed by the Commission.

Overall, I believe the new FR represents a good outcome for the UK. Our key principles for negotiation – greater simplicity, financial propriety, and transparency – are well reflected in the most comprehensive redraft of the Union’s financial rules since its inception. It is now for the Government, other Member States, the Commission and the European Parliament to ensure these themes are reflected in the new multiannual financial framework regulations. This Government will continue to drive improvements in financial management and transparency across the EU.

The Government hopes these reforms, and other simplification initiatives will, in time, lower error rates. We will monitor their impact through the annual discharge procedure and European Court of Auditors’ reports on the EU accounts, and continue to work towards accelerating progress towards greater financial propriety in the EU.

The agreed draft will now be subject to translation and technical revision, ahead of a Council and European Parliament formal vote, expected in October. The FR will then be signed and come into force. However, many of its provisions (relating to the next multiannual financial framework) will not commence until 1 January 2014.

8 August 2012

EURO AREA ECONOMIC GOVERNANCE: THE ‘TWO-PACK’ (17230/11, 17231/11)

Letter from Mark Hoban MP, Financial Secretary, HM Treasury to the Chairman

I wanted to update you on the latest developments regarding the ‘two pack’; two proposed economic governance regulations for the euro area which cleared all parliamentary scrutiny on 22 February 2012. While the proposals do not apply to the UK, the Government takes an active interest in their development.

The proposed regulations were discussed in the European Parliament on 13 June. Both rapporteurs’ reports, one on each proposal, were passed during plenary in Strasbourg, but voting on the draft legislative resolution was postponed to enable trilogue negotiations for a possible first reading agreement.

The European Parliament’s amendments to the draft regulations were discussed at Coreper on 9 July and Ecofin on 10 July and the regulations are now in the opening stages of trilogue meetings.

The European Parliament’s changes were quite broad and radical. The major changes of note were:

— A new Article, Article 6c of the Budgetary regulation, on coordinating debt issuance, including the partial pooling of euro area debt. Pooling of debt would take the form of a European redemption Fund, set up to group together all euro area members’ debt which exceeds 60% of their GDP; the intention being for debt to be repaid over 25 years and at a lower average interest rate. The Council Legal Service has been clear that this proposal is incompatible with the EU Treaties. The UK has said that solutions including eurobonds should be seriously considered.

— Article 10a, providing legal protection for countries at risk of default. The proposed legal protection is intended to provide a Member State more
clarity, stability and predictability in tackling its problems. Under such protection, a Member State could not be declared to have defaulted, its creditors would need to make themselves known to the Commission within two months, and loan interest rates would be frozen. The UK is in agreement with other Member States that this proposal would be incredibly damaging and disruptive regarding access to financial markets.

The Parliament’s amendments also intend to align the regulations more towards growth, for example a proposal for the Commission to be required to present a roadmap for introducing Eurobonds and a proposal for a growth instrument which would mobilise 1% of GDP per year, for infrastructure investments. Other changes include a proposal to make the Commission’s budgetary assessments of Member States more comprehensive, to ensure that budget cuts are not made, killing off investments with growth potential and an amendment meaning Member States would be required to detail which of their investments have growth and jobs potential.

There is broad agreement between Member States that provision of legal protection would be especially problematic for the euro area. We consider that this would prevent agreement on the whole regulation if European Parliament continued to pursue it.

15 July 2012

EUROPEAN GLOBALISATION ADJUSTMENT FUND (15440/11)

Letter from the Rt. Hon Chris Grayling MP, Minister for Employment, Department for Work and Pensions, to the Chairman

Thank you for your letter of 22 March on the European Globalisation Fund (2014-2020). As you requested, I am writing to report on developments prior to the EPSCO Council on 21 June, as this agenda item will just be taken as a progress report.

Current negotiations see an opposing Blocking Minority which is becoming stronger, with private indications from a few more Member States that they are openly considering joining the existing group of eight. Negotiations on the proposal for the new EGF under the next Multi-annual Financial Framework (MFF), 2014-20, are ongoing, led by HMT. These negotiations will need to be completed first to establish the continuation of the EGF.

If the EGF does end up being taken forward, after 2013, then a new and different Blocking Minority, which includes the UK, argues that the EGF should be inside the MFF. There is little support for an extension to agricultural workers. A broad consensus supports the extension of the EGF’s scope to different types of workers and to apply when unexpected crises arise, on which the UK will work to limit the scope and eligibility criteria.

I will of course write to you again on this dossier when the prospects are clear.

19 June 2012

Letter from the Chairman to the Rt. Hon Chris Grayling MP


We are grateful for the further update you give us on the progress of negotiations. We reiterate our view, set out in the Committee’s report on The Multiannual Financial Framework 2014-2020, that:

“We acknowledge the case for some form of crisis intervention instrument in the event of large-scale redundancies. However, we are not convinced that the European Globalisation Adjustment Fund is the most effective means by which to provide such support. We see merit in the Government’s suggestion that the European Social Fund could meet the purposes of the Globalisation Adjustment Fund, and we would encourage further review of the ESF in this context, perhaps with a view to incorporating a contingency fund within the current Fund.”
In the knowledge that there is some way to go before negotiations are concluded, we welcome your offer to write again on this dossier when the prospects are clear. We would also be grateful for an update on your suggestion that the ESF could be used to meet the purposes of the EGF. In the meantime we now clear the document from scrutiny.

3 July 2012

EUROPEAN GLOBALISATION ADJUSTMENT FUND: ACTIVITIES IN 2011 (13483/12)

Letter from the Chairman to Mark Hoban MP, Minister for Employment, Department for Work and Pensions

Thank you for your Explanatory Memorandum, dated 22 September 2012, on the report from the Commission to the European Parliament and the Council on the activities of the European Globalisation Adjustment Fund in 2011. The House of Lords European Union Sub-Committee on Economic and Financial Affairs considered this document at its meeting on 23 October 2012.

We have previously expressed our opposition to the extension of the European Globalisation Adjustment Fund (EGF) beyond 2013 since we believe it is not the most effective means by which to provide support in the event of large-scale redundancies. The Government have previously suggested that the European Social Fund (ESF) could meet the purposes of the EGF, a proposal for which we reiterate our support. Has further thought gone into exactly how the EGF could be absorbed into the ESF? If so, we would be grateful for details of this. As part of our report on “The Multiannual Financial Framework 2014-20”, published in May 2012, we suggested that this could be achieved by incorporating a contingency fund into the ESF.

The Commission has indicated that formal discussions in the European Parliament and Council are due to take place in 2012 and 2013. How do the Government plan to oppose extension of the EGF as part of these negotiations? How many other Member States share similar concerns?

Since the report is for information, we are content to clear it from scrutiny. However, we are keen for regular updates as negotiations over the extension of the EGF continue.

23 October 2012

EUROPEAN STATISTICS (9122/12)

Letter from the Chairman to the Rt. Hon Francis Maude MP, Minister for the Cabinet Office and Paymaster General, Cabinet Office

Thank you for your Explanatory Memorandum, dated 15 May 2012, on a proposal to amend the Regulation on the European Statistical Law. The House of Lords European Union Sub-Committee on Economic and Financial Affairs considered this document at its meeting on 12 June 2012.

We welcome this opportunity to scrutinise this proposal for reform of the European Statistical Law. We agree with your assessment that this proposal represents a shift in powers and responsibilities from Member States to the European Parliament and Council. Do you believe that this shift in balance is justified, and if so, on what basis?

We note your view that the proposal on professional independence of the Head of the NSI needs to be adjusted in order to reflect the devolved and decentralised nature of the UK statistical system. Whilst we understand that decisions with respect to official statistics are taken by the Chief statisticians in the devolved administrations, we would be grateful for more detail on the role of Heads of Profession for statistics in government departments and agencies. How many such Heads of Profession would be affected by the proposal? Do any other Member States share such a decentralised regime? How much support is there amongst other Member States for the amendments that the UK would wish to make? We would be grateful for an update on negotiations on this matter.

We also agree with you that the practical effect of the proposal on access to administrative data needs to be assessed, and would be grateful for an update on discussions in relation to this aspect of the proposal.

In anticipation of a response to these queries, we have agreed to hold the document under scrutiny. 

12 June 2012
Letter from the Rt. Hon Francis Maude MP to the Chairman

I am replying to your letter of 13 June 2012 with respect to the above Explanatory Memorandum. I shall address each of your specific questions in turn:

**CAN THE SHIFT IN POWERS AND RESPONSIBILITIES FROM MEMBER STATES TO THE EUROPEAN PARLIAMENT AND COUNCIL BE JUSTIFIED?**

There is currently no central requirement for quality management in Member States. The current European Statistical Law does not address the assessment of Member States’ European statistics against the European Statistics Code of Practice and other quality benchmarks. Each Member State has its own approach to quality management, which risks variations in quality standards.

The proposed regulation would mean enforcement by the EP and Council of common standards in independence and quality across Member States. This should mean that the quality and reliability of European statistics would be better safeguarded. Statistical comparisons between the UK and other Member States could therefore be made with more confidence. We should also be better able to trust the key statistics of interest to the UK about other Member States and the EU as a whole.

The Commission has proposed a decentralised approach, in preference to quality assessments conducted by Eurostat or another central EU institution. The proposal would require that each Member State produce a statement of confidence in their European statistics, based on a transparent self-assessment procedure conducted by the Member State. From the UK perspective therefore, this part of the proposal reflects and supports the UK legal framework for official statistics while enforcing similar standards in other Member States.

**MORE DETAIL ON THE ROLE OF HEADS OF PROFESSION IN GOVERNMENT DEPARTMENTS AND AGENCIES**

Every UK Government department or agency that produces ‘National Statistics’, produces or makes extensive use of ‘official statistics’, or employs an appreciable number of official statisticians, appoints a Statistical Head of Profession (HoP). This person is professionally accountable to the National Statistician for the integrity and quality of the official statistics of their department but remains in the formal line management of their own organisation. Such persons are formally appointed by the organisation’s Head of Department, after seeking the views of the National Statistician. There are currently 29 HoPs whose organisations produce European statistics, including the three Chief Statisticians in the Devolved Administrations who fulfil the role of HoP and other functions. A list of their departments/agencies is at Annex 1 [not printed]. HoPs are responsible for overseeing their own organisation’s statistical functions and meeting its statistical needs, and for implementing the provisions set out in statistical legislation.

**DO ANY OTHER MEMBER STATES SHARE SUCH A DECENTRALISED REGIME?**

Decentralised regimes are common-place across the EU. There are however varying degrees of decentralisation, ranging from the heavily regionalised systems of Germany and Spain to smaller countries whose main National Statistical Institutes produce the lion’s share of official statistics but who have to coordinate with one or two important other producers.

**HOW MUCH SUPPORT IS THERE AMONGST OTHER MEMBER STATES FOR THE AMENDMENTS THE UK WOULD WISH TO MAKE?**

The Commission’s proposed changes to Regulation 223/2009 strengthen existing provisions for the coordinating role of the lead department (National Statistics Institute) in the statistical system of the member state. The current structure of the UK statistical system already exceeds the strengthened requirement for coordination by a considerable margin. A Danish Presidency hearing in June found that most Member States with decentralised statistical systems agree that this element of the proposal is acceptable.

However, the same proposal makes a further and apparently conflicting requirement on Member States to vest all decision making powers for their European statistics in the head of the NSI alone. The government considers this part of the proposal to be incompatible with decentralisation in official statistics. The UK proposed amendment reinforces the decentralised approach to official statistics by requiring that all the persons responsible for statistical production (in the UK, HoPs and Chief Statisticians) should have professional independence when carrying out their statistical role.
There currently appears to be enough Member States, in terms of voting rights in Council, in favour of amendments that reflect the UK position to be confident that such amendments will be accepted. Moreover, there is currently little apparent incentive for fully centralised Member States to oppose such amendments.

AN UPDATE ON NEGOTIATIONS ON THIS MATTER:
A brief preliminary hearing was held in the Council Working Party on Statistics (CWPS) on 20 June. The first substantive discussion is due to be held at the CWPS on 11 July. The next discussion will not then take place until at least September after the summer recess. However, given the pressure of the current regulatory agenda in Council, negotiations may not be completed until after the Cyprus Presidency. A further Explanatory Memorandum will be provided when there are significant developments in these CWPS negotiations.

AN UPDATE ON DISCUSSIONS IN RELATION TO THE PROPOSAL ON ACCESS TO ADMINISTRATIVE DATA:
Discussions between the Office for National Statistics and HM Treasury solicitors have begun, with the latter still investigating what an initial Government position may look like.

3 August 2012

Letter from the Chairman to the Rt. Hon Francis Maude MP
Thank you for your letter, dated 3 August 2012, on EM 9122/12, on the Commission proposal to amend regulation no. 223/2009 on European Statistics. The House of Lords European Union Sub-Committee on Economic and Financial Affairs considered this document at its meeting on 18 September 2012.

We are grateful to you for your response to the Committee’s questions. We agree with you that the proposed regulation should mean that the quality and reliability of European statistics would be better safeguarded. We are now content to clear the document from scrutiny, but would be grateful to be kept informed of developments in relation to this proposal as negotiations progress.

18 September 2012

EUROPEAN VENTURE CAPITAL FUNDS (18499/11)

Letter from Mark Hoban MP, Financial Secretary, HM Treasury to the Chairman
I am replying to the letter from Lord Roper dated 25 April regarding the progress of this proposal. I apologise for the length of time this response has taken.

A general approach was reached at COREPER on 23 March. The main UK objectives were included. These were no depositary regime, to keep the 70 / 30 ratio of qualifying and non qualifying investments, the removal of operational costs of the fund from the calculation of the ratio, and a broader range of means by which funds can invest in SMEs including an element of debt financing.

The UK was not able to secure amendments to the criteria for investors who are not MiFID professional investors. The main requirement remains that they must invest at least €100,000.

Trilogues have commenced. The European Parliament is seeking a greater mediation role for ESMA beyond that envisaged in other financial services legislation, the introduction of a depositary requirement which the majority of the Council do not support, and restrictions on where a fund may domicile and invest where the Council and Commission have noted that “tax havens” should be addressed in tax rather than financial services legislation.

6 July 2012
Letter from the Chairman to Mark Hoban MP, Financial Secretary, HM Treasury

Thank you for your Explanatory Memorandum 6736/12, dated 5 March 2012, on the Commission’s report on the evaluation of the Union’s finances based on the results achieved. The House of Lords European Union Sub-Committee on Economic and Financial Affairs considered this document at its meeting on 22 May 2012.

Like you, we recognise the importance of the report in terms of improving transparency and effective scrutiny of the EU budget. We agree with you that the lack of budgetary information makes it extremely difficult to assess the value for money of the policy areas under consideration. We note the Commission’s desire to ensure that the report does not duplicate other sources of information. To what extent is such information that might enable such an assessment to be made available through other sources? You state that the new reporting series should complement other reports in terms of content, value-added and timing. What model would you suggest that this report should take in future in order to help achieve this? What is your view of the Commission’s intention to focus on a limited number of policy areas each year?

We note the Government’s assessment of the Commission’s conclusions on the two policy areas covered, Education and Culture and Research programmes. Whilst we recognise the benefits that these programmes can bring, like you we welcome the Commission’s intention to address the need for simplification, administrative cost reduction and better management of such programmes.

In terms of education and culture, we note your concerns that to date indicators on the contribution of culture and media to economic development and social inclusion have been input focused, rather than focussing on the outcomes achieved. We are pleased to note that the Government stand ready to support the Commission in developing better indicators for follow-up programmes in the 2014-2020 Multiannual Financial Framework.

In terms of research, we note that large and small company participation has declined over successive Framework Programmes, although the decline now appears to have been arrested. What do you understand to be the reasons for this decline taking place?

We would be grateful for a response to these queries within the standard ten working days. In the meantime we have agreed to clear the document from scrutiny.

22 May 2012

Letter from Mark Hoban MP to the Chairman

Thank you for your letter of 22 May, on the Commission’s report on the evaluation of the Union’s finances based on the results achieved.

You ask to what extent is information made available through other sources that might help to assess the value for money of EU programmes.

Currently, information is made available in a number of documents published by the Commission, including the Commission’s annual draft budget proposals, Impact Assessments accompanying other proposals, Annual Activity Reports produced by the Commission’s Directorate-Generals, periodic reports and programming documents in specific policy areas, including Annual Activity Statements, and the reports related to the annual discharge of the EU budget. While this information is voluminous, it arguably should be made easier to use and offer a more rigorous assessment of value for money.

You ask how this report might complement these other reports in terms of content, value-added, and timing. This depends on how the Commission works to improve its framework for self-assessment in future, in which shortcomings were identified by the European Court of Auditors (ECA) in its most recent annual report. In its recommendations on discharge of the 2010 EU accounts this year, the Council urged the Commission to take up the issues identified by the ECA without delay and in full transparency, in order to further improve its performance in the targeted and most economic use of the limited resources available. It also recalled the need to thoroughly analyse the effectiveness and efficiency of EU spending through the setting of coherent SMART annual and multiannual objectives, interim milestones, and performance indicators.

In terms of the Commission’s intention to focus on a limited number of policy areas in its future reports in this series, the Government would want to ensure that more routine reporting is sufficient to enable effective scrutiny of the entire EU budget each year.
You note that in terms of research, large and small company participation has declined over successive Framework Programmes, although the decline now appears to have been arrested.

Not all the reasons for the levelling out of industry participation in the Framework Programme are well understood. But contributing factors would have included: greater simplification of Framework Programme 7 (FP7), which reduced the burden on participants compared to Framework Programme 6 (FP6); work programmes that were more industrially relevant, reflecting the growing influence of the European Technology Platforms; some rationalisation of the support instruments, which among other things moved away from the unpopular large integrated projects; setting a target for SMEs to receive at least 15% of the EU funding available in the FP7 Cooperation Specific Programme, which encouraged a variety of SME-friendly initiatives in calls for proposals; and also the launching of a number of industrially led Joint Technology Initiatives and other forms of Public Private Partnership.

8 June 2012

FINANCIAL ASSISTANCE FOR NON-EURO AREA MEMBER STATES (12201/12)

Letter from the Chairman to the Rt. Hon Greg Clark MP, Financial Secretary, HM Treasury

Thank you for the Explanatory Memorandum from your predecessor, Mark Hoban MP, dated 18 July 2012, on EM 12201/12: a Proposal for a Regulation establishing a facility for providing financial assistance for Member States whose currency is not the euro. The House of Lords European Union Sub-Committee on Economic and Financial Affairs considered this document at its meeting on 18 September 2012.

We note your statement that the Government will consider the implications of the proposed regulation for the UK and ensure that the UK’s national interest is protected. What assessment have you come to in the two months since the EM was published? Are you in favour of the proposal as it stands? Which, if any, amendments do you wish to see made?

The regulation sets out proposed roles for bodies including the ECB, the ESAs, the ESRB and the IMF. Are you content with the proposed role that these bodies will take on? What is your assessment of the enhanced role that the so-called ‘troika’ appears to be taking on, both in relation to this proposal and in relation to euro area Member States? What are the implications of this developing role? What are the resource implications for the proposed role that such bodies, and the Commission itself, will take on in relation to non-euro area Member States?

What is your assessment of the proposal that the relevant Committee of the European Parliament may offer the opportunity to the Member State concerned to participate in an exchange of views on the progress made in the implementation of the adjustment programme? How will the proposal that representatives of the Commission be invited by the Parliament of the Member State concerned to participate in a similar exercise operate in practice? Do you regard these proposals as setting any kind of precedent in terms of the role and interaction of the Commission, European Parliament and national parliaments? If so, do you regard such a precedent as helpful or otherwise?

You state that access to a PCCL will be based on a set of pre-qualification eligibility criteria which the Member State must meet without exception. We would be grateful for further details of such criteria. Are such criteria appropriate in the Government’s view?

You also state that the proposal seeks to simplify and codify existing activation procedures not provided for in the regulation. Can you provide more information on this element of the proposal.

You state that, as of 18 July, a timetable has not yet been agreed. Has there been any progress since then?

We would be grateful for a response to these queries within ten working days. In the meantime we have agreed to retain the document under scrutiny.

18 September 2012

Letter from the Rt. Hon Greg Clark MP to the Chairman

Thank you for your letter of 18 September on EM 12201/12 regarding Financial Assistance for non-euro area Member States. I value your time and attention given to this important matter and welcome a dialogue with the Committee on all issues of concern.
Since my predecessor last wrote to you, there has been no further progress on establishing a
timetable for this proposal. As I’m sure you will appreciate, this is a complex matter with potential
implications across other live dossiers, which my officials are considering very carefully. As a result,
this policy work is ongoing and I will write to the Committee as soon as is practicable, responding to
your questions once implications of the proposal become clear. I understand that in the interim, the
document shall remain under scrutiny.

1 October 2012

FINANCIAL TRANSACTION TAX (14942/11)

Letter from the Chairman to Mark Hoban MP, Financial Secretary, HM Treasury

Thank you for the Government’s response, dated 24 May 2012, to the House of Lords European
Union Committee’s report, Towards a Financial Transaction Tax? Whilst we are grateful for this
response, we are concerned that it does not address all the issues raised in the Committee’s report.
In particular, we would like to draw your attention to paragraphs 119-128 of the report, under the
heading of The impact of a euro area FTT, and in particular the conclusion at paragraph 128, which
states:

"...If, as is likely, the Directive creating a euro area FTT equates the UK with third countries,
there would still be very significant effects on the UK financial sector. UK financial
institutions entering into financial transactions with euro area financial institutions would still
be liable for the FTT, which could still be collected through EU mutual assistance for the
recovery of tax or as a result of the provisions of joint and several liability. We urge the
Government to work to ensure that the UK financial institutions are not damaged, and that
UK tax authorities’ workload is not increased, by an FTT introduced by certain EU Member
states."

The Government’s response does not address these concerns in any depth, simply stating that “we
will continue to contribute to discussions on the proposal with these issues in mind”. We would be
grateful if you could provide the Committee with a more considered response to its concerns.

We would also be grateful for an update on negotiations in relation to EM 14942/11, on the
Commission’s proposal for a Financial Transaction Tax.

We would be grateful for a response within ten working days.

20 June 2012

Letter from Mark Hoban MP to the Chairman

Thank you for your letter of 20 June 2012 requesting clarification of the Government’s position in
relation to the conclusions of the Committee’s report into the European Commission’s proposal for a
Financial Transaction Tax (FTT).

Before I turn to your request for more a detailed response on the effects of a euro area FTT, I think
it is first worth providing you with an update of negotiations on this dossier.

At the last ECOFIN on 22 June, the Chancellor of the Exchequer re-stated the UK’s strong
opposition to the European Commission’s legislative proposal for a FTT. There now appears to be a
general acceptance among Member States that unanimity on this dossier will not be achieved.
Consequently, at that meeting, some member states, led by Austria and Germany, stated that they
wished to pursue a FTT at sub-EU-27 level, using enhanced cooperation procedures.

For a measure to proceed using enhanced cooperation, at least nine member states need to write to
the European Commission setting out the proposed objectives and scope of the measure. No letter
has been issued to date, and we await to see whether the requisite number of member states can
come together to agree such a proposal. At the 22 June ECOFIN, a number of euro area member
states signalled that they did not intend to join any sub EU-27 FTT.

The Chancellor has of course made clear that the UK will not participate in such an initiative. The
Chancellor also set out that, before taking a firm view on the use of an enhanced cooperation
procedure, the UK would need to fully understand the scope of any new proposal and what the
revenues would be used for.
If a letter proposing enhanced cooperation is issued from member states, both the Commission and the Council need to agree that this would be consistent with the Treaty before it can proceed. Only after the Council has agreed (at EU-27 level, using the Qualified Majority Voting procedure) can the Commission then bring forward a legislative proposal. This proposal is then discussed in Council by all member states, though only those participating in the proposal are eligible to vote on its agreement.

Turning to substantive issues, you highlight your wish to receive a more detailed response to the conclusion at paragraph 128 of the Committee’s report:

“... if, as likely, the Directive creating a euro area FTT equates the UK with third countries, there would still be very significant effects on the UK financial sector. UK financial institutions entering into financial transactions with euro area financial institutions would still be liable for the FTT, which could be collected through EU mutual assistance for the recovery of tax or as a result of the provisions of joint and several liability. We urge the Government to work to ensure that the UK financial institutions are not damaged, and that UK tax authorities’ workload is not increased, by a FTT introduced by certain EU Member States.”

As you are aware, the European Commission’s own analysis demonstrates how negative a FTT would be for growth and jobs, and these impacts would be felt across the EU. Any moves towards introducing a FTT through enhanced cooperation would still have economic impacts for those outside of any such group. For example, any increase in cost to EU manufacturers as a consequence of a FTT would likely be passed onto consumers, and damage the competitiveness of EU industry in a global marketplace.

However, we are sceptical whether other Member States will agree to a euro area only (or some other form of sub-EU-27) FTT or that it would work. If they decide to go ahead with a EU17 FTT, it may not necessarily be bad for the UK because:

— UK may gain market share; and
— the impact on the UK may be no different from that on other international financial centres outside the euro area such as New York or Hong Kong.

If, under any new proposal from the European Commission, UK financial institutions are required to pay tax to other EU governments this is not unprecedented. For example, the UK Bank Levy is charged on the global liabilities of UK headquartered banks, so the UK exchequer receives tax on their overseas operations. In addition, the UK exchequer also receives other tax revenues from activity overseas, and UK companies already pay tax to other jurisdictions.

In terms of additional burdens placed upon UK tax authorities, we do not see this to be a significant issue, but again this depends on the scope and scale of any proposal.

The Government will of course continue to proactively engage in discussions on this issue going forward in whatever form those take, and consider this carefully in the context of its impact on both the UK and EU economies.

17 July 2012

Letter from the Chairman to Mark Hoban MP


We are grateful for your response to our letter of 20 June 2012, although we are disappointed that the letter was not received within the standard ten working days as requested. This meant that the letter could not be taken into account in the 11 July 2012 House of Lords debate on the Committee’s report, nor at your own appearance before the Sub-Committee on 17 July. We urge you to ensure that such deadlines are adhered to in the future. We would also ask you to pass on our thanks to Lord de Mauley for his prompt reply to Lord Kerr’s question on the same topic, raised in the House of Lords debate on the Committee’s report, held on 11 July 2012.

We note your response to our request for further clarification of the Government’s view concerning the liability of UK financial institutions, as set out in paragraph 128 of the Committee’s report. We note your view that a sub-EU-27 FTT may not necessarily be bad for the UK, that financial liability of UK institutions is not unprecedented, and that you do not see the additional burdens placed upon UK
tax authorities as a significant issue. It remains to be seen whether such optimism is justified. Nevertheless, it is important that the Government remain apprised of the likely impact upon the UK of any such proposal, and we welcome your commitment to continue to engage in discussions on this issue going forward.

We are also grateful for your update on negotiations. We note that Germany, France and Austria have outlined their intention to seek the introduction of an FTT under enhanced cooperation. We would be grateful if you could keep us informed of the position of other Member States. You state that a number of euro area Member States have signalled that they do not intend to join any sub-EU-27 FTT. Which Member States are you referring to?

We note that the Chancellor has stated that, before taking a firm view on the use of an enhanced cooperation procedure, the UK would need to fully understand the scope of any new proposal and what the revenues would be used for. We would be grateful for further updates on the Government’s position on any FTT pursued under enhanced cooperation.

We would be grateful for an update in due course as negotiations progress. In the meantime we will continue to hold the document under scrutiny.

24 July 2012

Letter from Mark Hoban MP to the Chairman

Thank you for your further letter dated 24 July regarding the Government’s response to the Committee’s report ‘Towards a Financial Transaction Tax?’

Firstly, I would like to apologise for the late reply to your earlier letter. I regret that it could not be taken into account in the House of Lords debate on the Committee’s report. I will indeed pass on your thanks to Lord de Mauley for his response to Lord Kerr following the debate on 11 July.

The Government will ensure the Committee is kept informed on any further developments in European negotiations on a financial transaction tax, in particular as and when other member states launch any specific initiative to introduce such a tax using the enhanced cooperation procedures.

In the absence of a specific request from nine or more member states to use the enhanced cooperation procedures, it is difficult to identify which countries may or may participate in a sub-EU27 initiative. At the June ECOFIN discussion, Ireland and the Netherlands, as well as the Czech Republic and Sweden, stated that they do not intend to participate in any sub-EU27 financial transaction tax. Several other member states were unwilling to commit to the initiative, reserving their position until further specific details of a proposal were set out.

I hope you find this information helpful.

8 August 2012

Letter from the Chairman to the Rt. Hon Greg Clark MP, Financial Secretary, HM Treasury

Thank you for the letter from your predecessor, Mark Hoban MP, dated 8 August 2012, on EM 14942/11, on the Commission proposal for a Financial Transaction Tax. The House of Lords European Union Sub-Committee on Economic and Financial Affairs considered this document at its meeting on 18 September 2012.

We are grateful for the information on the position of other Member States, and for your commitment to ensure the Committee is kept informed on any further developments with regard to the introduction of a Financial Transaction Tax under enhanced cooperation procedures. In the meantime, in light of the continued uncertainty about the prospects of the proposal, we will continue to retain the document under scrutiny.

18 September 2012

Letter from the Chairman to the Rt. Hon Greg Clark MP

I am writing to you with regard to EM 14942/11, on the Commission’s proposal for a Financial Transaction Tax. In our most recent letter to you, dated 18 September 2012, we asked to be kept informed about any further developments with regard to the introduction of a Financial Transaction Tax under enhanced cooperation procedures.
We note that, at the 9 October meeting of EU Finance Ministers, 11 Member States announced their intention to request that a Financial Transaction Tax be taken forward under enhanced cooperation. In the light of this significant development, we would be grateful to receive further details of this discussion and your assessment of its likely ramifications. What is the timescale for the introduction of such a tax? What will be its rate and scope?

We also reiterate our deep concern about the effect of such a tax upon the UK. You have made clear that the UK intends to stand apart from such a proposal. Yet, as our March 2012 report on the Financial Transaction Tax proposals concluded (a copy of which I have enclosed) [not printed], UK financial institutions entering into financial transactions with financial institutions in Member States that had adopted the FTT would still be liable for such an FTT, which could be collected through EU mutual assistance for the recovery of tax or as a result of the provisions of joint and several liability. It is imperative that the Government work to ensure not only that UK financial institutions are not damaged by an FTT introduced under enhanced cooperation by certain EU Member States, but that Member States that wish to proceed with an FTT under enhanced cooperation are aware of the consequences that such a tax might have.

The Chancellor of the Exchequer has previously set out that, before taking a firm view on the use of an enhanced cooperation procedure, the UK would need fully to understand the scope of any new proposal and what the revenues would be used for. Article 326 of the Treaty on the Functioning of the European Union states that “Such [enhanced] cooperation shall not undermine the internal market or economic, social and territorial cohesion. It shall not constitute a barrier to or discrimination in trade between Member States, nor shall it distort competition between them.” In the light of these developments, what conclusion have the Government come to as to whether a Financial Transaction Tax taken forward under enhanced cooperation would be consistent with the Treaty?

We would be grateful for a response to these questions by 31 October. In the meantime we will continue to retain the proposal under scrutiny.

17 October 2012

FISCALIS 2020 (13346/12)

Letter from the Chairman to Sajid Javid MP, Economic Secretary, HM Treasury

Thank you for your Explanatory Memorandum 13346/12, dated 20 September 2012, on the Commission proposal for a Regulation establishing an action programme for taxation in the European Union for the period 2014-2020 (Fiscalis 2020). The House of Lords European Union Sub-Committee on Economic and Financial Affairs considered this document at its meeting on 23 October 2012.

We previously expressed our view that a merger between the Customs 2013 and Fiscalis 2013 Programmes was undesirable. We therefore welcome the Commission’s decision to separate the FISCUS proposal into two separate legal elements.

In relation to the original combined FISCUS programme, the Committee stated that we were unconvinced of the need of an increase of 39% over the combined budgets of the previous programmes. Our concerns remain in terms of the 28% increase proposed by the Commission in the revised Regulation, and we reiterate our support for the Government’s efforts to limit the financial consequences of this draft Regulation. You state that you will be seeking a “re-prioritisation of activities to focus on those of greatest benefit to Member States.” We would be grateful for further details of what you have in mind.

Notwithstanding these concerns, we recognise the value of improving administrative cooperation and sharing best practice between Member States. We therefore support the Fiscalis programme and would wish to see it continue.

We note your concern about the legal base of the proposal. You state that using Article 212 TFEU as a legal base could extend the remit of the programme into new areas such as concluding agreements on technical cooperation with third countries. Can you give a practical illustration of the effect that such an extension of remit would have? How would you respond to the Commission’s assertion that, given the increasing globalisation of the economy, the administrative cooperation with developed third countries is essential to efficiently fight against tax fraud?
Likewise, you express concern about the scope of the proposal. What would be the consequences of an extension of scope to cover all taxes falling within the scope of Article 2(1)(a) of the Mutual Assistance and Recovery of Claim Directive?

Do other Member States share your concerns, and if so, which ones agree with the Government’s point of view? What is the view of other Member States on the proposal as a whole?

Finally we note your assertion that the UK opt-in applies to this proposal even though it does not have a legal basis falling within Title V of Part Three of the TFEU. As with other matters where this question has arisen, we re-iterate that we do not consider that the UK opt-in is engaged in the absence of such an express legal basis. We accept however in this case that the difference does not have any practical effect given that the UK opt-in has been, or will be, exercised. We would be grateful for an update on your discussions with the Commission on this point.

We would be grateful for an answer to these questions, as well as an update on negotiations, when significant progress is made, and at the latest before the end of the year. In the meantime, we will retain EM 13346/12 under scrutiny.

23 October 2012

GENERALISED TARIFF PREFERENCES (10052/11)

Letter from Norman Lamb MP, Minister of State for Employment Relations, Consumer and Postal Affairs, Department for Business, Innovation and Skills, to the Chairman

I am writing to update you on the European Commission’s proposal for a new regulation on the Generalised System of Preferences (GSP).

In May I wrote to inform you that the Council had reached a compromise on this regulation at the Foreign Affairs Council (Trade) in March, which enabled the Presidency to enter into three-way “trilogue” negotiations with the European Parliament. Trilogues have now concluded, and an agreement has been reached which has been endorsed by the European Parliament and the Council. This is expected to be adopted by the Council in the autumn, and published shortly afterwards in the Official Journal of the European Union.

In these final negotiations there was a very real risk that the regulation might have been pulled in a more protectionist direction by some in the Council and Parliament. We therefore decided to give our consent to a compromise which secured gains for developing countries in terms of expanding GSP Plus (which should now include Pakistan), provided some increase in product coverage, and which gave additional transition periods secured for those countries which have initialled an alternative trade agreement with the EU.

The final agreement largely follows that reached with the Council in trilogues, but contains additional special safeguards measures, and limits the duration of the new regulation to 10 years. High Income and Upper Middle Income countries will be removed from the scheme. The new regulation will enter into force on 1 January 2014.

10 July 2012

HUNGARY: COHESION FUND & IRELAND: FINANCIAL ASSISTANCE (16670/11, 10827/12, 11069/12)

Letter from Mark Hoban MP, Financial Secretary, HM Treasury to the Chairman

I am writing to update you on developments in relation to the above European Commission Proposal, which sought to lift the suspension of €495m Cohesion Fund commitments for Hungary from 1 January 2013. You will recall that the measure was initially adopted in line with the 2006 Cohesion Fund Regulations on 13 March (EM 6893/12), following the Council Decision on 24 January (EM 5352/12) that Hungary had not taken effective action to address its excessive government deficit. The suspension would be lifted by the Council on a proposal by the Commission, following an assessment that action taken by Hungary appeared effective to correct its excessive government deficit.

This Proposal to lift the suspension of Cohesion Fund commitments was adopted on 22 June by ECOFIN, attended by the Chancellor. At this point, the Proposal had regrettably not cleared Lords
scrutiny. However, the UK supported the Proposal on the basis that, according to the Commission’s assessment (EM 10717/12), the measures taken by Hungary were sufficient to bring its forecast government deficit in 2012 and 2013 within the 3% reference value of the Treaty. As such, Hungary could be deemed to have taken effective action against Council Recommendations of March 2012 (EM 7141/12) with a view to correcting its excessive government deficit. Additional comfort in this respect is provided by the Commission committing to continue to closely monitor budgetary developments in Hungary; the Government believes that Member States should take forward fiscal consolidation as a priority to reduce their deficit and support recovery.

This Proposal was adopted on an accelerated timetable because upon imposition of the sanction in March, ECOFIN committed to return to the matter in June with a view to lifting the suspension if Hungary applied the necessary corrective action. This imposed an already tight timetable within which the necessary measures needed to be implemented and reported upon by Hungary and then assessed by the Commission and communicated to the Council. Although there are no policy implications for the UK arising from this Proposal, I regret that it was not given adequate time to pass through national Parliamentary scrutiny prior to adoption.

I would like to take this opportunity to thank the Committee for considering this document with expediency and for clearing this from scrutiny on 26 June 2012.

28 June 2012

Letter from the Chairman to Mark Hoban MP

Thank you for your letter, dated 28 June 2012, on EM 10827/12: Proposal for a Council Implementing Decision Lifting the Suspension of Commitments from the Cohesion Fund for Hungary. The House of Lords European Union Sub-Committee on Economic and Financial Affairs considered this document at its meeting on 17 July 2012.

We are grateful to you for your explanation of why an override was necessary in the case of EM 10827/12. We do not require any further action in relation to this document.

However, we note that EM 11069/12: Proposal for a Council implementing decision amending implementing decision 2011/77/EU on granting Union financial assistance to Ireland was also subject to an override at the same ECOFIN meeting on 22 June.

We note that your letter of 15 March on EM 16670/11 set out the Government’s intention to provide an EM on such financial assistance packages within five working days, and your request for the Committee to consider the document at the first Committee meeting following the submission of the document. You explained that “this will not always eliminate the risk of an override, but it should go some way to reduce that risk.” You also stated that the Government “intends to vote in favour of these Council decisions, where the Government agrees with the policy content and even if Parliamentary scrutiny has not been cleared. Not supporting these Council decisions runs counter to the Government’s overall support of the financial assistance programmes. Furthermore, this does not lend full support to our bilateral and EU relationships.”

The Committee’s reply, dated 27 March 2012, stated that “we welcome your suggestion that, on such occasions, the Government will endeavour to provide the Explanatory Memorandum within five working days rather than the usual ten. With regard to your request that the Committee considers the document at its first meeting following the submission of the EM, whilst we cannot guarantee that it will always be possible to do so, we will make every effort to ensure that this happens. It would be useful in this regard if you could provide the Committee with as much advance warning as possible when such a proposal is expected. Like you, we consider that such measures will go some way to eliminating the risk of an override.”

Whilst we appreciate that the tight timetable meant that an override was necessary in the case of EM 11069/12, and whilst we note that your letter of 15 March provided the Committee with advance warning that the Government would vote in favour of such packages in the future, we must emphasise the need to write to the Committee to inform us on every occasion when such an override takes place. Paragraph (5) (c) of the House of Lords Scrutiny Reserve Resolution Relating to the Work of the European Union Committee makes clear that “The Minister concerned may give agreement in relation to a document which remains subject to scrutiny – if the Minister decides that, for special reasons, agreement should be given; but he must explain his reasons – in every such case, to the European Union Committee at the first opportunity after reaching his decision.” We would be grateful if you could bear this in mind in relation to any future cases of financial assistance packages where an override occurs.
INVESTMENT PRODUCTS: KEY INFORMATION DOCUMENTS (12402/12)

Letter from the Chairman to the Rt. Hon Greg Clark MP, Financial Secretary, HM Treasury

Thank you for the Explanatory Memorandum from your predecessor, Mark Hoban MP, dated 29 August 2012, on EM 12402/12, on a Proposal for a Regulation on Key Information Documents for Investment Products. The House of Lords European Union Sub-Committee on Economic and Financial Affairs considered this document at its meeting on 9 October 2012.

Whilst we recognise the value of Key Information Documents, do you agree with us that such information does not negate the need to provide investors with a full prospectus as far as is possible? Is there any obligation for investors to be provided with a prospectus alongside the Key Information Document?

We note your concerns about the costs of including personal pensions in the regulation. What information can you provide on the outcome of the stakeholder group events you have conducted? Do you still wish to exclude personal pensions from the proposed regulation? How are negotiations over this progressing?

We also note your concerns over the proposed restrictions on the alternative dispute resolution (ADR) procedures. We are particularly concerned about the impact of these provisions on the rights of consumers. We would be grateful for further details of the issues that you raise. We would also appreciate an update on discussions at the Council Working Group which took place since your last correspondence and any further updates on negotiations as they proceed.

We would be grateful for a response to these questions by 24 October 2012. In the meantime we will continue to retain the document under scrutiny.

10 October 2012

Letter from Sajid Javid MP, Economic Secretary, HM Treasury, to the Chairman

Thank you for your letter dated 10th October regarding the above proposal. The committee requested more information about how negotiations are progressing and I have set out my response below. I have also included a summary of the costs and benefits associated with the proposal.

Where investment product manufacturers are also subject to the Prospectus Directive, both will apply. The Government agrees with this approach. While the Key Information Document will serve as a useful tool to aid high level comparisons between products, we do not regard it as a substitute to the prospectus (where applicable) which will encompass more detailed information.

We have consulted trade associations and consumer groups, who broadly welcome the proposals. Their main concerns centre on the form and content of the document and they hope that we can reach a more acceptable compromise during negotiations. Some also share our concern that the scope of the Regulation will define the perimeter of the additional selling practices for insurance investment products within the Insurance Mediation Directive. Opinions on the decision to include pensions are more diverse.

Council had its first exchange of views on the file during the working group on 12th September. The discussion was brief, high level and focused mainly on the scope of the proposals. The Commission’s decision to include personal pensions proved the most controversial subject. The presidency will hold the second working group on 30th October.

The Government still intends to seek an exemption for all pension products. Negotiations are in the early stages and opinion divides the Council but we have support from several Member States. There is general agreement that the current text unintentionally captures occupational schemes in some Member States. It is clear that it will be difficult to find a delineation of personal and occupational pensions acceptable to all Member States.

Of the eight Member States to submit written comments on ADR, all were critical of the proposals. Most suggest Member State discretion in this area, while others are concerned that the decisions will not be binding. Broadly we agree with the concerns raised and I am cautiously optimistic that we will be successful in seeking removal of the criteria.
MARKET ABUSE (16000/11, 16010/11)

Letter from Mark Hoban MP, Financial Secretary, HM Treasury to the Chairman

Following further developments in negotiations for a new Market Abuse Regulation (MAR) and accompanying Criminal Sanctions Directive for insider dealing and market manipulation (CSMAD), this letter is intended to provide an update to the European Union Committee.

CRIMINAL SANCTIONS DIRECTIVE

The passage of the Criminal Sanctions Directive, which attracts a UK “opt-in”, has been slower than that of the Market Abuse Regulation. This is a result of the fact that the Directive is seeking to define a criminal standard and criminal definitions for the offences of market abuse at the same time that the wider regulatory framework for market abuse is under review in MAR. Furthermore, Council discussion has been somewhat fractured as a result of the Directive being taken through the Justice & Home Affairs Council, while the Regulation is being taken through the Economic and Financial Council.

For these reasons, the Presidency issued a discussion paper seeking views from Member States in order to understand better how the first EU criminal regime for market abuse might be constructed in CSMAD. This will be taken forward under the Cypriot Presidency once MAR is better progressed to inform the overall direction of policy.

Under the Danish Presidency, “horizontal articles” – those that have been agreed in other criminal law instruments and have no particular bearing on market abuse policy and enforcement – were taken to the JHA Council, attended by the Secretary of State, for a partial General Approach on 26th-27th April 2012. These were Articles 5-13 and relevant recitals and cover issues such as Member States making provision for “effective, proportionate and dissuasive” sanctions in criminal law. These Articles also remain ‘open’, should they need to be revisited as a result of policy decisions in MAR that will affect the criminal instrument.

The core policy issues therefore remain untouched in CSMAD. The UK remains keenly interested in the progress of this dossier, considering that the UK already covers the offences of market abuse in its criminal law today. The key issue for the UK in deciding not to opt in at this time was sequencing: the difficulty of assessing with confidence the scope and implications of the proposal and how this might develop, while the wider regulatory regime was being simultaneously negotiated in MAR.

The passage of CSMAD should, under the Cypriot Presidency, be helped by the Danish Presidency now producing its first full compromise text on MAR. The Presidency’s revisions should help influence the overall direction of CSMAD and enable the incoming Presidency to tackle the underlying policy issues. MAR will now be considered at attachés level.

MARKET ABUSE REGULATION

The UK broadly supports the Presidency’s compromise text on MAR – although this is at a very early stage of negotiations, and thus I will reserve my comments to areas where significant developments have been made.

Overall, greater legal certainty has been afforded to the text with the Presidency making the scope of the proposal clearer to market actors and reinstating key provisions from the previous Market Abuse Directive 2003 which were missed in the Commission’s proposal. The scope and construction of the offences of insider dealing and market manipulation are also more clearly articulated.

Furthermore, good progress has been made with respect to the accessing of telephone records for market abuse investigations, unwinding the restrictions proposed by the Commission on accessing content (data traffic held by telecoms operators, and recorded telephone content held by investment firms). This would have been a fundamental step backward from the powers given to competent authorities under the Market Abuse Directive 2003, and would have significantly reduced the effectiveness of UK enforcement against market abuse.

The discussion of inside information has been challenging, not least as the scope of the existing definition is currently being reviewed in a significant piece of case law, pending at the Court of Justice
of the European Union (ECJ). Set against this reinterpretation of inside information by the ECJ, the UK concept of additional ‘relevant information’ has currently been deleted from the Presidency’s compromise text. However, the suggestion made by the Presidency is that the scope of this information is sufficiently covered by the existing definition of inside information and a dual-mechanism (trading ban vs. disclosure) should be introduced for inside information, much in the way that the UK already has a dual regime for information that must not be traded on (relevant information) and information that must be disclosed (inside information). Negotiations are at a very early stage and there is no common thinking or concrete drafting yet proposed – and this will, no doubt, be affected by the final judgement given by the ECJ this summer. For now, the UK is interested in the proposal and is reserving its position, as we seek to understand how such a proposal might work and what is covered.

I hope this update has been helpful in informing the Committee of the progress currently being made in the MAR and CSMAD negotiations. This progress, and particularly the publication of the first compromise text on MAR will, in turn, be influencing the thinking of the European Parliament – which is due to publish its reports in July 2012.

18 May 2012

Letter from the Chairman to Mark Hoban MP

Thank you for your letter, dated 18 May 2012, on EMs 16000/11 and 16010/11, on the Commission’s proposals for a new Market Abuse Regulation (MAR) and accompanying Criminal Sanctions Directive for insider dealing and market manipulation (CSMAD). The House of Lords European Union Sub-Committee on Economic and Financial Affairs considered this document at its meeting on 10 July 2012.

We note that the Government are broadly supportive of the Commission’s review in order to increase the quality, coverage and application of the market abuse framework across the EU, and that many of the changes being made to the market abuse framework reflect the UK’s application of the EU Market Abuse Directive and the UK’s domestic provisions relating to market abuse first introduced in 2001. We also note your observation that the difficulty of prosecuting for market abuse and, in particular, establishing the intention of the abuser to commit market abuse is well-documented, and your view that the Criminal Sanctions Directive helpfully reinforces the need to ensure that criminal sanctions only apply where there is evidence of intention.

However, we note your decision not to opt in at this time due to the difficulty of assessing with confidence the scope and implications of the Criminal Sanctions Directive while the wider regulatory regime was being simultaneously negotiated in MAR. Does this remain the Government’s position?

We note that the proposal seeks to extend the market abuse regime by aligning it with the MiFID regime to apply to Multilateral Trading Facilities (MTFs) and to the proposed new category of Organised Trading Facilities (OTFs), as well as to over-the-counter (OTC) trading where this affects instruments traded on regulated markets. You will know that the Committee’s report on MiFID II has now been published, where we expressed concern that the likely implications of the OTF proposal have not been fully assessed. We argued that it is essential to ensure that market participants, regulators and legislators can all with confidence anticipate the impact of the introduction of an OTF category before a change of such magnitude is introduced. We also considered the issue of market manipulation in relation to the MiFID II proposals for regulation of commodities markets. We found that, whilst the Commission’s proposals could be a useful deterrent to market manipulation, there is also potential for a serious negative impact on liquidity, investor choice and price formation.

In the process of taking evidence on MiFID II, we asked witnesses to the Committee for their view of the MAR and CSMAD proposals. A number of concerns emerged. The Investment Management Association (IMA), the Association for Financial Markets in Europe (AFME) and Guy Bates, Partner at Clifford Chance, were concerned that seeking to impose across the EU the UK RINGA (relevant information not generally available) provisions would not work because of the issues raised by moving away from the accepted definition of insider trading, not least in terms of creating barriers between investors and managers. Guy Bates, Clifford Chance, told us that there was particular concern about RINGA in other parts of the EU because it is an unfamiliar feature of the UK regime.

Witnesses were also concerned about how the criminal regime would work. Mr Bates told us that the scope of the criminal regime meant that actions could be deemed as criminal that were not capable of falling within the civil regime, and that a lot of the defences and gateways that have been put into the civil regime would not be reflected in the criminal regime. He argued that it was necessary to identify conduct that would be within the scope of, and sanctionable under, the civil
Criminal Sanctions

Your letter requested an update on the UK Government’s position on the opt-in to the Criminal Sanctions Directive (CSMAD), and outlined some specific observations provided by the market on the Directive. You also asked what progress had been made on the proposal, following the Danish discussion paper on CSMAD.

The Government’s position on the Criminal Sanctions Directive is unchanged. We are supportive of the Commission’s work on market abuse but think that it is very challenging to assess the implications while the broader framework in the Market Abuse Regulation is still being decided (as well as the wider regulatory framework in MiFID).

Your letter also made reference to the criminal regime focusing on the issue of ‘intention’ and the extent to which this would be effective in practice. From the UK’s perspective, the concept of ‘intention’ is not as important as Member States having the flexibility to go further, and determine in
what circumstances a criminal penalty should be available. A minimum standard of intention with the
capacity of Member States to establish stronger regimes would be compatible with our regime today –
the critical issue is not restricting Member States freedom here. We note that as the concept of
‘intention’ is undefined in the Directive, the matter of whether intention is determined on the basis of
circumstantial evidence or not would be a matter for Member States to determine within the
framework of their national law. This is appropriate. Such a fundamental concept of criminal law
should not be determined by a sectoral financial services proposal designed to ensure criminal
sanctions are available for market abuse across Member States.

The comments made by the market about the scope of the proposed Criminal Sanctions Directive –
namely, that this may capture behaviour not covered by the civil Market Abuse Regulation (MAR) – is
correct. I would like to think that this demonstrates in practical terms the challenges of trying to
come up with two legal instruments simultaneously, and thus emphasises why the UK was right not to
opt-in at the outset. The issue here is that certain defences to market abuse – which exist in the
current Market Abuse Directive (MAD 2003) – have been reintroduced into MAR during negotiation.
Additionally, the MAD 2003 concept of accepted market practices has also been reintroduced. As a
result, the scope of the two proposals is currently not aligned. However, Council Legal Services and
Member States are well aware of this fact; it is a by-product of the Regulation making progress far
more quickly than the Directive. On the basis of these comments, we expect this issue to be resolved
in due course.

In terms of wider developments, CSMAD has now been reopened by the Cypriots for discussion but
there has only been one meeting. A compromise text is expected for the next Council Working
Group (likely October), reflecting Member State responses to the Danish Presidency questionnaire
and, particularly, the policy progress now made in MAR.

RELEVANT INFORMATION

Your letter also touched upon the issue of relevant information (or “RINGA”), which is the UK’s
wider standard of inside information as defined in MAD 2003.

The UK’s view on this provision is unchanged: we supported its introduction in the Commission’s
original proposal but noted that the drafting did not provide the requisite degree of legal certainty for
industry and Member States. We wanted to work with this basic notion of having a strong standard of
information on which you cannot trade, and refine this so it is workable in an EU context.

It is difficult to provide much of an update at this time: the Commission’s text was deleted by the
Danish Presidency and the issue of inside information was paused until the outcome of the ECJ
decision. The judgment was handed down on 28 June 2012, and was a positive reading of the existing
regime under MAD 2003. However, the timing of the judgement has not yet allowed for any
discussion at an EU level as to the implications and views across EU Member States. I will be in a
better position to update you on developments in this area in the Autumn, when inside information is
brought back to Council.

INTERBANK OFFER RATES

Your letter made reference to an article in the Financial Times reporting that Commissioner Barnier
will amend the EU market abuse regime to address potential ‘loopholes’ surrounding abuse of
interbank offer rates, such as LIBOR and EURIBOR. Since then, on 25 July 2012, the Commission’s
amendments were published. The Government supports the Commission taking swift action in this
area and has maintained an open dialogue with domestic and international stakeholders on this issue.

You may be aware of the fact that the UK has established a domestic review of the functioning of
LIBOR and other interbank offer rates, such as EURIBOR, in the wake of international (including FSA)
investigations into attempted manipulation. This review is being conducted by Martin Wheatley,
Managing Director of the FSA and CEO-designate of the incoming Financial Conduct Authority. As
part of this review, the regulatory framework and sanctioning powers will be considered in a
European context; and we intend to draw on the expertise of the Review committee and the FSA to
establish a clear understanding of what regulatory action is needed; the scope of such offences to be
effective etc. I will update you on this matter in the Autumn, once Council discussion has re-
commenced and there has been an opportunity to consider the amendments proposed in more detail.

8 August 2012
Letter from the Chairman to Greg Clark MP, Financial Secretary, HM Treasury

Thank you for the letter from your predecessor, Mark Hoban MP, dated 8 August 2012, on EMs 16000/11 and 16010/11 on the Commission’s proposal for a regulation and a directive on insider dealing and market abuse. The House of Lords European Union Sub-Committee on Economic and Financial Affairs considered this document at its meeting on 18 September 2012.

We are grateful for your response to our letter of 10 July. We sympathise with your view regarding the challenge of seeking to assess the implications of the Criminal Sanctions Directive while the broader framework in the Market Abuse Regulation is still being decided. We also acknowledge the difficulty of determining intent in seeking to apply criminal sanctions. We note that the scope of the two proposals is currently not aligned, but that Council legal Services and Member States are aware of this and that you expect these issues to be resolved. Given that negotiations continue we would be grateful to you to keep us informed as they progress over the coming months.

We also note that the Commission’s amendments seeking to address potential ‘loopholes’ surrounding abuse of interbank offer rates have now been published. We are grateful to you for agreeing to update the Committee on this matter once Council discussion has recommenced and there has been an opportunity to consider the amendments proposed in more detail. We look forward to receiving details of your considered view of the Commission’s proposals.

Given that agreement on these proposals remains some way off, and in anticipation of further correspondence from you, we have agreed to retain the proposals under scrutiny.

18 September 2012

MARKET ABUSE: AMENDED PROPOSAL (13023/12, 13037/12)

Letter from the Chairman to the Rt. Hon Greg Clark MP

Thank you for the Explanatory Memorandum from your predecessor, Mark Hoban MP, dated 29 August 2012, on EMs 13023/12 and 13037/12, on proposed amendments to the Market Abuse Regulation and Directive. The House of Lords European Union Sub-Committee on Economic and Financial Affairs considered this document at its meeting on 9 October 2012.

Like you, we broadly welcome the publication of these amendments, and support the Commission’s efforts to ensure that such benchmarks as LIBOR and EURIBOR cannot be manipulated. We also welcome the continuing work of the Parliamentary Commission on Banking Standards in this field. What update can you give us on negotiations on the Commission’s proposal? When is it anticipated that the proposed Regulation and Directive will enter into effect?

We note your view that further technical drafting refinement may be required to ensure that all possible scenarios of misconduct are clearly captured. Are there any specific scenarios that you are concerned could fail to be captured by the proposal as drafted? What is the consequence of the Commission’s decision not to propose a corresponding amendment to the Directive to bring manipulation of benchmarks within the reach of the market abuse regime?

You state that the response to the Wheatley Review into the functioning of LIBOR will further inform the Government’s position on the Commission proposals. Since your EM was received, the findings of the Wheatley Review have been published. What is the Government’s response to the findings of the report? What reforms do you intend to introduce in response to its findings? What impact have its findings had on the Government’s position in relation to the Commission’s proposal?

We would welcome a response to the questions by 24 October. In the meantime we will continue to retain the document under scrutiny.

10 October 2012

MIFID II (15938/11, 15939/11)

Letter from the Chairman to Mark Hoban MP, Financial Secretary, HM Treasury

Thank you for your letter, dated 30 April 2012, on EMs 15938/11 and 15939/11, on a proposal for a Directive and a Regulation on Markets in Financial Instruments (MIFID II), and for Explanatory Memorandum 8253/12, also dated 30 April, on the Opinion of the ECB on these proposals. The
House of Lords European Union Sub-Committee on Economic and Financial Affairs considered these documents at its meeting on 22 May 2012.

We are grateful for the update that you provide on the report of Markus Ferber MEP, rapporteur for the MiFID review, and for the summary of the opinion of the ECB on the proposals. We will take this information into account in our ongoing scrutiny of the MiFID II package. Whilst we will continue to hold EM 15938/11 and 15939/11 under scrutiny, we are content to clear EM 8253/12 from scrutiny.

22 May 2012

Letter from the Rt. Hon Greg Clark MP, Financial Secretary, HM Treasury to the Chairman

Further to Lord Roper’s letter of 17 April, I am writing to provide you with an update on the progress of the MiFID review in both the European Parliament and the Council of the European Union. I am also writing to provide the Government’s response to the House of Lords report on MiFID II of 10 July.

You will also note with interest the recent update on negotiations in Council, submitted to the House of Commons European Scrutiny Committee and enclosed here for completeness [not printed].

On 26 September the European Parliament’s Economic and Monetary Affairs committee voted on a consolidated package of amendments to the European Commission’s proposals for a Directive and a Regulation. This package will now form the basis of the European Parliament’s negotiating position for the later stages of the legislative process. I include as an annex [not printed] a summary of the European Parliament’s amendments.

The Council of the European Union is continuing to discuss the text at working level. However, the Cypriot Presidency now hopes to move to political agreement, and intends to seek a General Approach at the Ecofin meeting scheduled for 13 November.

24 October 2012

PRUDENTIAL REGIME FOR THE EU (13284/11, 13285/11)

Letter from Mark Hoban MP, Financial Secretary, HM Treasury, to the Chairman

Thank you for your letter, dated 25 April 2012, clearing EM 13284/11, a proposal for a Regulation on prudential requirements for credit institutions and investment firms, and EM 13285/11, a proposal for a Directive on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms, from scrutiny in advance of the extraordinary ECOFIN meeting on 2 May.

At the 2 May ECOFIN, we made considerable progress on delivering the UK’s priorities. For example, the current text provides a comprehensive range of tools to Member States for conducting macro-prudential policy. The text also provides some unconstrained discretion, most notably by allowing Member States to tighten risk weights for exposures secured by residential and commercial property, intra-financial exposures and large exposure limits up to a certain level without EU control. Beyond this discretion, a macro-prudential measure which a Member State wished to take could only be rejected by a negative qualified majority in Council, i.e. a qualified majority would be required to block a measure. This mechanism, aligned with the significant flexibility afforded to Member States through the countercyclical buffer, delivers satisfactory scope for the Financial Policy Committee (FPC) to implement a macro-prudential regime.

In addition to this, we were able to address some of our key concerns in relation to Basel 3 implementation. Prior to the ECOFIN on the 2 May the text made no firm commitment to implementing binding liquidity standards in the EU from 2015. In a positive development the text now makes a firm commitment to have the liquidity coverage ratio (LCR) in place from 2015 as envisaged by the Basel committee. The text also requires banks to disclose their leverage ratios from 2015 and includes a Council declaration that the capitalisation of exposures to central counterparty default funds will reflect the conclusions due to be reached by the Basel Committee later this month.

However, the Government was unable to agree to the 2 May compromise as the text would have not allowed us to implement the ICB’s recommendation that retail ring-fenced banks should hold 10% common equity tier (CET) 1 against all exposures on their balance sheet. The May 2 text contained
provisions designed to give Member States the flexibility to set higher capital requirements through a systemic buffer. Our concern here was based on the approval mechanism for applying the buffer to exposures located in other Member States. Essentially, if the systemic buffer was applied to exposures in other Member States, an affected Member State could object and enter into a process of binding mediation. This would therefore have allowed affected Member States to object to the UK imposing the systemic buffer to require retail ring-fenced to hold up to 10% CET1 on all exposures. As ultimately the fiscal risk of failures of systemic firms in the UK falls with UK tax payers, regardless of where losses may be incurred, we felt this was inappropriate and contrary to the ICB recommendations.

The Presidency decided to put this issue on the agenda for the 15 May ECOFIN, with a view to agreeing a general approach by unanimity or qualified majority if a compromise could not be reached. The Presidency circulated an amendment on the systemic buffer prior to discussions at this ECOFIN that would allow the UK to require ring-fenced retail banks to hold 10% CET1 against all exposures, alongside a few other amendments. This compromise was agreed unanimously, barring a few technical amendments agreed at the attachés working group on 16th May.

The general approach agreed by Council will therefore allow the UK to fully implement the ICB recommendation, provide the Financial Policy Committee with sufficient flexibility to conduct macroprudential policy and allow Member States wishing to fully implement the Basel agreement to do so.

Council has now entered into negotiations with the European Parliament and the Commission through trialogues. We will keep you informed on any further developments.

11 June 2012

SHADOW BANKING (7988/12)

Letter from the Chairman to Mark Hoban MP, Financial Secretary, HM Treasury

Thank you for your Explanatory Memorandum 7988/12, dated 12 April 2012, on the Commission’s Green Paper on Shadow Banking. The House of Lords European Union Sub-Committee on Economic and Financial Affairs considered this document at its meeting on 22 May 2012.

We recognise the significance of the shadow banking sector, and acknowledge both the benefits and the risks that it can give rise to. Like you, we welcome the Commission’s efforts to develop a better understanding of the risks associated with shadow banking in Europe and what kind of policy response might be appropriate. We agree with you that it is important to ensure that any steps taken at EU level take full account of global thinking on this issue, and welcome your efforts to ensure that the policy response in Europe is consistent with the international consensus. We also stress the importance of work undertaken on a national level. What steps have the Government taken to address the role of shadow banking within the UK financial sector?

We agree with you that an assessment of the risk associated with shadow banking must be based on robust evidence, and that it must be ensured that any further policy response is proportionate to the risk posed. We welcome your statement that any follow-up proposals, including legislative measures, will be carefully evaluated by the Government. However we would be grateful for further information from you as to the Government’s current thinking on this issue. What further steps do you believe need to be taken, and do you believe that legislative measures will be necessary? Do you perceive a need for such proposals to be brought forward as a matter of urgency?

We would be grateful for a response to these queries within the standard ten working days. In the meantime we have agreed to clear the document from scrutiny.

22 May 2012

Letter from Mark Hoban MP to the Chairman

Thank you for your letter of 22 May 2012 in response to my Explanatory Memorandum of 12 April on the Commission’s Green Paper on shadow banking. You have asked a number of questions, which I will deal with in turn.
WHAT STEPS HAVE THE GOVERNMENT TAKEN TO ADDRESS THE ROLE OF SHADOW BANKING WITHIN THE UK FINANCIAL SECTOR?

From the outset it is important to note that many of the entities and activities which are frequently referred to as forming part of the shadow banking sphere are, in fact, already subject to regulation, albeit not necessarily the full, prudential regulation that applies to banks. To take just two examples, hedge fund managers are subject to regulation under the Alternative Investment Fund Managers Directive as well as to FSA surveillance. Similarly, many investment firms will be subject to regulation under UCITS (Undertakings for Collective Investment in Transferable Securities).

As you note in your letter, a consistent international approach will be necessary to ensure that we are able to respond to the issues posed by the shadow banking sector effectively and without opening up risks of regulatory arbitrage or competitive distortion.

However, this does not preclude potential work at both the national and international levels, which is why, as part of this developing area of policy on shadow banking, under the Financial Services Bill the Financial Policy Committee (FPC) has a particular responsibility to recommend, in light of its statutory objective to contribute to the achievement by the Bank of its financial stability objective, whether HMT should bring new activities within the scope of regulation via an amendment to the Financial Services and Markets Act 2000 (Regulated Activities) Order 2001.

The FPC may also make recommendations that certain activities should be brought within regulation or, where an activity is already regulated, make recommendations as to which regulator (the Financial Conduct Authority (FCA) alone, or the FCA and the Prudential Regulation Authority) should regulate that activity.

WHAT FURTHER STEPS DO YOU BELIEVE NEED TO BE TAKEN, AND DO YOU BELIEVE THAT LEGISLATIVE MEASURES WILL BE NECESSARY?

In the first instance, I believe it is important that we take further steps to increase our understanding of this complex system of shadow banking.

Non-bank credit intermediation plays an important role in the financial system by offering an alternative source of liquidity and funding to both market participants and the real economy. It therefore acts as a complement to the traditional banking sector, a role that is of increasing importance as we seek to target growth in our economies at a time when banks are deleveraging. The non-bank sector may even be able to provide credit to the economy more efficiently than a bank could, through specialisation and competition in particular parts of the credit intermediation chain.

It is therefore important to say that inclusion or participation in the shadow banking system neither means that an entity or the activities it undertakes is unregulated (for example, many people would suggest that there are UCITS firms which engage in shadow banking – by definition they are subject to regulation) and nor does it necessarily mean that it is unacceptably risky.

It does, however, appear to be the case that the chain of credit intermediation and the resulting degree of interconnectedness across the system can create risks, and that some entities participating in the system may have functions that parallel those of banks, and may therefore generate risk that is ‘bank-like’ in one or more respects. It is in those areas, distinct from the wider shadow banking system, that we should focus our attention.

This is why I believe that there is more work to do both nationally and internationally to ensure that we can distinguish between the benefits and the growth the shadow banking system may offer, and the specific risks that we need to address to ensure that those benefits are safely realised.

This would in turn inform thinking about next steps, including whether legislative measures will be necessary.

HM Treasury will submit a response to the consultation set out by the Commission in its Green Paper in line with their 15 June deadline (this has been extended from 1 June since I sent my Explanatory Memorandum of 12 April). That response will set out our thinking in more detail and I will therefore write again with a copy for your information. We expect that this response will ultimately be published by the Commission.

DO YOU PERCEIVE A NEED FOR SUCH PROPOSALS TO BE BROUGHT FORWARD AS A MATTER OF URGENCY?

As I outline above, our first priority should be to ensure that we understand this system properly. The international work led by the Financial Stability Board (FSB) will make an important contribution
to building that understanding and is due to report by the end of 2012. Any proposals will be better informed if brought forward once the FSB work has concluded and its implications have been fully considered.

In the short term I think there is more merit in establishing some clear principles that will help to ensure that any future response to shadow banking — including possible legislative proposals — supports our agenda for growth, while addressing risk where that is demonstrably present.

I would therefore propose that any response to shadow banking should be:

— based on a sound understanding of the benefits of non-bank intermediation generally and the contribution a well regulated system of non-bank intermediation could make to growth in Europe, complementing the role of banks in ensuring credit flows efficiently to the real economy
— based on robust evidence of risk and an improved understanding of the function of the system as a whole
— focused on ensuring that banks do not exploit the non-bank intermediated sector to avoid regulation
— based on an understanding of the extent of our existing regulation and its interaction with the shadow banking system
— alive to the risk of distorting market choices; where possible we should foster diversity and competition between entities and products; and
— in line with international consensus to guard against risks of regulatory arbitrage and to avoid distortion to competition

8 June 2012

Letter from Mark Hoban MP to the Chairman

Further to my Explanatory Memorandum submitted to the Committee on the Commission’s Green Paper on shadow banking and my letter of 8 June 2012, I would like to inform you that the Treasury has now submitted its response to the Commission’s consultation on this issue. As I set out in my letter, I have also enclosed a copy of that response for your information [not printed].

22 June 2012

SHORT SELLING AND CREDIT DEFAULT SWAPS (13840/10)

Letter from Mark Hoban MP, Financial Secretary, HM Treasury, to the Chairman

I am writing to update you on the Government’s position on Article 28 (previously Article 24) of the Short Selling Regulation.

In my letter of 21 November 2011, I explained that although there were some improvements in the text during the Trilogue negotiations, our concerns regarding the lawfulness of Article 28 were not addressed. Given the seriousness of the legal concerns regarding Article 28, the Government decided it could not support the package at Coreper on 10 November 2011 and therefore chose to abstain.

Subsequently, a general approach was agreed at ECOFIN on 21 February 2012, where the UK supported the content of the Regulation in general. However, as was the case at Coreper, the UK had to abstain as we had significant concerns as regards the legality of Article 28 of the Regulation. We made a written statement to this effect noting that we would be considering how best to ensure legal certainty is provided.

The Short Selling Regulation was published in the Official Journal of the EU on 24 March. Today the Government has made an application to the Court of Justice of the European Union (CJEU) to clarify the legal position on Article 28 of the Short Selling Regulation. This represents no change to our policy, approach or position in any way.

The Government notes your view that it is necessary for ESMA to have intervention powers due to the highly cross-border nature of the CDS trade. The Government supports the creation of European Supervisory Authorities (ESAs). But it is vital that as they come into being, the valuable work of the ESAs has a sound legal basis and that ESA decisions are not subject to legal uncertainty.
That is why we are seeking legal clarity as regards Article 28 of the Short Selling Regulation, specifically how this proposal sits with principles derived from existing case law. As set out in my letter of 21 November 2011, the Government’s primary concern with Article 28 is that it does not comply with the principle set out in the judgment of the CJEU in the case of Meroni. That principle states that “a discretionary power, implying a wide margin of discretion which may, according to the use which is made of it, make possible the execution of actual economic policy” cannot be conferred on an EU agency.

We are therefore seeking to clarify how proposals that give ESMA a largely unfettered power to restrict or ban short selling sit with the principles established under the Meroni case.

It is essential to clarify legal technicalities to ensure that the valuable work of the ESAs’, in particular during times of financial stress, has a sound legal basis. Therefore it is crucial to give that legal certainty to the ESAs at an early stage to ensure that ESAs actions are credible and robust and that they are able to effectively deliver the important programme that has been given to them. Failure to do so could expose the ESAs to challenge by persons affected by their decisions, including financial institutions and financial market participants, at the very time when a legally certain approach is most needed.

31 May 2012

STANDARD TEXT ON PROTECTING THE EU’S FINANCIAL INSTRUMENTS

Letter from Mark Hoban MP, Financial Secretary, HM Treasury, to the Chairman

The Council’s Working Party on Combating Fraud has recently developed a standard provision on the protection of the financial interests of the EU, which would apply to spending programmes (direct expenditure and external aid) under the next Multi-Annual Financial Framework (MFF).

The text of this standard provision, which is annexed to this letter, merely restates existing powers and duties of the Commission, European Anti-Fraud Office and the European Court of Auditors with regards to combating fraud involving EU funds, and does not impose new burdens on Member States in the area of Justice and Home Affairs. The text arguably means that that the Commission is now fulfilling its responsibility to address fraud more systematically across EU programmes, as required by the Financial Regulations applicable to the EU budget.

As such, and given the importance both of improving the management of EU funds and of efforts to reduce fraud in the EU budget, the Government believes this is a helpful development.

This text will now be included in relevant legal bases (listed in the documents annexed to this letter) [not printed] subject to discussion of specific additional provisions in some policy areas, as part of on-going negotiations on EU spending programmes over the next MFF.

19 July 2012

STATUTORY AUDITS OF PUBLIC ACCOUNTS AND PUBLIC-INTEREST ENTITIES
(16971/11)

Letter from the Chairman to Norman Lamb MP, Minister of State for Employment Relations, Consumer and Postal Affairs, Department for Business, Innovation and Skills

Thank you for your letters, dated 5 March 2012 and 1 May 2012, on EMs 16971/11 and 16972/11, on the proposal for a Directive and a Regulation on the statutory audits of annual accounts. The House of Lords European Union Sub-Committee on Economic and Financial Affairs considered these documents at its meeting on 29 May 2012.

We are grateful for your comprehensive response to the Committee’s queries. In light of your response, we reiterate our view that the proposal raises serious concerns in relation to the subsidiarity principle. We note the important discussions taking place in Council working group on whether a Regulation or a Directive is the appropriate legal vehicle. We would be grateful if you could advise us of the contribution that the Government are making to these discussions, and for an update on negotiations in this respect.
We note your view that the Commission has failed to establish a direct connection between the financial crisis and any deficiency in the performance of the audit profession or the operation of the audit market as a result of the structure of the audit market. However, we would be grateful if you could clarify whether, and why, it is in your view unreasonable to argue that the auditing profession bears some responsibility for the failings that became apparent during the financial crisis.

We acknowledge your statement that those elements of the proposals that address the oversight and regulation of the audit profession, the adoption of international audit standards, and improvements in audit reporting, form the majority of the Articles in the draft documents, and agree with you that such proposals are broadly proportionate.

Nevertheless, we note your concerns about the proportionality and appropriateness of the proposals for a mandatory six year rotation rule. You state that “there is evidence that the Commission’s proposals may make competition worse”. What evidence do you have in mind? We would also be grateful for further information on the experience of Italy that you refer to in relation to a mandatory rotation rule.

In your letter, you set out a number of alternative mechanisms to seek to reduce the current levels of market concentration. We would be grateful for further details of these proposals. How, for instance, would you make the case for a new 10 year retendering requirement? What assessment would you make at this stage of the attitude of other Member States to such proposals?

On the extension of the definition of PIEs, you state that “some of these are generally considered too small to warrant such categorisation. It appears that this view is shared by other Member States.” We would be grateful for further information on the views that you refer to.

We also sympathise with your concerns about the proposal to limit fees for related financial audit services, but agree with you that a distinction should be made between such services and non-audit services, for which there may be a stronger case for a ban.

We are grateful for the information you have provided on the steps taken in the UK to address the issue of professional scepticism. However we urge the Government and regulatory bodies to do more to ensure that auditors apply sufficient scepticism.

Thank you for the update on recent developments, and we would be grateful for further updates as negotiations progress.

We would be grateful for a swift response to the queries outlined above. Given the importance of these proposals, and given that agreement remains some way off, we have agreed to continue to hold the documents under scrutiny.

29 May 2012

Letter from Norman Lamb MP to the Chairman

Thank you for your letter of 29 May.

The Government is an active participant in the discussions taking place in Council working Groups. These discussions are effective in identifying the issues that will need to be addressed if the proposals are to be developed into a form that Member States support. However, notwithstanding the numerous points being raised by representatives of Member States, the Commission continues to reiterate its position on the contentious areas.

Subsidiarity and the argument that the proposals affecting Public Interest Entities (PIEs) should be in a Directive rather than a Regulation continue to be raised by a significant number of Member States, including the UK.

Areas where Member States have raised subsidiarity include:

— the conflict in the proposals arising from the proposed audit report requirements and the requirement to adopt International Auditing Standards;
— The former are prescriptive and take no account of national requirements;
— the extension of the PIE definition, without any size threshold (and the extent to which Member States can add or subtract from that list); and
— the absolute limitation on the value of audit-related services.

The choice of instrument for much of the proposals relating to audits of PIEs has been raised as a general concern, but it has direct relevance to all of the issues above.

29 May 2012
The Government recognises that there are lessons to be learned by the audit profession from the financial crisis – but that is not the same as saying that it was responsible for that crisis. Those lessons include the importance of regular conversations between banking auditors and the relevant prudential regulator, which might have given earlier warning of the crisis. This issue has been addressed by new requirements introduced by the Bank of England. Other lessons include the importance of professional scepticism, which is commented on below.

We have examined the evidence for whether mandatory rotation increases competition in the audit market. Mandatory rotation exists (every 9 years) in Italy, and has not reduced concentration in the audit market. Independent academics found that mandatory rotation there “did not give small to medium sized firms the opportunity to compete with the Big Audit Firms… it has perhaps even contributed to the generation of collusive behaviour among the Big Audit Firms.” A 2005 review of the literature by Bocconi University also came to an unfavourable conclusion on mandatory rotation.

The Competition Commission in the UK is currently investigating competition in the audit market for the largest audits, and their interim conclusions are expected by November this year. Their conclusions will be a valuable addition to the European debate.

The Financial Reporting Council (FRC) is currently consulting on amending the UK Corporate Governance Code (the Code) to require tendering of audits of the biggest companies on the FTSE 350 on a “comply or explain” basis. I support this consultation.

Under the FRC proposal, the introduction of the tendering will be phased in to ensure that the audit market is able to cope. Tendering will ensure that audit relationships are subject to proper market discipline and that other audit firms are given the opportunity to bid for the business, whilst not preventing the audit committee recommending reappointment of the current auditor as a result of the tendering process if they believe that this is in the best interests of the company. Tendering may also encourage audit innovation.

The “comply or explain” requirement has been shown to work well in the UK. Companies need to provide clear and meaningful explanations when they choose to deviate from the Code, so that their shareholders can understand the reasons for doing so and judge whether they are content with the approach the company has taken.

This approach is being promoted by the UK Government in the Council Working Groups. Some Member States support a mandatory rotation requirement on the grounds that this promotes audit independence. However, given the consequences of introducing rotation described in the research referred to above, the UK continues to believe that its tendering proposals are appropriate, proportionate and have the benefit of not exposing investors and companies to unintended adverse consequences.

The FRC is also continuing its work on auditor scepticism in its consultation on amendments to the Code by requiring the report of every listed company’s Audit Committee to the shareholders to contain “an assessment of the effectiveness of the external auditor.”

The definition of PIEs has generated a range of views. Some Member States support the increase in the scope of the definition. Others would like the existing definition of PIEs in the current Directive to be retained. Other Member States have, like the UK, expressed particular concern about the addition of UCITS (Undertakings for Collective Investments in Transferable Securities) and Alternative Investment Funds to the definition of PIEs. The arguments have not yet been developed further by other Member States. The Government’s concern (based on discussions with the FSA and the FRC) is that the increased burdens consequent on being categorised as a PIE, which are not limited to the audit requirements, are unduly burdensome and, therefore, not proportionate. The UK would prefer to include such businesses in the definition of a PIE together with either a size criterion or the ability for Member States to make their own assessment based on the national circumstances.

21 June 2012

Letter from the Chairman to Norman Lamb MP

Thank you for your letter, dated 21 June 2012, on EM 16971/11 and 16972/11: Statutory Audits of Public Accounts and Public-Interest Entities. The House of Lords European Union Sub-Committee on Economic and Financial Affairs considered this document at its meeting on 10 July 2012.

We are grateful for the update that you provide on the progress of negotiations. We note that negotiations continue on central elements of the proposal, including the subsidiarity principle and whether a regulation or directive is the appropriate legal vehicle, the proposals on mandatory
rotation and the definition of PIEs. We note in particular the Government’s advocacy of a “comply or explain” model, and the proposal for the PIE definition to include a size criterion or the ability of Member States to make their own assessment based on national circumstances. These both seem sensible suggestions, and we too support the Financial Reporting Council’s consultation on amending the UK Corporate Governance Code to require tendering of audits of the biggest companies on a “comply or explain” basis.

We would be grateful to be kept updated on the development of negotiations in relation to this important proposal. In the meantime we have agreed to clear the document from scrutiny.

10 July 2012

STRUCTURAL FUNDS (13730/12)

Letter from the Chairman to Michael Fallon MP, Minister for Business and Enterprise, Department for Business, Innovation and Skills

Thank you for the Explanatory Memorandum dated 2 October 2012, on EM 13730/12 on the amended proposal for more strategic use of Structural Funds. The House of Lords European Union Sub-Committee on Economic and Financial Affairs considered this document at its meeting on 16 October 2012.

We note your concerns relating to the inclusion of indicative actions as a delegated act as well as the use of a delegated act to amend the annex. Are you aware of other Member States that share these concerns? We note your concern over the inclusion of additional requirements that were not in the original proposal, and would be grateful for further details of your views in relation to this. We would welcome updates on negotiations as they proceed.

Finally, the Committee is particularly troubled by the accelerated timetable being sought in relation to this matter. We welcome your efforts to ensure appropriate time is allowed for national Parliaments to scrutinise this proposal and would be interested to know if you have been successful in revising this timetable.

17 October 2012

THE 2012 UK NATIONAL REFORM PROGRAMME AND THE CONVERGENCE PROGRAMME (10834/12, 10557/12, 10846/12)

Letter from Lord Sassoon, Commercial Secretary, HM Treasury, to the Chairman

I am writing with regard to the European Semester process for the surveillance of Member States’ economies. As you will recall, the European Union Committee previously raised concerns that the timing of the 2011 European Semester was particularly tight and did not allow for correct Parliamentary scrutiny.

The Government wrote to the European Commission to highlight these concerns, and notes that the Commission published the Annual Growth Survey (AGS) earlier than expected in November 2011. This allowed more time for scrutiny of the AGS document, a point that was acknowledged when the House of Commons’ European Scrutiny Committee debated the AGS on 20 February 2012.

We have continued to press this point with the Commission. The 2012 package of draft Country-specific recommendations, opinions on Stability and Convergence Programmes and in-depth reviews under the Macroeconomic Imbalances Procedure will be published on 30 May 2012. Although this is one week earlier than last year, timing will once more be very tight: ECOFIN will discuss the package on 22 June, while Heads of State or Government will be expected to provide endorsement at their meeting on 28-29 June. The package will receive formal sign-off from Ministers at the 10 July ECOFIN meeting.

I would therefore invite the Committees to take note of the tight timing of the final stages of the 2012 European Semester, particularly when scheduling debates. The Government will endeavour to process the relevant Explanatory Memoranda as quickly as possible.

14 May 2012

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Letter from the Chairman to Mark Hoban MP, Financial Secretary, HM Treasury

Thank you for your Explanatory Memorandum, dated 11 June, on the Commission Communication on Action for Stability, Growth and Jobs; the Council Recommendation on the UK’s 2012 National Reform Programme and delivering a Council opinion on the UK’s updated Convergence Programme 2012-17; the Assessment of the 2012 National Reform Programme and Convergence Programme for the UK; and in In-Depth Review for the UK on the prevention and correction of macroeconomic imbalances. The House of Lords European Union Sub-Committee on Economic and Financial Affairs considered these documents at its meeting on Tuesday 19 June 2012.

We reiterate the conclusion set out in our March 2011 report on The future of economic governance in the EU, that Member States will benefit greatly from the introduction of the European Semester, which will lead to greater coherence in the way the Commission offers advice on how Member States should coordinate economic policies across the EU. Rather than downgrading the role of national parliaments, a European perspective can only strengthen national parliaments’ scrutiny by providing more information. To that end we welcome the publication of these documents and the Government’s response to them.

On the draft Council Recommendation and Opinion, in our February 2012 report on The Euro area crisis, we concluded that, whilst improved budgetary discipline is necessary in order to make progress in resolving the euro area crisis, ultimately the resumption of sustainable economic growth will hold the key. We called for a renewed emphasis on job creation and the single market, but concluded that the real challenge for policymakers will be the sustained implementation of measures which are both effective in supporting economic growth, and which do not threaten the drive to improve budgetary discipline. We therefore welcome the Government’s acknowledgement that Member States should prioritise measures that support growth and job creation, including, specifically, the focus on young unemployed people, and that this is one of the key components of a sustainable exit from the crisis. However, as the draft Council Recommendation and Opinion suggests, this needs to be a priority not only for the euro area, but also for the UK.

We also agree with the Commission’s recommendations for the UK to address the destabilising impact of high and volatile house prices and high household debt; improve the employability of young people; step up measures to facilitate the labour market integration of people from jobless households; further improve the availability of bank and non-bank financing to the private sector, in particular to SMEs; and pursue a long-term strategy for improving the capacity and quality of the UK’s network infrastructure. We note the steps that you are taking to address these issues, and call on the Government to redouble their efforts to enhance the competitiveness of the UK economy in these areas. In relation to export data, can you confirm whether the Commission’s figures include invisible exports?

We also agree with the findings of the in-depth review for the UK that household debt and the housing market, and external competitiveness, are areas of particular potential concern. However we note the Commission’s conclusion that, though the UK is experiencing macroeconomic imbalances, none is excessive. We also note that the Government will not have to submit a Corrective Action Plan. However we would be grateful if you could provide us with a more details breakdown of household debt in the UK, including full details of the other factors that contribute to the figures aside from mortgage debt.

In terms of the Commission Communication: ‘Action for Stability, Growth and Jobs’, we note the Government’s continued opposition to any new taxes, including a Financial Transaction Tax, to fund the EU Budget. In our recent report, Towards a Financial Transaction Tax?, we expressed our own concerns about the Commission’s proposal for such a tax, and concluded that the Commission’s objective of using an FTT as a revenue stream for the EU budget was unlikely to be met.

On the proposal of steps towards a banking union, you state that the Government believe that further steps need to be taken by the euro area, but that the interests of those outside of the currency union must be acknowledged and protected. What steps do the Government believe need to be taken, and how do you believe that the balance between the interests of those inside and outside the currency union can be met? Is it not inevitable that the creation of a banking union in which the UK did not participate would adversely affect London’s position as Europe’s banking capital? We would also be grateful for further details of the Government’s assessment of the case for a paid-in capital increase for the European Investment Bank.

Noting that Ministers are due to discuss the draft Council Recommendations and Council opinions on 21 and 22 June, we have agreed to clear the documents from scrutiny. However we would be grateful
for a swift response to the questions outlined above, as well as an update on the forthcoming discussions in Council.

20 June 2012

**Letter from Lord Sassoon, Commercial Secretary, HM Treasury, to the Chairman**

Thank you for your letter to Mark Hoban MP dated 20 June requesting supplementary information on the Explanatory Memorandum, dated 11 June, on the Commission Communication on Action for Stability, Growth and Jobs; the Council Recommendation on the UK’s 2012 National Reform Programme; and delivering a Council opinion on the UK’s updated Convergence Programme 2012-17; the Assessment of the 2012 National Reform Programme and Convergence Programme for the UK; and the In-Depth Review for the UK on the prevention and correction of macroeconomic imbalances. I am replying as the Minister responsible for EU growth issues.

Given the pace of recent events, I thought that it would be helpful to hold back this letter for a couple of days in order to update you on the outcome of discussions regarding the capital increase of the European Investment Bank and the proposed Banking Union, which took place at the recent European Council, held on 28-29 June.

As you are aware, the European Council agreed a ‘Compact for Growth and Jobs’ which sets out concrete commitments for supporting growth at EU level. Many of these policies follow on from the areas set out in the letter “A plan for growth in Europe”, which the Prime Minister and 11 other Heads of State or Government signed in February 2012. It is important that the EU as a whole maintains a sense of momentum and delivers on the ambitious structural reform commitments set out in the February 2012 letter.

You asked what steps, in the Government’s view, need to be taken towards a banking union, while also acknowledging and protecting the interests of those outside the currency union. The Government has been clear that the UK will not take part in the fundamental elements of a banking union. A banking union is a natural extension to a fiscal and monetary union, not for the single market or the EU as a whole. Any banking union should be designed for the single currency. The UK will not be part of common deposit guarantees or under the jurisdiction of a single European financial supervisor.

Furthermore, I would like to be clear that our non-participation in any banking union will not adversely affect London’s position as the leading financial centre in Europe. A euro area banking union will not change the fundamental Treaty freedoms that underpin the single market, including freedom of establishment and free movement of capital. The single market will continue to give UK-based firms access to the whole EU. A single EU rulebook, with national supervisory discretion and firms able to passport across the EU, is not being questioned as an underlying premise for proposals for a banking union.

Clearly, rules for financial services are required at the level of the single market and it is very important that we have a say over them. However, as stated above, the fundamental elements of banking union flow from the single currency, not the single market. That is why that union should be put in place at 17, not at 27. The June European Council committed to ‘preserve the unity and integrity of the single market’ in any proposals that are to be brought forward.

The June European Council also endorsed a proposal to increase the paid in capital of the EIB by €10 billion. You asked for further details of the Government’s assessment of this proposal. It is anticipated this capital increase will support additional EIB lending of up to €60 billion over the next three to four years. The UK’s contribution to the capital increase will be €1.6 billion (in line with our 16.17 per cent shareholding). The proposal will now be submitted to EIB Governors for their approval. The Government supports the proposal, subject to it being structured in a way that enhances the long term soundness of the bank.

You also asked first in your letter, whether the figures relating to exports used by the Commission contained data on invisible exports. I understand that exports of both goods and services are included in the data and are referred to in Table I on page 31 of the Commission’s Staff Working Document, ‘Assessment of the 2012 National Reform Programme and Convergence Programme for the United Kingdom’.

You also asked for a more detailed breakdown of household sector debt in the UK. According to Bank of England data, 85.6 per cent of total household debt is secured on housing; 3.8 per cent is credit card debt; and 10.4 per cent is categorised as ‘other’. Other debt includes personal loans not secured on housing, such as car loans and furniture.
THE 2013 DRAFT EU BUDGET

Letter from the Chairman to Mark Hoban MP, Financial Secretary, HM Treasury

Thank you for your Explanatory Memorandum, dated 5 June 2012, on the Statements of Estimates of the Commission for 2013 (Preparation of the 2013 Draft Budget). The House of Lords European Union Sub-Committee on Economic and Financial Affairs considered these documents at its meeting on Tuesday 19 June 2012.

We are grateful to you for agreeing to appear before the Committee at its meeting on 10 July 2012, when the Committee will ask you to give an update on the ongoing euro area crisis. We would also like to take the opportunity to raise a number of queries in relation to the draft EU budget for 2013, as follows:

You state that, “at a time of ongoing economic fragility in Europe, with countries across Europe taking difficult decisions to reduce public spending, a 6.8% increase in EU spending is unacceptable.” We note your concerns about the high level of increase, and would be grateful if you could expand on them. In particular, how can your desire to cut EU spending be reconciled with the need to fulfil the spending commitments that have already been made? You also state that “the Government’s key objective will be to limit the size of the 2013 EU budget.” What would be the level of the UK’s contribution to the overall budget as proposed by the Commission? What level of spending within the overall EU budget would you deem to be acceptable? Also, has any assessment been made of the likely impact of the draft budget on VAT receipts?

You state that “by spending more smartly, the EU budget can meet the key challenges without soaring expenditure”. In what specific ways do you believe that the EU budget can be spent more “smartly”? Which areas of the Commission’s proposals do you deem acceptable, and in which areas (if any) do you perceive there to have been an improvement in “smart spending” in comparison with past budgetary proposals? It has been reported that about €80 billion of EU structural funds are available but unspent. Can you confirm whether this is the case?

Once again, the Government state that they intend to focus on reducing waste. What specific proposals can you give us of how waste can be reduced? You also advocate “seeking savings in administrative spending outside of Heading 5 to ensure that programme spending is channelled to the front line”. This echoes the Government’s position in past years. What success have you had in achieving such savings in relation to past budgets, and what specific proposals are the Government bringing forward to achieve this in 2013?

You state that EU spending must deliver high added-value, “which will require strict and rigorous prioritisation”. Which areas and Headings do you believe should be prioritised, why is this, and how do you think such prioritisation can be achieved? You particularly cite the need to “send the clearest possible signal about orienting the 2013 EU budget towards growth and competitiveness.” In what specific ways can this be achieved?

In relation to heading 1b (Cohesion for Growth and Employment), you state that “the Commission should provide proper justificatory evidence for any increase in payments this year, in order to avoid over-allocating funds”. What projects are you referring to?

In relation to Heading 2 (Preservation and Management of Natural Resources), you state that Pillar 1 of the CAP represents very poor value for money, and that the budget should fall substantially over the next MFF. Can you expand on your concerns, and how likely is it that the Government will achieve their objectives in relation to the CAP?

You state that “the Government’s success in the 2013 programme will depend on corralling a group of like-minded Member States around a strong position” on the budget. What do you anticipate to be the position of other Member States in relation to the Commission’s budgetary proposals at this early stage of negotiations?

We look forward to addressing these issues in your appearance before the Committee on 10 July. However we would also be grateful for a written response to these queries in advance of your appearance. In the meantime we have agreed to hold the documents under scrutiny.

20 June 2012
Letter from Mark Hoban MP to the Chairman

Thank you for your letter of 20 June on the 2013 EU budget. You raise a number of important points and ask a series of questions, which are addressed in groups below. I look forward to discussing this further with your Committee on 10 July.

In your letter, you ask: about the Government’s concerns regarding the Commission’s proposed increase in spending in 2013; about reconciling the aim of cutting EU spending with the need to meet spending commitments that have already been made; and what level of spending within the overall EU budget the Government would deem to be acceptable.

Budgetary restraint at EU level remains an important means of supporting Member States’ ongoing efforts to put their public finances on a sound footing in order to pursue growth.

The Commission’s proposal for a 6.8% increase in EU spending is unacceptable and fundamentally undermines the tough action that is being taken across Europe to curb excessive spending.

The Government is clear that, in terms of the outcome of negotiations on the 2013 EU budget, we want to limit budgetary growth. Substantial savings can and should be made to the Commission’s proposal. The Government recognises that commitments do generate current payments, especially towards the end of programming periods, and that programmes take time to bed down. However, the Commission’s forecasts of payments needs, especially for Structural and Cohesion Funds, are unreliable and a large volume of payments are linked to entirely new commitments.

Payment appropriations should be set at the minimum necessary to fund programme implementation, and based on realistic implementation rates and estimates of Member States’ absorption capacity. Ruthless prioritisation of EU spending is needed, taking into account the fiscal and economic context of Member States. This way, large savings are available without leaving projects on the ground unfinished.

You ask what the level of the UK’s contribution to the overall budget would be, as proposed by the Commission, and if any assessment has been made of the likely impact of the draft budget on VAT receipts.

The Commission’s proposal for the 2013 budget is €137.9bn in payment appropriations, which is a 6.8% increase on the 2012 budget. On that basis, the UK’s gross contribution would be approximately €21.4bn pre-abatement and €16.8bn post-abatement.

In terms of VAT, the EU Budget does not have an obvious impact on the UK’s VAT receipts. If the Committee is referring to the ‘VAT-based own resource’, the UK does not pay any of its VAT receipts to the EU. Member States do make ‘VAT-based’ contributions to the EU Budget; however, these contributions do not change with the size of the EU budget. Only the GNI-based contributions change with budget size, as these finance the residual expenditure not funded by other own resources and revenues.

You ask about the positions of other Member States on the 2013 EU budget.

The annual EU budget is co-decided by the Council and European Parliament. Council’s position will be agreed by qualified majority voting before the end of July. The UK does not have a veto in these negotiations. Therefore, it is important for the Government to work with other Member States to build support for a strong budget-disciplined position on the 2013 EU budget.

There are two broad groups of Member States: those that are net-contributors and those that are net-recipients. In general, net-contributors support a smaller and better-targeted EU budget and the UK is a leading voice in this group. On the other hand, net-recipients are more supportive of the Commission’s proposal for an increase in payments and to protect key receipts, such as for Cohesion policy in 2013.

You ask about prioritisation of spending within the EU budget, including which areas and headings should be prioritised and why and how this can be achieved.

The EU budget should be focused on those activities that offer the greatest EU added-value and where spending at an EU level makes sense. As part of this, the Government welcomes the focus on the Europe 2020 strategy, and also recognises the importance of programmes in Heading 1a (Competitiveness for growth and employment) and Heading 4 (the EU as a global player).
Nevertheless, large savings in both areas are feasible, both on grounds of past implementation and prioritisation.

**YOU ASK HOW THE BUDGET CAN BE SPENT MORE "SMARTLY".**

It is important to improve the value for money of EU expenditure. This includes through spending more “smartly”. There are a number of tools to achieve smarter spending, including: the use of SMART objectives for EU programmes, as a means of assessing progress and prioritising activity; undertaking value for money assessments and impact assessments of EU proposals before they are agreed; having annual reviews of multi-annual programmes, rather than only when they have finished (building on concerns raised by the European Court of Auditors); taking better account taken of implementation rates and absorption capacity in Member States; better prioritisation of spending across the Commission; and more accurate forecasting of EU spending and actual needs, by the Commission and other EU bodies and by Member States.

The Commission’s draft budget proposal outlines “performance savings in the 2013 EU budget”. For example, on Heading 1a, the Commission argues that they have made a comprehensive assessment of the performance of operational programmes and corresponding needs for administrative support, and that they have used performance savings identified to help finance additional needs for the ITER project in 2013 (€360m) and also to reinforce projects that support growth and jobs (€128.1m). This is encouraging but arguably does not go far enough, as this exercise has not offered net savings.

Progress towards ‘smarter’ EU spending might be better assessed in the context of the Commission’s new annual report on the evaluation of the Union’s finances based on the results achieved, on which the Government submitted Explanatory Memorandum 6736/12 on 5 March and we have since been in written correspondence.

**YOU ASK ABOUT REDUCING WASTEFUL SPENDING WITH THE EU BUDGET AND THE SCOPE FOR MAKING ADMINISTRATIVE SAVINGS THROUGHOUT THE BUDGET.**

Last year the UK and other net contributors secured cuts to Heading 5 (Administration) totalling €18.5m. Although the Council proposed cuts of €40.1m from EU decentralised agencies’ budgets in 2012, the European Parliament refused to agree during conciliation. This year the Government has put forward a proposal to minimise growth in administrative spending, both within Heading 5 and elsewhere in the Budget, including around €45m via enforcing the 1% reduction in EU staff proposed by the Commission.

**YOU ASK ABOUT THE REPORTED CLAIM THAT ABOUT €80 BILLION OF EU STRUCTURAL FUNDS ARE AVAILABLE BUT UNSPENT.**

The €80 billion of EU structural funds that are reportedly available but unspent are estimates by the Commission, but we do not have access to EU level aggregated data that could confirm this. We understand the term ‘available but unspent’ to refer to Member States’ allocations of Structural Funds for the period 2007-2013 that to date have not yet been translated into payments. Within this category, we think that there are many cases where contractual agreements with implementing firms have been arranged, but payments not yet made. As a result the overall figure for Structural Funds that are available, for reprogramming for example, is likely to be significantly lower than €80 billion.

**YOU ASK ABOUT HEADING 1B (COHESION FOR GROWTH AND EMPLOYMENT) AND PROPOSED SPENDING INCREASES FOR DIFFERENT PROJECTS.**

Payment appropriations for all areas under this Heading should be set at the minimum necessary to fund programme implementation, and based on realistic implementation rates and estimates of Member States’ absorption capacity.

While there is considerable pressure on payment appropriations in this area, the Government is pressing the Commission for more information and evidence on its forecasting methodologies and assumptions, so as to be better able to assess the Commission’s requests for appropriations in 2013.

**YOU ASK ABOUT THE VALUE FOR MONEY OF PILLAR 1 OF THE CAP AND REDUCING THIS SPENDING OVER THE NEXT MFF.**

Pillar 1 of the CAP inhibits the development of an efficient agricultural sector and comes at significant fiscal cost. However, the Government’s scope for achieving reductions to CAP Pillar 1 payments via
the annual budget process is limited, as allocations and ceilings are pre-set and payments flow mechanistically. Beyond this, we must scrutinise budget proposals for possible cuts, especially in light of under-spending and margins last year.

The Government continues to press for restraint in the size of the EU budget over the next MFF. The CAP is a significant share of the Commission’s proposal, and the UK wants to see a very substantial reduction in the CAP budget, focused on Pillar 1. Some other Member States share the UK’s concern on these matters. Negotiations are ongoing and we will continue to build alliances with other member states in the pursuit of a much smaller CAP as part of a more restrained and balanced EU budget.

4 July 2012

Letter from Mark Hoban MP to the Chairman

Following on from the EU Sub-Committee A evidence session on Tuesday 17 July, I am writing to respond to the questions that the Committee raised on the EU budget during the session.

ADMINISTRATIVE SAVINGS AND WASTE

The Committee asked for additional information on the administrative savings that the Government has been able to secure in past years and examples of where waste has been cut throughout the budget. As the Committee is aware, the Government has adopted a tough stance on budget discipline at EU level in this and recent years, which has involved a concerted effort to reduce waste and inefficiency in EU spending, especially administrative costs, and ensure it delivers high added-value.

The Government assesses spending proposals on the basis of EU added-value, past implementation rates, and absorption capacity, to ensure value for money for UK taxpayers. This rigorous approach has resulted in real savings being realised and wasteful expenditure being cut.

During negotiations on the 2011 EU budget, the Government limited growth in payments to the EU budget to 2.91%, rather than the nearly 6% demanded by the Commission and European Parliament, thereby saving EUR 3.6bn against the Commission’s draft budget proposal. This outcome was also EUR 7.8bn below the ceiling agreed for EU spending in 2011, as set out in the current Multi-Annual Financial Framework (MFF) (2007-13). This included savings against the Commission’s proposal of EUR 889m in Heading 1b (Cohesion for Growth and Employment) and EUR 1.76bn in Heading 2 (Preservation and Management of Natural Resources), where the Government believes there is cause for concern about EU added-value and accurate financial programming by the Commission.

For the 2012 EU budget, the Commission proposed to increase EU spending (payment appropriations) by 4.9% over 2011 levels. However, the final agreed budget was of an increase of 2.02% – thereby saving EUR 3.58bn against the Commission’s draft budget proposal. This outcome was also over EUR 12bn below the ceiling agreed for EU spending in 2012, as set out in the MFF. This included savings against the Commission’s proposal of EUR 1.3bn in Heading 1b and EUR 831m in Heading 2.

Specifically on administrative spending, for 2011, the Commission proposed a 4.4% increase over 2010 levels. The Government worked hard during negotiations that year to limit this spending and Council’s initial position cut its growth to 2.5%. Although subsequent amendments were made, including changes to reflect automatic pay adjustment for EU staff, the Government clearly signalled that efficiency savings to EU administrative spending are a priority.

To some extent, the Commission responded the following year. While the Commission was compiling its draft 2012 EU budget, Commissioner Lewandowski wrote to all EU institutions and agencies asking that they limit bids for funds in 2012 to at most 1% above 2011 levels. In the draft 2012 EU budget, the Commission proposed to freeze its own administrative budget. This demonstrates the impact of the Government’s lobbying to reduce administrative expenditure. At the end of last year we saw an even more substantial result of the sustained pressure from the Government and like-minded Member States calling for cuts to Heading 5 (Administration), namely that the Commission made a proposal to reduce EU Institution staff by 5% over the next MFF (2014-20), beginning with a 1% reduction in the 2013 Budget. The Government is working actively to hold the Commission to account on this proposal, and continues to push for the Commission to go further in its ambitions for savings.

Furthermore, pressure for savings from the Government and like-minded Member States has led to the Commission to look for “performance savings in the 2013 EU budget”. On Heading 1a, the
Commission argues that they have made performance savings totalling EUR 531.4m (EUR 351.3m in Framework Programme 7 (FP7) and EUR 180.1m in non-research programmes).

This is encouraging but does not go far enough, as demonstrated by the Commission’s inflation-busting proposal for a 6.8% increase in spending in 2013 over 2012 levels. The Government has led efforts at Council to seek further savings across the budget; the outcome of which is demonstrated in Council agreeing to a 2.79% increase in payments in 2013 over 2012 levels – EUR 5.23bn less than the Commission’s proposal. As you know, however, the Government voted against this proposal, as we believe that further savings can and should have been found.

UK CONTRIBUTIONS

The Committee asked for clarification on the accuracy of figures quoted in The Daily Telegraph (21 March 2012), which stated that Britain’s real and forecast net contribution in the four years from 2010-11 to 2013-14 increased from £31.3bn at the Autumn Statement, to £33.1bn at the Budget.

The Office for Budget Responsibility (OBR) is responsible for forecasting the UK contributions to the EU. Their March forecast was based on the best information available at the time.

The figures used in The Daily Telegraph article were consistent with the OBR forecast in March 2012; but it is important to note that the 2011-12 figures were estimates and not actual outturns, since the OBR forecast was made before the end of the fiscal year. Following a query from Lord Flight, the Treasury confirmed that once Departments had provided full returns, the Treasury would publish outturn figures in its annual European Union Finance publication.

On 13 July 2012, the Treasury published the actual outturn figures in the European Union Finances 2012 document. This showed that, taking into account full returns from Departments, the estimated outturn for net contributions in 2011-12 were in fact £7.4bn in 2011-12 (Table 3.C, page 17), £1.3bn less than the OBR forecast of £8.7bn.

Taking into account the updated outturn estimates from the European Union Finances 2012 publication and using unchanged OBR forecasts for 2012-13 and 2013-14, the UK’s net contribution from 2010-11 to 2013-14 (the period the news article looks at) will now be £31.5bn, not £33.1bn as stated in the article.

23 July 2012

Letter from the Chairman to Mark Hoban MP

Thank you for your letters, dated 4 July 2012 and 23 July 2012, on the Draft EU Budget 2013. The House of Lords European Union Sub-Committee on Economic and Financial Affairs considered this document at its meeting on Tuesday 24 July 2012.

We are grateful to you for your response to the queries raised by the Committee in our previous letter. We are also grateful to you for appearing before the Sub-Committee at its meeting on 17 July to give evidence on the draft EU budget, and for your prompt response to the requests for further information at that meeting. There are a number of issues in relation to which we would appreciate further clarification.

In our previous letter, we asked for the Government’s view as to what level of spending within the overall EU budget would be deemed to be acceptable. You told us in evidence that the Commission’s proposal of a 6.8% increase is unacceptable, and that at a time when Member States are having to make significant savings in their domestic budgets, the fact that the Commission is not sharing that burden is disappointing. You state that Council agreed last week to a compromise of a 2.79% increase, but that you opposed it as still too high. You also state that the UK and like-minded states have made a statement that you are not prepared to go beyond 2.79% in further negotiations. You told us that your aim had been for an increase of 1.9%. We share the Government’s view that a 6.8% increase is unacceptable in the current economic and financial climate and support your efforts to secure a more appropriate figure as close to a real-terms freeze as possible.

You state that net-contributors support a smaller and better-targeted EU budget and the UK is a leading voice in this group, but that net-recipients are more supportive of the Commission’s proposal for an increase in payments and to protect key receipts. You also point out that the two groups currently form blocking minorities. Can you clarify which Member States support a smaller budget, and which are more supportive of the Commission’s proposal? You told us that, “if we stick together, I think we will get a satisfactory outcome this year, albeit one where the increase is higher than we would prefer.” How would you define a “satisfactory outcome”? Do you remain confident that the
UK and its allies will be successful in securing final agreement on a smaller and better-targeted budget? How realistic is it that an increase of anything below 2.79% can be achieved? In the context of continuing negotiations, which areas of the Budget do the Government regard as deal-breakers?

You state in your letter that the Commission’s forecasts of payments needs, especially for Structural and Cohesion Funds, are unreliable. What specific examples can you give us of such unreliable forecasts? You also stress the need to ensure that these funds are targeted on countries with economic performance below the EU average. You state that the Government have pressed for this in negotiations. What success have you had, and to what extent have your aims been achieved? Does it remain your ambition to ensure that a fundamental review of budget headings is undertaken and that a system of zero-based budgeting is brought about in time for the Multiannual Financial Framework from 2021-27?

On the question of prioritisation of spending within the EU budget, you highlight the importance of programmes in Heading 1a (Competitiveness for growth and employment) and Heading 4 (the EU as a global player). We agree with you that spending should be prioritised on areas that promote economic growth, productivity and capacity. We also agree with you that it is important to set such priorities now and to ensure that sectoral negotiations are productive so as to have a positive influence on the shape of the Multiannual Financial Framework 2014-2020. Notwithstanding this, you state that large savings in both areas are feasible. In what specific areas do you believe that savings under these Headings can be achieved? You also state that “the question is how we transform the EU budget so that it helps to drive economic growth”. What is your answer to this question?

You state that the CAP is a significant share of the Commission’s proposal, and the UK wants to see a very substantial reduction in the CAP budget. In what other areas do you believe that a substantial reduction is most necessary? You stressed the importance of ensuring that the priorities set for each budget line “are not simply an opportunity to waste money on pet projects”. Which particular projects did you have in mind?

In terms of administrative spending, you told us that “there is a lot that we could do ... partly under Heading 5 of the budget but there are also administrative costs scattered throughout the other budget headings.” You also state that the Government have put forward a proposal to minimise growth in administrative spending elsewhere in the Budget. We agree with your view that the Commission should do more to seek to reduce its administration costs. Nevertheless we would be grateful for further information on the specific proposals that you have put forward.

We have agreed to clear the documents from scrutiny in anticipation of the ongoing negotiations in Council. However we would be grateful for a swift response to these questions, as well as regular updates on negotiations as they progress.

24 July 2012

Letter from the Rt. Hon Greg Clark MP, Financial Secretary, HM Treasury to the Chairman

Thank you for your letter of 24 July on the 2013 EU budget. You ask a series of important questions, which are addressed in groups below.

You ask which member states support a smaller budget, and which are more supportive of the Commission’s proposal.

When Council formally agreed its position on the 2013 EU budget, on 24 July, two sets of joint-statements were made by groups of Member States. The first, by the UK, Austria, Denmark, Finland, France, Germany, Sweden, and the Netherlands, stated that they are not prepared to go above the 2.79% increase agreed by Council in further negotiations this year. The second, by Estonia, Hungary, Poland, and Romania, states that “... the level of payments agreed in the Council position on the 2013 draft budget constitutes a minimum (especially as far as sub-heading 1b is concerned), which should be seen as a starting point for negotiations with the European Parliament in autumn”.

You ask about the Government’s views on the possible final outcome for negotiations later this year.

The Government will be pressing very hard for an outcome in line with the Government’s joint-statement with other Member States. The Government will continue to press for further savings in all
areas of the budget; but, against that, some Member States are pushing for yet higher EU spending. The Government will also press for a better shape to the budget, focused on growth.

**YOU ASK FOR SPECIFIC EXAMPLES OF THE COMMISSION’S FORECASTS OF PAYMENTS NEEDS, ESPECIALLY FOR STRUCTURAL AND COHESION FUNDS (SCF), AS BEING UNRELIABLE.**

The EU Budget Commissioner, Janusz Lewandowski, in February 2012 suggested that more funds may be required in 2012 to pay bills for SCF. He claimed that the Commission received some EUR 15bn of SCF bills from Member States in December 2011, and that after paying out for some of this, around EUR 11bn of SCF bills were left outstanding at the end of 2011.

However, as recently as October 2011, when the Commission presented its proposal for Draft Amending Budget Number 6 to the 2011 EU budget (DAB 6/2011), the Commission was forecasting outstanding SCF payments for 2011 of only EUR 1bn; and requested only EUR 404m in new funding to meet this gap, with the rest to be financed by redeployments from within the existing budget. The Commission was not forecasting anything close to the EUR 15bn of bills that were then received only two months later and the payment pressures this would generate.

**YOU ASK WHAT PROGRESS THERE HAS BEEN IN BUDGET NEGOTIATIONS TOWARDS ENSURING THAT SCF ARE TARGETED ON COUNTRIES WITH ECONOMIC PERFORMANCE BELOW THE EU AVERAGE.**

There is limited scope to make these changes through the annual budget process. However, it is one of the Government’s key objectives for SCF in the next Multi-Annual Financial Framework (MFF) (2014-2020). The Government has consistently made its position clear that the overall level of SCF payments should fall in real terms and that the richer regions, particularly in the richer Member States, should take the greatest cuts. There is text in the Danish Presidency negotiating box that could help facilitate this, but we will not know how far our aims have been achieved until an overall deal on the MFF is agreed.

**YOU ASK ABOUT THE GOVERNMENT’S VIEWS OF REVIEW OF THE BUDGET HEADINGS IN THE NEXT MFF.**

The Government’s overriding priority for the next MFF negotiations is to restrain the overall size of the budget to at the very most a real-terms freeze in payments. The MFF negotiations are also an opportunity to ensure that the budget is spent effectively in the future. In the next MFF, the Government wants to see a greater share of the budget going towards research and innovation, external action, and climate change. Very substantial reductions are needed to Pillar One of the CAP and to administrative expenditure.

The Government is also concerned by the continuing uncertainty and lack of transparency in the EU budget system. In particular, the Commission’s forecast of EUR 237bn of unspent commitments (RAL) by the end of 2013 is a serious concern, which threatens to undermine the control of the budgetary authorities in the next MFF. Of this, particular action is needed to address the EUR 70bn of RAL which the Commission has accepted is ‘greater than expected’. The Government is also arguing for greater focus on the level of payments in the budget (as opposed to commitments). Payments are the only measure which directly determine the cost to EU taxpayers and therefore are the only way to truly manage expenditure.

**YOU ASK IN WHAT SPECIFIC AREAS OF HEADING 1A (COMPETITIVENESS FOR GROWTH AND EMPLOYMENT) AND HEADING 4 (THE EU AS A GLOBAL PLAYER) CAN SAVINGS BE ACHIEVED.**

Significant savings throughout Heading 1a are feasible, without impacting negatively on growth or meeting past commitments.

The Commission have proposed significant increases on 2012 spending for many of this heading, but they haven’t given full justifications for these. We question whether these significant increases are really justified, and argue that a much lower level of increase should be proposed.

Examples of such large increases include:

- Security (budget line 02 04 01 02), with a 45% increase on 2012 levels, to EUR 198m.
- Health (budget line 08 02), with a 53% increase to EUR 757m.
— Ideas (European Research Council, budget line 08 10), with a 50% increase to EUR 1.23bn.
— Food, agriculture, fisheries and biotech (budget line 08 03), with a 75% increase to EUR 318m.

On Heading 4, the Government is able to accept the cuts proposed by the Commission for: Development Cooperation Instrument (DCI); Industrialised Countries Instrument; Democracy and Human Rights; EC Guarantees for Lending Operations; and Other Actions and Programmes.

In particular, further large savings are available from the Instrument for Pre-Accession (IPA). Given its relatively poor implementation, an increase of over 20% in 2013 is not realistic.

Further savings are also possible in some of the smaller instruments, including EU Macro Financial Assistance and the Partnership Instrument.

YOU ASK FOR THOUGHTS ON HOW TO TRANSFORM THE EU BUDGET SO THAT IT HELPS TO DRIVE ECONOMIC GROWTH.

A restrained EU budget should focus on promoting growth and jobs, and on those activities where spending at an EU level makes sense.

Growth and competitiveness, both of which are underpinned by research and innovation, are priority areas for the Government and, for the next MFF, should have a proportionately larger share of a budget that is frozen in real terms.

If spent properly, EU funds in these areas can generate added-value, support spillovers, and promote cross-border actions, as well as being complementary to Member State actions.

The EU budget should also complement other non-spending ways to promote growth and jobs, including: deepening the Single Market; completing the Digital Single Market; completing the internal energy market; reducing the regulatory burden; and agreement on the EU patent.

YOU ASK ABOUT THE IMPORTANCE OF ENSURING THAT THE PRIORITIES SET FOR EACH BUDGET LINE ARE NOT SIMPLY AN OPPORTUNITY TO WASTE MONEY ON DIFFERENT PROJECTS.

The Government has been clear that it wants to see real budgetary restraint in the EU in order to avoid unaffordably high costs to the UK and to UK taxpayers. To deliver this goal, the Government is committed to continue to work hard to limit EU spending, reduce waste and inefficiency, and ensure that where EU funds are spent they deliver the best possible value for money for taxpayers. As part of this, it is essential that EU expenditure is closely scrutinised on the basis of value for money.

Under Heading 5, the European Parliament are currently extending the Konrad Adenauer building in Luxembourg at a cost of EUR 363m, and are developing a new ‘House of History’ in Brussels; and the European Council are also in the process of building their state-of-the-art new EUR 300m headquarters in Brussels.

Given the significant cuts and efficiency reforms being made to the administrative budgets of most EU Member States civil services, the Government thinks such projects are inappropriate and should only proceed with the utmost economy and efficiency.

YOU ASK ABOUT MINIMISING GROWTH IN ADMINISTRATIVE SPENDING OUTSIDE OF HEADING 5, IN OTHER AREAS OF THE BUDGET.

Administrative spending from outside of Heading 5 of the EU budget comes principally from the budgets of the EU agencies. An Inter-Institutional review of EU agencies was completed in June 2012. Although the ‘common approach’ resulting from this review is not legally-binding, it sets helpful new standards for agencies on such issues as appointing directors, management board structures, and financial operations. The Government is currently formulating an engagement strategy to promote the implementation of this common approach, which seeks to instil efficiency and reform within the agencies.

Additionally, the EU Staff Regulations, which dictate the pay, pensions, and benefits of all EU staff, including those employed by agencies, are currently under review. The Government is seeking reforms to the Regulations, to offer better value for money and make significant savings.

25 September 2012
Letter from the Chairman to the Rt. Hon Greg Clark MP

Thank you for your letter of 25 September 2012 on the Draft EU Budget 2013. We are grateful for your detailed response to our letter of 24 July, although we note that you did not answer a question as to which areas of the Budget did the Government regard as deal-breakers in the context of continuing negotiations.

On administrative spending, we are grateful for the information that you provide on the Inter-Institutional review of EU agencies, completed in June 2012. You state that the Government are formulating an engagement strategy to promote the implementation of this common approach. We would be grateful for further details of the work that you are undertaking in this regard.

We would be grateful for further updates as negotiations on the shape of the 2013 draft budget continue.

23 October 2012

VAT: COMMISSION WHITE PAPER ON THE FUTURE OF VAT (18288/11)

Letter from David Gauke MP, Exchequer Secretary, HM Treasury, to the Chairman

Thank you for your letter, dated 25 April 2012, on EM 18288/11: the Commission Communication on the Future of VAT.

You asked about the impact of the high VAT registration threshold (currently at £77,000) on UK businesses and organisations. This keeps the smallest businesses out of VAT altogether and relieves many smaller businesses from the administrative burdens associated with VAT. Business views on the threshold are divided. Many argue for a higher threshold which would facilitate the expansion of their business, whilst others contend that a lower threshold would provide a fairer competitive environment.

The case for change has been regularly reviewed over the years, including more far-reaching options that would require negotiation in Europe. The Government believes that the UK’s current registration threshold achieves a reasonable balance between competing interests, taking into account the need to keep burdens on the smallest of businesses to a minimum.

You also asked about the opinion of other Member States on the application of such a high threshold. When I wrote to you on 30 January 2012 on the proposed Council Implementing Regulation to underpin the VAT Mini One Stop Shop (EM 5389/12), I touched on some outstanding simplification measures (EM 14248/04). They included a proposal to give Member States more flexibility in setting national thresholds, enabling Member States to set a threshold of up to Euros 100,000 (around £85,000 at current rates).

When the idea was last discussed by Member States, a number raised concerns about the level. Although it was optional, enabling individual Member States to choose anything up to that ceiling, some were concerned about domestic pressure that might be brought to bear and thereby forcing their hand, if the proposal were agreed. This may well be one of the reasons why that proposal remains on the Council table and no Presidency has taken it up since agreement to the VAT Package in 2008. Indeed, recent discussions on the White Paper in Working Group would suggest that views have not changed since then.

I hope that this is helpful to you and to the Committee.

10 May 2012

VAT FRAUD: QUICK REACTION MECHANISM (13027/12)

Letter from the Chairman to David Gauke MP, Exchequer Secretary, HM Treasury

Thank you for your letter dated 16 September 2012, on EM 13027/12 on a Commission proposal to amend Directive 2006/112/EC on the common system of value added tax as regards a Quick Reaction Mechanism (QRM) against VAT fraud. The House of Lords European Union Sub-Committee on Economic and Financial Affairs considered this document at its meeting on 9 October 2012.
We are in agreement over the importance of this initiative in tackling the problem of delays when derogating from the VAT Directive in the case of fraud. We are also sympathetic to your concerns over the increasing role of the Commission but recognise that this is intended to streamline the process. Would you be able to provide us with more details of the alternative approaches you are exploring with the Council?

We believe that the proposal could be made more responsive by incorporating a number of anti-fraud measures into the proposal rather than just the reverse charge mechanism. It would be useful for the Government proactively to suggest additional anti-fraud measures that could be included. Do you have any indication of what further anti-fraud measures might be included? Do you have any details on when the full list of anti-fraud measures will be published?

More generally, we would be interested to learn more about the timetable for negotiations over this proposal when more details emerge.

We would be grateful for a response to these questions by 24 October. In the meantime we have agreed to retain the proposal under scrutiny.

10 October 2012

Letter from David Gauke MP to the Chairman

Thank you for your letter dated 10 October on the above Explanatory Memorandum. I am grateful for your confirmation of the importance of tackling delays in derogating from the VAT Directive in cases of fraud and for your understanding of the concerns that the Government has over the increased role of the Commission. You also asked for additional information in relation to negotiations on the Quick Reaction Mechanism (QRM).

In particular you requested details of the alternative approaches we are exploring with the Council. In conjunction with Germany, we have introduced three alternatives to the negotiations. These build upon some of the features of the Commission’s proposal but do not concede competence to the Commission.

The three options are:

— Streamlining the current arrangements to accelerate the system where the criteria for a QRM were met.

— An optional reverse charge included in the Directive which could be engaged through a notification, rather than legislation. This would mirror a much more limited provision already in the Directive which is restricted to specified cases such as scrap metal and construction services.

— Reversion to a system similar to that prior to 2004 which again dispensed with a Commission proposal and relied on the tacit agreement of Member States to a deemed decision, based on the request letter, but in a short timescale.

The Commission opposed all three suggestions but several Member States share our concerns and others are prepared to look at alternatives, particularly focusing on the idea of streamlining. We will continue to work on alternative approaches and will keep you informed of any major developments.

Your Committee’s view was that the proposal could be made more responsive by including other measures than just the reverse charge. The proposal allows for an expansion of the list of measures which could be authorised by the QRM. It is currently restricted to a reverse charge because that is the most widely used and effective anti-fraud mechanism. The Government would support the addition of other mechanisms which are similarly effective. However, to date no such widely applicable alternative has been identified by either Member States or the Commission. The Commission’s proposal envisages a list of measures which can be amended over time in the light of developments, rather than a once and for all publication.

With regard to the timetable of negotiations, although discussions are now underway, it is unclear when the dossier might be resolved. Given the desirability of improvements, the Presidency are looking to make progress. A further meeting to look at a compromise text is planned for 6 November 2012.

23 October 2012
Letter from the Chairman to David Gauke MP, Exchequer Secretary, HM Treasury

Thank you for your Explanatory Memorandum, dated 28 May 2012, on an EU Commission proposal to amend the Principal EU VAT Directive to seek to provide a uniform VAT treatment of vouchers across the EU. The House of Lords European Union Sub-Committee on Economic and Financial Affairs considered this document at its meeting on 26 June 2012.

We note your view that the Commission’s proposals are an opportunity to seek to remove problems of distortion and double or non-taxation across the EU. However we are concerned that the proposal may overcomplicate the issue. Is there a case for a more straightforward method of applying VAT to vouchers?

You state that the Government will counter unhelpful ideas. Are you content with the Commission’s proposals as they stand? You also state that the Government have recently announced changes to UK law to prevent tax avoidance. What further details can you give us of these changes? Are they compatible with the Commission’s proposals?

We would be grateful for a response to these queries within ten working days. In the meantime we have agreed to hold the proposal under scrutiny.

28 June 2012

Letter from David Gauke MP to the Chairman

Thank you for your letter dated 28 June 2012 asking for further details in respect of the EU Commission’s Proposal for a revised VAT treatment of vouchers.

You express some concern that the Proposal may overcomplicate the issue and ask if there is a more straightforward method of applying VAT to vouchers. Vouchers from a VAT perspective are already complex. When thinking of the VAT treatment of vouchers, it is necessary to consider whether there is something being provided by way of goods or services, whether some discount is being provided or whether the service is merely a payment medium. Each of these services has an implication for the VAT treatment.

Vouchers fill the spectrum between event entrance tickets and payment media such as cash, cheques, credit and debit cards. At both edges of this spectrum the distinction can be difficult. While everyone can recognise a voucher in the form of a gift voucher (in either traditional paper or modern electronic form), the distinction between a theatre ticket purchased on theatre entry and a voucher for an identical seat provided as part of a holiday package is difficult. At the other end of the spectrum the money loaded on to a Pay As You Go mobile phone by a top up voucher can increasingly be used to make non-telecoms purchases. These can vary from the purchase of ringtones to TV voting lines, weather lines, to car parking space and the weekly shop. Payment can be made via premium rate calls, premium SMS or increasingly more sophisticated systems that charge straight to the customer’s bill making use of the banking interchange system (the platform used by credit and debit cards). Many of these services are in direct competition with services provided by banks but their starting point is often some form of voucher.

In order to ensure a smooth operation of the Single Market and equal treatment for all businesses trading across the EU, the VAT Directive lays down the agreed rules to ensure a harmonised approach to the questions about how much VAT to charge, when it should be declared and to which tax jurisdiction the tax should be paid to.

However, vouchers present difficulties to all these questions. Even though a voucher may permit a purchase at a set price, the voucher itself may be sold at a reduced price (or may be free). Long distribution chains can disrupt the information flow, to the extent that the redeemer of a voucher may have no knowledge of how much has been paid for the voucher. Furthermore, sales across borders, particularly via the internet, can cause confusion as to which Member State is entitled to receive the tax. As a result of these difficulties, it is clear that in some cases no tax is charged and in others tax is charged twice.

Where vouchers are issued for consideration, some Member States define the taxable amount as the total received from the consumer, some as the face value of the voucher and some as the amount attributed to an actual supply made to the consumer, allowing non-taxation where there is no use of the voucher. Increasing cross border use of vouchers and cross border distribution and the
differences in treatment between Member States is one of the main causes of double or non-taxation. There is nothing in the existing EU VAT legislation that addresses this.

The Commission has been trying to introduce new legislation for many years but has had great difficulty in reconciling the differing approaches taken by Member States to produce a standard VAT treatment that Member States are likely to agree to. At the same time the products are becoming increasingly complex and businesses are continually introducing new products. While there may be several shortcomings in the Commission Proposal, we think that it should be welcomed in broad terms. It is addressing issues that need to be addressed if VAT is going to work smoothly across the Single Market.

With the ability to start with a blank sheet of paper, the Commission has been able to set out a very straightforward approach to the problems. The concepts of Single Purpose Voucher (SPV) and Multi Purpose Voucher (MPV) and the capture of VAT on the distributions systems described in the Proposal seem very clear-cut. However along with other Member States, we need to examine it in detail before providing a certain view as to the practicality and effectiveness of the changes suggested and we need to be clearer as to how these new rules fit with the existing rules.

My comment about unhelpful ideas and erosion of national sovereignty was directed towards the text of the new Article 30a(2) that suggests that a reference to the EU Directive 2007/64 (Payment Services) was sufficient to identify a payment service in the context of vouchers. As an amendment to that Directive would be agreed under the qualified majority voting procedure, it could result in a consequential amendment to VAT law not being subject to unanimous agreement. We have already signalled that such references are not acceptable and indeed, several Member States have already agreed with us.

You also ask for further detail about recent changes to UK law to prevent tax avoidance. As a result of the recent Lebara CJEU case that concerned the treatment of phonecards, the UK was forced to make urgent changes to the UK VAT treatment of vouchers in the Finance Bill 2012. This was because the CJEU found that tax was due on issue of the vouchers in question. In effect they are seen by the Court as similar to SPVs in the Commission’s Proposal and the current changes to UK law in this year’s Finance Bill go in a similar direction to the Commission’s Proposal. Indeed, the Lebara case in itself will cause some alignment of diverse treatment across the EU. The change in UK law was necessary to correct the potential tax loss arising from the fact that under EU law, VAT on such vouchers would be due at issue, whereas, unless corrected, under UK law tax would be due on redemption. In practice this could have allowed some vouchers to escape VAT altogether. The change requires VAT to be accounted for at issue when a voucher is for a single product, where the rate and place of supply is known.

I hope that this response assists the Committee in its debate on the Proposal. As indicated above, there is still some uncertainty about the detail in this Proposal but we expect to clarify several aspects during discussions in Brussels.

11 July 2012

Letter from the Chairman to David Gauke MP

Thank you for your letter, dated 11 July 2012, on EM 9926/12 on the proposal to amend the Directive on the common system of VAT as regards the treatment of vouchers. The House of Lords European Union Sub-Committee on Economic and Financial Affairs considered this document at its meeting on 24 July 2012.

We are grateful for your response to our questions. We note your response to our concern that the proposal may overcomplicate the issue and your belief that the proposal should be welcomed in broad terms. Is it not true that when vouchers are used, VAT is self-adjusting, but when they are not used, VAT does not apply? How would you justify the approach taken by the Commission? In addition, what is your assessment of the impact of the increase in the volume of online transactions on applying VAT to vouchers?

We also note your objection to a consequential amendment to VAT law not being subject to unanimous agreement. You have stated that you have made clear that such references are not acceptable and that several Member states have already agreed with you. Do you therefore anticipate that changes will be made to the text of the proposal to reflect your concerns?

We also note your statement that there is still some uncertainty about the detail of the proposal, and that the Government will need to examine the proposal before coming to a final view as to the
practicality and effectiveness of the changes proposed. We would be grateful if you could keep us informed of the Government’s emerging view as negotiations continue.

We would be grateful for updates as negotiations progress. In the meantime we have agreed to clear the document from scrutiny.

24 July 2012