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 1 December 2010 to 31 May 2011.

ECONOMIC AND FINANCIAL AFFAIRS AND INTERNATIONAL TRADE (SUB-COMMITTEE A)

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In light of the political agreement on the Alternative Investment Fund Managers Directive (AIFMD) 1 thought it would be helpful to provide this Committee with an update on the final outcome, and how this compares to the Council’s general approach and the European Parliament’s committee positions.

As you are aware, the Council of Ministers reached a general approach on the AIFMD at the 18 May ECOFIN, which gave the Presidency a mandate to start negotiations with the Parliament. At this ECOFIN the Chancellor secured a minute statement that noted that some Member States still had concerns with certain aspects of the Council text, particularly in respect of the treatment of third countries, and called for the Presidency to take these into account when entering trilogue negotiations.

Throughout the trilogue discussions the question of third country funds’ and managers’ access to the EU continued to be the most contentious issue. The European Commission and the European Parliament both supported the extension of the European passport to third country managers and funds, while a majority of the Member States continued to oppose it. However, this was by no means
the only contentious issue and there were a number of other proposals that would have had a significant impact on UK interests, such as the provisions on depositary liability and proposals to bring passive marketing within the scope of the Directive.

Following intense discussions, political agreement was reached in ECOFIN on 19 October, with all Member States supporting the final text. The European Parliament voted in favour of this text, with some relatively minor amendments, on 11 November. Following translations and consideration by legal experts, the final text is likely to be formally adopted in the second quarter 2011. Member States will then be given two years to transpose the Directive into national law. In the interim, the Commission will – in consultation with national governments, regulators, the European Securities and Markets Authority (ESMA) and the European Parliament – draw up detailed implementing measures which will also need to be implemented to the same timescale.

THIRD COUNTRY PROVISIONS

As you are aware, the Government’s strongly held view throughout these negotiations was that all AIFMs – irrespective of their or their funds’ domicile – should be entitled to an EU marketing passport. This Government believed that this was essential in order to allow firms to realise the full benefits of the single market, and meet the G20 Commitment for financial regulation to be implemented in an internationally consistent and non-discriminatory way.

This view was strongly contested by others, who argued forcefully to restrict the passport to EU managers of EU funds – as set out in the ECOFIN general approach. In spite of this opposition, the Government engaged actively with other Member States, the Presidency, European Commission and Members of the European Parliament, and successfully argued for extending the passport to all managers and funds irrespective of their domicile. The final text therefore includes a provision for the passport for third country managers and funds to be introduced. Two years following the end of this transposition period, ESMA shall assess the functioning of the EU passport and advise the Commission on whether the passport should be extended to third country managers and funds. On the basis of positive advice from ESMA, the Commission shall extend the passport to third country managers, and managers of third country funds, through delegated acts. This will allow UK managers (many of whom use third country funds) to passport to EU investors without recourse to individual supervisors. It also ensures that the EU meets its G20 commitments of non-discrimination.

Whilst the extension of the passport to third countries was key for UK interests, the Government was also conscious that this was a new marketing regime, hitherto untested in this industry. The Government therefore strongly argued that national private placement rules – which provide a regime under which third country domiciled/managed funds can be marketed to EU investors on the basis of national rules – should be allowed to run in parallel, until such time as the passport could be proved to be a workable and effective alternative. The Government also considered that a premature termination of national private placement regimes would potentially negatively impact on UK investors’ access to third country AIFMs – affecting investment returns – and hinder funds in developing countries in particular from marketing to EU investors.

The European Commission and the European Parliament in particular strongly argued in favour of an immediate end to national private placement regimes. However, the Government successfully argued that prematurely terminating national private placement risked damaging EU investor access to third country AIFMs at a time when affected industries were adapting to the Directive’s new rules. As part of the final political deal, national private placement regimes are maintained on implementation. The provisions on national private placement in the Directive only provide for minimum harmonisation and therefore allow Member States to impose stricter rules if they wish. The Directive requires that third country managers of third country funds comply with the requirements on transparency and private equity disclosure, that there are appropriate cooperation arrangements in place between the supervisor of the third country manager and fund and the EU supervisor and finally, the third country where the fund and manager are domiciled must not be listed as a non-cooperative country by the Financial Action Task Force on anti-money laundering and terrorist financing. For EU managers of third country funds, there are equivalent provisions but EU managers must comply with all the requirements of the Directive except for the detailed provisions on depositaries.

National private placement regimes may only be terminated a minimum of three years after the marketing passport has been extended to third country managers and funds (as outlined above). After this period has elapsed, ESMA shall assess the functioning of the third country passport and issue advice on terminating the national private placement regimes. In formulating its advice, ESMA shall consider, inter alia any potential negative effect on investor access or investment in or for the benefit
of developing countries. ESMA’s terms of reference had previously been cast more narrowly, focusing more on questions such as systemic risk, which risked leading to an unbalanced assessment that neglected these important considerations. If ESMA considers that there are no significant obstacles to terminating the national private placement regimes, the Commission do so through delegated acts. It should be added that if, for some reason, the Commission does not exercise its delegated act to extend the passport to third country managers and funds, then it cannot exercise its delegated act to end national private placement regimes.

The deal brokered on third countries represents a very significant advance for UK interests when compared to the Commission proposal, EP proposals and ECOFIN general approach. The structure of regulation agreed meets the G20 commitments which was an extremely important objective for the Government and benefits the UK in particular as a global centre for alternative investment fund management.

**DEPOSITORY REQUIREMENTS**

(i) **Level of liability**
There is now a more proportionate level of liability for depositaries than provided for in the previous Council text. The ECOFIN general approach would have required a high level of liability to be placed on depositaries that would have increased costs on affected industries, potentially increased systemic risk (by requiring banks to take on liability for loss of assets outside of their control), and would have been disproportionate. The Government successfully negotiated a level of liability that is workable and more appropriate for the AIFM industry, and professional investors. Again, this was in spite of significant support for a very high level of liability. Liability can in some instances and subject to contract also be transferred to a sub-custodian where the depositary has delegated the custody of some of the assets: this is an important provision to allow continued investment by AIFs in emerging markets (many of which require the appointment of a local sub-custodian).

(ii) **Scope of the depositary requirements**
The agreed text requires all EU AIFM managing an EU fund to use a single EU depositary. However, the agreed text limits the extent to which the depositary rules apply under national private placement regimes (as this is minimum harmonisation and Member States are free to impose stricter requirements). Member States would therefore retain discretion to disapply most of the depositary rules to EU managers of third country funds who use private placement – the Directive only requires the manager to ensure that it has in place entities to carry out the depositary functions of safe-keeping, administration and the monitoring of subscriptions and redemptions. In this way these managers can broadly continue with their current operational structure until such time as the private placement regime is reassessed. This is particularly significant to the UK, as a large number of UK managers use funds in third countries.

(iii) **Non-EU depositaries allowed for non-EU AIF**
The text requires an EU AIF to have a single depositary established in the same Member State as the AIF. For a non-EU AIF the depositary may be an entity established in the third country where the AIF is established, or in the home Member State of the manager or in the Member State of reference of the manager. A third country depositary can only be appointed if it fulfils a number of requirements, inter alia that the third country’s legislation on depositaries provides for effective prudential regulation and supervision which are to the same effect as the provisions laid down in European Union law and that appropriate supervisory cooperation arrangements are in place. This provides sufficient flexibility whilst providing a higher regulatory standard for non-EU depositaries than at present.

**PRIVATE EQUITY**
The European Parliament proposed a range of requirements that would have had a detrimental effect on the private equity industry, and would have risked depriving firms of much needed capital during economic recovery. The Council resisted proposals to bring acquisitions of SMEs into scope, to ban leveraged buyouts and to introduce disproportionate reporting requirements on private equity firms acquiring a stake in unlisted companies.

The Parliament also proposed to apply the capital adequacy regime under the Second Company Law Directive to a target company acquired by a private equity fund. This was also resisted by the Council as it would have competitively disadvantaged private equity compared to other ownership structures. As a compromise, the final text does, however, include provisions to prevent asset stripping of the
target company, which is a far more proportionate response to the EP's stated policy intent of encouraging private equity to take better account of the interests of the target company and its employees.

The final text requires notification to be made by the AIFM to the supervisor, of major holdings in target companies when the proportion of voting rights reaches or exceeds 10%, 20%, 30%, 50% and 75%. When control of a target company is acquired (50% of a non-listed company and for issuers control as defined in Article 5(3) of Directive 2004/25/EC on take over bids) the AIFM shall notify and disclose certain information to the target company, its shareholders and the supervisor. The AIFM shall request that the board of directors of the target company also pass the information on to the employees. These measures are far more proportionate than those proposed by the European Parliament.

DELEGATION

The Directive imposes requirements on an AIFM that delegates the function of portfolio or risk management, administration, marketing and activities related to the assets of the AIF. There must be an objective reason for the delegation and it must be notified in advance to the supervisor. Specific rules apply when portfolio or risk management is delegated, for instance, where the delegation is given to a third-country undertaking, cooperation between the supervisor of the AIFM and the supervisor of the third country undertaking must be ensured.

Many of Parliament’s proposals were burdensome and could have forced significant organisational changes in the industry e.g. they proposed restricting delegation of key functions only to other EU AIFMs and only allowing delegation to third country entities in respect of non-EU assets. The EP’s more damaging proposals were not successful and the Government believes that the final text represents a balanced approach.

LEVERAGE

The topic of leverage caps was controversial, with the European Parliament proposing to give ESMA a significant role in this process and allowing it to set leverage caps on individual firms. The Government argued that the power to set leverage caps was best placed with national supervisors, considering their better understanding of their domestic market.

The final text represents a reasonable compromise and requires AIFM to set maximum levels of leverage in respect of each AIF it manages. Supervisors shall use the information on leverage provided by the AIFM to assess the overall level of leverage in the system and associated risks. If the supervisor considers it necessary, it may introduce limits to the levels of leverage employed by a particular AIFM. The leverage information collected by the national supervisor shall be shared with other supervisors and EMSA. ESMA can, where it considers there is a substantial risk to stability and integrity of the financial system, advise national supervisors on remedial measures. Where the supervisor decides not to follow the advice given by ESMA, it shall give reasons for this.

SCOPE

The final text introduces a threshold which is not, as in the earlier Council proposal, to the discretion of Member States. The Directive shall only apply to AIFM which manage portfolio of AIF whose assets under management in total do not exceed a threshold of EUR 100 million. The threshold is EUR 500 million when the AIF are not leveraged and have no redemption rights exercisable during a period of 5 years following initial investment. There are also exemptions for those firms who will be exiting the industry relatively shortly after the end of the transposition period.

The final text usefully clarifies that holding companies and joint ventures are not caught by the Directive. However, the exact scope of the Directive is not entirely clear and will need to be determined in the national implementation of the Directive.

This Directive will not introduce any restrictions on passive marketing as the European Parliament had proposed. The Government argued that rules on passive marketing would be disproportionate and unworkable. This Directive will consequently only regulate active marketing and passive marketing rules will remain at the discretion of national supervisors. As a compromise, it was agreed that a future review would consider the issue of passive marketing.
**REMUNERATION**

The Directive will impose restrictions on the amount and form of remuneration that an AIFM can pay to certain categories of staff. The AIFM shall apply the rules in a way that is consistent with the size, internal organisation and nature, scope and complexity of the activities. Some key requirements include that at least 40% and, in some cases, 60% of variable remuneration must be deferred over at least three years. There is also a requirement that at least 50% of variable remuneration is paid in units or shares in the relevant AIF which should also be subject to an appropriate retention policy. The scope of the provisions also extends to carried interest and includes provisions on claw-back arrangements.

As I mentioned in my previous letter, the Government was in favour of the Council position. The final text represents a compromise between the Council and Parliament text but, crucially, contains the proportionality provisions agreed in the Capital Requirements Directive.

**SHORT SELLING**

While the Council general approach did not include any restrictions on short selling, the Parliament proposed to amend the Market Abuse Directive. The Government is pleased that the final text does not include any provisions on short selling as this would have risked creating a unlevel playing field. As the Committee is aware, on 15 September the Commission adopted a proposal for a harmonised regime on short selling, which the Government believes is the more appropriate legislative instrument for such policy considerations.

**ROLE OF ESMA**

The role of ESMA in relation to the AIFMD was also a hotly debated topic. The Government was committed to ensuring that ESMA’s role should not be extended in the AIFMD beyond what had been agreed in the package on financial supervision. Other Member States argued that giving ESMA direct supervisory powers should be a precondition for extending the passport to third country managers. According to the agreed text ESMA has been given power to adopt technical standards and guidelines in a number of areas, for example, the minimum content of the cooperation arrangements between supervisors. It may also act as a mediator, in particular in cases where one Member State disagrees with the assessment of another Member State on whether certain criteria are fulfilled in relation to third countries. ESMA will receive information from national supervisors, have a coordination function and give advice to supervisors, in particular on levels of leverage. Crucially, ESMA’s powers in respect of direct interventions are extremely limited— the agreed text stipulates that ESMA may request supervisors to take action against individual third country managers where there is a substantial threat to the functioning and integrity of the financial market or to the stability of the financial system and the supervisor had not at its own initiative taken such measures or they have not been sufficient. This is within the scope of the broad powers conferred to ESMA as part of the package on financial supervision.

**REVIEW**

The text provides for a review of the Directive four years after the end of the transposition period. The Commission shall base its review on public consultation and discussions with competent authorities. The review shall analyse the Directive’s impact on investors, on AIF and AIFM, both inside and outside the EU and how far the objectives of the Directive have been achieved and, if necessary, propose appropriate amendments. The text specifies a number of issues that the Commission should consider in its review and includes the impact on investor access and the impact on investment in or for the benefit of developing countries, which in the Government’s opinion, are extremely important elements of the review.

**LEVEL 2**

The AIFMD will include extensive Level 2 and 3 provisions. The Commission shall adopt delegated acts in a number of areas and in particular on operating conditions, organisational requirements, delegation and leverage. Also, the Commission shall adopt delegated acts in relation to the depositary rules and in particular, decide on whether the prudential regulation and supervision in third countries is equivalent to that which applies to EU depositaries. There is also extensive power granted to ESMA to adopt technical standards and guidelines. The Government, working closely with the FSA, will...
continue to argue for an outcome of the level 2 process that is workable and proportionate and does
not put UK industry at a competitive disadvantage.

I hope that the Committee has found this a helpful summary of the outcomes on the key issues of the
Directive.

28 January 2011

Letter from the Chairman to Mark Hoban MP

Thank you for your letter on the Alternative Investment Fund Managers (AIFM) Directive dated 28
January 2011. The EU Economic and Financial Affairs and International Trade Sub-Committee
considered this document at its meeting on 5 April.

We welcome your comprehensive update on the AIFM Directive. The final shape of the Directive
does not make all the changes the Committee concluded were necessary in our report on the AIFM,
but we agree that it is a better outcome than the Commission’s initial proposal. We understand that
much of the final impact of the AIFM Directive will depend on the nature of the delegated acts
adopted by the Commission and ESMA and we welcome your engagement in the process.

We do not require a response to this letter.

06 April 2011

AMENDING ARTICLE 136 TFEU

Letter from the Chairman to the Rt. Hon David Lidington MP, Minister of State for
Europe and NATO, Foreign and Commonwealth Office

Thank you for Explanatory Memorandum EUCO 33/10 on a Draft Council Decision on amending
Article 136 of TFEU, and your letter, dated 22 December, on the same matter. The EU Sub-
Committee on Economic and Financial Affairs and International Trade considered these documents
at its meeting on 1 February.

We fully support your view that it is in the UK’s interest to support a stable and prosperous
Eurozone. Given that this Treaty amendment would not apply to, or have any financial risks for, the
UK, we support your intention to vote in favour of this amendment. We have agreed to clear this
document from scrutiny.

We do not require a response to this letter.

1 February 2011

AMENDING BUDGET NO 1 AND A MOBILISATION OF THE EU SOLIDARITY FUND
(5330/11, 5331/11)

Letter from the Chairman to Justine Greening MP, Economic Secretary, HM Treasury

Thank you for your Explanatory Memorandum on documents 5330/11 and 5331/11, and your letter,
dated 1 March 2011, on Draft Amending Budget No 1 and a Proposal to mobilise the EU Solidarity
Fund. The EU Economic and Financial Affairs and International Trade Sub-Committee considered
these documents at its meeting on 8 March.

We recognise your support for the mobilisation of the EU Solidarity Fund (EUSF) in this case, and
your view that these funds should be found within the existing 2011 budget. We support your efforts
to restrain any growth in the overall size of the EU Budget 2011 at a time when Member States’
budgets are under intense pressure.

Your letter indicates that the debate has rather moved at this point, and now focuses on the use of
the negative reserve. You state that you oppose the use of the negative reserve, but do not give any
arguments beyond arguing that the reprioritisation of funds could take place immediately. It does not
seem to us that there is any harm in allowing the Commission to reallocate the funds at a later date –
indeed their argument that this would allow them to see better where implementation rates are low.
or where funds are being under-spent seems reasonable. It may help ensure that the reallocated funds are not those which could best be used elsewhere.

We understand that these proposals will be adopted at ECOFIN on 15 March, so we have agreed to clear these documents from scrutiny. We would, however, appreciate a response to this letter within the standard ten working days.

8 March 2011

Letter from Justine Greening MP to the Chairman

Thank you for your letter of 8 March. I am writing to provide an update on progress on Draft Amending Budget (DAB) No 1. I note and welcome that the Lords EU Economic and Financial Affairs and International Trade Sub-Committee cleared the proposal at its meeting on 8 March. You state that your Committee sees no harm in using the negative reserve, thereby allowing the Commission to reallocate funds at a later date. The Government continues to favour clarity now on reprioritisation, to avoid the risk that this decision is unnecessarily complicated by other budgetary issues later in the year.

As scheduled, the Council adopted its position, by qualified majority, on Draft Amending Budget No 1 at ECOFIN on 15 March, agreeing to finance the necessary funds using the negative reserve. The Government abstained for two reasons. First, an abstention best reflects the Government’s support, in principle, for using the EU budget to assist recovery in the flood-damaged Member States concerned but also its concerns regarding use of the negative reserve. Second, an abstention best accommodates the divergent positions of the Lords European Union Committee and the House of Commons European Scrutiny Committee. Whilst your Committee has cleared the proposal and expressed an understanding of the merits of delaying reprioritisation until later this year, the Commons Committee has encouraged the Government to continue to resist use of the negative reserve as it favours reprioritisation now, and continues to scrutinise Draft Amending Budget No 1.

The Council’s position will now be forwarded to the European Parliament for it to consider.

18 March 2011

Letter from the Chairman to Justine Greening MP

Thank you for your letter, dated 18 March, on Draft Amending Budget No 1 and a proposal to mobilise the EU Solidarity Fund. The EU Economic and Financial Affairs and International Trade Sub-Committee considered this document at its meeting on 3 May.

We note your reasons for abstaining from the vote adopting Amending Budget No 1 at ECOFIN on 15 March, and we welcome the decision to ensure the funds for the mobilisation of the EU Solidarity Fund come from within the 2011 EU Budget.

Amending Budget No 2 was cleared at Chairman’s Sift on Monday 4 April, but we note that it also proposes a mobilisation of the EU Solidarity Fund through an overall increase to the 2011 EU Budget. We again support the Government efforts to ensure that this funding comes from reallocation of existing resources.

We do not require a response to this letter.

04 May 2011

COMMON CONSOLIDATED CORPORATE TAX BASE (7263/11)

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

Thank you for your Explanatory Memorandum 7263/11 on a Commission proposal for a Common Consolidated Corporate Tax Base and a Supplementary Explanatory Memorandum on the subsidiarity aspects of this proposal. The EU Economic and Financial Affairs and International Trade Sub-Committee considered these documents at its meeting on 3 and 10 May.

We note that you “will not agree to a proposal that might threaten or limit our ability to shape our own tax policy”. Given that the Commission’s proposal for a CCCTB will inevitably impact on the UK’s corporate tax policy, and in particular the Government’s ability to set the UK corporate tax
base, does this mean that the Government will be opposing this proposal in Council? Since matters concerning national tax have to be decided by unanimity, is the Government considering using its veto in this case?

You raise concerns about the Commission’s impact assessment, stating that there are “significant shortcomings” to it “as a whole”. In what way do you feel the impact assessment is inaccurate? In what areas, in particular, would the Government reach different conclusions?

We are concerned that the Commission’s impact assessment does not make a convincing case for the need for a CCCTB. In particular, we note that in the short-term the CCCTB would have a detrimental effect on employment, investment and GDP. This proposal seems badly timed given the difficult fiscal circumstances of many Member States. Are you surprised that the impact assessment concludes that the short-term impact of the proposal would be largely negative? Does the Government believe that a CCCTB would bring long-term benefits to the UK? Has any attempt been made to quantify these longer-term benefits?

You state that informal cooperation and bilateral agreements could take the place of the CCCTB proposed by the Commission – why do you believe these mechanisms would be as effective as a CCCTB? If the CCCTB proposal goes forward, would it replace all the existing bilateral agreements that currently govern corporate tax arrangements between Member States, or must these be kept in place for those companies which chose not to opt-in to the CCCTB? What impact would this proposal have on the OECD’s role in transfer pricing?

What impact might this proposal have on countries that rely heavily on tax competition to promote investment, such as Ireland? We note that the Commission’s impact assessment estimates that Ireland would suffer a 3% decline in GDP as a result of this proposal – the largest decrease among EU Member States. Why is this? Would implementing this proposal now put more strain on Ireland’s already weak economy?

You note that running two separate tax systems would increase costs. Has any estimate been made of the scale of these increased costs?

We would also be interested to know what businesses in the UK think about this proposal: what representations has the Government received on this subject?

Finally, we note that your EM comments on the proposal’s “potential impact” on companies, particularly “if taken forward by a smaller group of Member States under enhanced cooperation”. What might be the “potential impact” on companies? What might be the consequences for the UK if this proposal was taken forward through enhanced cooperation, perhaps by those Member States who have signed up to the Euro Plus Pact?

We have agreed to hold this document under scrutiny, and we would be grateful for a response to this letter in the standard ten working days.

10 May 2011

Letter from David Gauke MP to the Chairman

Thank you for your letter concerning the EU Commission proposal for a Council Directive on a Common Consolidated Corporate Tax Base (CCCTB), which raises a number of important issues.

No date for a Council discussion of this proposal has been set. To date, there have been two working group discussions on the proposal. In these early meetings, while a few Member States expressed support for the proposal, a number of Member States expressed concerns, and it has been clear that there are many questions that need to be addressed concerning the substance of the proposal and its overall effects.

On the question of whether the UK would adopt the CCCTB, I can assure you that we will not agree to any proposal that would jeopardize our ability to shape our own tax policy and stop us from achieving our objective of creating the most competitive corporate tax regime in the G20.

On the veto, as you will appreciate, the advent of enhanced co-operation under the Lisbon Treaty means that a Member State veto does not automatically lead to a unanimity proposal being blocked. Rather, it can mean the discussion of the proposal moving from the EU 27 to a smaller grouping. Given that the adoption of a CCCTB by such a smaller grouping would still have implications for the UK and for UK business, I judge it to be very much in our interests to participate fully in the discussion of the proposal in the EU 27, and not to precipitate a premature move to enhanced co-operation.
You asked whether the Government feels the Commission’s Impact Assessment is inaccurate. The Government does not think the Impact Assessment is inaccurate, rather we would question some of the assumptions underpinning its findings and believe that there are significant omissions concerning associated costs which may further reduce any purported benefits.

For example, one assumption made is that all EU multinational groups would opt for an optional CCCTB. We do not believe that this would be the case, rather only companies who benefit from the proposal would be likely to join. This means that the revenue impact of the proposal is likely to be underestimated.

Another assumption that we would question is that the proposal would result in a 100% reduction in compliance time and costs for setting up a new subsidiary relating to transfer pricing documentation. We believe that companies would still have to deal with transfer pricing rules for transactions to and from entities in non-CCCTB countries.

We also believe that the failure to include a quantification of the amount of time and resources that companies would have to devote to deciding whether or not to opt into the CCCTB under an optional system is a major omission on the cost side. Taking account of these costs is crucial to understanding whether or not a CCCTB could actually reduce compliance costs.

Furthermore, the Impact Assessment does not include an assessment of the increased costs to tax administrations associated with running two separate tax systems.

You questioned whether the Government believes that a CCCTB would bring long-term benefits to the UK. The Government believes it remains important that Member States retain the flexibility to shape their tax policy to suit their own economic circumstances and compete in a global environment. I do not believe relinquishing this flexibility would be of long-term benefit to the UK. You also asked whether any attempt has been made to quantify long-term benefits to the UK. The proposal and accompanying Impact Assessment do not contain sufficient detail to allow a sensible estimate to be made of the long-term impact. Indeed, the Commission makes no attempt to quantify the improvement of the overall macroeconomic performance in the medium and longer term in the EU that it maintains can be expected. We would expect the Commission to make a quantitative assessment of the long-term impact of the proposal.

Turning to your question on whether the Government has made an estimate of the increased costs to tax administrations associated with running two separate tax systems. The Government has not made a quantitative assessment of these costs, although notes there will be both one-off costs associated with the implementation of a new system and running costs. The Government believes the Commission should produce a fuller assessment on this issue.

You asked whether I am surprised that the Impact Assessment concludes that the short-term impacts of the proposal are largely negative. I am not overly surprised, given that the CCCTB as proposed would lead to a widening of the corporate tax base. However, I am surprised the Commission would choose to bring forward a proposal which would have a largely negative short-term impact, particularly at a time when the EU should be prioritising growth.

You queried why I believe informal cooperation and bilateral agreements would be as effective as a CCCTB in addressing the cross border taxation issues the Commission has identified. The UK is involved in a wide range of EU and other international working groups, fora, cross border agreements and initiatives which tackle these issues:

— The EU Joint Transfer Pricing Forum which looks at transfer pricing issues relating to intra group EU cross border transactions;

— The EU Arbitration Convention which eliminates double taxation arising from transfer pricing adjustments between tax administrations of MSs in respect of individual companies;

— The UK’s network of Double Tax Treaties, which covers all EU Member States and which set out mechanisms for allocating taxing rights to minimise the double taxation of companies, and structures for reaching agreement on double taxation relief and exchange of information; and

— The Mutual Agreement Procedure framework for tax administrations to resolve cross border disputes related to tax, including transfer pricing.
The view of the Government is that, taken together, these measures are effective and established methods of resolving cross border taxation issues. Furthermore, they do not involve the uncertainty and complexity associated with an optional CCCTB.

You queried whether a CCCTB would replace all existing bilateral agreements between Member States. As the CCCTB proposal is currently drafted, existing bilateral agreements would still apply to matters relating to companies not opting into the CCCTB.

You also questioned what impact the proposal would have on the OECD’s role in transfer pricing. Guidance on the internationally agreed transfer pricing principle is developed by the OECD. Therefore for a group of companies operating exclusively within a CCCTB regime, where that principle would not apply, the role of the OECD would be diminished. However, the application of OECD guidance will remain necessary for intra-group transactions where at least one group company is outside a CCCTB regime. As such, I do not expect the OECD’s role to change.

You asked about the impact on countries, such as Ireland, that rely heavily on tax competition to promote investment. The proposal would limit Ireland’s ability to define its tax base. Given tax competition is about both the rate and the base, this could constrain Ireland’s ability to compete for investment. The definition of the corporation tax base is important, as it determines the burden placed on businesses to compute their liabilities and also the scope and reach of the tax system. As you note, the Impact Assessment shows Ireland suffering a 3% fall in GDP. In the case of Ireland, it has chosen its rate and base to make it an attractive location for international investment, and as such has been successful in attracting financial and intangible assets. These types of assets are largely not included in the apportionment formula that would be used to redistribute taxing rights between participating Member States. The apportionment formula takes account of sales, payroll, the number of employees and fixed tangible assets. As such, the Impact Assessment predicts Ireland would lose significant tax revenues. You also asked whether implementing the proposal now would put more strain on Ireland’s economy. As you have highlighted, the Impact Assessment shows Ireland suffering a substantial fall in GDP. It will of course be for Ireland itself to decide whether or not to participate in a CCCTB.

Turning to your query as to what representations the Government has received from businesses in the UK on the proposal. We have received a range of views from UK businesses. In general, business has not been actively calling for this proposal. Some bodies, such as the CBI, have welcomed the proposal, and in particular the prospect of allowing for cross-border loss consolidation and the potential for eliminating cross-border transfer pricing issues. However they have stressed that their support depends on the optional nature of the proposal. Others have expressed concerns about potential compliance and administrative costs, and the lack of certainty over how some aspects of the system would work. Some have even gone as far as stating that a CCCTB would add nothing but complexity and cost. We are continuing to engage with Business Representative Bodies and interested parties.

You asked about the potential impact on companies if the proposal is taken forward by a smaller number of Member States under enhanced cooperation. UK companies with permanent establishments in the Member States taking forward an optional CCCTB (the Commission’s preferred option) under enhanced cooperation would be affected by the proposal. They would have to devote resources to deciding whether or not to opt into a CCCTB, and also to monitoring whether they would be better off in or out. This could actually result in an increase in complexity and compliance costs, placing burdens on UK businesses. As I have previously highlighted, the Commission’s Impact Assessment makes no attempt to quantify these costs.

You also asked about the potential impact on the UK if the proposal is taken forward by a smaller number of Member States under enhanced cooperation. Any CCCTB taken forward by a smaller group of Member States could pose a risk to the UK’s ability to collect tax by offering opportunities for UK businesses to avoid UK tax. If the proposal is taken forward under enhanced cooperation, we will seek to ensure it does not place undue burdens on UK businesses, or pose a risk to the UK’s ability to collect tax.

As I am sure you are aware, the House of Commons has concluded that the proposal does not respect the principle of subsidiarity, and has issued a Reasoned Opinion to the EU institutions.

I will of course keep you and the Committee updated on the progress on negotiations on the proposal.

I hope you find this information helpful.

20 May 2011
Letter from the Chairman to Mark Hoban MP, Financial Secretary, HM Treasury

Thank you for your letter on the recast of the Deposit Guarantee Scheme Directive (EM 12386/10). The EU Economic and Financial Affairs and International Trade Sub-Committee considered this document at its meeting on 30 November.

As we stated in our initial letter, we support the objectives of this recast to maintain financial stability by preventing bank runs and protecting depositors’ savings. We are grateful for your comprehensive response to the issues raised in our previous letter. We do, however, have further questions about the mutual borrowing facility.

We note your concerns that the obligation to lend between deposit guarantee schemes could lead to contagion and have, potentially, destabilising consequences for the financial system. However, the crisis has raised important issues about the ability of governments to underwrite deposit guarantee schemes and to fulfil their obligations under the Deposit Guarantee Schemes Directive (as in the case of Iceland).

The solution provided by the home country safety net proved insufficient in this case. Given the Government’s concerns about mutual borrowing facility schemes, what alternatives do you have in mind to ensure that depositors are protected irrespective of the place the deposits are held, and in case of cross-border banks? To what extent can the natural tendency of countries to protect their own depositors be reconciled with the need to establish a system of deposit guarantee schemes in line with the single market? What is your view on suggestions that ultimately there should be an EU-wide deposit guarantee scheme?

We would like to know how matters develop in negotiations, and the position of the European Parliament on these issues. We would also be interested to know the views expressed in working group discussions on controversial items such as the level of pre-funding required and the reduction to seven days of the deadline for schemes to reimburse depositors.

In the meantime, we will continue to keep the proposal under scrutiny. We would be grateful for a response within the standard ten working days.

6 December 2010

Letter from Mark Hoban MP to the Chairman

Many thanks for your letter of 6 December.

The recast of the Deposit Guarantee Schemes Directive includes a number of requirements, separate from mutual borrowing, that are designed to promote robust schemes across the EEA. The implementation of these requirements is designed to ensure greater financial stability and increased protection, for both domestic and cross-border depositors, and avoid a repetition of the situation in Iceland in 2008.

In order to ensure that schemes are robust the Directive includes requirements for better stress-testing, transparency and peer review processes, which will enable member states to challenge each other’s schemes. These measures will help to single out weak schemes and advantage UK depositors with EEA cross-border deposits. The UK has also been pushing for schemes to have good corporate governance, by requiring them to have open and transparent board appointment procedures; non-executive participation on boards; and mandating schemes to publish an annual report.

You asked about how the need of member states to protect their own depositors can be reconciled with the aims of the single market. It is of course important for member states to protect their own depositors, but often this is best done through EU single market mechanisms. By harmonising the coverage limit across member states, UK depositors are guaranteed up to the same level, no matter if they keep their deposits with a UK or cross-border bank. It also has the advantage of diminishing cross-border distortions caused by differences in coverage levels. In addition, harmonised payout requirements of schemes mean customers will have the same experience if their bank fails no matter which member state their deposits are based in.

However, there are limits to what harmonised measures can achieve. Although the Government supports sound, well-functioning deposit guarantee schemes throughout the EU, we do not support an EU level deposit guarantee scheme. We believe that member states should have a level of flexibility.
to ensure that they adapt their schemes to the requirements of their financial services industry. An EU scheme would not allow the UK, or other member states, to do that. It would also mean that UK institutions would be liable to contribute to costs of failures in member states with less stable financial sectors. This would be likely to lead to increased levies for UK institutions, and these costs could be passed on to customers or translate into reduced lending or capital accumulation.

You asked for an update on progress on the dossier in the European Parliament. The EP has announced a timetable for its work on the Directive. They will release a draft report in February 2011 and plan a vote in the ECON committee in April. Officials have had initial conversations with interested MEPs on this matter.

Negotiations in Council have been progressing with working groups in November and December. We expect these to continue into the Hungarian Presidency. I am happy to continue to keep you updated on further progress in the EP and in Council.

16 December 2010

Letter from the Chairman to Mark Hoban MP

Thank you for your letter on the recast of the Deposit Guarantee Scheme Directive (EM 12386/10) dated 16 December 2010. The EU Economic and Financial Affairs and International Trade Sub-Committee considered this document at its meeting on 8 February.

We are content to release the proposal from scrutiny. However, we would be grateful for continuing updates on the progress of negotiations, especially with regard to provisions on the mutual borrowing facility scheme and the home-host divide. Should the Directive take a significantly different shape from what was originally proposed, we would expect a further Explanatory Memorandum in line with the usual procedure.

8 February 2011

Letter from Mark Hoban MP to the Chairman

Following my Explanatory Memorandum of 13 October and subsequent correspondence, I am writing to update your Committee on negotiations on the Deposit Guarantee Schemes Directive.

The Government has negotiated the Directive through both expert and attaché working groups during the Belgian and Hungarian Presidencies. The Directive is now provisionally on the ECOFIN agenda for agreement to a general approach on 20 June.

PROGRESS ON KEY UK CONCERNS

The Government has successfully protected provision within the Directive for non-euro Member States to convert the harmonised €100,000 coverage level into national currencies and for the level to be rounded by up to €2,500. This level is to be reviewed every 5 years, unless unforeseen events necessitate an earlier review. In line with these proposals the FSA consulted on and implemented a new Financial Services Compensation Scheme (FSCS) coverage limit of £85,000 on 31 December 2010, providing a clear and memorable figure for consumers.

The Commission has proposed harmonised funding proposals in the Directive including provisions for Member States to build up a pre-fund of up to 1.5% of deposits by 2020. The UK opposes such a fund on the grounds that it is too burdensome on industry. The Government’s priority has therefore been to ensure the pre-fund does not impose any unnecessary burdens on the financial services industry. The UK has been supported by other Member States in this goal. The Presidency continues to try to find a compromise on funding.

Your Committee previously outlined its concerns around the Commission’s mutual borrowing proposals, on the grounds that they do not comply with the principle of subsidiarity. Following strong Member State opposition, including from the UK, the proposal has now been dropped. The European Parliament also did not consider the proposal viable and have not taken it forward.

Your Committee also raised concerns about protecting deposits across the home-host divide. The harmonised deposit protection limit means that consumers have the same levels of protection if they have their deposits in their home state or cross-border in another Member State. The Directive also includes new measures, such as standardised information templates, to ensure that consumers are better informed if they have cross-border deposits.

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The original Commission proposal included a reduction in the deadline for schemes to payout to depositors within seven working days of a bank failure, a position supported by the UK as it provides a better outcome for consumers. However, most Member States did not support this proposal as their deposit guarantee schemes do not have the capacity to payout within such a short amount of time. As a result the Presidency has reverted to the original deadline of 20 working days. This does not affect the UK as the FSCS can already pay out within seven days in a majority of cases and will continue to do so.

The Government continues to assess the likely impacts of the Commission’s proposal, in particular looking at the costs to firms and to the FSCS of the changes that will be agreed as part of the Directive. This work has informed our negotiations in Council especially on the funding proposals where any changes will mitigate costs to industry. We continue to use this work to assess the impact of the Presidency’s compromises as negotiations progress, ensuring that we avoid imposing unnecessary burdens on the FSCS and on the UK financial services industry.

EP NEGOTIATIONS
The Parliament has also been progressing with negotiations in parallel to Council. They voted on amendments to their report on 25 May and we expect that it will go to vote at a plenary session in June.

26 May 2011

DRAFT EU BUDGET 2011

Letter from the Chairman to Justine Greening MP, Economic Secretary, HM Treasury
Thank you for your letter of 23 November updating the Committee on the progress of negotiations on the EU Budget 2011. The EU Select Committee, and its, Economic and Financial Affairs and International Trade Sub-Committee, considered this at their meetings on 30 November.

We regret that the Council is likely to adopt a decision to abrogate the normal eight week scrutiny period for national Parliaments with respect to the Commission’s new draft EU Budget 2011. However, we recognise that exceptional circumstances make it necessary on this occasion and that respecting the scrutiny period would make it impossible to agree the EU Budget 2011 before the deadline on 31 December. We wish to make it clear that the eight week period for parliamentary scrutiny should normally be observed and whilst there are exceptional circumstances in this case for the override of the 8 week period, it should not set a precedent.

We make these observations, however, in the expectation that the Commission’s new draft Budget is unlikely to be substantially different from that previously scrutinised by the Committee. We would like to restate the view that there should be no increase above 2.91% and that there should be no concessions made to the European Parliament.

If the draft Budget proposes significant changes that national parliaments will not have an opportunity to scrutinise we will be gravely concerned.

We welcome your undertaking to provide the Committee with an Explanatory Memorandum on the new draft Budget by the end of the week commencing 29 November, and we expect to consider it in time to communicate our views in advance of the draft Budget’s proposed adoption by Council on 10 December.

1 December 2010

Letter from the Chairman to Justine Greening MP
Thank you for your Explanatory Memorandum, dated 2 December 2010, on the new draft EU Budget 2011, published by the Commission on 26 November. The EU Sub-Committee on Economic and Financial Affairs and International Trade considered this document at its meeting on 7 December.

We welcome the fact that the new draft Budget proposes an increase of only 2.91%, and that it maintains or increases funding in areas that offer high value for money, for example within the competitiveness and growth heading, while reducing funding for lower value for money areas, such as those within the agriculture and administration headings.
We would like to be updated if there are further changes in the draft Budget as a result of negotiations between the Council and European Parliament. In the meantime, we have cleared this document from scrutiny.

7 December 2010

Letter from Justine Greening MP to the Chairman

Thank you for your letter of 7 December on the 2011 EU budget. Further to HMT’s Explanatory Memorandum of 2 December on the Commission’s second Draft Budget 2011 proposal, I am pleased to update you on the final adoption of the 2011 EU budget.

On 10 December 2010, the Council adopted its position on the Commission’s Draft Budget, making some minor modifications that are set out below. On 15 December, the European Parliament approved Council’s position, meaning that the 2011 EU budget was therefore finally adopted.

The Government was pleased that an EU budget for this year was successfully agreed in this timeframe, and that it increases by just 2.9% from 2010. This is the level that the majority of member states supported early in negotiations in the summer, while we wanted a budget freeze. We worked hard throughout negotiations to ensure that the EU budget for next year was no higher than this; rejecting earlier calls from the European Parliament and Commission for a 6% increase, which were completely unacceptable at a time of deep fiscal consolidation across the EU.

The Government was also clear that it was inappropriate for the European Parliament to condition agreement to this budget on negotiations on an increased EP role in strategic budget decision-making. We welcome therefore that the final agreement reached was to the 2011 budget only, with no strings attached. This was the responsible course of action for all the institutions to take.

ADOPTED 2011 BUDGET – OVERVIEW

The agreed 2011 budget set commitment appropriations at €141,909m (£122,169m) and payment appropriations at €126,527m (£108,927m), corresponding to approximately 1.01% of EU GNI. Compared to the Commission’s first Draft Budget 2011, from May last year, commitments in the adopted budget decreased by €656m (£565m), and payments by €3.6bn (£3.1bn). Both Council and the European Parliament also agreed to mobilise the Flexibility Instrument, as proposed by the Commission on 29 November, to provide: €34m (£29m) in commitments in Heading 1a (competitiveness for growth and employment) for the Lifelong Learning and Competitiveness and Innovation Programmes; and €71m (£61m) in Heading 4 (EU as a global player) for Palestine.

In adopting its position on the Commission’s second Draft Budget 2011, from November last year, Council made slight changes to reflect the impact of the European Court of Justice judgment of 24 November 2010 in respect of the 2009-2010 salary increase for EU officials. That judgment overturned Council’s decision to award a 1.85% pay increase for the relevant reference period, meaning that the Commission’s original proposal of a 3.7% pay increase had to be implemented. Much of the funding necessary to do this was found within existing resources in the 2010 EU budget. Some of the funding required from the 2011 budget was generated through savings within the Draft Budget’s allocation for Heading 5 (Administration): €17m (£15m) from a reduction in the 2010-2011 pay increase from 0.4% to 0.1%; and €3.3m (£2.8m) from the budget of the European Schools.

An outstanding amount of €91.1m (£78m) remained to be found. The Commission stated that reprioritisation of commitments of this amount was not possible, and the sum was therefore added to the overall commitments total of the 2011 budget, compared to the Commission’s second Draft Budget. Payments were, however, reprioritised to accommodate this figure, with one third coming from both of Headings 1b (Cohesion for growth and employment) and 2 (preservation and management of natural resources), and the remaining third split proportionally between Headings 1a, 3a (freedom, security and justice) and 4. These changes are reflected in detail below.

The Government was disappointed by the European Court of Justice judgment on the 2009-2010 salary adjustment, and did not support Council’s adoption of a 3.7% pay increase for EU institutions’ staff for this period. The Government believes this to be completely unacceptable in the current period of deep fiscal consolidation around the EU, and inconsistent with the tough decisions being taken by Member States on public sector pay. While it was necessary, in order to comply with the Court judgment, to finance this increase partially from the 2011 budget, the Government believes the entire amount should have been found through reprioritisation within Heading 5 (Administration) of the budget. We, and several other member states, put these views firmly on record at the time.
Under Heading 1a, commitments were set at €13,021m (£11,210m), excluding the amount of €500m (£430m) for the European Globalisation Adjustment Fund. This was €416m (£358m) lower than in the Commission’s first Draft Budget 2011, and €1,841m (£1,585m) lower than the 2010 adopted budget, which had included €1.98bn (£1.7bn) in this heading for the European Economic Recovery Plan. No changes were made to commitments allocations within the heading between the adopted 2011 budget and the Commission’s second Draft Budget 2011 proposal from November.

Payments were set at €11,580m (£9,969m), €530m (£456m) lower than the Commission’s first Draft Budget 2011, and €238m (£205m) or 2% higher than the 2010 adopted budget. Payments decreased by €17.9m (£15.4m) compared to the Commission’s second Draft Budget 2011, the bulk of this made up of a €10m (£8.6m) decrease in the Research Framework Programme. Compared to the 2010 adopted budget, the most significant changes in payments levels in the adopted 2011 budget were:

— An increase of €366m (£315m) for the Research Framework Programme;
— A decrease of €41m (£35m) for the Trans-European transport and energy networks; and
— A decrease of €54m (£47m) for the Competitiveness and Innovation Framework Programme.

Under Heading 1b, commitments were set at €50,981m (£43,890m). This was €11m (£9.5m) higher than in the Commission’s first Draft Budget 2011, and €1,593m (£1,371m) higher than in the 2010 adopted budget. No changes were made to commitments allocations within the heading between the adopted 2011 budget and the Commission’s second Draft Budget 2011 proposal from November.

Payments were set at €41,652m (£35,858m), €889m (£765m) lower than in the Commission’s first Draft Budget 2011 and €5,267m (£4,534m) or 14% higher than in the 2010 adopted budget. Payments decreased by €30m (£25.8m) between the Commission’s second Draft Budget 2011 and the adopted budget, €26m (£22.4m) of this from the Structural Funds and €4m (£3.4m) from the Cohesion Fund. Compared to the 2010 adopted budget, the most significant changes in payments levels in the adopted 2011 budget were:

— An increase of €3,311m (£2,850m) in funding under the convergence objective; and
— An increase of €775m (£667m) for the Cohesion Fund.

Under Heading 2, commitments were set at €58,659m (£50,500m). This was €827m (£712m) lower than in the Commission’s first Draft Budget 2011, and €840m (£723m) lower than in the 2010 adopted budget. No changes were made to commitments allocations within the heading between the adopted 2011 budget and the Commission’s second Draft Budget 2011 proposal from November.

Payments were set at €56,379m (£48,537m), €1,757m (£5,513m) lower than in both the Commission’s first Draft Budget 2011 and the 2010 adopted budget. This represented a decrease of 3% from the 2010 adopted budget. Payments decreased by €30m (£25.8m) between the Commission’s second Draft Budget 2011 and the adopted budget, including €29m (£25m) from the rural development area. Compared to the 2010 adopted budget, the most substantial differences in payments levels in the adopted 2011 budget were:

— A decrease of €907m (£781m) in agriculture markets payments under market-related expenditure and direct aids;
— A decrease of €838m (£721m) for rural development;
— A decrease of €23m (£20m) for the European Fisheries Fund; and
— An increase of €46m (£40m) for the Life Plus instrument.

Under Heading 3a, commitments were set at €1,139m (£981m). This was €4m (£3.4m) higher than in the Commission’s first Draft Budget 2011, and €132m (£114m) higher than in the adopted budget for 2010. No changes were made to commitments allocations within the heading between the adopted 2011 budget and the Commission’s second Draft Budget 2011 proposal from November.

Payments were set at €813m (£700m). This was €39m (£34m) lower than in the Commission’s first Draft Budget 2011, and €75m (£65m) or 10% higher than in the adopted budget for 2010. Payments decreased by €1m (£0.86m) between the Commission’s second Draft Budget 2011 and the adopted
budget. Compared to the 2010 adopted budget, the most significant changes in payments in 2011 were:

— An increase of €62m (£53m) for solidarity and the management of migration flows;
— An increase of €23m (£20m) for the decentralised agencies; and
— A decrease of €14m (£12m) for security and safeguarding liberties.

Under Heading 3b (Citizenship), commitments were set at €683m (£588m). This was €15m (£13m) higher than in both the Commission's first Draft Budget 2011, and the adopted budget for 2010. No changes were made to either commitments or payments allocations within the heading between the adopted 2011 budget and the Commission's second Draft Budget 2011 proposal from November.

Payments were set at €646m (£556m). This was €7m (£6m) higher than in the Commission's first Draft Budget 2011, and €13m (£11m) or 2% lower than in the adopted budget for 2010. In comparison to the 2010 adopted budget, the main changes in payments in 2011 were:

— A decrease of €37m (£32m) for ‘other actions and programmes’;
— An increase of €11m (£9.5m) for the public health and consumer protection programme;
— An increase of €9m (£7.7m) for the decentralised agencies; and
— An increase of €6m (£5.2m) for the Civil Protection Financial Instrument.

Under Heading 4, commitments were set at €8,500m (£7,318m), excluding the amount of €254m (£219m) for the Emergency Aid Reserve. This was €114m (£98m) lower than in the Commission's first Draft Budget 2011, and €359m (£309m) higher than in the adopted budget for 2010. No changes were made to commitments allocations within the heading between the adopted 2011 budget and the Commission's second Draft Budget 2011 proposal from November.

Payments were set at €7,238m (£6,231m). This was €364m (£313m) lower than in the Commission’s first Draft Budget 2011, and €550m (£473m) or 8% lower than in the adopted budget for 2010. Compared to the 2010 adopted budget, the most significant changes in payments were:

— An increase of €99m (£85m) in the Development Cooperation Instrument;
— An increase of €46m (£40m) for the Common Foreign and Security Policy;
— A decrease of €338m (£291m) for the Instrument for Pre-Accession;
— A decrease of €16m (£14m) for democracy and human rights; and
— A decrease of €15m (£13m) for humanitarian aid (excluding the Emergency Aid Reserve).

Under Heading 5, commitments were set at €8,173m (£7,036m). This was €82m (£71m) lower than the Commission’s first Draft Budget 2011, and €284m (£244m) higher than the 2010 adopted budget. The commitments level increased, as explained above, by €91m (£78m) between the Commission’s second Draft Budget 2011 and the adopted budget.

Payments were set at €8,172m (£7,035m), €84m (£72m) lower than in the Commission’s first Draft Budget, and €91m (£78m) higher than the second Draft Budget. This was an increase of €283m (£244m) or 3.6% on the adopted budget 2010. Significant changes in payments from the adopted budget in 2010 included:

— A reduction of €289m (£249m) in the Commission’s budget, in part reflecting the transfer of some Commission resources to the European External Action Service; and
— Reflection for the first time of an annual operating budget for the European External Action Service, of €464m (£400m).

FINANCING FOR THE ITER NUCLEAR FUSION PROJECT

In my letter of 2 December, I explained that the Presidency had proposed a solution for funding the ITER financing shortfall in 2012-2013. This proposal achieved broad consensus in Council. Its main elements were to: reduce the overall shortfall from €1.4bn (£1.21bn) to €1.3bn (£1.12bn); finance
€460m (£396m) through reprioritisation within Heading 1a in 2012 and 2013; and secure the balance through transferring available budget margins in 2010 and 2011, to Heading 1a in 2012 and 2013.

The Government was disappointed that the European Parliament was not able to agree this at the end of last year. We will continue to work actively towards a funding solution, based on the types of elements already proposed and agreed in Council, and are determined that this issue will be resolved before the additional commitment appropriations agreed on are required.

I hope this information is helpful to the Committee.

5 February 2011

Letter from the Chairman to Justine Greening MP

Thank you for your letter of 5 February 2011 on the 2011 EU Budget. The EU Economic and Financial Affairs and International Trade Sub-Committee considered it at its meetings on 2 March.

We welcome the final agreement on the 2011 EU Budget. In particular, we are pleased that the Government were able to keep the overall increase in the Budget to 2.9%.

We do not require a response to this letter.

2 March 2011

ECONOMIC, SOCIAL AND TERRITORIAL COHESION REPORT OF 2011

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

Further to my letter to you of 14 February I am writing to inform you of developments regarding the Council Conclusions on the above document following the meeting of the General Affairs Council held on 21 February.

At the meeting, it was considered that the Council Conclusions reflected the existing consensus on the key principles of the policy and the Commission (Commissioner Hahn) welcomed the support that the Conclusions showed for the Commission’s report. The Conclusions were therefore adopted.

I would further like to assure you that these Council Conclusions do not in any way establish any new policy, policy direction, plan or recommendation for EU legislation and that they are without prejudice to the future financial framework.

You may also be interested that there was unanimous support for thematic concentration and focus on Europe 2020 goals for the future of the policy. The proposal for a Common Strategic Framework was also warmly welcomed and the UK (Minister for Europe) stressed the possibility it offered to align the policy with other EU policies and national investment to provide a bespoke system rather than producing rigid top down targets. He also stressed the need to see the policy in the context of budget ceilings and the need to get the maximum value for money.

I enclose a copy of the text of the Council Conclusions for your information.

22 March 2011

EU FRAMEWORK FOR CRISIS MANAGEMENT IN THE FINANCIAL SECTOR (15375/10)

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

Thank you for Explanatory Memorandum 15375/10, dated 9 November, on an EU framework for crisis management in the financial sector. The EU Sub-Committee on Economic and Financial Affairs and International Trade considered this at its meeting on 7 December.

The Communication reflects the significant progress the Commission is making in developing the concepts and tools necessary to underpin an EU framework for crisis management. We welcome the Commission’s careful and gradual approach to undertaking a wide review of the issue before proposing legislation. We recognise the importance, and the complexity, of establishing common tools
capable of addressing the “too big to fail problem” in light of the lessons learnt from the financial crisis that the failure of financial institutions can pose a risk to financial stability.

We started to examine this issue of banking crisis management in a previous report, The future of EU financial regulation and supervision, and we concluded that “uniformity of winding up procedures, including common early intervention mechanisms across the EU, will help the single market in financial service. We agree that there is a case for further harmonisation of rules on the winding up and reorganisation of credit institutions.”

We note that you consider it a priority to ensure that the suggested European framework is aligned with the UK special resolution regime to deal with crises in the banking system. We would like to have more detail regarding the aspects of UK legislation that you would like to see extended to the rest of the EU.

We would appreciate your clarification on the definition of a banking ‘crisis’, and whether there are differences between the domestic and European contexts. What factors will be considered to determine whether the troubles of a financial institution are merely a matter for corporate concern, are serious enough to be of national concern, or have wider implications for the EU? Is the recent crisis in Ireland of any significance in this respect?

The Communication considers the use of triggers for early intervention and resolution. Is the Commission’s approach to include a mix of qualitative and quantitative triggers going in the right direction?

Are there concerns that the types of preventative measures suggested in this Communication may have the effect of driving banks to off-shore locations? What assessment has been made of this likelihood, and are there any measures, in particular, which you feel may have adverse consequences for the financial sector?

We note that you support stronger coordination in the event of a cross border failure, whilst still remain keen to ensure that the European framework will ensure flexibility for national authorities to act quickly to deal with bank failure. We have seen the limitations of a purely domestic approach to deal with the failure of cross border financial institutions, where the absence of adequate EU arrangements resulted in ad hoc national solutions which proved to be a burden for tax payers. Do you believe that the Commission’s work on crisis management goes far enough to address the assumption that banks are “international in life and national in their death”?

Managing a cross-border crisis is a matter of common interest for all Member States affected, and we would like to hear your view on the extent to which it is possible for Member States to cooperate and prepare, in normal times, for a potential common burden.

We hope that the Commission’s legislative proposals will be able to address the cross-border element of a bank’s failure without creating disruption to single market principles. Like you, we feel that it would be beneficial to clarify the role of the new resolution colleges and their powers.

You express some reservations with regard to the Commission’s intention to extend the scope of the crisis management framework to large investments firms. It would be helpful if you could expand on the reasons you feel this may not be appropriate.

We also consider the inclusion in the proposal of a debt write tool (bail in) of great significance. We would like to receive clarification of the implications of the use of such a mechanism, and the extent to which the use of such tool is also contemplated by the work of the Financial Stability Board.

While we recognise that EU action is necessary, we also understand that the problems of cross-border banking groups extend beyond the EU, and many significant financial groups are global in their organisation. We share your view that the European approach should also reflect on going work undertaken by the Financial Stability Board, and consider the direction taken by the G20.

We would be grateful for a response within the standard ten working days, and in the meantime we will hold this document under scrutiny.

8 December 2010

Letter from Mark Hoban MP to the Chairman

Your letter of 8 December concluded that as part of the Committee’s scrutiny of the above Explanatory Memorandum (EM), it would like to further information on:
— which specific aspects of UK banking legislation the Government seeks to take forward into Europe;
— the definition of a banking crisis and whether there are differences between the domestic and European contexts; and
— the Government’s view on:
  a) the European Commission’s intention to include investment banks in scope of the framework;
  b) triggers for early intervention;
  c) potential unintended consequences of the framework on financial services (such as encouraging off-shoring);
  d) cross border co-operation and burden sharing arrangements; and
  e) the proposal for a debt write down tool and how the EU proposals link with ongoing work in the Financial Stability Board.

With your agreement, I would like to respond to these questions by sending you the joint response by HM Treasury, the Bank of England and the Financial Services Authority to the Commission’s consultation on the EU Crisis Management Framework. We expect the Commission to publish this later this month and we will respond by the end of February. Where our response does not deal with your question, we will provide additional information. The Commission’s work to date has been very high level and we expect the document published later this month to be much more detailed.

I appreciate that this does not fall within the timetable of responding to the Committee’s questions but I hope this proposal is suitable and that you would welcome considered answers that are consistent with our consultation response.

20 December 2010

Letter from Mark Hoban MP to the Chairman

Further to my letter of 20 December 2010, I am pleased to enclose the UK response to the European Commission’s consultation on proposals to introduce an EU framework for bank recovery and resolution. The response was developed in conjunction with the Bank of England and the Financial Services Authority. We support the Commission’s work in this important area and further welcome the main features of the proposed EU framework, agreeing that it is crucial that all Member States have a common legislative framework to respond to financial crises, with credible tools and powers to intervene quickly to avert or manage the failure of a bank. Some aspects of the Commission’s proposed framework appear to borrow heavily from current UK legislation in this area.

The January 2011 Commission consultation on the framework superseded their October 2010 Communication on the same subject. The UK response should address many of the points you have raised in your letter of 8 December 2010 in response to my Explanatory Memorandum on the Communication, in particular in relation to where we intend to utilise our experience of designing and deploying the UK Special Resolution Regime to shape a framework suitable for the EU. However, I would like to set out for the Government’s thinking in relation to a number of important areas:

SCOPE OF THE FRAMEWORK

As you will find in the response, the Government supports the Commission’s intention that the EU framework for bank recovery and resolution should capture all credit institutions, systemically important investment firms and financial holding companies and their affiliates in the event that the orderly resolution of one or more of these entities in necessary.

Following further consideration, the Government is content with the European Commission’s proposals to expand the scope of the proposed EU framework to include systemically important investment firms. However, further work is necessary to determine the precise nature of investment firm resolution tools so that they are consistent with and appropriate to the nature of investment firms and enable the UK authorities to resolve them with minimum recourse to public funds.
TRIGGERS FOR THE TOOLS AND POWERS WITH THE FRAMEWORK:

(i) Recovery

During the early intervention phase of the framework, we would not consider it appropriate to have a framework solely involving ‘hard’ quantitative triggers, as it could unduly constrain the actions of the authorities. It would be important, however, to have an approach which creates presumptions that regulatory actions will be taken at certain points with a view to increasing probability of recovery, and ensuring that a judgement-led approach will be applied proactively where a supervisor has concerns and that action is taken.

This approach should set out a number of clearly demarcated stages – that map to increasing levels of risk - and a list of presumed actions at each of those stages. Firms will move between those stages depending on the regulatory authorities’ views of the risks they face.

The decision to place a firm within a particular stage should be based on an assessment against a number of indicators, including capital adequacy, liquidity profile, and governance and risk management. As you may be aware, the Government, in establishing the new Prudential Regulation Authority, is considering these issues and would be keen to ensure that supervisors are able to take decisive action on a case-by-case basis.

(ii) Resolution

Under the proposed the framework the Commission has proposed three possible triggers for resolution (and therefore when a bank has reached its crisis point):

— something close to an insolvency test; or
— a regulatory assessment of viability; or
— a quantitative capital test.

The Government is supportive of a trigger for resolution based on a regulatory assessment of non-viability, which should be based on the ‘threshold conditions’ for authorisation. We consider that:

— an insolvency trigger will generally be too late to effect an orderly resolution of a bank; and
— a capital test is insufficiently broad or forward-looking, failing to recognise that bank failures may often result quickly from shortages of liquidity.

A regulatory assessment based, for example, on "threshold conditions" for authorisation, covers possible causes of bank failure other than inadequate capital, including shortages of liquidity and poor risk management. Furthermore, the concept of the threshold, authorisation or licensing conditions is recognised in other EU legislation, so could act particularly appropriately as a trigger for resolution measures in the EU. The test should be, effectively, that the threshold conditions are not met and there is no reasonable prospect of their being met.

In your letter you have raised specific concerns on the definition of a 'banking crisis' and how this may interplay with national and EU interests. In our response we outline that we share the Commission’s desire to explore ways in which the group resolution authority could play a role in proposing a coordinated resolution, but this must be subject to national resolution authorities remaining ultimately responsible for resolving legal entities in its jurisdiction that meet the trigger for resolution (as outlined above).

As you will be aware, the package of reforms to EU Supervision established that the new European Supervisory Authorities (ESA) will have tightly circumscribed powers in the case of:

— adverse developments which may seriously jeopardise the orderly functioning and integrity of financial markets or stability of the whole or part of the financial system in the Union. Under this circumstance these ESA powers are limited to facilitating and, where deemed necessary, coordinating any actions undertaken by the relevant national competent authorities; or
— the European Council has determined the existence of an emergency, in order to address any adverse developments as noted in the above bullet. Under these circumstances, the ESA may adopt individual decisions requiring competent authorities to take the necessary action to address any such developments in accordance with the existing sectoral legislation.
In the unusual event that a competent authority does not comply with the decision of the ESA, the ESA may adopt an individual decision addressed to a firm. However, direct powers over firms in emergencies are limited to only enforcing EU law (i.e., a firm or supervisor would have to be in breach of the law to be subject to them) and we do not expect our national supervisory authority to be found in breach of EU law.

The interactions between the package of reforms to EU Supervision and the new framework on bank recovery and resolution still need to be fully considered as the Commission’s legislative proposal is firm ed up.

**CROSS-BORDER COORDINATION**

Further to the October Communication, the Commission in its consultation proposes to establish statutory “resolution colleges” for cross border groups in the EU, replacing any existing EU Cross Border Stability Groups (CBSGs). While the Government understands the Commission’s desire to put cross border groupings on a statutory basis, we believe that the operational flexibility of the CBSG in two specific areas should be retained in any future arrangements, namely:

— the ability to address wider stability and pre-crisis issues, including contingency planning; and
— the flexibility to set up bilateral and regional groups, rather than being restricted to firm-specific groups.

Irrespective of the chosen format of the groups, we further set out in the consultation response that a number of factors should be considered in establishing EU groupings, including:

— threshold: member states should not be obliged to establish cross border crisis groupings where it is clear that the financial institution is primarily a domestic institution;
— composition: host member states should sit on the cross border crisis grouping if a bank branch is considered significant, which would replicate the approach taken in supervisory colleges, and should avoid having every host represented on the groups. In line with the 2008 EU Memorandum of Understanding on financial stability, it will also be important that finance ministries within the grouping; and
— minimising duplication with existing cross border groups: where an Financial Stability Board (FSB) Crisis Management Groups exists for the EU’s very largest institutions, we recommend that a distinct EU group should only be established if a clear added value can be demonstrated.

Turning to your specific point about burden sharing, the UK shares the views of other member States that, given the fiscal implications, ex-ante burden sharing arrangements between Member States will not be workable. Instead we believe that there is real value in highlighting a range of activities that Member States should undertake through cross border crisis management groups to mitigate risks and improve preparedness for resolution, including:

— removing barriers to orderly resolution e.g., ensuring continuity of operational interdependences in a resolution;
— identifying and potentially removing financial channels of contagion between jurisdictions or financial interconnectedness if deemed a barrier to orderly resolution; and
— developing bilateral/multilateral authority resolution agreements on individual banks.

**MULTI-LATERAL POLICY DEVELOPMENT**

The Government welcomes the Commission’s approach in providing leadership and widely consulting on such important policy measures. However, we strongly believe that development of a framework for bank recovery and resolution should continue to be considered on a multilateral basis in international fora, including the FSB, to maximise their effectiveness, and minimising any impacts on the competitiveness of the financial markets operating in the EEA. This would be particularly important for measures including, bail-in, recovery and resolution plans, and cross border resolution.
While the Government is supportive of this regulatory initiative, we stress the importance of proper evidence, and a hard quantitative and economic impact assessment, include that on competition, being undertaken in good time. This is most critical in areas where legislation at EU level is being introduced for the first time and for ensuring a strong, credible crisis management framework.

I hope you find that this letter adequately responds to the remained if the points you raised in the context of the latest thinking from the Commission. As you can appreciate a number of the points you raised in your letter are still under consideration. Even though Government supports the Commission’s work, the detail of a future commission proposal may create concerns for burden sharing and competitiveness and so we will remain vigilant.

7 March 2011

Letter from the Chairman to Mark Hoban MP

Thank you for your letters dated 20 December 2010 and 7 March 2011 on Explanatory Memorandum 15375/10 on an EU framework for crisis management in the financial sector. The EU Economic and Financial Affairs and International Trade Sub-Committee considered these documents at its meeting on 10 May.

We are grateful for your detailed response to most of our questions. We would still be interested to know what factors will distinguish a national banking crisis from a crisis of European or international significance. What lessons have been learnt from the Irish crisis in this respect?

Bearing in mind the range of legislation relating to the financial sector being discussed both nationally and at an EU level, are you concerned that the proposed framework might encourage some financial institutions to relocate away from London?

We appreciate that there are numerous issues that are still under consideration, but we would like to be kept informed on discussions over the inclusion of a debt write tool (also known as a bail-in) as an additional resolution tool.

In the meantime, we have agreed to clear this document from scrutiny. We look forward to discussing this issue with you in more depth when the Commission’s legislative proposals are published later this year.

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

10 May 2011

Letter from Mark Hoban MP to the Chairman

Thank you for your letter of 10 May 2011, clearing the above document. I shall keep the Committee informed on the issue of bail-in as this topic is taken forward internationally and in the EU.

You also asked two questions: the first was on what factors distinguish a national banking crisis from one of international significance. The determination of whether a banking crisis should be regarded as of national or international significance would be undertaken on a case-by-case basis, and factors such as its causes and effects, and whether they are limited to one country or common to many would be taken into consideration.

You mentioned the Irish crisis. The problem here was not limited to the Irish banks but also affected the Irish government. In this case, the UK offered assistance to the Irish government, rather than directly to any Irish financial institutions. The Chancellor made clear at the time that the UK’s decision to provide assistance to Ireland was in part based on the business and financial linkages between our countries.

You also asked about the impact of legislation on the competitiveness of London as a financial services centre. The competitiveness of London’s financial services sector is a key priority for the Government.

We consider that the robust international and domestic regulatory reforms underway will help to reinforce the stability of the financial services sector, which is in itself a factor in promoting the attractiveness and longevity of the UK as a business destination. Indeed, the fragmentation of global financial markets as a result of international regulatory arbitrage is a greater risk. As such, the UK continues to lead the argument inside the EU and internationally for robust and consistent regulatory standards that will bring long term benefits. Crucially, reforms must be proportionate and based on robust evidence, with any impact on competitiveness being carefully considered.
Furthermore, the Government remains committed to a competitive environment for financial services in the UK and one favourable to business more generally: this is the reason, for example, that the Chancellor announced measures at Budget 2011 that will give the UK one of the most competitive tax regimes in the G20 by 2014.

19 May 2011

EUROPEAN FINANCIAL STABILISATION MECHANISM

Letter from the Chairman to Justine Greening MP, Economic Secretary, HM Treasury

Thank you for Explanatory Memorandum 17361/10, dated 21 January 2011, on a Commission Communication on the European Financial Stabilisation Mechanism. The EU Economic and Financial Affairs and International Trade Sub-Committee considered this document at its meeting on 2 March 2011.

We are pleased to note that at present the Commission believe that the EFSM can be accommodated under the Own Resources ceiling, and we agree that the current state of the market is not yet settled enough to justify dismantling the EFSM.

We have agreed to clear this document from scrutiny. We do not require a response to this letter.

2 March 2011

EU – SOUTH KOREA: FREE TRADE AGREEMENT (8502/10, 8523/10)

Letter from Edward Davey MP, Parliamentary Under Secretary of State, Department for Business, Innovation and Skills to the Chairman

I am writing to inform you of the status of the EU-South Korea FTA and the bilateral safeguard clause which was negotiated alongside the Agreement.

The FTA was signed by Member States on 16 September 2010 and by the South Korean Trade Minister, the European Commission and Belgian Presidency on 6 October 2010.

The European Council, European Commission and the European Parliament reached agreement on an amended bilateral safeguard clause on 15 December 2010. The clause is attached, with the agreed amendments in bold. We believe this will provide effective protection without undermining the benefits of the FTA.

The European Parliament gave its consent to both the FTA and the amended safeguard clause on 17 February 2011. The clause now needs Council approval in April, followed by signature and adoption in May. With this completed, the FTA and the bilateral safeguard clause will provisionally enter into force on 1 July 2011.

24 March 2011

EU STATISTICS (8300/10)

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

At the 17 November meeting of the ECOFIN Council, the Chancellor of the Exchequer endorsed a set of Council conclusions on EU statistics. These conclusions were agreed unanimously by Member States and I should give the Committee an overview of the document and outline the implications for the UK.

COUNCIL CONCLUSIONS ON EU STATISTICS

The Council stressed that the Greek authorities needed to resolve the institutional and methodological issues which have been manifested in their high number of data revisions. These have been negatively impacting the credibility of the Greek statistical system. However, progress has been made on the Action Plan on Greek statistics and governance (adopted in May of this year) and this has
contributed towards re-establishing confidence in the transparency and reliability of Greek statistics. Finally, the Council approved any further assistance that Eurostat may provide to Greece.

A section of the Council conclusions covers the Code of Practice, which sets out how the preparation of statistics should be carried out. It is based on a set of fifteen principles to which governance and statistical authorities in the EU are committed to adhere. They cover a variety of issues including confidentiality, impartiality, independence, cost effectiveness, timeliness and relevance. The Council stated that the binding nature of the Code of Practice should be reinforced by legally enshrining minimum standards. Where necessary, Member States need to accelerate the pace at which they align their statistical legislation with the principles of the Code and European Statistics Regulation. Furthermore, the speed at which provisions within the code are implemented should be accelerated by the European Statistical System (ESS); and, to fully comply with the Code, the implementation of national improvements actions needs to be given higher priority. Finally, the Council appreciated that implementing the Code would require extra resources, in terms of financial cost, human capital and other inputs. However, it also reiterated the need to invest across a number of areas.

The Council noted the 2010 Status Report on Information Requirements in Economic and Monetary Union, in particular the situation with Principle European Economic Indicators (PEEI) targets, with some having been met while others were behind schedule or unavailable. It stressed that further statistical harmonisation was needed to ensure consistent approaches across all Member States, and encouraged Eurostat and National Statistical Institutions (NSIs) to maintain their involvement. The Council also emphasised that the PEEI framework needed further development and requested that EUROSTAT, the ECB and National Statistics Authorities work together to determine long term targets. Additionally, the Council acknowledged that, in order to meet current and future demands, an optimum level of resources needed to be made available. This applied, in particular, to the Europe 2020 Strategy and to the European Systemic Risk Board (ESRB).

The Council conclusions also covered statistical considerations relating to enhanced economic policy coordination. It welcomed the findings and advice of the Van Rompuy Task Force report to strengthen EU statistics. Paragraph 31 of the report states that:

"Stronger surveillance and enforcement mechanisms must rest on transparent, reliable and timely statistics. A regulation reinforcing the audit powers of Eurostat has recently been agreed by the Council. But further steps, including to strengthen further the professional independence of the European Statistical System as well as Eurostat's audit powers should be considered. Sanctions for repeated statistical problems, such as lack of validation of data by Eurostat, should also be considered. The binding nature of the “European statistics code of practice” should be reinforced and some of the minimum standards should be enshrined in a legal act. Full implementation of the provisions in the code needs to be accelerated, in particular to reinforce mandates for data collection, and to further enhance quality."

The Council asked for the Commission to present its proposals based on the advice set out in the report.

The Council also advised that the statistical indicators used in this initiative should be handled in a manner that is consistent with the principles set out in the European Statistics Code of Practice, and that the ESS should be involved in issues pertaining to this.

The Council welcomed recent developments in the revision of the European System of Accounts (ESA) and reiterated the crucial role that national accounts play in relation to economic and monetary policies. It also welcomed the impact assessment and noted the implications for GDP and GNI levels, but acknowledged that this assessment is only provisional, and asked Eurostat to place emphasis on an assessment of the impact on government debt and deficit figures when going forward. The Council therefore asked countries for timely cooperation with requests made for any information on GDP and GNI data. For administrative purposes, the Council stated that it would be sensible to refer to the agreed set of national accounts standards when ESA is revised and, finally, emphasised that every action should be taken to ensure that the transition between ESA95 and the new system, ESA2014, takes place as quickly as is practicable.

**UPDATE ON DEVELOPMENTS SINCE THE 17 NOVEMBER ECOFIN**

On 15 November, Eurostat released a revised Provision of deficit and debt data for 2009 – Second notification. This included statistics from Greece, and Eurostat has subsequently formally lifted the reservation on Greek data as the Hellenic Statistical Authority are now viewed to have addressed all
outstanding issues. The release of this document was too late to be taken into consideration for the 17 November ECOFIN meeting. The UK Government welcomes the release of the revised data and is encouraged by the news that the reservation on Greek data has been lifted.

COUNCIL CONCLUSIONS – IMPLICATIONS FOR THE UK

Overall, the conclusions are positive and represent a satisfactory outcome for the UK. The Code of Practice section focuses on attempts to increase the strength of statistical infrastructure and these reforms are supportive of and conducive to the Government’s approach. The Government feels that the UK is currently well placed to meet the aims specified in the Code of Practice.

The Government welcomes any moves to encourage transparent, reliable and robust national accounting, statistical and fiscal data. Independent statistics can greatly enhance credibility and such an approach is reflected in our own strong national fiscal framework, with the Office for National Statistics and the recent development of the Office for Budget Responsibility, which introduces independence, greater transparency and credibility to the economic and fiscal forecasts in the UK.

6 December 2010

FIFTH COHESION REPORT (16336/10)

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

Thank you for your Explanatory Memorandum 16366/10 and your letters dated 14 February and 22 March 2011 on the fifth report on economic, social and territorial cohesion. The EU Economic and Financial Affairs and International Trade Sub-Committee considered the documents at our meeting on 5th April.

The EU Select Committee has concluded an inquiry on the EU financial framework from 2014 which sets out our views on the matters considered in the Commission’s document.

We note that Council adopted conclusions on the 5th Report on economic, social and territorial cohesion before we were able to clear the document from scrutiny. As you have explained that that the Council Conclusions do not establish a new policy or recommendation for EU legislation, we do not consider that a scrutiny override has occurred. We also look forward to scrutinising the draft structural and cohesion fund regulations that will follow the agreement on the Financial Framework.

We have agreed to clear this document from scrutiny. We do not require a response to this letter.

06 April 2011

FINANCIAL REGULATION AND COMMUNICATION ON TOLERABLE RISK OF ERROR (10561/10, 10346/10)

Letter from Justine Greening MP, Economic Secretary, HM Treasury, to the Chairman

Thank you for your letter of 19 October following consideration by your Sub-Committee of my Explanatory Memoranda on the Commission’s proposal for a revision to the Financial Regulation and the communication on controls over EU spending.

The UK has been a consistent supporter of sound financial management in the EU, including leading the way towards greater transparency by, for example, publishing a consolidated statement of EU funds in the UK. And, of course, as many households and governments are taking difficult steps to balance their budgets, effective financial management to ensure that EU funds are being used, in the right way, on high value-added projects is more important than ever.

In this light, the fact that the European Court of Auditors (ECA) has been unable to sign off on the EU accounts for over 16 years is clearly unacceptable. And the fact that the bulk of errors detected represent such things as small overpayments to farmers and payments for expenditure which does not meet strict eligibility rules, is of little consolation as it does not inspire confidence amongst the general public that the EU is spending taxpayer money wisely. As such, the UK is looking for new
ways of improving financial management, including through greater responsibility being taken by Member States to improve the management of EU funds at national level.

Turning to the specific questions in your letter, the Government is concerned that the Commission’s management of real estate policy lacks transparency, as currently Commission institutions are only required to submit real estate projects of significant impact to the EU budget before the Budget Authority (Council and European Parliament) for an opinion, not for approval. Therefore, Member States are unable fully to scrutinise the Commission’s management of real estate. The Government considers this unacceptable, since it is Member States’ contributions to the EU budget that funds the Commission’s and other institutions’ real estate.

Although institutions will be required to submit significant real estate projects financed through a loan to the Budget Authority for approval, the Commission’s proposal does not address the lack of transparency for funding real estate projects through grants. This could allow institutions to approach the Budget Authority with a proposal to fund a real estate project through a loan, on the basis that it will provide savings compared to funding the project by way of a grant, with the institution still able to fund the project through a grant if the proposal is rejected.

In addition, the Government is concerned that the Commission’s proposal on allowing institutions to raise loans to purchase buildings may present additional spending implications by way of unintended risks to the EU budget. Therefore, the Government will push for greater transparency on the Commission’s management of real estate and will work with other Member States during further discussion in budget committee to ensure that the UK’s financial interest are protected.

The Government welcomes the Commission’s proposal to remove the requirement to review the Financial Regulation on a triennial basis, so that the Financial Regulation will only be revised when it proves necessary. The Government is content with the Commission’s view that a fixed timescale for a review does not take into account the multiannual programming cycle of the EU budget and related sector legislation.

On Tolerable Risk of Error (TRE), while it is too soon to draw firm conclusions or agree new levels of tolerable risk, the Government does not rule out its possible introduction in the future. Before that judgment can be made, however, the full impact of recent simplification of procedures, guidance and regulations need to play out. Moreover, there is scope for further simplification of these rules and regulations. Finally, more work on TRE rates across different policy areas is needed.

The Government has doubts that the Commission’s proposal to further harmonise control and audit obligations will improve Member States’ management of EU funds, particularly in the area of Structural and Cohesion Funds. The current system of shared management for Structural and Cohesion Funds between the Managing Authority, Certifying Authority and Audit Authority was only introduced in 2007. The Government believes that the current system should lead to an improvement in financial control, given time, and are unsure as to how the new model proposed will be applied to multi-annual Structural Fund programmes. In addition, the Government is concerned that the Commission propose shifting away from the current system without a detailed review of whether the changes introduced in 2007 have improved financial control. These are views that the Government shares with the majority of other Member States.

DISCUSSIONS IN BUDGET COMMITTEE

Council’s budget committee met on several occasions in September and October to discuss aspects of the Commission’s proposals for the Financial Regulation. Part of these discussions included the Commission’s proposal for Tolerable Risk of Error levels, however the Commission’s Communication (EM 10346/10) was mainly discussed outside of negotiations on the Financial Regulation.

Under the guidance of the Belgian Presidency, the Commission presented twelve themed fiches on its proposal for the Financial Regulation. These fiches focused on budgetary principles, the Commission’s proposal to introduce Tolerable Risk of Error levels, shared management of the budget and methods of implementation, methods of implementation other than shared management, powers and duties of the Authorising Officer, implementation of the budget (the rules for commitments, payments and recoveries), procedure, grants, financial instruments, EU Trust Funds, building policy and Public-Private Partnerships. This offered Member States an initial opportunity to discuss certain aspects of the Commission’s proposal. As budget committee will return to the Commission’s proposal in early 2011, for line-by-line study, Member States’ preliminary reactions generally focused on probing the Commission on certain aspects of their proposal and highlighting areas of significant concern.
On the proposal to allocate EU funds to financial instruments managed by International Financial Institutions (IFIs), such as the European Investment Bank (EIB), the UK and other Member States expressed concern about the potential implications for the budget and the apparent proliferation of these funds without any oversight on their total number from the Council. For example, if IFIs are not required to de-commit unused EU funding allocated for a specific project, the EU funds may stay in the account of the IFI awaiting a suitable project, at a cost to the EU.

Member States, including the UK, also expressed concern that the Commission changed the procedure for the recovery of fines without informing the Budgetary Authority (Council and the European Parliament). Previously, fines imposed by the Commission for competition infringements were held in basic bank accounts while the decisions imposing them were subject of a potential European Court of Justice ruling. As these provisional amounts now represent a huge sum (approximately €8.9bn (£7.7bn)), the Commission decided to create a fund managed by DG ECFIN to invest in sovereign bonds. The Commission maintain that this is a Commission decision, the legal base already exists and that the amendment to the Financial Regulation provides greater flexibility with regards the rate of interest.

Member States welcomed the Communication on Tolerable Risk of Error, however were generally of the view that it is too soon to implement such a concept for EU budget financial management. In particular, Member States recalled the need for further simplification of existing legislation and improved programme management in order to reduce the current error levels. Furthermore, there was agreement that the concept for determining the appropriate risk levels needs further refinement. As such, the Commission was encouraged to continue its work on this issue, to look into more detailed methods for identifying the tolerable risk of error by assessing the costs and benefits of controls, and to further reflect on the appropriate level of aggregation across Member States by policy area, fund, programme or mode of budget implementation. Finally, it was agreed that a complete overview of the level of error in all policy areas is required before it would be possible to enter into political discussions on the tolerable risk of error with all parties concerned.

23 December 2010

GREEN PAPER: AUDIT POLICY: LESSONS FROM THE CRISIS (15274/10)

Letter from the Chairman to Edward Davey MP, Parliamentary Under Secretary of State, Department for Business, Innovation and Skills

Thank you for your Explanatory Memorandum 15274/10 on a Commission Green Paper on Audit Policy: Lessons from the Crisis. The EU Economic and Financial Affairs and International Trade Sub-Committee considered this at its meeting on 30 November.

The Green Paper constitutes an opportunity to reflect upon the shortcomings which have emerged in the audit system in the aftermath of the financial crisis and the extent to which additional EU action is potentially required on audit policy. We agree that it is appropriate to discuss the possibility of action at EU level because of the cross-border nature of capital markets in which listed companies operate. We consider the Green Paper on audit policy an integral aspect of the Commission’s on-going work on corporate governance.

We would like to receive the Government’s response to the Commission Green Paper, when it is published, before considering this document in further detail. In the meantime, we will hold this document under scrutiny.

We do not require a response to this letter in the standard ten working days.

6 December 2010

Letter from the Chairman to Edward Davey MP

Thank you for your letter on Explanatory Memorandum 15274/10 on a Commission Green Paper on Audit Policy: Lessons from the Crisis, and for the Government’s response to the Green Paper. The EU Sub-Committee on Economic and Financial Affairs and International Trade considered these documents at its meeting on 18 January.

We agreed to release the Green Paper on Audit Policy from scrutiny, but we would be grateful for updates on any future developments on this area. We note that the Commission conference on 10
February will assess the results of the consultation and determine whether there is a need for any EU measures as a follow-up to the Green Paper.

We do not require a response to this letter.
19 January 2011

Letter from Davey MP to the Chairman

Thank you for your letter of 19 January releasing the Green Paper from scrutiny but asking for updates on any future developments.

The only recent development arising from the February Commission conference in this area was that Commissioner Barnier announced that he was expecting a White Paper from the Commission with their proposals on audit policy in November this year. The only hint of the contents of the White Paper given by the Commissioner was that the status quo was not an option.
8 March 2011

GREEN PAPER: THE FUTURE OF VAT (17491/10)

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

Thank you for your Explanatory Memorandum 17491/10 on a Green Paper on the future of VAT. The EU Economic and Financial Affairs and International Trade Sub-Committee considered this document at its meetings on 3, 10 and 17 May.

We would support attempts to cut administrative costs and reduce opportunities for fraud with the VAT system. The suggested destination based tax would be a significant overhaul of the VAT system. Have the Government reached a view on this proposal and its potential costs and benefits? Is such an approach feasible, or likely to prevail?

The Green Paper considers whether the single market requires a greater harmonisation of VAT rates. We have doubts over any suggestion that there could or should be greater harmonisation of the scope or rates of VAT in the interests of the single market.

The report reflects upon the ideas included in the report “A new strategy for the single market” published by Professor Mario Monti in May 2010 which argued that variations in VAT rates affect capital and trade movements and that coordinating policies directed at raising standard VAT rates or limiting the application of reduced VAT rates may be beneficial. We recognise, however, the historical and cultural differences in countries’ VAT systems and note that, as the third largest revenue stream for the Government, VAT is a significant tool for budgetary management in the UK. What is the Government's current position on further convergence, coordination or harmonisation of VAT rates?

We have noted your concern over the Commission’s suggestion to use majority voting to agree implementing decisions which provide clarity to EU VAT directives and regulations. You note that this proposal might erode UK sovereignty on tax issues. In what way might the Commission’s suggestions constitute a threat to tax sovereignty? Would any decision to further harmonise VAT require a decision by unanimity?

We have agreed to hold this document under scrutiny. We would be grateful for a response within the standard ten working days.
17 May 2011

Letter from David Gauke MP to the Chairman

Thank you for your letter of 17 May 2011, in response to the Explanatory Memorandum on the Commission’s Green Paper on the future of VAT. In your letter you have asked for clarification on a number of points.

You have asked about the destination system, and in particular the Government’s view and whether such an approach is feasible or likely to prevail. Although the current EU VAT system is transitional, it is in fact based on the principle of taxation at the place of destination, with a commitment to change eventually to taxation at the place of origin. Taxation at the place of destination is a good reflection
of taxation at the place of consumption. By contrast, an origin basis would need a greater degree of harmonisation of VAT rates and a system of revenue redistribution to reflect taxation at the place of consumption. For a number of years the focus has therefore been on making the current transitional system work better rather than replacing it with an origin based system.

Since the Green Paper emerged, UK officials have been actively engaging with UK businesses in order to better understand their views, including their priorities and key concerns. UK business is generally supportive of an approach aimed at making the current VAT system work better. They see this as pragmatic and achievable. They therefore support the current system, based on taxation at the place of destination, and do not favour a move to a system based on taxation at the place of origin. A system based on destination is also the basis for all other VAT systems across the world, which is important in terms of consistency for businesses involved in international trade. As the Government agrees with this assessment, the UK response endorses this approach.

You also asked about the Government’s position on further convergence, coordination or harmonisation of VAT rates. The UK response highlights the importance of the principles of subsidiarity and national sovereignty, including the Government’s position on VAT rates, and makes it clear that the UK would not support ideas that would erode these principles.

With regard to a potential threat to UK tax sovereignty in the Commission’s suggestions on implementing decisions, although such decisions provide clarity, they also raise question of interpretation and as they are directly applicable, they can have potential impacts on the UK. We would therefore not want to see such decisions made on a qualified majority basis. The UK response endorses the principle of unanimity in taxation. I can also confirm that any decision to further harmonise VAT would require a decision by unanimity.

I have attached a copy of the draft UK response to the written consultation, for your information. The UK has informed the Commission that we intend submitting a formal response but that it will go up slightly after the 31 May deadline. This is to give both Committees the opportunity to view the draft taking into account the Whitsun recess.

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

24 May 2011

INTERINSTITUTIONAL AGREEMENT ON BUDGETARY DISCIPLINE (9193/10)

Letter from Justine Greening MP, Economic Secretary, HM Treasury, to the Chairman

Thank you for your letter of 17 November, in which you posed a question on the Government’s approach to the multiannual financial framework regulation (MFF) regulation.

Specifically, you asked why the Government is opposing a measure that is merely a technical exercise incorporating existing budget rules into new legal instruments, as required by the Lisbon Treaty.

As set out in my letter of 6 November, the Government is broadly supportive of the Commission and Presidency’s technical approach. In the autumn last year, it became apparent that it might not be possible, for legal reasons, to transpose a flexibility provision that allows for the MFF to be revised by up to 0.03% of the EU’s Gross National Income, by QMV in Council, into the new MFF regulation, which must be agreed by unanimity. This was the only outstanding issue for Council on the draft MFF regulation during late 2010.

In order to resolve any legal uncertainty, the Presidency came forward with a proposal to create a ‘contingency margin’. Technically, this would be similar to the existing flexibility provision, but instead this margin would sit wholly above the MFF ceilings. This is a significant change from the existing arrangements, whereby the current flexibility to revise the MFF by 0.03% has usually resulted in no overall increase to the MFF ceilings. Rather, it has been used to move money between budgetary headings to accommodate unforeseen expenditure.

The Government did not support this proposal because a contingency margin above and separate from the MFF ceilings would present risks to budget discipline by allowing for additional spending that is not constrained by the MFF ceilings. In answer to your question, it was important to take the opportunity to limit the UK’s potential cost exposure over the next few years, when deficit reduction is the Government’s priority, and to reflect the period of deep fiscal consolidation throughout the EU.
During conciliation negotiations of the EU annual budget for 2011, the Government explored ways to limit the Presidency’s proposed contingency margin and to link it more closely to the MFF. The Government received significant support from other Member States for this objective.

As a result, on 22 December COREPER agreed to establish a ‘contingency margin’ of €3.5bn annually, created outside the MFF and accessed by qualified majority voting. However, in a given year, the contingency margin can only be used up to the amount already available under the total MFF spending limit, and not already budgeted in the year’s annual budget. This establishes an important link to the MFF and reduces the budget exposure of the contingency margin, under qualified majority in Council, to only €2bn–€2.5bn over the rest of the current MFF. In effect, this ensures that use of the contingency margin is constrained by the MFF ceilings. Furthermore, a specific clause and separate, written Commission declaration state that no use of the contingency margin in 2011 can lead to additional payment appropriations that year; this protects the agreement to limit growth in payments to the EU budget in 2011 to 2.91% from 2010 levels.

Having argued strongly to limit the expected cost exposure of any flexibility measures, the Government is satisfied that these final proposals improve on current flexibility arrangements. The text of the draft MFF regulation, and the accompanying draft Inter-institutional Agreement on cooperation in budgetary matters and sound financial management, were agreed in COPERER in late December. We expect Council to request consent to the draft MFF regulation from the European Parliament later this month, and hope that both instruments will be adopted early this year.

14 January 2011

Letter from the Chairman to Justine Greening MP

Thank you for your letter, dated 14 January, on EM 9193/10 on the Interinstitutional agreement on budgetary discipline and sound financial management. The EU Economic and Financial Affairs and International Trade Sub-Committee considered this document at its meeting on 25 January.

We note your explanation of the Government’s position on the proposed contingency margin. The Lords EU Select Committee is currently considering the Commission’s Communication on the EU Financial Framework from 2014, and we will consider the issue of flexibility within the EU Budget further as part of that inquiry.

We do not require a response to this letter.

25 January 2011

INTERNATIONAL FINANCIAL ASSISTANCE TO PORTUGAL

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

Thank you for your letter, dated 5 May, on international financial assistance to Portugal. The EU Economic and Financial Affairs and International Trade Sub-Committee considered this document at its meeting on 17 May.

We are grateful for your update in relation to the provision of EU assistance to Portugal. We understand that it will not be possible to respect the Parliamentary scrutiny reserve on this occasion.

The Council has now adopted a Decision to provide Portugal with a €52 billion loan coming in equal proportion from the European Financial Stabilisation Mechanism and from the European Financial Stability Facility. We would be grateful for further detail on how the decision to bail out Portugal will affect the UK.

We look forward to receiving your Explanatory Memorandum and an account of the decisions made by ECOFIN on 16 and 17 May. We would be grateful for a response to this letter within the standard ten working days.

17 May 2011
Letter from the Chairman to Mark Hoban MP, Financial Secretary, HM Treasury

Thank you for your letter, dated 15 November, on a Proposal to amend the Directive on investor compensation schemes. The EU Economic and Financial Affairs and International Trade Subcommittee considered this at its meeting on 30 November.

We appreciate your comprehensive and thoughtful answers to the questions we raised in our last letter. However, we would be grateful for some further clarification on the following points.

On the issues of harmonising compensation limits, we note that while you maintain your view that Member States should be able to set their maximum compensation limit, you do not seem particularly convinced that this will be the case; rather your letter focuses on the greater scope offered by the Financial Services Compensation Scheme (FSCS), and stresses that even if compensation limits are harmonised it will seek to ensure the UK can provide greater scope. Do you think it is likely that the final Directive will include a harmonised maximum compensation limit that is lower than that currently offered by the FSCS? Given your argument that customers are less likely to be influenced by compensation limits when choosing investments services, will this have a significant impact on UK businesses?

We note that you argue that Member States should be able to decide whether their schemes should be pre-funded or not. This raises the question of whether all governments would effectively fund their schemes; would this not risk a situation where some Member States did not properly fund their schemes – potentially leaving UK investors in those countries at risk?

Two of the reasons you give for opposing mutual borrowing schemes are the risk of contagion, and concerns that they might impose on the Government’s fiscal sovereignty. We note that in your letter to us on the Deposit Guarantee Schemes Directive, dated 3 November, which contains provisions for a similar scheme, you state that the FSCS would be obliged to contribute to a loan “provided it was not itself judged to be underfunded”. This implies that if a fund was under pressure from domestic compensation claims it would not be required to contribute to a loan to other Member States. Is this also the case within the investor compensation scheme proposal? If so, and given that the amount to be made available for lending at an EU level is only 10% of the pre-fund, the risk of contagion seems small. In addition, given that the Commission states in the proposal that “the borrowing mechanism should not impinge any fiscal responsibility of the Member States”, could the Government not work to allay your concerns by strengthening the circumstances in which a Member State did not have to contribute to any lending between national schemes; i.e. in circumstances where their own funds were such that to do so might necessitate, or increase the likelihood of, the raising of additional levies or loans?

Finally, we would like to continue to be informed on discussions on UCITS depositaries.

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

6 December 2010

Letter from Mark Hoban MP to the Chairman

Thank you for your further letter of 6 December on the Commission’s proposal to amend the Investor Compensation Schemes Directive (ICSD).

Before addressing the specific questions in your letter, perhaps it would be helpful if I updated you on the state-of-play of negotiations. There have been three expert-level Council Working Groups under the Belgian Presidency to discuss the Commission’s proposal. The current Presidency has indicated that it does not intend to produce its own compromise proposal, but will present a progress report to the succeeding Presidency. It is not clear how Hungary intends to handle this dossier under its Presidency, but it has not so far added it as an item to any provisional ECOFIN agenda.

You ask whether I thought it was likely that the final Directive would include a harmonised maximum compensation limit that is lower than that currently offered by the Financial Services Compensation Scheme (FSCS). There is not yet a clear majority view on compensation level or harmonisation within Council. Although some Member States are still to indicate their preference, a small majority is in favour of minimum harmonisation, allowing Member States to offer a higher compensation limit than the EU minimum should they wish to do so, as is currently the case. Several Member States have
suggested that the current €20,000 is a suitable compensation level in relation to the particular characteristics of their national markets.

As there has been no evidence of regulatory arbitrage for investor compensation, it is unlikely that maximum harmonisation would reduce the competitiveness of UK firms. However, reducing the compensation level could impact on investor confidence, a vital component of financial stability, and we will continue to work to ensure that UK protection is not reduced by the proposed Directive. In Council Working Groups, the Government has argued strongly against any outcome that would require the UK to reduce the compensation limit currently offered by the FSCS.

You note that if investor compensation schemes in other Member States were not properly funded this could leave UK investors in those countries at risk. This risk does of course exist, but is mitigated by limited cross-border provision of Markets in Financial Instruments Directive (MiFID) investment services, which the ICSD covers. The Commission is proposing harmonisation of funding because it is concerned that a number of Member States are not providing suitable coverage. We do not believe that further harmonisation is necessarily required to address this, but also recognise the importance of robust schemes. As I set out in my response to your 6 December letter on the Deposit Guarantee Schemes Directive (DGSD), the DGSD includes a number of requirements that are designed to promote robust schemes. We may be able to combine these with the UK’s extensive experience of compensation schemes and work with the Commission and other Member States to amend the ICSD proposal so that it addresses the Commission’s concerns on funding, while still providing Member States with a large amount of national discretion and flexibility. This is important so that they can take into account the heterogeneity of national markets. We will work with the European Commission and incoming Presidency to explore the options here.

On mutual borrowing, you ask whether schemes would be required to contribute to a loan to other schemes if it was under pressure from domestic compensation claims. The ICSD proposal does not include such a condition, but does provide that schemes with an existing loan cannot borrow again or lend to others until the loan is repaid.

Further conditions on mutual borrowing would not fully mitigate the risks and concerns, and would not account for domestic compensation claims that may arise after a loan. As with exchange rate fluctuations, I do not consider it worthwhile to press for amendments to the Directive to strengthen the mutual borrowing proposal, given that there is strong opposition from a majority of Member States. More importantly, the Government’s fundamental objection to mutual borrowing, as set out in my previous letter, would remain.

UCITS depositaries were discussed again at the third Council Working Group meeting, which took place on 8 December. There remains strong and almost unanimous opposition from Member States to extension of scope to include UCITS depositaries at this time, preferring to wait until the content of the Commission’s forthcoming UCITS V proposal is clearer. The Commission continues to argue that discussions on compensation and depositary liability can be separated, but has not convinced most Member States. Many Member States also highlight the operational difficulties with the proposal, especially in relation to cross-border cases, for example where the investor, the UCITS management company and the UCITS depositary are each located in a different Member State.

I hope that this has been a helpful update on negotiations, and that I have addressed the points raised by the Committee.

21 December 2011

Letter from the Chairman to Mark Hoban MP

Thank you for your letter, dated 21 December, on the Investor Compensation Schemes Directive (EM 12346/10). The EU Economic and Financial Affairs and International Trade Sub-Committee considered it at its meeting on 2 March.

We note your continued opposition to a harmonised maximum/minimum level of compensation under this Directive, on the basis that reducing the compensation available to investors in the UK might impact investor confidence. We do not find this argument particularly persuasive. You have previously argued that there has been no evidence of regulatory arbitrage because the main risk for investors is investment risk for which there is no compensation. If this is the case, then it seems unlikely that a reduced compensation limit will have anything more than a negligible effect on investor confidence.
We are pleased that you recognise our concern that the Directive should ensure that all Member States properly fund their national schemes. We note that you will attempt to meet these concerns, while maintaining in the Directive provision for a high level of national flexibility.

Finally, we note that the mutual borrowing provisions are strongly opposed by a majority of Member States, and therefore are unlikely to be taken forward in the final version of this Directive.

We will continue to hold this document under scrutiny, and we would like updates as negotiations progress. In particular, we would appreciate a prompt update should there be developments on either the harmonisation of funding arrangements, or on the mutual borrowing provisions.

2 March 2011

IRELAND: FINANCIAL ASSISTANCE AND EXCESSIVE DEFICIT (17211/10, 17210/10)

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

As you will be aware, on 28 November the Chancellor attended an additional ECOFIN following the request of the Irish government for financial assistance from the EU. I am writing to update your Committee on what was agreed, and to alert you to the timetable for adoption of the Council decision to issue assistance under the European Financial Stability Mechanism (EFSM).

At the additional ECOFIN Ministers unanimously agreed, in principle, to grant financial assistance to Ireland, in order to safeguard financial stability in the euro area and the EU as a whole.

Euro area and EU financial support will be provided on the basis of a programme which has been negotiated with the Irish authorities by the Commission and the International Monetary Fund, in liaison with the European Central Bank.

The financial package of the programme will cover financing needs up to €85 billion, including €10 billion for immediate recapitalisation measures, €25 billion on a contingency basis for banking system supports, and €50 billion covering budget financing needs. Half of the banking support measures (€17½ billion) will be financed by an Irish contribution through the Irish Treasury cash buffer and investments of the National Pension Reserve Fund. The remainder of the overall package should be shared equally (€ 22½ billion each) amongst:

— the European Financial Stabilisation Mechanism (EFSM);
— the European Financial Stability Facility (EFSF) together with bilateral loans from the UK, Denmark and Sweden; and
— the IMF.

In principle, the UK’s bilateral loan is for £3¼billion, and the rate of interest on the loan will be similar to the rates levied by the IMF and the euro area. HM Treasury will have parallel conversations with Parliament on the Ireland loan bill.

On 7 December, ECOFIN will adopt a Council recommendation to Ireland with a view to bringing an end to the situation of an excessive government deficit. It will also agree a Council decision to grant financial assistance to Ireland according to the Council Regulation 407/2010 establishing a European financial stabilisation mechanism.

Regrettably, the accelerated timetable means that full scrutiny of the Council decision to grant assistance under the EFSM will not be possible before its adoption. However, I hope that your Committee will agree that in such exceptional circumstances there is a need for the EU to act quickly to ensure stability in Europe. The Government will of course provide an explanatory memorandum as soon as the documents are publicly available and answer any questions the Committee has, as usual.

6 December 2010

Letter from the Chairman to Mark Hoban MP

Thank you for your Explanatory Memoranda 17211/10 on a Council decision granting financial assistance to Ireland and 17210/10 on a Council recommendation on the situation of an excessive deficit in Ireland. These documents and your letter, dated 6 December, on these two memoranda, were considered by the EU Sub-Committee on Economic and Financial Affairs and International Trade at its meeting on 18 January.
We note that, due to an accelerated timetable, it was necessary for the Government to override parliamentary scrutiny on these documents. Given the financial situation in Ireland we accept the Government’s view that this was justified.

We are currently considering the issues surrounding these documents as part of our inquiry into economic governance, and will discuss them further in our report which will be published in March. We do not require a response to this letter.

19 January 2011

OMNIBUS II (5523/11)

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

Thank you for your Explanatory Memorandum 5523/11 on the Omnibus II Directive, dated 3 February 2011. The EU Economic and Financial Affairs and International Trade Sub-Committee considered this document at its meeting on 29 March.

Omnibus II is one of a number of legislative proposals contributing to efforts to reform EU financial supervision. We agree that this new proposal for legislation will help align existing sectoral legislation with the mandate of the new European Supervisory Authorities.

Omnibus II appears to make significant changes to the Solvency II Directive. It will, for example, grant extended powers to the European Insurance and Occupational Pension Authority (EIOPA). These will allow it to intervene to eliminate differences among national supervisors in the supervision of international insurance groups. You suggest that EIOPA’s binding mediation role should not result in a transfer of competence away from national supervisors where Solvency II already provides for a decision maker. In addition, you state that you will ensure that negotiations do not grant EIOPA additional powers beyond those set out in Solvency II. To what extent are the proposed new powers granted to EIOPA by Omnibus II necessary to ensure that EIOPA operates efficiently as opposed to an attempt to further erode the powers of national supervisors? What transfer of powers from national supervisors might these amendments allow? How is the FSA engaging with EIOPA and preparing for the implementation of Solvency II?

We have agreed to release the proposal from scrutiny for possible agreement at the next ECOFIN Council in May, but in the meantime we would be grateful for a response to this letter within the standard ten working days.

30 March 2011

Letter from Mark Hoban MP to the Chairman

Thank you for your letter, dated 30 March 2011, following the EU Economic and Financial Affairs and International Trade Sub-Committee’s consideration of Explanatory Memorandum (EM) 5523/11 on Omnibus II, in which you agreed to release the proposal from scrutiny.

As you note, Omnibus II proposes to make a number of changes to the Solvency II Directive, including an extended role for the European Insurance and Occupational Pensions Authority (EIOPA). As stated in the EM, these changes have been developed with the intention of creating a more harmonised set of financial rules in the implementation of Solvency II. The Government supports this objective, subject to Omnibus II’s consistency with the Regulations establishing the European Supervisory Authorities (ESAs) and – in Solvency II and Prospectus - the sectoral Directives that it amends.

You also raised a number of specific questions, the responses to which are set out below.

To what extent are the proposed new powers granted to EIOPA by Omnibus II necessary to ensure that EIOPA operates efficiently as opposed to an attempt to further erode the powers of national supervisors?

The Government is satisfied that the majority of the changes that Omnibus II proposes making to the Solvency II Directive are justified in terms of the powers and tasks that EIOPA should have under the new regime. For example, the Authority’s role in drafting technical standards to supplement the European Commission’s delegated acts should result in a more harmonised standard in the rules
applicable to the European insurance industry. The Government also considers that EIOPA’s binding role in settling cross-border supervisory disagreements - in compliance with Article 19 of the EIOPA Regulation - is a welcome addition to the Solvency II Directive.

Discussions are currently ongoing in the relevant EU Council Working Group to finalise which roles or tasks should be assigned to EIOPA to allow it to operate efficiently. The Government’s view is that any additional tasks assigned to EIOPA should be consistent with the powers allocated to EIOPA in the Regulation establishing it (Regulation 1094/2010) and should respect the limits placed on the powers of EU agencies by the case law of the European Court of Justice (ECJ). Generally, the Government considers the changes proposed in Omnibus II are within these confines. There do appear to be, however, some exceptions. The main example of this is the power to determine when an ‘exceptional fall in financial markets’ has occurred (as explained in more detail below). The Government is of the view that this role can be carried out more effectively by national supervisors.

WHAT TRANSFER OF POWERS FROM NATIONAL SUPERVISORS MIGHT THESE AMENDMENTS ALLOW?

As noted in the EM and acknowledged in your letter, the Government is seeking to ensure that previously-agreed issues (such as those determined at the time of negotiating the Solvency II Directive) are not re-opened as part of the Omnibus II discussions, including where a new role is conferred on EIOPA that conflicts with existing positions. In relation to EIOPA’s binding mediation role, the Government considers that Article 19 of the regulation establishing EIOPA, which gives EIOPA the power to enter into binding mediation, contains sufficient safeguards so as to prevent a transfer of competence away from national supervisors. Thus, the expectation is that such a binding mediation role would be limited to those areas of Solvency II where joint decision-making, cooperation or co-ordination already exists (i.e. more than one national supervisor is involved in the decision), and this is a development that the Government welcomes.

As mentioned above, there is one role in particular that Omnibus II proposes to transfer from the national regulator to EIOPA - the determination of when an ‘exceptional fall in financial markets’ exists. Under the Solvency II Directive where a firm is in breach of its capital requirements, national supervisors are permitted to extend the period of non-compliance to permit the firm to re-establish its capital requirements or reduce its risk profile, where the national supervisor considers that there is an exceptional fall in financial markets. The draft Omnibus II text would, if adopted, transfer the role of declaring such an exceptional fall to EIOPA. The Government’s view is that this is a decision that would be better taken by national supervisors, and that introducing a new power for EIOPA to make the determination would be a disproportionate response to the goal of achieving harmonisation in this area. We continue to make this point in European negotiations.

HOW IS THE FSA ENGAGING WITH EIOPA AND PREPARING FOR THE IMPLEMENTATION OF SOLVENCY II?

The FSA is heavily engaged with EIOPA at all levels. Hector Sants is the UK member of the Board of Supervisors of EIOPA and has also been elected to the Management Board, which comprises the Chairman and six EIOPA members. The FSA is actively involved in all the Solvency II work streams, where advice to the European Commission is formulated and Level 3 measures developed. The FSA chairs two Solvency II-related groups: one dealing with the policy and implementation of the Solvency II internal models regime; and the other looking at the equivalence of third country supervisory regimes governing reinsurance and group-related supervision.

The FSA has had a programme of work in place for some years to prepare for the implementation of Solvency II. As well as continuing to negotiate policy in Europe, the FSA has projects in place to ensure that it has the necessary processes and capabilities to comply with its obligations under the Solvency II Directive. At the same time, the FSA is also working with regulated firms to ensure that their implementation plans are robust and deliverable, and that it is in a position to respond to their requirements in areas such as internal model approval.

The Government would, once again, like to reiterate its support for the overarching objectives of the Omnibus II Directive and stress its commitment to achieving a desirable outcome, both for the United Kingdom and in the context of a harmonised European framework for the supervision of insurance and reinsurance companies.

26 April 2011
Letter from the Chairman to Edward Davey MP, Parliamentary Under Secretary of State, Department for Business, Innovation and Skills

Further to my predecessor’s letter of 18 February 2010, I am writing to update you on the position of the proposal for a Council Regulation on Origin Marking introduced in 2005.

At the end of last year, the European Parliament adopted a First Reading Opinion, expressing support for the proposal but suggesting a number of amendments.

The proposal has now moved to Council where divisions remain between Member States. Nevertheless, discussions will begin later this month in the Trade Questions Council Working Group. The UK will engage constructively in these, but we continue to have strong reservations about the proposal in its current form on the grounds that it will be expensive to implement and introduces unnecessary administrative burdens.

We will of course keep Parliament fully informed of any progress on this dossier.

12 February 2011

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

Thank you for your letter dated 25 November on a Commission proposal for a Regulation on OTC derivatives (EM 13917/10). The EU Sub-Committee on Economic and Financial Affairs and International Trade considered it at its meeting on 14 December.

We welcome your thorough response to the questions we raised. We recognise that further developments are likely to take place, and we would appreciate updates on the progress of negotiations in relation to: CCP access to central bank liquidity; discretion in clearing obligations; the potential powers to be granted to ESMA in respect of the authorisation and supervision of CCPs; and, on any other points of disagreement among Member States. In addition, we would be interested to know the outcome of the first discussion of this item in the European Parliament Economic and Monetary Affairs Committee that took place on 30th November.

We are also aware that the Belgium Presidency has proposed a compromise text for this Regulation. We would be grateful if you could send us a copy of this text, as well as the Government’s view of the proposed compromise.

Finally, we would like to reiterate our view that the overall impact of the proposed legislation on derivatives will depend on the decisions made, and the technical standards developed, by ESMA. We would appreciate clarification on what role will be left to national parliaments and the European Parliament to scrutinise delegated legislation emerging from ESAs’ deliberations, and how transparency will be ensured.

In the meantime, we will continue to keep the document under scrutiny. We would be grateful for a response to this letter within the standard ten working days.

15 December 2010

Letter from Mark Hoban MP to the Chairman

Thank you for your letter dated 15 December asking for an update on the ongoing negotiations of the proposal for a regulation on OTC derivatives, CCPs and trade repositories.

On the specific issues you have raised in your letter, the latest Presidency compromise text allows for CCPs to meet their liquidity needs through commercial bank lines as an alternative to central bank liquidity. It also leaves discretion in applying the clearing obligation by allowing for a phased implementation. We welcome these proposals. With regards to supervision and authorisation of CCPs, we believe the current text could be further clarified to ensure primacy of the home competent authority in these matters.
Finally, as is foreseen by the ESA legislation, any binding technical standards developed by the ESAs would be subject to endorsement by the Commission. In the case of regulatory technical standards, the technical standard cannot come into force if either the European Parliament or the Council objects.

We have enclosed the latest Presidency compromise text for your information.

10 January 2011

Letter from the Chairman to Mark Hoban MP

Thank you for your letter, dated 10 January, on the Commission proposal for a Regulation on OTC derivatives (EM 13917/10). The EU Sub-Committee on Economic and Financial Affairs and International Trade considered it at its meeting on 1 February.

We would like further clarification on the provisions regarding clearing obligations, especially for non-financial users. In your previous letter you mention that the latest compromise text "leaves discretion in applying the clearing obligation by allowing for a phased implementation". What does a “phased implementation” entail?

We note that the Hungarian Presidency has prepared a new compromise text. What are the issues that are still hampering an agreement in the Council and how does the Hungarian compromise differs from the Belgian text? What view is the European Parliament taking on the proposal?

We will continue to hold this document under scrutiny until the outcome of negotiations become clearer, and we would be grateful for a response within the standard ten working days.

1 February 2011

Letter from Mark Hoban MP to the Chairman

Thank you for your letter dated 1 February 2011 requesting detail on the process envisaged in implementing the clearing obligation and on the outstanding negotiating items in the Council discussions.

Your letter asked for clarification regarding the clearing obligations. The Government is of the view that the clearing obligation needs to be implemented in a flexible way allowing for phasing in. In our view, an obligation to centrally clear all derivative contracts from day one could entail risks for both the central counterparty (CCP) and market participants. At this stage, the details of a ‘phased implementation’ are not yet decided. We believe that ESMA is best placed to determine how this flexibility should be applied in practice with a view to minimising systemic risk.

Outstanding issues remain around the authorisation process for CCPs, the supervision of trade repositories, and the scope of the legislation.

The Government continues to oppose the current compromise text which requires a joint positive opinion by the College of Commissioners before a CCP can be authorised by the home competent authority. In light of the fiscal implications of a failure of a CCP, the home competent authority needs to be able to take authorisation decisions without explicit consent from the College. On trade repositories, we continue to argue that home state authorisation and supervision powers should be maintained.

The main difference between the Belgian and the Hungarian compromise text is the extension of the scope of this regulation to all derivatives which has received strong push back from some Member States. The Government believes that restricting the scope to OTC derivatives only risks creating a loophole. Firms could simply trade through trading venues to avoid the clearing obligation which would run counter to the G20 objective of reducing counterparty credit risk. The Government is therefore supportive of the amended text.

At this stage the views of the European Parliament are unclear. We will know more when the Rapporteur publishes an English version of his report, due shortly. MEP amendments to this text are expected by mid March.

I hope this provides a satisfactory response to your questions. I would also like to make you aware that the Economic and Financial Affairs Council is due to adopt a general approach on this regulation on 15 March.

12 February 2011
Letter from the Chairman to Mark Hoban MP

Thank you for your letter, dated 12 February 2011, on a Commission proposal for a Regulation on OTC derivatives. The Economic and Financial Affairs and International Trade Sub-Committee considered it at its meeting on 3 May.

In anticipation of a general approach on the proposal, we have agreed to release the proposal from scrutiny. We believe that it is significant that the proposal, originally intended to provide the rules for central clearing and risk mitigation of OTC derivatives, now may apply to exchange-traded derivatives as well. What are the implications of this change in light of the fact that the US Dodd-Frank legislation is limited to OTC derivatives? Is this change of scope also supported by the European Parliament? We would appreciate your view on the position of the European Parliament and a continued update on the negotiations, especially with regards to points related to supervision and authorisation of trade repositories and CCPs.

Finally, we would appreciate clarification on the treatment of non-financial organisations which use derivatives for the purposes of risk management, such as farmers. Will they be exempt from the clearing obligation where they are hedging commercial risk or are not systemically important? If so, will they have to hold more capital against non-cleared contracts? Are there any other rules which will apply such non-financial organisations?

We would be grateful for a response to this letter in the standard ten working days.

4 May 2011

Letter from Mark Hoban MP to the Chairman

Thank you for your letter dated 4 May 2011 requesting an update on the negotiations, in particular the scope of the legislation and the authorisation and supervision arrangements for Central Counterparties (CCPs) and Trade Repositories (TRs).

The Government believes there is a strong case for extending the scope of the regulation to all derivatives. A narrower scope of the legislation could create loopholes, potentially allowing firms to avoid the clearing obligation by trading on organised trading venues that are under no obligation to centrally clear. A broad scope would close this loophole. It would also allow CCPs access to trading venues (and vice versa), thereby encouraging competition. A legislative scope capturing all derivatives is also similar to the Dodd-Frank Act in the US which applies to all swaps irrespective of whether they are traded over the counter or on exchange.

On the supervision and authorisation of CCPs and TRs, we continue to argue for responsibility to remain with national Competent Authorities. We have received some support but discussion continues in Council. In the European Parliament, the ECON Committee is due to vote on EMIR amendments on the 24th May and I would be happy to report back to you on the outcome once the vote has taken place.

On your final question regarding non-financial users of derivatives, I can confirm that these have been excluded from the scope of the legislation to the extent that their use of derivatives is for pure commercial hedging purposes. They will not be obliged to centrally clear, and as non-financial firms will not be directly subject to changed capital rules for these transactions. Any indirect impact from new capital rules will be determined by the outcome of the Capital Requirements Directive IV negotiations.

I hope this provides satisfactory responses to your question. I would also like to make you aware that this regulation is likely to feature on the agenda for the June ECOFIN.

19 May 2011
and Financial Affairs and International Trade Sub-Committee considered this document at its meeting on 17 May.

We would be interested to know whether you believe that the Commission has chosen the appropriate procedure for each of the 24 Regulations covered and, in particular, whether there are any instances where the examination procedure has been chosen when the delegated legislation procedure would be more appropriate.

Secondly, we note that in 16 of the 24 Regulations the Council reserved the right to adopt measures to itself, including implementing powers. We presume that there were reasons for doing so at the time they were adopted. Is the Government happy that these reasons are no longer relevant and that the Commission should now be responsible for implementing these Regulations? Are there any instances where the Government feel that the power to implement should be retained by the Council, as envisaged by Article 291 TFEU?

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

17 May 2011

PROPOSALS ON ECONOMIC GOVERNANCE (14496-14498/10, 14512/10, 14515/10, 14520/10)

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

Thank you for your two Explanatory Memoranda on a package of Commission proposals on economic governance (covering documents 14515/10, 14512/10, 14496/10, 14497/10, 14498/10 and 14520/10). The EU Economic and Financial Affairs and International Trade Sub-Committee considered these at its meeting on 30 November.

The Sub-Committee is considering these proposals as part of its inquiry on economic governance, and consequently they will be held under scrutiny until its report has been published and debated in the House.

We do not require a response to this letter.

6 December 2010

Letter from the Chairman to Mark Hoban MP

The EU Economic and Financial Affairs and International Trade Sub-Committee is currently carrying out an inquiry on the future of economic governance in the EU. The report will cover the Commission’s legislative proposals, the recommendations of the van Rompuy taskforce, and the Council’s recent decision to establish a permanent crisis resolution mechanism for euro area Member States. This report will be published at the end of March, before the European Council meeting on 24 and 25 March.

This letter sets out our position ahead of consideration of the Commission’s proposals for improved economic governance at ECOFIN on 15 March. We stress that these views are still preliminary; our final opinion on these proposals will be set out in the published report later this month.

AMENDING THE STABILITY AND GROWTH PACT

— We support the Commission’s proposals to introduce an explicit public debt trigger into the excessive deficit procedure. We note your opposition to the introduction of a numerical benchmark for reducing public debt. We believe that very highly indebted countries should have to reduce their levels of debt faster than those who are only slightly breaching the 60% criterion, and that for these countries the setting of a benchmark is justified.

— The markets now recognise that different Member States in the euro area present different levels of risk. They will in future therefore play a key role in restraining fiscal irresponsibility among Member States. The markets have not, however, always proven effective at enforcing responsible fiscal
behaviour and a sanctions regime to reinforce compliance must also be available.

Sanctions have proven ineffective in the past. The Commission has proposed a series of measures to make it more likely that they will be imposed and thus make them a real deterrent to irresponsible fiscal policies. These measures would involve more graduated sanctions and the introduction of ‘reverse majority voting’ to make it harder for the Council to block sanctions. We support these measures. The final responsibility for imposing sanctions, however, will continue to rest with the Council – as is only appropriate. Only time will tell whether the collective will of Member States will be strong enough to ensure that the sanctions process is applied rigorously once the current crisis is over.

Budgetary Frameworks of Member States

We welcome the Commission’s proposal to complement the top-down oversight of fiscal policy through the incorporation of EU-wide fiscal rules into domestic fiscal frameworks. We note, however, that the Directive may be more effective if Member States implement these rules through national legislation as far as possible, rather than relying on administrative provisions.

Macroeconomic Surveillance and Enforcement

The euro area crisis made clear the need to extend surveillance beyond fiscal matters, and we welcome therefore the Commission’s proposals to monitor excessive macroeconomic imbalances. In particular, we welcome their recognition that levels of private debt should fall under this surveillance.

There is an intrinsic difficult in defining, measuring and analysing macroeconomic imbalances, and in distinguishing between excessive and benign imbalances. The success or otherwise of the planned measures will depend on the capacity of the early warning system to detect excessive imbalances at a sufficiently early stage, and on Member States having the political will to engage in honest discussion of the results. There will be a need for judgement to distinguish between macroeconomic developments which can be blamed on national policy choices, improvements in competitiveness that arise from sound structural policies, and current account divergences that reflect inconsistencies in domestic demand between Member States.

Where excessive current account deficits arise as a result of national policy choices it is proper that they should be subject to corrective recommendations under these proposals. While we recognise that there are two sides to current account imbalances we do not believe it is appropriate or realistic to issue corrective recommendations to a country with a current account surplus. Nevertheless, surpluses are not always benign and it is important that surplus countries also face pressure to contribute to the reduction of imbalances.

Because of the intrinsic difficulty in determining what constitutes an excessive imbalance, we have strong reservations about resorting to sanctions within the excessive imbalance procedure.

The causes of the current crisis are now well known; the causes of any future crises, however, are likely to be different. We recommend that the Commission and Member States ensure that the criteria and types of imbalances covered by this surveillance are regularly reviewed to maintain their relevance as EU and global economies develop.

The European Systemic Risk Board

The ESRB will serve as the interface between macro-prudential and macroeconomic surveillance regimes in the EU. More consideration should
be given to the way in which the ESRB interacts with the Commission and ECOFIN within the economic governance framework.

— The ESRB is the route through which central banks, and the ECB in particular, should be able to contribute actively to discussions on the fiscal and macroeconomic position of Member States. The analyses of the ESRB must be considered and acted upon when looking at the results of the new macroeconomic surveillance.

OVERALL CONCLUSIONS

— While the measures for enhanced coordination proposed by the Commission will (with the exception of sanctions) apply to all Member States, it is in the euro area that these measures are most necessary.

— In design, we believe that they are a step in the right direction, and will complement the constructive work that has already been done to strengthen regulation and oversight of the financial sector. The proposals relating to fiscal discipline and cooperation should make it easier for Member States in the euro area to arrive at a collective fiscal stance that is coherent with a centralised monetary policy. Similarly, the proposals for more intensive macroeconomic surveillance should help detect and address excessive imbalances which have the potential to destabilise the euro area. We do, however, stress that the excessive imbalance procedure should not result in countries with a current account balance in surplus being asked to make adjustments which will harm their competitiveness in a global economy.

— Above all, it is the implementation of these measures that we have the greatest concerns about. Previous attempts to enforce fiscal discipline on Member States were largely ineffective. If these new proposals for economic governance are to have any chance of success it is essential that the political authorities of the EU take them seriously and abide by the rules. Governments will, in future, be encouraged to do so by markets which are less likely to make the same mistakes again in treating the sovereign debt of all euro area Member States as risk-free. The markets are not foolproof however and will need to be supplemented by effective enforcement mechanisms. The political resolve of Member States, particularly France and Germany, will determine whether these measures to increase the long-term stability of the EU, and the euro area in particular, are successful. We remain sceptical that this will be the case.

We are aware that a general approach on these proposals might be reached at ECOFIN on 15 March. We make these observations to inform the Government’s deliberations in advance of that meeting. Although we will continue to hold the proposal under scrutiny, we have agreed to grant a scrutiny waiver should your consent be necessary to make progress on the proposal.

We do not require a response to this letter.

10 March 2011

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

I write further to your letter of 10 March and previous correspondence relating to your inquiry into the future of economic governance in the EU. I thank you for advising me of your preliminary thoughts on this subject ahead of the 15 March discussion at ECOFIN and for granting us a scrutiny waiver. As you are aware, these negotiations have been progressing very quickly and your flexibility with regard to scrutiny assisted us in achieving positive results in the negotiations.

At the meeting ECOFIN agreed general approach texts on the European Commission’s six economic governance proposals. I am writing to update you on the significant changes that were agreed.

PROPOSED DIRECTIVE ON BUDGETARY FRAMEWORKS

The Council agreed that Articles five, six and seven of the proposed Directive would not apply to the UK. These are the provisions that set requirements on the design and application of domestic
numerical fiscal rules, including that Member States have numerical fiscal rules in place that take into account the Treaty reference values of three per cent and sixty per cent of GDP respectively. A Recital has been inserted into the draft legislation recognising that, by virtue of the UK’s Protocol opting out of the single currency, these values are ‘not directly binding’ on the UK. It further recognises that the Protocol similarly precludes the application to the UK of an obligation for multi-annual budgetary objectives in medium-term budgetary frameworks to be consistent with Stability and Growth Pact thresholds.

These Articles were the basis for the concerns we had previously expressed relating to subsidiarity and the possibility of an infringement of the UK’s fiscal sovereignty. I am therefore delighted that Council has recognised the UK’s unique position in relation to the Treaty in this respect.

Alongside this decision, the European Commission has confirmed in a letter to the UK that transposition of the Directive need not involve Member States enacting national legislation. The letter further confirms that the Commission does not consider there to be any serious deficiencies in the UK’s fiscal framework and that in several areas it can be considered an example of EU best practice. The letter also welcomes the Government’s creation of the OBR and the improved transparency and credibility it provides.

I believe this is an excellent outcome for the UK and I am particularly pleased at the Commission’s acknowledgment of the UK’s strong domestic fiscal framework.

Regulations on strengthening the surveillance of budgetary positions and the surveillance and coordination of economic policies, and on speeding up and clarifying the implementation of the excessive deficit procedure

The Council formally stated that in general it will follow the proposals or recommendations of the European Commission when making decisions relating to these Regulations. Where it does not do so, the Council will undertake to provide a written explanation of the reason for diverging from the Commission recommendations.

The Council also agreed that Member States should have increased discretion in deciding the level of risk from public liabilities to be reflected in medium-term budgetary objectives.

Overall I believe the Council has struck the right balance. It is right and proper that the Council retains discretion on decisions regarding the Stability and Growth Pact. However, a general understanding that the Council will provide an explanation for where it departs from the Commission’s recommendations then should help ensure that the rules are applied more consistently and effectively than occurred pre-crisis.

REGULATION ON THE PREVENTION AND CORRECTION OF MACROECONOMIC IMBALANCES

The Council clarified that the Regulation would provide for a ‘more formal and detailed’ framework for the surveillance of macroeconomic imbalances, one which would operate within the existing Treaty mechanisms and procedures for surveillance under Article 121.

This is a useful clarification that I hope will help to assuage any concerns that the proposed legislation introduces new surveillance. As the Council has now made clear, the measures proposed would simply formalise surveillance already provided for by the Treaty and undertaken previously under the Lisbon Agenda and the Europe 2020 strategy.

The Council agreed that the Commission and Council should ‘closely cooperate’ in setting up the scoreboard of indicators that will be used to monitor macroeconomic developments and the emergence of imbalances within and across Member States. In practice this may mean confirming the indicators in a code of conduct, along the lines of that which exists for the Stability and Growth Pact. Discussions are ongoing in Council on which indicators and ‘alert thresholds’ (that would highlight issues for further analysis) Member States agree should be used in the scoreboard.

The use of a Code of Conduct for the proposed macroeconomic indicators would be a sensible approach. It creates the flexibility necessary to respond to changing economic conditions over time without having to amend legislation.

The legislation sets out only the procedure for adopting the scoreboard, and not the precise indicators and alert thresholds that will be used. However, the general approach contains some principles for the scoreboard that will guide ongoing negotiations on these, including that they should be ‘differentiated’ between euro-area and non-euro area Member States. The Government is of
course actively engaged in these discussions on indicators and thresholds and I will write to you again in due course to advise you of the outcome.

The Council agreed with many of the main elements of the Commission’s proposed ‘Excessive Imbalances Procedure’ comprising policy recommendations to Member States followed by reporting on corrective action. The Council clarified that an Excessive Imbalances Procedure would be closed when the Member State concerned had taken the recommended corrective action and Council agrees it to be no longer affected by excessive imbalances.

I understand the concerns of some Member States that excessive imbalances might persist even after all recommended corrective action has been taken, since they are not entirely within a government’s control. However, the Government agrees that it is sensible that, in such circumstances, the excessive imbalances procedure should be held in abeyance rather than closed altogether.

REGULATIONS RELATING TO ENFORCEMENT OF BUDGETARY AND MACROECONOMIC SURVEILLANCE IN THE EURO AREA

There was broad support for an amendment to the original Commission proposals on the treatment of fines and interest on deposits received from euro area countries under the Excessive Deficit Procedure or the Excessive Imbalances Procedure. The Commission had originally proposed that these should be redistributed among euro area Member States not in excessive deficit or excessive imbalance. However the amendment, subsequently formally agreed at March European Council, directs these funds into the European Financial Stability Facility or its successor mechanism, the European Stability Mechanism.

Whilst the Government broadly supports the concept of sanctions within the euro area, it must be primarily for the governments of those Member States affected to determine policy in this area. Nevertheless the Government is happy with the outcome of these discussions.

Thank you for notifying me of the publication of your report The future of economic governance in the EU. My officials are currently considering its contents and we will shortly be preparing the Government’s response. I shall of course ensure that this is forwarded to you within two months in accordance with your requirements.

14 April 2011

Letter from the Chairman to Mark Hoban MP

Thank you for your letter, dated 14 April 2011, on a series of Commission proposals relating to economic governance in the EU. The EU Economic and Financial Affairs and International Trade Sub-Committee considered this document at its meeting on 10 May.

We welcome this update, and we hope that negotiations on these six proposals continue to progress smoothly. Our views are set out in detail in our report The future of economic governance in the EU, to which we look forward to receiving the Government response by the end of the month.

We do not require a response to this letter.

10 May 2011

PROPOSED REGULATION ON NATIONAL AND REGIONAL ACCOUNTS (5053/11)

Letter from the Chairman to Francis Maude MP, Minister for the Cabinet Office

Thank you for your Explanatory Memorandum 5053/11 on a Proposal for a Regulation on the European system of national and regional accounts in the European Union, dated 20 January 2011. The EU Economic and Financial Affairs and International Trade Sub-Committee considered this document at its meeting on 5 April.

You note that “many of the economic data series feeding into analyses used to either support establishing new policy or amend existing policy will change” as a result of the adoption of ESA 2010. Might this have any knock-on effect on existing legislation or policies, or result in accounts that are not comparable to previous years?
We have agreed to clear these documents from scrutiny, but we would be grateful for a response to this letter within the standard ten working days.

6 April 2011

Letter from Francis Maude MP to the Chairman

Thank you for your letter dated 6 April regarding the above EM. You asked if the adoption of ESA2010 would have any knock-on effect on existing legislation or policies, or results in accounts that are not comparable to previous years.

The changes within the ESA2010 reflect the measurement of economic activity, evolution of new products and processes (e.g. financial services), and makes for better quality measurement. The move onto the ESA2010 helps to ensure that the UK and other EU Member States' accounts are still comparable. As a result, this will help to better support legislation and new policies. There is no known issue whereby existing legislation or policy would have been different had the accounts already moved onto ESA 2010.

In terms of the accounts being comparable, as part of moving the National and Regional Accounts onto the ESA 2010, the Office for National Statistics (ONS) will rework previous years' accounts to ensure that the consistency of time series is retained and no discontinuities introduced. This was also the approach applied by the ONS when the accounts were moved onto the ESA 1995 in 1998.

19 May 2011

REPORTS ON THE FOLLOW-UP TO THE DISCHARGE FOR THE 2008 FINANCIAL YEAR, AND THE 2009 EU BUDGET (16662/10)

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

Thank you for your Explanatory Memorandum 16662/10 on a Commission report on the follow-up to the discharge for the 2008 financial year, dated 18 December, and an unnumbered Explanatory Memorandum on the European Court of Auditors’ (ECA) Annual Report on Implementation of the 2009 EU Budget, dated 25 November 2010. The EU Economic and Financial Affairs and International Trade Sub-Committee considered these documents at its meeting on 5 April.

You draw attention to the fact that the ECA has not provided a clear indication of the overall proportion of the 2009 EU Budget that received a positive Statement of Assurance in relation to its legality and regularity. Given that the Commission has a stated aim to increase the 2008 percentage by 20% by 2014 this seems like an unhelpful omission. What action is the Government taking to ensure that the ECA produce an overall figure in their Annual Report on the 2010 EU Budget?

We support your view that more needs to be done to ensure a rapid progression towards an overall positive Statement of Assurance from the ECA, but we are encouraged that the Commission has continued the trend of improving its performance year on year.

We note that expenditure on cohesion policy continues to show the highest rate of error in the EU Budget. The ECA notes that the error rate is above 5%; do they provide a more definite figure setting out how much above 5% the error rate was in 2009? Why is expenditure on cohesion policy so much more prone to error than other policy areas?

Has an assessment been made of any differences in error rates between those funds directly disbursed and administered by the Commission, and those for which responsibility is shared with Member States? Does the ECA carry out or publish any assessment of how effectively each Member State administers EU funds? To what extent are Member States, rather than the Commission, responsible for the continuing high error levels in the EU Budget?

We welcome the continued preparation of a Consolidated Statement on the use of EU funds in the UK, but we note that in the Consolidated Statement for the year ended March 2009 the Comptroller and Auditor General identified “a number of significant accounting and other issues which need to be addressed” to ensure the Consolidated Statement presented an accurate view of the use of EU funds in the UK. In addition, he pointed to losses of £398 million in 2008-09 and the provision for future losses of £601 million in the future through financial corrections by the Commission. The Government has said that it is introducing new measures to improve financial discipline of EU funds spent in the UK. We hope that these prove effective and that the next Consolidated Statement shows
an improvement in the UK’s performance in this field. We believe that this would give the UK Government a strong platform from which to encourage other Member States to adopt similar initiatives. Is there any formal sharing of best practice in administering EU funds among Member States?

We note that the UK abstained from the vote to recommend the discharge of the 2009 EU Budget in Council. We have agreed to clear EM 16662/10 on the follow-up to the 2008 Budget from scrutiny, but have decided to keep the ECA Annual Report on the 2009 EU Budget under scrutiny. We would be grateful for a response to this letter within the standard ten working days.

6 April 2011

Letter from Justine Greening MP, Economic Secretary, HM Treasury, to the Chairman

Thank you for your letter of 6 April following consideration by your Sub-Committee of my Explanatory Memoranda on the Commission’s report on the follow-up to the discharge for the 2008 EU budget and the European Court of Auditors’ (ECA) Annual Report on the 2009 EU budget.

In previous years, the ECA published statistics on the percentage of the EU budget to receive a positive Statement of Assurance in relation to its legality and regularity. Their report on the 2008 EU budget indicated a positive figure of 47%, compared to 40% in both 2006 and 2007, 35% in 2005 and just 6% in 2003. No such statistics exist in the report on the 2009 EU budget and the ECA have not given a concrete explanation for this omission.

Given that the ECA is an independent body, the Government cannot directly influence the work of the ECA. However, the UK takes the management of EU funds very seriously. All EU spending must adhere to the highest possible standards of financial management and transparency. The UK has called for the publication of more detailed and useful information on the state of EU financial management, and will continue press for improvements in Council’s budget committee.

While the UK welcomes the ECA’s unqualified positive Statement of Assurance on the reliability of the EU’s accounts, the high error rate for Cohesion Policy remains a concern. The majority of errors and irregularities relating to Cohesion Policy are due to the sheer complexity of rules and regulations and hence, misinterpretation or misapplication of the rules by Member States’ implementing authorities. Although the likely error rate for Cohesion Policy has declined significantly since 2008, the Government believes that further progress should be made, particularly given that Cohesion Policy accounts for around 30% of EU Budget expenditure.

The ECA does not consistently announce the exact error rates for any given area of spend. However, as the policy section of my Explanatory Memorandum indicates, we understand from informal discussions with the ECA that the likely error rate for 2009 is around 6%, compared to an error rate in the region of 11% in the report on the 2008 EU Budget.

The Cohesion Policy works on multi-annual programming periods. Actual implementation of EU spending from each programming period may overlap at certain points in time. At present, the current period 2007-2013 is being implemented, the 2000-2006 programmes are on the verge of being closed, and some 1994-1999 programmes are still partially open. In terms of irregularities reporting, this means that the Commission is currently receiving reports concerning three programming periods. Furthermore, the closure of the programming period 2000-2006 implies increased check and audit activities on these programmes, resulting in a higher number of irregularities being detected and reported. This increase in reported irregularities is in line with that observed around the closure of most programmes from the period 1994-1999.

The Government regrets that no detailed assessment of the differences in error rates between funds administered by the Commission and those implemented by Member States is available from the ECA. The Government notes that the European Anti Fraud Office (OLAF) 2009 Fight Against Fraud report does indeed give a summary of the statistics on irregularities reported by Member States in those areas where they implement the EU budget (Agricultural and Cohesion Policy and Pre-Accession funds), and for the collection of the Union’s Own Resources. It also gives an estimate for the expenditure that it manages directly. This should be considered as an instance of good practice, which the ECA could also adopt.

In terms of assessing the effectiveness of how each Member States administers EU funds, the Government considers that this would be a particularly positive step forward, and regrets that such figures are not currently available. In a bid to increase transparency, the joint statement signed by the UK, Sweden and the Netherlands at the 15th February ECOFIN Council calls on the ECA to include a
“scoreboard” of recovery rates by Member State, and also requests Member States to include more meaningful information on financial management in their annual summaries. I therefore wholeheartedly welcome the Committee’s suggestion, which accords with the Government’s position.

The areas of EU expenditure that regularly demonstrate the highest rates of error in the budget are implemented under shared management, which account for more than 80% of the budget. The Commission remains ultimately responsible for the execution of the budget. It is right, however, that Member States take responsibility for the high error rate in these areas, as the majority of errors and irregularities under shared management are due to misinterpretation or misapplication by Member State implementing authorities of the complex rules and regulations currently in place. The Government takes its responsibility for the management of EU funds very seriously, and is working hard to obtain simplification of the necessary rules and regulations relating to EU programmes as part of the regulatory framework for the next Financial Perspective.

While there is currently no formal sharing of best practice in administering EU funds amongst Member States, OLAF has compiled a compendium of lessons learnt from its operational activities, which are systematically and effectively exploited to prevent and deter future frauds. OLAF’s fraud prevention and intelligence activities aim at ensuring that the fraud types, trends, threats and risks posed to the EU budget can be better understood, more quickly identified and stopped by those responsible for managing EU funds. While fraud and financial mismanagement are clearly very different issues, OLAF’s sound practice in this area could nevertheless be applied by Member States authorities responsible for implementing EU funds. In parallel, the Government is currently pushing for the introduction of a ‘one-stop-shop’ at EU level for information and advice to those who implement EU funds, in order to reduce errors.

12 May 2011

Letter from the Chairman to Justine Greening MP

Thank you for your letter, dated 12 May 2011, on a Commission report on the follow-up to the discharge for the 2008 financial year, dated 18 December, and on an unnumbered Explanatory Memorandum on the European Court of Auditors’ Annual Report on Implementation of the 2009 EU Budget. The EU Economic and Financial Affairs and International Trade Sub-Committee considered these documents at its meeting on 24 May.

We support your efforts to encourage the European Court of Auditors (ECA) and other Member States to publish information on the effectiveness of the implementation of EU funds administered by Member States. Given that the majority of EU funds are implemented under shared management, this appears to us to be an essential step if the EU Budget is to progress towards receiving an unqualified positive Statement of Assurance from the ECA.

We would also welcome your continued efforts to press for the ECA to publish an assessment of the overall percentage of the EU Budget that receives a positive Statement of Assurance in relation to its legality and regularity. This seems to us to be an important tool to determine the progress being made in improving the management of EU funds.

We have written to the European Court of Auditors to express our views on these matters. A copy of the letter is attached.

We would also back your efforts to establish an EU level “one-stop-shop” for information and advice for those implementing EU funds. This seems a sensible innovation given the continuing mistakes made implementing EU funds by Member States.

We have agreed to clear European Court of Auditors’ Annual Report on Implementation of the 2009 EU Budget from scrutiny. We do not require a response to this letter.

24 May 2011

SANCTIONING REGIMES IN THE FINANCIAL SECTOR (17849/10)

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

Thank you for your Explanatory Memorandum 17849/11, dated 31 January 2011, on a Commission Communication on sanctioning regimes in the financial sector. The EU Economic and Financial Affairs and International Trade Sub-Committee considered it at its meeting on 3 May.
We welcome the reflections by the Communication on how to improve the convergence of sanctioning regimes across the EU. It is important that standards of sanctioning regimes across the EU are consistent to avoid the possibility of regulatory arbitrage. We support the Commission’s approach to promote convergence rather than harmonisation of sanctions regime across the EU.

The new European Supervisory Authorities (ESAs) would have a key role in ensuring the consistency of applications of sanctions and we will explore this aspect in forthcoming evidence sessions with the EBA and FSA.

While we have agreed to clear this document from scrutiny, we understand that this Communication might pave the way for further initiatives on sanctions. We would therefore like to be updated on progress on discussions and receive a copy of the Government’s response to the consultation.

We look forward to receiving a response in due course.

4 May 2011

Letter from Mark Hoban MP to the Chairman

Thank you for your letter, dated 4 May, which outlines the Committee’s approach in this area and also the confirmation of clearance from scrutiny.

You asked for the UK response to the Commission’s consultation. HM Treasury and the Financial Services Authority submitted a joint response on 21 March, and this is attached for your information.

The Commission is currently looking at all the responses received and we have been informed that they intend to issue a legislative proposal by end 2011. I will, of course, keep your Committee updated with any developments.

26 May 2011

SHORT SELLING AND CREDIT DEFAULT SWAPS (13840/10)

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

Thank you for your letter on a Commission proposal for a Regulation on short selling and certain aspects of credit default swaps (EM 13840/10). The EU Economic and Financial Affairs and International Trade Sub-Committee considered this document at its meeting on 25 January.

We understand that discussions continue in the Council’s working group with regard to this proposal. We would be grateful for an update that highlights the different points of view and controversy among Member States, and in particular we would like to know which Member States have supported the UK in opposing restrictions on naked short selling. We are also interested in the discussions concerning the potential effects of a ban on naked short-selling and CDS on sovereign bonds.

We would also like to clarify your view on ESMA: you note that ESMA’s powers to intervene do accord with the principle of subsidiarity, ie coordinated intervention at an EU would be more effective than action by individual Member States, but you object to ESMA being given intervention powers. It is proposed that ESMA could only intervene where a Competent Authority has not taken adequate measures to address a threat with cross-border implications. By taking away any power to intervene you leave ESMA powerless to address cross-border risks where a single Competent Authority refuses to act. Does this not defeat the purpose of having a cross-border authority?

We would also like to hear about any sticking points concerning the powers of ESMA now that this authority is in place. Finally, we would like to seek your view on the report prepared by MEP Pascal Canfin on the Commission's proposal. In the meantime, we have agreed to keep the document under scrutiny.

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

25 January 2011

Letter from Mark Hoban MP to the Chairman

Thank you for your letter of 25 January. You have asked about the key issues under discussion in relation to the above regulation and the positions of other Member States. The main issues to date
have been sovereign debt, naked short selling, a marking regime for shares and ESMA powers. These areas are dealt with in turn below.

Regarding the positions of Member States, by convention the positions taken in Council working groups are confidential. I regret that I cannot therefore be specific in outlining those positions. However, the Government is keen to provide a balance between this understanding and its commitment to facilitate effective Parliamentary scrutiny of EU dossiers. In order to assist the Committee’s consideration of this proposal I will provide an outline of the direction of negotiations.

SOVEREIGN DEBT

The inclusion of measures to restrict the short selling of sovereign debt and CDS has generated significant discussion in the Council working groups. Officials have argued strongly for a removal of all references to sovereign debt from the proposal on the basis that there is a lack of evidence to support the assertion that short selling of sovereign debt or sovereign CDS has played a significant part in the recent financial crisis. You may wish to be aware that the European Commission’s recently published CDS taskforce report does not suggest the need for regulation.

Officials have produced evidence to support our views at working group and highlighted the likely effect of the proposals on the ability of member states to raise sovereign debt by way of a paper prepared jointly by HM Treasury and the UK Debt Management Office. Six other Member States have supported removing sovereign debt from scope.

RESTRICTIONS ON UNCOVERED SHORT SELLING

As you are aware, the Government has taken a robust line that there should be no restrictions on uncovered short selling and that such measures should be deleted from scope. We have been supported by a number of Member States. Two alternative positions on this issue have also emerged: some Member States have proposed the retention of restrictions to uncovered short sales on sovereign debt but an exemption for intra-day short selling of sovereign, municipal debt and equities. Others have suggested that the regulation should be amended to provide for different treatment of uncovered short sales in different instruments.

MARKING

The proposal includes a regime to electronically mark all orders made on trading venues for the purpose of shorting. Government officials have been very vocal in opposing the marking regime, pointing out that it involves much cost for little benefit and may be detrimental to smaller market participants. The majority of Member States support the deletion of the marking provisions and the Presidency and Commission have acknowledged the consensus in Council in favour of deletion.

ESMA POWERS

It is necessary to consider ESMA’s intervention powers in the context of both the regulation which established ESMA (the ESMA Regulation) and the case law of the European Court of Justice. The ESMA Regulation clearly sets out the scope of ESMA’s powers. It contains enabling provisions, and any power given to ESMA in reliance on these enabling provisions must respect the parameters set out in the ESMA Regulation. It must also comply with the limits in the relevant case law on the powers which may be delegated to EU agencies. Our concern is that the intervention powers set out in Article 24 of the proposal do not respect these parameters.

The balance of the powers assigned to the EU institutions is an essential characteristic of the EU structure and is set out in the Treaties. The case of Meroni considered how this fundamental guarantee is affected by the delegation of powers to EU agencies. It established the principle that if EU institutions delegate powers which have been conferred on them by the Treaties to agencies, such delegation must be limited to executive powers that are clearly defined and entirely supervised by the delegating institution, on the basis of specific and objective criteria. On the other hand, such delegation cannot concern discretionary powers which may involve the execution of policy, since this would jeopardise the balance of powers between the institutions.

The Government’s concern is that the short selling proposal seeks to confer intervention powers on ESMA that do not comply with this principle. They seek to confer on ESMA a wide discretionary power which would make possible the execution of economic policy; such a power cannot be lawfully delegated. Even if it could be said that the powers fall within the permitted delegation and are merely
executive powers, there is no attempt to set out in the proposal the objective criteria which would render ESMA’s decision subject to the strict review that Meroni requires.

The Government notes your concern that if ESMA is not given the intervention powers set out in this proposal, it would be unable to address cross-border risks, should a competent authority refuse to act. However, this is not the case: the regulation establishing ESMA gives ESMA power to act, including a direct power over firms, should such a competent authority be in breach of EU law, or if the Council has declared an emergency situation.

Finally, you asked for views on the Canfin Report. A number of the areas highlighted in the report run counter to the priorities I have outlined above, for example on the marking regime, general short selling restrictions and banning naked sovereign CDS. In addition, Mr Canfin is seeking to extend the remit of the regulation to new areas such as restricting short selling in corporate debt and CDS, as well as adding a notification requirement for leveraged long positions which the Government does not support. However, the report also recommends an exemption from short selling for market makers which the UK and other Member States have supported.

7 February 2011

Letter from the Chairman to Mark Hoban MP

Thank you for your letter, dated 7 February, on a Commission proposal on short selling and certain aspects of credit default swaps (EM 13840/10). The EU Economic and Financial Affairs and International Trade Sub-Committee considered this item at its meeting on 8 March.

This letter sets out our position on the document ahead of discussions on the proposal at ECOFIN on 15 March. This letter is informed by written evidence which we took in late 2010.

Our letter covers the following points:

— A General consideration of the proposed legislation on short selling and certain aspects of credit default swaps;
— The effect of credit default swaps and short selling on sovereign bonds;
— Restrictions on uncovered short selling;
— The need for a global approach; and
— Institutional considerations.

A GENERAL CONSIDERATION OF THE PROPOSED LEGISLATION ON SHORT SELLING AND CERTAIN ASPECTS OF CREDIT DEFAULT SWAPS

As stated in our earlier correspondence, we support a uniform approach to regulating short selling across the EU. Different regulatory regimes across Member States are detrimental to the efficiency of the single market in financial services.

Short selling is an established and common practice in most financial markets. We received evidence that stressed its positive effects on the financial markets, including price discovery and market liquidity, as well as hedging options for professional investors.

We recognise that short selling can promote the efficiency of functioning market. However, we are concerned about the difficulties in determining how much short selling, especially through credit default swaps (‘CDS’), there is in the sovereign bond markets. This is especially relevant since the repercussions for the cost of sovereign borrowing are unclear and hard to assess. When the market is not sufficiently transparent it can allow market manipulation.

The same concerns apply to the lack of transparency in CDS operations. These are mostly over the counter (OTC). As CDS are opaque credit risk transfer instruments, their contribution to systemic risk is difficult to gauge. As we concluded in our previous report, The future regulation of derivatives markets, derivatives have an important economic function, namely the redistribution of risk, but some forms of derivatives, including CDS, can be used as tools for speculation by participants in the financial market. Coupled with a lack of transparency in the market where increases in risk cannot be detected by supervisors, derivatives could help destabilise the financial system. It is clear that the systemic risks of CDS are not fully identified because of the opacity of the market.
We welcome therefore this aspect of the Commission’s proposed regulation which would enhance further the transparency of these types of operations. We support uniform rules across the EU providing for greater disclosure to supervisors. We hope that these new provisions might go some way to provide supervisors with the necessary information needed to analyse the market and monitor the effects of CDS on financial stability and sovereign borrowing.

In our report on derivatives, we conclude that the impact of CDS on financial stability depends on clearing mechanisms and capital and liquidity requirements for large protection sellers. A CDS market where all major dealers participate in clearing facilities with adequate reserves can contribute to mitigating systemic risks. These are measures supported by the Commission’s proposal for legislation on OTC derivatives and we endorse them.

THE EFFECT OF CDS AND SHORT SELLING ON SOVEREIGN BONDS

The euro area crisis has focused attention on CDS and their interplay with government bond markets. It has been argued that the widening bond spreads for some countries have been exacerbated though the CDS market. We considered whether the trading of CDS, especially when uncovered, may make a market prone to speculative attacks on the underlying bonds and whether bond yields cause CDS spreads to increase or vice versa.

We heard no conclusive evidence one way or the other. Evidence from city firms argues that there is no strong evidence to suggest that sovereign CDS activity influences prices in the underlying bond markets. They state that there is no correlation between the volume of sovereign CDS transactions and either CDS or bond spreads.

On the other hand, we heard evidence that CDS transactions can impact the cost of the underlying sovereign bonds, and therefore the cost of government borrowing. George Soros, for example, has previously observed that “going short on bonds by buying a CDS carries limited risk but almost unlimited potential. This asymmetry encourages speculating on the short side, which in turn exercises a downward pressure on the underlying bonds.”¹ Evidence arguing from this perspective suggested that with naked CDS the risk/reward asymmetry works in the opposite way to that in normal shorting selling operations.

On balance, we concur that naked CDS are not equivalent to short-selling as there is no capital risk. The trade in naked CDS involves buying a CDS without ownership of the underlying security. This implies a moral hazard issue as CDS permit speculators to insure “without an insurable interest”. It has been suggested that naked CDS could be therefore used to make speculative gambles.

Supporting the continued use of naked CDS, we heard that firms use them to insure against general risk exposure to a country’s corporate and banks, rather than just their exposure to sovereign debt. We recognise that there are intrinsic difficulties in separating genuine insurance from speculation.

RESTRICTIONS ON UNCOVERED SHORT SELLING

The proposed Regulation would restrict uncovered short sales of shares and EU sovereign bonds unless the seller has either borrowed, or entered into an agreement to borrow the security or made other arrangements with a third party to ensure that the security can be borrowed in time to settle the sale. The Commission does not propose an outright ban on uncovered CDS.

Evidence submitted to us advanced reservations about the idea of introducing restrictions on CDS and naked short selling. We were warned that if investors were prevented from hedging their positions, there would be greater uncertainty involved in holding the debt and fewer investors in the market. This would lead to lower liquidity and increased borrowing costs. On the other hand we heard that restrictions would remove the main route of shorting sovereign bonds, thereby making them less vulnerable to the uncertain effects of speculation. Some witnesses were strongly in favour of a ban on naked CDS. This is the preferred option of the European Parliament rapporteur on this proposal.

The evidence we received on this point was polarised, and there was no conclusive evidence provided to us on the effect that naked CDS have on the cost of the underlying sovereign bonds. In the absence of concrete evidence, therefore, we support the view that restrictions on naked short selling and CDS on sovereign bonds should be removed from the Commission’s proposals.

¹ WSJ editorial on March 4, 2009, “One Way to Stop Bear Raids: Credit default swaps need much stricter regulation.”
Similarly we would therefore not support the introduction of an outright ban on naked CDS at this stage. We are concerned that a blanket ban naked CDS might carry with it some adverse and unintended consequences, including an increase in stock borrowing costs and a reduction in liquidity.

We note that, although there is no concrete evidence to suggest that the trade in naked CDS has a detrimental effect on sovereign bond markets, the arguments supporting such a view were persuasive. We are deeply concerned about this potential risk to financial stability.

The CDS market is relatively young and little research has been done to assess its costs and benefits. The impact of CDS market developments on sovereign bonds in particular warrants a better understanding. Before any restrictions or bans are introduced it would be necessary to assess the possible effects of any restrictions of naked CDS trading on sovereign borrowing. Given, however, the urgent concerns that we express above, we recommend that further analytical work on this issue be undertaken as soon as possible. The Commission’s proposals for increased transparency in the derivatives market and short selling will help this aim.

**THE NEED FOR A GLOBAL APPROACH**

It is essential that the regulation of CDS and short selling should take place in coordination with US policy. EU regulation should be aligned with, and complement, global arrangements. Restrictions on CDS and uncovered short sales in the EU would be meaningless if they could be circumvented by operating outside the EU. It might also hinder the competitiveness of the financial sector in the EU. We urge the Government to ensure that this Regulation does not result in regulatory arbitrage.

**INSTITUTIONAL CONSIDERATIONS**

We support the principle that national supervisory authorities should intervene in exceptional situations to impose restrictions necessary to ensure financial stability. Such powers should be uniform and coordinated at an EU level to avoid disruptions in the market.

Article 24 of the proposed regulation grants significant powers to ESMA allowing it to implement temporary prohibitions on short selling and CDS. We believe that such intervention powers might at times be necessary, in light of the highly cross-border nature of the CDS trade, to preserve financial stability in the EU. We are conscious that this might imply a temporary override of the powers of national supervisory authorities.

In your letter of 7 February 2011, you state that Article 24 contravenes the Meroni principle concerning the delegation of powers by an EU institution to another body. We note, however, that ESMA was established by legislation directly based on Article 114 TFEU which confers on it certain powers. Article 24 of the proposal would also confer powers directly under the Treaty. That does not amount to the delegation of powers to ESMA by another body or institution. It is not clear to us, therefore, that the emphasis on the Meroni principle is well placed.

We are aware that a general approach might be reached at ECOFIN on 15 March. We make these observations to inform the Government’s deliberations in advance of the meeting. Although we will continue to hold the proposal under scrutiny, we have agreed to grant a scrutiny waver should your consent be necessary to make progress on the proposal.

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

*8 March 2011*

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

Thank you for your letter of 8 March, setting out the Committee’s views on the European Commission proposal on short selling and certain aspects of credit default swaps. I am grateful for the comprehensive response, including your detailed exposition of the responses to the Committee’s recent call for evidence.

Before I respond to the points raised in your letter, I wish to make you aware that the draft regulation was in fact withdrawn from the 15 March ECOFIN agenda following discussions at COREPER on 9 March. The Presidency concluded that further deliberations would be needed on Articles 12 (uncovered short selling) and 24 (ESMA powers) before ministers could agree a general approach. Instead, a progress report was delivered by Commissioner Barnier to ECOFIN, and the Council mandated COREPER to give further consideration to the draft regulation with the intention
of securing a political agreement at the 17 May ECOFIN. Trilogue discussions between the Presidency, Council and European Parliament are expected to begin at the end of March.

GENERAL CONSIDERATION OF THE DRAFT LEGISLATION

Turning now to your letter, I note your comments on the desirability of a uniform approach on short selling and the need for greater transparency. As you are aware, the Government is supportive of the approach of this Regulation to improve transparency and in providing clear and unequivocal powers to regulators to take action against short selling in appropriate circumstances within a common European framework. The FSA currently requires disclosure during rights issues and for all UK financial sector companies. We believe that our national regime has been successful in improving the behaviour of market participants and we are very supportive of the disclosure provisions in the short selling regulation. Your letter also mentions the role of credit default swaps (CDS) in the over the counter derivatives market. This matter is being addressed in the European Markets Infrastructure Regulation.

CDS, SHORT SELLING ON SOVEREIGN BONDS AND UNCOVERED SHORT SELLING

I note the Committee’s remarks that “although there is no concrete evidence to suggest that the trade in naked CDS has a detrimental effect on sovereign bond markets, the arguments supporting such a view were persuasive.” You also support the view that “restrictions on naked short selling of CDS or sovereign bonds should be removed from the Commission’s proposal. The same dilemma faces Ministers in the Council. It may be helpful if I set out the Government’s view as to why a ban on naked sovereign CDS could have a detrimental effect on sovereign debt markets.

The main argument is that investors need to have the ability to hedge their exposure to the sovereign. This exposure can take the form of:

— long positions in debt instruments issued by the sovereign;
— debt instruments not issued by the sovereign but whose value is closely correlated to the value of a particular sovereign debt (for example the value of RBS bonds are closely linked to the value of UK Gilts because of the high level of government shareholding in RBS);
— other counterparty exposures to the sovereign, such as interest rate swaps with issuers of sovereign debt or state owned banks; or
— general exposure to the markets in that country (e.g. large holdings in equities, indices, property market etc).

The first and second indents do not constitute uncovered CDS for the purposes of the Regulation and so would not be banned under the EU legislation proposal. The third and fourth would constitute uncovered CDS and would therefore be banned. Reducing hedging opportunities within a particular market may be detrimental because it reduces liquidity and increases volatility and transaction costs, which can be a major disincentive to investment.

The Government would not want to see investors deterred from entering into markets generally or from entering into other counterparty exposure with the sovereign. Specifically, interest rate swap transactions between sovereign issuers and banks provide a crucial method of facilitating sovereign debt issuance as it enables sovereigns to reduce their own risks. However, the banks that enter into the swap transactions need to be able to mitigate the risks that they have taken on through the interest rate swap. They do this by entering into CDS contracts relating to the sovereign that issued the debt, even though they have not bought the debt instruments themselves (i.e. they are uncovered). Reducing or eliminating the bank’s ability to mitigate risk could disincentivise the banks from entering into interest rate swaps and so could make debt issuance more difficult for the sovereign. We are all agreed that it would be desirable to establish a greater understanding of the workings of complex areas of the securities markets before legislative proposals are brought forward.

TAKING A GLOBAL APPROACH

The Government recognises the importance of international coordination and always aims to use global fora such as G20 to co-ordinate action on financial regulation. We believe that international coordination among regulators is crucial to avoid regulatory arbitrage which can lead to financial instability due to fragmentation and also a loss of competitiveness.
KEY ISSUES

There are two main issues on the short selling regulation which remain to be resolved. These are Article 12, which deals with uncovered short selling and has particularly references to sovereign debt, and Article 24, which provides ESMA with substantial additional intervention powers.

ARTICLE 12

Article 12 introduces restrictions on short sales of all financial instruments, including sovereign debt. Our key concern has been the potential impact on pricing and liquidity of gilts if these restrictions are introduced (as discussed above). The Commission’s proposals are stricter and more extensive than regulations in the US or Asia and their implementation risks placing the EU at a material competitive disadvantage. We will continue to propose changes to this article in negotiations.

ARTICLE 24

I note the Committee’s comments in relation to Article 24. However, ESMA is an EU agency, established by the ESMA Regulation (No 1095/2010), a regulation of the Council and of the European Parliament. It is not one of the EU institutions provided for in the TFEU; indeed EU agencies are not provided for in the Treaties. The ESMA Regulation therefore contains a delegation of powers to ESMA. This is not affected by the fact that the legal base for the Regulation is found in the TFEU: all legislative acts of the EU require a Treaty base.

The powers conferred on ESMA must be granted and exercised consistently with the case law of the ECJ. This includes the case of Meroni, which established the principle that the power delegated to a Union body, office or agency cannot be “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.” The delegation of a power to adopt acts having the force of law is also excluded. The Government remains concerned that the powers it is proposed ESMA exercise under Article 24 of the short selling regulation would give ESMA a wide discretion to make decisions concerning economic policy in contravention of the principle established in Meroni.

27 April 2011

Letter from the Chairman to Mark Hoban MP

Thank you for your letter, dated 27 April 2011, regarding the Commission’s proposal on short selling and certain aspects of CDS. The Economic and Financial Affairs and International Trade Sub-Committee considered it at its meeting on 24 May.

We understand that this proposal was endorsed by ECOFIN on May 17. As we had previously granted a scrutiny waiver we note that this does not constitute a scrutiny override. While we are pleased to see that a consensus was reached on this proposal, we had outstanding concerns in relation to some aspects of the proposed regulations, particularly with regards to the introduction of restrictions or a ban on naked CDS and short selling of sovereign bonds.

We would like to receive an account of the decisions made, and the reasons for those decisions, with regard to this proposal, and in particular the provisions covered by Article 12 (concerning short selling) and Article 24 (concerning ESMA’s powers).

24 May 2011

TAXATION: ADMINISTRATIVE COOPERATION (6035/10)

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

I understand that you were in correspondence with my predecessor on this proposal during the last Parliament and asked to be kept informed of developments.

I am pleased to report that Ministers reached political agreement on a Presidency compromise text for the new Directive at ECOFIN on 7 December. The outcome of proceedings, including the agreed text, can be found on the Council website (document 17581/10). The result is a good outcome for the UK in that it will strengthen administrative cooperation in tackling tax evasion while keeping burdens on industry to a minimum.
You will recall that the main issue of discussion among Member States was the extent of automatic exchange of information between tax authorities. Some Member States favoured a far-reaching approach that would involve automatic exchange of information from the outset on a wide range of categories of income and capital, whether or not that information was readily available to the tax authority providing it. Other Member States, the UK in particular, were concerned that this would impose disproportionate burdens on industry in terms of new reporting requirements to ensure that the tax authorities had comprehensive information to exchange.

The Presidency compromise on which agreement was reached takes a step by step approach to automatic exchange of information, which takes full account of potential burdens on industry. Automatic exchange will take place in a limited number of categories, and in so far as information is readily available, from 2015 (two years after the rest of the Directive takes effect). More extensive automatic exchange may only take place after 2017, on the basis of a Commission report on the costs and benefits and a decision by the Council to go further.

As well as taking sensible steps forward in terms of automatic exchange of information, the new Directive brings the EU as a whole into line with OECD standards of exchange of information on request. The Presidency compromise took account of the concerns of certain Member States that have traditionally been reluctant to accept greater tax transparency by specifying certain details that must be included in requests, thus guarding against “fishing expeditions”.

The new Directive also improves the efficiency of exchange of information by providing for standard forms and formats as well as time limits and feedback. In addition, it encourages spontaneous provision of information and closer cooperation between officials in investigations.

24 January 2011

TAXATION OF THE FINANCIAL SECTOR (15282/10)

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

Thank you for your Explanatory Memorandum 15282/10 dated 16 November on the Commission Communication on financial sector taxation. The Economic and Financial Affairs and International Trade Sub-Committee considered this item at its meeting on 15 March.

We welcome the way in which the Commission Communication has provided some clarity to discussions on taxation of the financial sector. We find the distinction between a financial transaction tax and a financial activities tax and the subsequent analysis useful as work continues on this area at EU and global level.

The Select Committee is currently examining the debate around the FTT as a possible additional revenue for the EU budget as part of its inquiry on the Budget Review. In this letter therefore we restrict our considerations to the policy implications of these taxes rather than their significance for the EU budget.

It is inevitable that the proposal for a FTT attracts attention in the UK, and often immediate rejection, on the basis of the predominance of the City of London as a centre for financial transactions. It has, however, been suggested to us that while a huge proportion of a transaction tax would accrue in London, it is not clear that the revenues raised would belong to the UK. Would such a tax be levied on all transactions, even if the funds do not originate from within the EU? We have also heard that the UK stamp duty on financial transactions has not driven away business from the City and that therefore a new tax would not necessarily lead business to relocate. What is the Government’s opinion of these views? Would the introduction of a transaction tax at EU level necessarily entail the relocation of business outside London or affect the competitiveness of the financial sector? What progress, if any, has been made in G20 discussions on the introduction of a transaction tax at a global level?

We understand that the Government is already examining the costs and benefits of a FAT. The Commission warns that unilateral action by individual Member States should be avoided, and we note that no concrete EU legislative proposals have yet been announced. Does the Government consider that a FAT could be introduced unilaterally by the UK? What do the Government feel would be the purpose of such a tax? Your EM summarises three main policy objectives set out by the Commission for financial sector taxes (paragraph 2): what priority do the Government attach to each of these objectives?
We would be grateful for a response to this letter within the standard ten working days. In the meantime, we have agreed to keep this document under scrutiny.

15 March 2011

Letter from David Gauke MP to the Chairman

Thank you for your letter of 15 March regarding the Commission Communication on financial sector taxation. I am pleased that this document has provided the Committee with greater clarity of the work of the Commission in this area.

It is understandable that this document has prompted a number of follow up questions in relation to Financial Transaction Taxes. This is reflective of the Government's view that there are a series of complex issues regarding such taxes that are yet to be resolved. Questions such as to which transactions the tax would apply and how revenues would be allocated would need to be addressed as part of any international discussions. As you know, France holds the Presidency of the G20 for 2011, and has stated that it will make discussions on financial transactions taxes one of its priorities for the year.

The Government remains firmly of the view that financial transaction tax could not be viable unless implemented globally. Our current stamp duty regime is limited to trading in UK shares and as such can be policed relatively effectively. However, even here, the IMF, in their report to the G20, noted that other financial instruments, such as Contracts for Difference, have been developed which do not attract stamp duty. International experience also highlights the risks of imposing transaction taxes on existing markets. For example, Sweden saw significant falls in trading volumes when it imposed a unilateral transaction tax in the 1980s, prompting its abolition just a few years later.

You also asked about a Financial Activities Tax. At this stage the Government believes it is appropriate to explore such a tax with international partners to establish the extent to which international coordination would be necessary or desirable.

You also asked how a Financial Activities Tax would fit with the objectives for financial sector taxation more broadly. In considering this, the Government believes it is important to consider tax issues in the round and consider the cumulative effects of all significant taxes on the financial sector.

In this regard, it is particularly important to bear in mind the Bank Levy which the Government introduced in January. The Levy is designed to ensure banks pay a fair share in respect of the potential risks they pose to the UK financial system and wider economy. The Levy will also encourage banks to move away from riskier funding.

I hope you find this information helpful.

4 April 2011

Letter from the Chairman to David Gauke MP

Thank you for your letter, dated 4 April 2011, regarding the Commission's Communication on financial sector taxation. The Economic and Financial Affairs and International Trade Sub-Committee considered it at its meeting on 17 May.

We appreciate that there are a series of complex issues regarding the introduction of financial transaction taxes that are yet to be resolved. We would welcome continuing updates on any progress made by the G20 on the introduction of financial transaction tax, especially if they provide clarification on how revenues would be allocated and on which transactions the tax would be levied.

You explained that the stamp duty regime is limited to trading in UK shares, and that other financial instruments, such as contracts for difference, have emerged which are exempt from this duty. Has the favourable taxation regime for contracts for difference encouraged the diffusion of such instruments and do they promote excessive risk taking? Is there pressure at international level to change the favourable regulatory framework of such instruments?

Turning to a Financial Activities Tax, have you determined to what extent international coordination is necessary? To what extent is the Government's thinking in line with the Commission's idea of a FAT?

With regard to the bank levy introduced in January, to what extent has the levy encouraged banks to move away from riskier funding and is the Government putting pressure in for such levy to be introduced elsewhere in the EU?
Should the Commission put forward specific proposals in this area, we would look to scrutinise them in detail. In the meantime, we have agreed to clear the proposal from scrutiny in anticipation of legislative proposals at a future date.

17 May 2011

THE FINANCIAL REGULATION AND TOLERABLE RISK OF ERROR (5129/10, 15759/10, 10561/10, 10346/10)

Letter from the Chairman to Justine Greening MP, Economic Secretary, HM Treasury

Thank you for your Explanatory Memorandum 5129/10 on a Proposal for a Regulation on the Financial Rules applicable to the EU Budget, dated 31 January 2011, EM 15759/10 on the ECA Opinion on proposed changes to the Financial Regulation and your letter, dated 23 December, on EMs 10561/10 and 10346/10 on the Financial Regulation and a Communication on tolerable risk of error. The EU Economic and Financial Affairs and International Trade Sub-Committee considered these documents at its meeting on 5 April.

We note your comments about the transparency of the Commission’s management of real estate. We would, of course, support any increase in transparency in the administration of the EU Budget. In relation to the Commission’s proposals to raise loans on the EU Budget to purchase buildings, we stress that this should not be the start of a more widespread introduction of Commission borrowing secured by the EU Budget. We would be grateful to be kept informed if and when this policy is implemented.

We note that the Court of Auditors draws attention to the considerable uncertainty surrounding the definition and application of tolerable risk of error in relation to the EU Budget. Your letter indicates that Commission proposals on tolerable risk of error are unlikely to be implemented soon, but that the Commission has been encouraged to continue to develop its work in this area. In light of this, we will clear the document from scrutiny, but we look forward to discussing this issue with you again in the future when the Commission’s work is more developed.

We have agreed to clear these documents from scrutiny. We do not require a response to this letter.

06 April 2011

TRADE GROWTH AND WORLD AFFAIRS: TRADE POLICY AS A CORE COMPONENT OF THE EU’S 2020 STRATEGY (16183/10)

Letter from the Chairman to Edward Davey MP, Parliamentary Under Secretary of State, Department for Business, Innovation and Skills

Thank you for your Explanatory Memorandum 16183/10 on a Commission Communication entitled “Trade, Growth and World Affairs”. The EU Sub-Committee on Economic and Financial Affairs and International Trade considered this document at its meeting on 18 January.

We have agreed to hold this document under scrutiny and correspond with you more fully on its contents at a later date. We understand that the Council will be publishing its conclusions on the Communication in the near future, and we have agreed to waive our scrutiny reserve on this occasion so you are able to vote on this document in Council.

We do, however, have a few general comments we wish to make at this stage before the Council publishes its conclusions.

We support the Commission’s intention to introduce support measures to help SMEs export, and we welcome the Government’s statement that it thinks this area is an important addition to trade policy. We also feel that the Communication could have suggested more action on how trade could help poorer countries, and we hope that this area is given more emphasis in future.

We feel that the importance of encouraging competitiveness should also be acknowledged and measures taken to ensure that EU economies remain competitive at a time when international trade will be vital to economic growth.
The Commission places a welcome priority on successfully concluding the Doha Round – we support this strongly, and hope that an agreement can finally be reached.

We note that services remain a relatively small proportion of world trade; given that three-quarters of UK GDP is produced by the services sector, we would strongly support measures to encourage the growth of the international services industry.

Finally, we will also keep a close eye on emerging policies in this area, and we welcome the Government’s support for the Commission’s focus on trade and investment as a means of securing growth.

We do not require a response to this letter.

19 January 2011

UN FIREARMS PROTOCOL: PROPOSED REGULATION (10963/10)

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

Thank you for your letter of 10 November 2010 about the decision of the EU Sub-Committee on Economic and Financial Affairs and International Trade to hold this document under scrutiny.

As some further time has now elapsed, I wanted to update your Committee on the latest negotiations in Brussels. To this end, I have attached a detailed summary prepared by my officials, that I hope provides both clarification on the meaning of some parts of the text and some flavour of the discussions.

I still judge, however, that it is not possible to provide a UK-specific Impact Assessment at this time. It is not yet clear how certain important elements of the text will develop during further discussions that are set to continue in the Working Party on Customs Union (Custom Legislation and Policy).

I would very much welcome any detailed views that your Committee are able to provide on the proposed Regulation at this time based on the greater detail provided by our paper. I’m hopeful this paper will enable you to do so as it is important that your voice is heard and included in the UK negotiating positions in Brussels as discussions gather pace.

21 March 2011

Letter from the Chairman to Mark Prisk MP

Thank you for your letter, dated March 21 2011, on a Proposed Regulation implementing Article 10 of the UN Firearms Protocol. The EU Economic and Financial Affairs and International Trade Sub-Committee considered this document at its meeting on 24 May.

Article 10 of the UN Firearms Protocol covers both export and import licensing or authorisation. The Regulation, however, only covers the export of firearms. The Regulation states that imports are subject to Council Directive 91/477/EEC. Does this Directive ensure that Member States meet the import requirements of Article 10 of the UN Firearms Protocol?

Not all countries have signed up to the Protocol. Are the procedures proposed by this Regulation valid even if transit or destination countries are not signatories to the UN Firearms Protocol?

Article 3 of the draft Regulation exempts all “State to State transactions or State transfers”. This seems wider than the scope in the preamble which states that such transactions or transfers are not covered “in cases where the application of the Protocol would prejudice the right of a State Party to take action in the interest of national security”.

The preamble states that the Regulation should not apply to firearms “that are intended specifically for military purposes”. Article 3 seems to split this exemption in two, stating that firearms are exempt if they are “specifically designed for military use” (item b) or if they are “destined for armed forces” (item c). The phrasing in item (b), if taken at face value, would seem to exempt nearly all firearms. Has an alternate wording been considered?

The exemptions in Article 3 cover “collectors and bodies concerned with cultural and historical aspects of firearms...recognised by such by the Member State in whose territory they are established”. Are there common procedures for recognising such bodies, or does each Member States set their
own criteria? Will this article mean that museums sending firearms overseas for exhibitions will be exempt from this Regulation?

Article 3 also exempts “deactivated firearms” – does the definition in the Regulation conform to the same standard as the UK’s existing definition of deactivated firearms?

The UN Firearms Protocol states that before giving export licenses States shall verify that “transit states have, at a minimum, given notice in writing, prior to the shipment, that they have no objections to the transit”. The draft Regulation, however, suggests a “tacit consent” procedure whereby if exporters have submitted a written request to a transit state and have received no response within twenty working days the transit state “shall be regarded as having no objection and as having given its tacit consent to the transit”. This “tacit consent” procedure does not seem to meet the requirements of the UN Firearms Protocol which states that written notice has to be given. Has progress been made in coming to a consensus on this aspect of the Regulation?

Article 7 sets out a simplified procedure for temporary exports for “verifiable lawful purposes”. How would it be verified that an export is for a “lawful purpose”?

We will continue to hold this proposal under scrutiny until the details have been finalised. In the meantime, we would be grateful for a response to this letter within the standard ten working days.

24 May 2011

VAT REFUND PROCEDURES (12391/10)

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

Thank you for your letter of 8 November, on a Commission Proposal on VAT refund procedure (EM 12391/10). The EU Economic and Financial Affairs and International Trade Sub-Committee considered this at its meeting on 30 November.

We are grateful for your detailed explanation of the reasons behind the Government’s decision to support the first element of this proposal, namely extending the deadline for VAT refund claims.

Turning to the second element of the proposal, to grant the Commission additional powers to further harmonise certain aspects of national VAT refund portals, we understand that this is the subject of further work by the Commission, but that in the meantime this proposal remains an active document. Is there any evidence that there will be costs and difficulties for the UK if certain aspects of national VAT refunds portals are harmonised?

We will continue to hold this document under scrutiny, and would appreciate an update when further action is proposed.

We would be grateful for a response to this letter within the standard ten working days.

6 December 2010

Letter from David Gauke MP to the Chairman

Thank you for your letter dated 6 December 2010 about the Commission’s proposal to extend by six months (until 31 March 2011) the EU deadline by which businesses can submit their 2009 cross-border VAT refund claims.

In respect of the second element of the proposal, to grant the Commission additional powers to further harmonise certain aspects of national VAT refund portals, you ask whether, if this were to be agreed, this would impose costs and difficulties for the UK.

As mentioned in my previous letter, primarily as a result of UK pressure, the Commission is currently preparing a prioritised EU level Action Plan to address the various technical and other problems currently being experienced with the cross-border VAT refund system, including with Member State VAT refund portals. The Commission plans to discuss the draft Action Plan at the next meeting of the Standing Committee on Administrative Co-operation (SCAC) which is scheduled for February 2011. Until that meeting has taken place we cannot be certain what harmonisation measures the Commission has in mind, nor what additional powers it thinks might be required. But earlier this year the Commission issued to Member States a non-binding draft best practice ‘Guideline’ on the design and functioning of VAT refund portals. As the UK (HMRC) VAT refund portal already meets nearly all
the requirements mentioned in this Guideline, HMRC consider it unlikely that any attempt to harmonise national portals will present any significant costs or difficulties for the UK.

I will of course provide you with a further update when and if any further action is proposed.

20 December 2010

Letter from the Chairman to David Gauke MP

Thank you for your letter of the 20 December 2010, on a Commission proposal on VAT refund procedure (EM 12391/10). The EU Sub-Committee on Economic and Financial Affairs and International Trade considered this at its meeting on 18 January.

We are pleased to hear that the UK already meets nearly all the requirements in the Commission’s best practice guidelines, and that this means there are unlikely to be significant costs or difficulties if the national VAT portals are further harmonised.

We will continue to hold this document under scrutiny until the Commission’s plans are finalised, and we would welcome an update when negotiations progress.

We do not require a response to this letter.

19 January 2011

WHITE PAPER: INSURANCE GUARANTEE SCHEMES (12360/10)

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

Thank you for your letter, dated 16 December 2010, on Explanatory Memorandum 12360/10 on a White Paper on Insurance Guarantee Schemes. The EU Economic and Financial Affairs and International Trade Sub-Committee considered this document at its meeting on 5 April.

Thank you for sending us the Government’s response to the White Paper on Insurance Guarantee Schemes.

We have agreed to release this document from scrutiny, but we look forward to returning to the issue at a later date when the Commission releases more detailed proposals for legislation.

We do not require a response to this letter.

06 April 2011